

Manufacturing



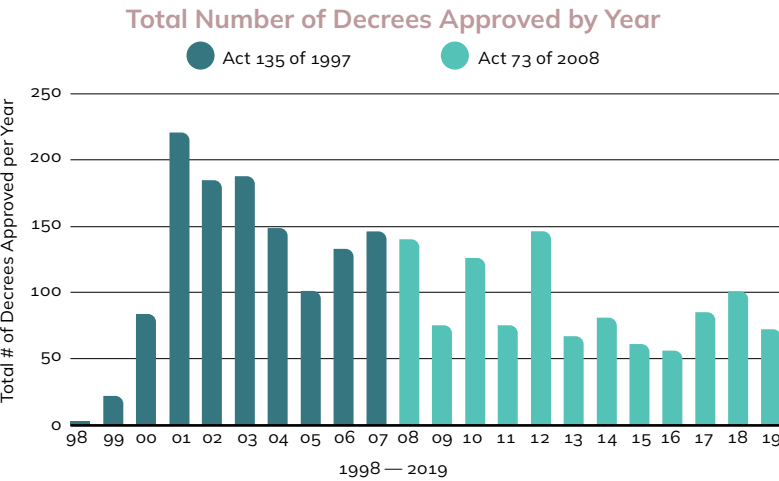
Puerto Rico has offered tax incentives for manufacturing companies since the early 1940s. In the past 30 years, the incentives transitioned away from the textile industry and moved towards supporting pharmaceutical and tech-enabled manufacturing activities. The latter now include software, video game design, artificial intelligence, and other designations included in this chapter, as all types of manufacturing businesses (even the non-traditional ones) fall under manufacturing.



Since the introduction of the amendment of the manufacturing incentives of 1998,¹ 2008, and 2019, over 2,300 corporations have filed and obtained a tax incentive.² By 2022, these firms comprised just under 5% of the total businesses registered and operational in Puerto Rico.³

Unlike exporting activities, manufacturing and tech-enabled manufacturing activities may apply these tax incentive benefits to all their Puerto Rico and global-sourced income. Most big-name Puerto Rican companies and brands benefit from this incentive, from Medalla to Pan Pepín and Productos La Aguadillana, among many others.

Additionally, most of Puerto Rico’s research and development (R&D) activities are also included under this incentive. By offering competitive tax credits for creating new products or innovating existing tools, the island’s government has consistently emitted over \$40,000,000 annually to corporations, sometimes even emitting over \$75,000,000. When considering a 50% tax credit rate for all research and development activities, the economic activity related to experimentation and innovation translates into over \$80,000,000 and even up to \$150,000,000 per year.⁴



1 Tax Incentives Act of 1998, 13 L.P.R.A. secs. 10101 et. seq. <https://bvirtualogp.pr.gov/ogp/Bvirtual/leyesreferencia/PDF/135-1997.pdf>

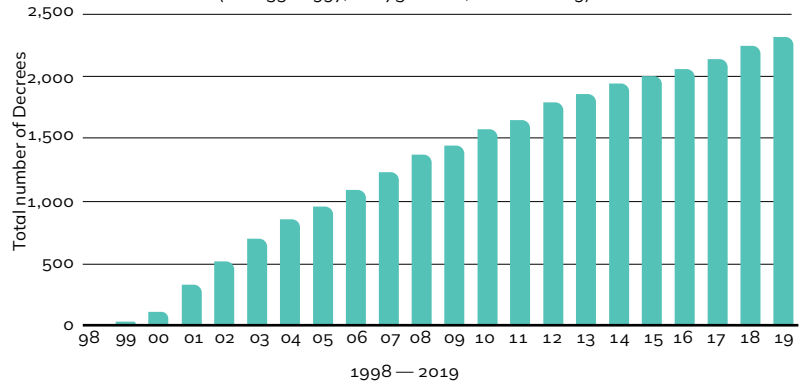
2 Department of Economic Development and Commerce. “Acceso a la información,” n.d., <https://www.desarrollo.pr.gov/acceso-informacion>.

