



## THE POWER OF BEING UNDERSTOOD

# TAX BENEFITS UNDER THE PUERTO RICO QUALIFIED OPPORTUNITY ZONES ACT

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## Introduction

Qualified Opportunity Zones ("QOZ") were introduced by the Tax Cuts and Jobs Act (TCJA), seeking to encourage economic growth, job creation, and investment in designated distressed communities by providing federal tax benefits to taxpayers who invest in businesses located within these zones. The QOZ provisions allow investors to defer the recognition of capital gains in the United States ("US") by investing said gains in a Qualified Opportunity Fund ("QOF"), which must invest 90% or more of its assets on businesses located in a QOZ.

Under the federal QOZ provisions, almost the entire Island of Puerto Rico was designated as an Opportunity Zone. To attract more investments to Puerto Rico QOZ, Act 21-2019, known as the "*Act for the Development of Opportunity Zones of 2019*" ("*PR-QOZ Act*"), a local counterpart to the US QOZ provisions, was enacted on May 14, 2019. The PR-QOZ Act provides for potential higher returns from Puerto Rico investments.

## Local Tax Benefits from Investing in Puerto Rico Qualified Opportunity Zones

Under the PR-QOZ Act, the following local tax benefits are granted:

- 15 years exemption period
- 18.5% flat income tax rate on income derived from eligible activities by an exempt business
- 100% tax exemption on dividend distributions from earnings and profits generated from eligible activities
- 100% tax exemption on subsequent dividend distributions, no implicit dividend
- 18.5% withholding tax rate on royalties paid by the exempt business to a non-resident party in connection with eligible activities
- 25% exemption on Municipal License Tax (May be increased by the Municipality up to 75%)
- 25% exemption on Personal Property Tax (May be increased by the Municipality up to 75%)
- 25% exemption on Real Property Tax (May be increased by the Municipality up to 75%)
- 25% exemption on Municipal Construction Excise Tax (May be increased by the Municipality up to 75%)
- Up to 25% transferrable investment credit
- Net operating losses (NOL) from eligible activities available against other Opportunity Zone Exempt Business
- Deferment of capital gain recognition on the sale of assets if reinvested in an QOF
- No employment requirement

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## TAX BENEFITS UNDER THE PUERTO RICO QUALIFIED OPPORTUNITY ZONES ACT (CONTINUED)

### Incentives Request Procedure

To benefit from the tax incentives provided by the PR-QOZ Act, a Tax Exemption Decree must be granted. To this end, the investor must file an exemption decree application before the Office of Industrial Tax Exemption ("OITE"), at the Department of Economic Development and Commerce.

### Deferral of Capital Gains

Similar to US QOZ dispositions, under the PR-QOZ Act, capital gains may be deferred upon the earlier of December 31, 2026 or the date the investment is sold. Similarly, under local law, investments in a QOF that are held for at least five (5) years are entitled to a 10% basis increase. As a result, only 90% of the deferred gain will be taxed. In the case of investments held for at least seven (7) years, a basis increase of 15% is allowed resulting in only 85% of the deferred gain being taxed.

In the case of investments held in a QOF for at least ten (10) years, the basis of the investment will be equal to the fair market value of the investment on the date it is sold. Therefore, any appreciation on the initial investment will qualify for a permanent exclusion of gross income.

The following example illustrates the foregoing rules:

Individual investor A sells an existing investment on January 1, 2019 and realizes a capital gain of \$300. Within 180 days, A invests \$300 (gain amount, not proceeds) into a QOF. Since A timely invested an amount equal to his gain, he will be able to defer the recognition of the capital gain for tax purposes upon the earlier of December 31, 2026 or the date the investment is sold.

A's initial basis on the investment will be zero (\$0). If A sells the investment within four (4) years, he will be taxed on full \$300 gain because he kept his investment for less than five (5) years.

However, if A holds the investment in a QOF for at least five (5) years, he will be able to take a 10% basis increase on the investment, and his new basis will be \$30 ( $\$300 \times 10\%$ ). Thus, if A sells the investment after five (5) years, he will only be taxed on \$270 ( $\$300$  original gain less \$30 basis). Similarly, if A holds the investment in a QOF for at least seven (7) years, his basis will increase to \$45 ( $\$300 \times 15\%$ ), and he will only be subject to tax on \$255, instead of \$300.

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Finally, if A holds his investment beyond December 31, 2026, the tax on \$255 of the deferred gain (only 85%) will be triggered even though he still holds the investment, since there is a deemed sale on December 31, 2026 for the original gain amount. However, if A holds the investment for at least ten (10) years and it appreciates to \$700, A will pay no tax at all on the \$400 appreciation (\$700 fair market value, minus \$300 investment) when the investment is sold.

### Other Considerations

Business activities eligible for incentives under other tax incentives laws, including Act 20–2012 (“Export Services Act”), Act 73–2008 (“Economic Incentives Act for the Development of Puerto Rico”), Act 74–2010 (“Tourism Development Act”), Act 83–2010 (“Green Energy Incentives Act”), among others, are not be eligible to request tax incentives under the PR-QOZ Act.

At RSM Puerto Rico we are available to advise our clients on how to take advantage of the tax incentives available for investing in Puerto Rico Qualified Opportunity Zones. Please contact our tax advisors at (787) 751-6164 | [tax@rsm.pr](mailto:tax@rsm.pr) for help or more information.

### Reminders & Due Dates

- July 10, 2019 – Monthly Declaration of Imports
- July 10, 2019 – Monthly Excise Tax Return
- July 15, 2019 – Deposit of Income Tax withheld on payments for services rendered
- July 15, 2019 – Deposit of Income Tax withheld on salaries of those employers classified as monthly depositors
- July 20, 2019– Monthly Sales & Use Tax Return