3 United States Census Bureau. “U.S. Census Bureau QuickFacts: Puerto Rico,” n.d., <https://www.census.gov/quickfacts/fact/table/PR/BZA010221>.

4 Office of Economic and Financial Affairs of the Puerto Rico Department of Treasury (Hacienda), “Puerto Rico Tax Expenditure Report for Tax Year 2023,” accessed May 5, 2023, https://hacienda.pr.gov/sites/default/files/tax_expenditure_report.pdf.

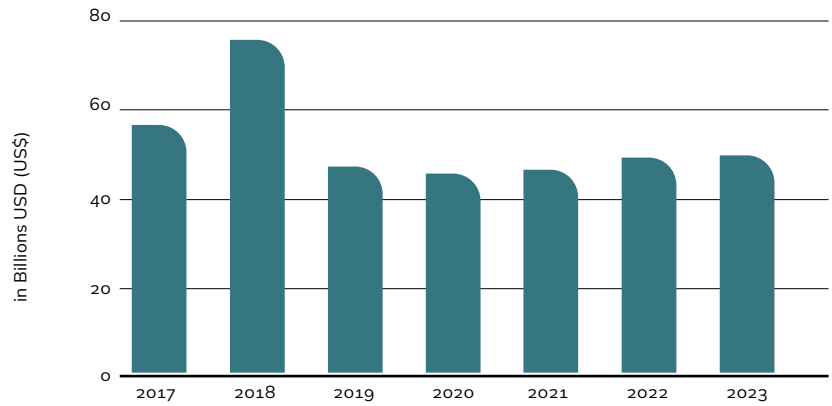
Total Number of Decree Applications by Year

Tax Incentive Application Under Manufacturing
(Act 135 - 1997, Act 73 - 2008, Act 60 - 2019)



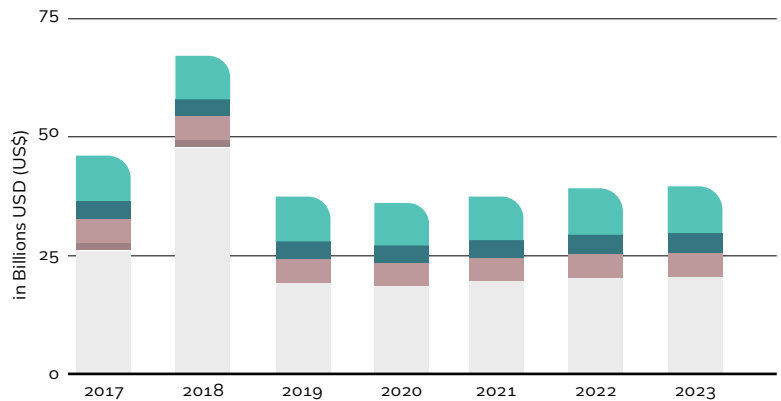
Total Research and Development Tax Credits Granted Annually

Total Research & Development



Total Research and Development Tax Credits by Expenditure Type

TEB 116 - R&D TEB 117 - Strategic Project TEB 203 - Investment
TEB 208 - R&D TEB 262 - R&D





Eligible Businesses⁵

1. Manufacturing Businesses

These are businesses that are permanently established to produce manufactured goods. They include any unit, plant, factory, machinery, or set of machinery (an industrial unit). As an additional requirement for eligibility, the output of said businesses must be sold at scale to qualify.

2. Businesses Finishing Unfinished Goods

This designation includes any business whose product cannot be completely produced on the island due to the monetary costs, whether those are expensive raw materials, personnel, or other reasons. It includes businesses that import or purchase unfinished goods or materials and finish the assembly or manufacturing in Puerto Rico or its ports.

3. Enterprises Providing Manufacturing Services at Scale

These involve offices, businesses, or establishments with equipment, machinery, and the expertise to provide services on a commercial scale, such as:

- a. Essential services to business conglomerates (a “Business Cluster”)
- b. Key supplier services, which include:
 1. Specialized storage
 2. Raw material inventory management and all kinds of processed materials

⁵ Puerto Rico Incentives Code, Art. 2061.01, 13 L.P.R.A. § 45551 (2023). <https://bvirtualogp.pr.gov/ogp/Bvirtual/leyesreferencia/PDF/2-ingles/60-2019.pdf>

3. Logistics regarding distribution and export of manufactured products
4. Document digitization and quality control
5. Equipment qualification
6. Repair and remanufacturing
7. Process engineering
8. Technical training
9. Development and generation of educational programs
10. Programming services and data systems management, etc.

4. Property Dedicated to Industrial Machinery

This designation applies to businesses renting a property and machinery for industrial use, such as machine shops or maker spaces.

5. Animal Breeding for Research

Overlapping with the incentives covered in Chapter 8, this designation includes companies breeding animals with the purpose of selling them to research laboratories, medicine research facilities, or other similar institutions.

6. Research and Development

This involves any scientific or industrial research and development conducted by any company to create new products or develop new services or industrial processes through basic or applied experimentation. The research carried out must be conducive to creating new products, improving existing products, or creating new services or processes of commercial value.

7. Partial or Total Recycling Activities

This designation applies to any business that fully or partially collects, distributes, reconditions, compacts, crushes, pulverizes, or employs another physical or chemical process to transform recyclable articles and materials into new goods.

8. Hydroponics, Aquaculture, Biotechnology, and Pasteurization

Eligible activities that fall under this designation are vertically integrated crops with value-adding processes, such as hydroponics, aquaculture, milk pasteurization, agricultural biotechnology, and any other agri-industrial or agricultural processes, including packaging, preservation, or processing of agricultural products.

9. Value-Added Activities Through Ports

This designation includes tugboats, storage and dispatch of merchandise, repackaging products for shipment from the port, and finishing semi-processed products to be shipped to other markets.

10. Software Development

This designation is for any company developing software to be sold at scale, be it to companies, governments, or individuals. Moreover, it applies to businesses developing software as a service and charging a fee (recurring or not) to their users.

11. Telecommunications, Data Storage, and Satellites

Eligible businesses under this designation are those that provide telecommunication services, data storage, and other connectivity services to businesses and individuals at scale. They can also be companies engaged in the research, development, manufacturing, transportation, launch, and operation of satellites from Puerto Rico.

12. Intellectual Property and Intangibles

This designation is for any business licensing intangible property, whether developed or acquired. This may include patents, intellectual property, software, or other intangible assets.

13. Repair of Air and Sea Vessels

Any business that repairs or maintains airplanes, boats, or other vessels used for commercial or individual purposes can apply under this designation.

14. Video Game Development

This designation is for any business coding and developing a video game with the intent of selling it through a mobile app store, online, or for any console.

Eligibility Requirements

New Businesses

1. Any business or individual may apply if they qualify for any of the designations.



Decree-Bearing Businesses

If a company received manufacturing tax incentives in recent years, such as through Act 135-1997 or Act 73-2008, the company may apply again for the Act 60 incentives. The requirements are as follows:

1. The business should be operational. If the business does not operate for 6 consecutive months, it will not be eligible to apply.
2. At the time of application, the business should have at least as many employees as the business employed, on average, over the past 3 years. If the average number of employees is less than that average, the business may not be eligible to apply.
3. During the first year of operations, the business must increase the number of employees by 25%.
4. The business must not use physical facilities, land, buildings, machinery, equipment, inventory, patents, distribution facilities, trademarks, and marketing outlets with a value of \$50,000 or more that were also used under the past decree. This does not apply to the designation of businesses leasing industrial properties. The business must invest in said properties and expand.

The DDEC may grant some exceptions to the above requirements.

General Benefits

1. The incentive has a duration of 15 years. It can be extended upon request for 15 additional years, providing a total of up to 30 years of preferential tax treatment to the business.
2. The corporate income tax rate is 4%.
 - a. If the company is less than 3 years old and has not surpassed \$3,000,000 in gross revenues at the moment of applying for the incentive, the eligible business may obtain a 2% corporate income tax during its first 5 years of operations as a new SME (see Chapter 1).
 - b. An 8% fixed tax rate applies if a license for using intellectual property in manufacturing is made to people outside Puerto Rico.
3. The incentive has a 25% tax credit for purchasing goods manufactured in Puerto Rico and a 30% tax credit if a new SME makes the purchases during its first 5 years.
4. There is a 50% tax credit for expenses related to research and development.
5. The incentive has a 100% exemption on eligible investment income.⁶
6. It includes a full deduction on the incurred costs on the purchase, acquisition, or construction of buildings, structures, machinery, and equipment when:
 - a. It was not previously depreciated in Puerto Rico.
 - b. It is used to manufacture eligible products or render eligible services assigned to the company.
7. The incentive has a credit for intangible license payments that cannot be sold or transferred but can be carried forward for 8 years. This credit is meant for those bringing foreign technology to the island.
8. It has a 75% exemption on personal and real estate property and municipal taxes.
9. The incentive has a 50% exemption on municipal patents.
10. There is a 100% exemption on real estate to expand operations.

⁶ Interest, dividends, capital gains, rental and royalty income, and non-qualified annuities.

11. The incentive has a 50% exemption on property tax for properties dedicated to industrial development (this applies to someone leasing their property for industrial use).
12. There are complete exemptions from the sales and use tax on the following items acquired by the business:
 - a. Raw materials to be used in Puerto Rico in the production of finished products, including:
 1. Natural gas and propane gas used to produce electrical or thermal energy
 2. Products in their natural form derived from agriculture or extractive industries, including by-products, residuals, or partially manufactured or finished products
 3. Sugar in bulk or in 50-pound or more bags to be used for manufacturing products
 4. Machinery, equipment, and accessories used in the manufacture, construction, and repair of vessels, on or off the factory premises (including trucks or forklifts), including equipment required by law
 5. Administrative or commercial equipment, when 90% is used in manufacturing
 6. Equipment used in laboratories of an experimental and research nature, for the development of science and technology, including renewable energy
 7. Mineral analysis equipment for mineral exploitation development
 8. Fuel needed for business operations
 9. Materials for wastewater treatment
13. It allows the deduction of expenses incurred in the purchase, acquisition, or construction of buildings, structures, machinery, and equipment if they have not been previously used in Puerto Rico and are used for the manufacture or services covered by the decree.
14. Operations can be established in other municipalities without requesting a new decree if the business notifies the government within 30 days of the start of operations at the additional unit. The new unit would be entitled only to the remaining time of the decree at the time of its establishment. In other words, if a business establishes a unit at Year 5, the unit is entitled to the benefit for the remaining 10 years.

Tax Credits

Puerto Rico's research and development (R&D) tax credits are the most aggressive in the United States, at twice those of New York and Texas. Entrepreneurs should always keep detailed documentation about eligible research, purchases, and investments. To apply for these credits, businesses must prove to the agency that they were used for eligible purposes.

A 25% Tax Credit on Local Purchases

This tax credit is meant to incentivize businesses to collaborate with Puerto Rican companies and make their purchases on the island, especially when locally manufactured products tend to be more expensive.

A 50% Tax Credit on R&D

The availability of this tax credit for R&D purposes illustrates the government's interest in promoting and investing in new products and operations. While not every type of research or development qualifies, the regulations define the following as eligible activities:

- a. Activities to design a prototype or experimental manufacturing or any activity eligible under the Incentives Code that contributes directly to advancing science and technology, or to creating new products or processes
- b. Activities to test a prototype through research and development to determine if the design is appropriate before its commercial launch
- c. Development of new processes to enable an eligible activity under the Incentives Code
- d. Software development lifecycle activities up to the product launch

Any other activities that are not mentioned above will not be considered eligible R&D. However, the government added the Incidental Activities designation, recognizing that other activities help make R&D possible. These incidental activities can comprise up to 20% of the total activities claimed for R&D tax credits. Activities are considered "incidental" if their operational costs are directly related to the R&D activities.

The operating costs are the following:

- a. Payroll, including marginal benefits
- b. Insurance premiums
- c. Employer payroll taxes, municipal taxes, and licenses
- d. Net costs in electricity, water, and telecommunications
- e. Materials
- f. Depreciation or rent payments for the building that solely houses the R&D activities
- g. Rent cost or depreciation of equipment and machinery used for R&D
- h. Repair costs of R&D equipment
- i. Technical professional services
- j. Technical training related to R&D projects (does not include required continued education)

Activities that are ineligible for the R&D tax credits include the following:

- a. Quality control activities for a manufactured product or process
- b. Activities made to adapt a product to a specific client
- c. R&D activities in the creation or improvement of a product, process, or service for just one client instead of a market
- d. R&D for a third party when there is no financial risk in such activities
- e. Market tests and marketing
- f. Adapting to comply with regulations and routine materials analysis, with the main objective of adjusting the products to the rules
- g. Activities that could be readily ascertained by consulting a competent professional in the field without having to go through R&D
- h. Investigations financed by the government of Puerto Rico or any instrumentality, including public-private partnerships, via grants or any other form of subsidy
- i. Fine-tuning or any other process that does not affect the underlying science or technology
- j. Compiling information or other type of content—something must be done with the data to be considered R&D

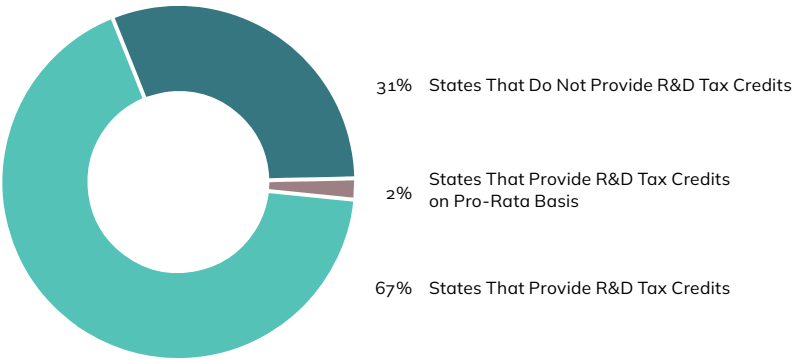
- k. Management of pilot plants, machinery, and equipment after the scientific or technological uncertainties are resolved
- l. Design activities that do not contribute to resolving technological or scientific uncertainties
- m. Activities to improve the appearance of a product
- n. Regulatory activities that do not advance knowledge to generate new products
- o. Maintenance phase in the software development lifecycle

An Overview of Tax Credits in the United States

Tax credits for R&D are not new. Many jurisdictions worldwide, including most states in the United States, promote the creation of new products and technologies by granting tax credits for eligible investments. These credits may be issued by a county, a state, or a central government. To highlight Puerto Rico's unique position in the United States, the following data explores the total amount of tax credits granted by each state for eligible R&D activities.

As all 50 states, Puerto Rico, and the U.S. Virgin Islands are examined, 35 states and jurisdictions provide R&D tax credits. One state, Hawaii, offers tax credits on a pro-rata basis and does not declare a fixed percentage. Sixteen states do not offer any tax credits.

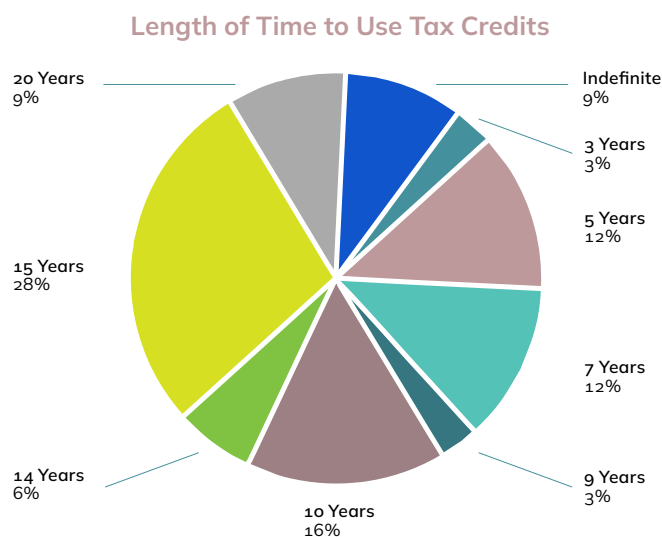
Percentage of States and United States Jurisdictions that Provide R&D Tax Credits



Puerto Rico's R&D credits (of up to 50%) position the island ahead of every state and jurisdiction. Only when paired with the federal government's R&D incentives do states like Nebraska surpass this amount. On average, most states provide a tax credit for R&D that sits below 10%.

Furthermore, most states and jurisdictions regulate the fungibility of these credits, with only 7 (13%), allowing the sale of tax credits to other individuals, corporations, or financial institutions. Seven additional states and jurisdictions allow the partial sale of credits, and the remaining 39 (73%), do not allow the sale of tax credits. Each state and jurisdiction have different requirements, evaluating agencies, and operability.

An additional element that distinguishes Puerto Rico from other jurisdictions is the length of time during which these credits may be implemented. Usually, R&D tax credits in Puerto Rico may be claimed during the 15 years of the decree. If a company extends the decree after the first 15 years, these benefits may be accessible for up to 30 years. In the case of most states and jurisdictions in the United States, 52% offer R&D tax credits for a length of 15 years or less. Twenty-eight percent offer a length of 15 years, and the remaining 19% offer a length of 20 years or more.





Illustrative Example

Hailey, a chemical engineer, identified a growing market for plant-based packaging. With rising consumer demand for sustainable products, she launched GreenPack Solutions. In the first year, Hailey invested \$45,000 in payroll, \$12,000 in materials, \$6,000 for rent, and \$3,000 for utilities, totaling \$66,000 directly related to R&D expenses.

Applying for tax credits, she secured \$33,000, equivalent to 50% of the total R&D costs.

After a year, Hailey developed a biodegradable food container prototype that attracted interest from restaurant chains. To scale production and meet demand, she set out to raise \$600,000 from investors to purchase advanced machinery and raw materials. Hailey assured investors that tax credits would be available as part of their investment activities. Additionally, she highlighted that dividends would be tax-free, and GreenPack Solutions would enjoy a reduced 2% corporate tax rate for the first 5 years.

Hailey successfully raised \$600,000 and created a budget for the second year. Her plan allocated \$66,000 for continued R&D, \$300,000 for new equipment, \$150,000 for local agricultural materials, and \$84,000 for operational expenses.

Ultimately, Hailey would obtain:

- » 50% tax credits on R&D activities, totaling \$33,000 for Year 1 and \$330,000 for Year 2, yielding \$363,000 in tax credits.
- » 30% tax credits on local agricultural materials, resulting in \$45,000 in credits for the \$150,000 spent in year 2.

Cost to File

The cost to file the decree without additional professional help is \$1,005. The timeline to obtain an approved decree is unpredictable and varies; currently, it may take over 18 months for decrees to be evaluated.

Cost to File		
Filing	Transaction Fee	Service Fee
Manufacturing Business	\$5	\$1,000
Property Dedicated to Industrial Development	\$5	\$1,000
Property Dedicated to Industrial Development - Machinery	\$5	\$1,000