

(Substitute for
H. B. 4351)
(Conference)

(No. 147)

(Approved August 1, 2008)

AN ACT

To create the new “Puerto Rico Small Business Development Incentives Act”; to amend Section 1015 of Act No. 120 of October 31, 1994, as amended; to amend subsection (b) of Section 1016 of Act No. 120 of October 31, 1994, as amended, for the purpose of exempting certain corporations from payment of surtax on net income; to add a new subclause (E) and (F) to clause (1) of subsection (k) of Section 1023 of Act No. 120 of October 31, 1994, as amended, in order to allow a corporation or partnership to opt for a deduction of the total cost of computer system equipment and the installation thereof for the year in which it was acquired and installed, and to allow this type of taxpayer to have a deduction for two (2) years of the total cost of transportation and environmental conservation equipment; to add new paragraphs (iii) and (iv) to subclause (B) of clause (1) of subsection (a) of Section 1023 of Act No. 120 of October 31, 1994, as amended; to amend the first paragraph of Section 2 and the first paragraph of Section 38 of Act No. 45 of April 18, 1935, as amended, for the purpose of extending the same to owners of businesses or trade or to individual employers whose gross income does not exceed one million (1,000,000) dollars; to amend Sections 6.02(a) and 6.02(c) of Act No. 83 of August 30, 1991, as amended, for the purpose of exempting from filing under oath and submittal of audited financial statements for personal property tax returns of those corporations whose gross income does not exceed three million (3,000,000) dollars; to amend Section 1018(c) of Act No. 120 of October 31, 1994, as amended, to exempt from submittal of audited financial statements for tax returns of those corporations or partnerships whose gross income does not exceed three million (3,000,000) dollars; to amend Sections 10(a)(1), 10(a)(i), and 10(a)(ii) of Act No. 113 of July 20, 1974, as amended, to exempt from filing under oath and submittal of audited financial statements, those persons whose business

volume does not exceed three million (3,000,000) dollars; and to amend Section 15.01 (A)(1) of August 10, 1995, as amended, to exempt from submittal of audited financial statements together with the corporation's annual report, those corporations whose business volume does not exceed three million (3,000,000) dollars; and for other purposes.

STATEMENT OF MOTIVES

Since the beginning of the economic model known as "Operation Bootstrap," established in the 1950s, the standard has been the importation of industrial capital to promote the economical growth of Puerto Rico. At that historic juncture, said strategy made sense since the Island did not have the material basis to begin an economical growth based on local resources. Said strategy depended essentially on capital tax incentives, the availability of inexpensive manpower, the free access to the North American market, and the common currency. All these determining factors were a result of a particular geo-political and historical juncture that is no longer present.

However, under the industrialization-by-invitation model, as it was known, Puerto Rico was able to evolve from an agricultural economy to an industrialized and relatively modern economy. Between 1950 and 1970, the Island experienced a boost in the growth rates ranging from six percent (6%) to nine percent (9%), which allowed for an increase in income and quality of life of several sectors of the Island's population. Throughout history, the industrial base evolved in different concepts. First came the traditional manufacture, then the petrochemical industry, and later on, the electronics and chemicals manufacture began its heyday. The boom of the pharmaceutical industry came towards the end of the 1970s with the amendment of Section 931, which later became Section 936, and more recently, Puerto Rico has entered the era of biotechnological manufacture.

In spite of this industrial evolution, the main flaw of the economic model has been the absence of a mechanism to integrate local companies within a chain of value integrated to the manufacturing activity. This flaw has rendered local companies unable to fully take advantage of the presence of a large amount of multinational companies located in Puerto Rico, creating an economic duality in the Island. Said duality is manifested in the presence of a modern and innovative economic sector which coexists with more outdated and less innovative economic sectors. In other words, the external industrial mechanism operating in the Island has not been sufficiently integrated to the local productive sector, thus preventing the creation of a fuller and more balanced productive environment.

After fifty years and at the end of the tax incentives era in 2005, we have experienced the continuous shutdown of manufacturing companies because Puerto Rico is no longer the competitive and tax haven it used to be. It is estimated that between 1996 and 2005, the Island has lost over fifty thousand (50,000) direct jobs in manufacturing and around one hundred thousand (100,000) indirect and induced jobs. The 1950's model no longer provides the tools for the Island to compete in a new economic setting featuring globalization and new global and regional competitors. In spite of the relative importance that the manufacturing sector still has, which generates around forty percent (40%) of the Gross Domestic Product and over one hundred thousand (100,000) direct jobs, it is compelling to take a look at other strategies of economic development that are more oriented to the local capital.

Different studies have shown the importance of the present international economic reality and of promoting the development of a local capital base. Economically successful countries are those that have been successful both at attracting external investment and at furthering their local capital. In fact, recent studies on the economy of Puerto Rico (Brooking Institute and the General Accounting Office – GAO) have noted that any future strategy for the local economy has to be aimed at boosting local economic sectors. In view of this, there is a pressing need to examine other strategic approaches to promote the economic development of Puerto Rico and to examine incentives that allow us to stimulate the growth of medium and small businesses of local capital (Pymes, Spanish acronym). Although the so-called Pymes have had neither the government support that other economical sectors have had, nor the tax incentives, they have experienced a gradual strengthening. Like the United States, where sixty percent (60%) of newly created jobs have been generated by small and medium businesses, Puerto Rico ought to design a strategy to strengthen its Pymes. The strengthening of this sector is going to have the effect of creating the economic bases of local capital so as to alleviate the effects of the weakening of the external industrial sector.

The development of a public policy in favor of the Pymes is more relevant in the face of the present economic scenario. The intensification of the competition from the so-called mega stores, the increase in operation costs, and the tax pressures produced by the effectiveness of the Sales and Use Tax, without tax relieves, demand a revision of the present approaches towards local Pymes. Likewise, the fact that non-exempt corporations are subject to a tax rate that can reach 42%, makes it necessary to present a new

tax and non-tax incentives model to promote the development of the Pymes as employment and economical activity generators. Those high rate taxes imposed, combined with all the other direct and indirect taxes, are discouraging the expansion of private investment and the growth of economic sectors such as the Pymes. Upon the evaluation of international trends, it is evidenced that those countries experiencing high economic growth are those that have reduced their corporate tax rates to levels lower than thirty percent (30%), that have also reduced public spending and that have entered the global markets.

In view of this scenario, the Legislature deems it necessary to enable a public policy that includes a new tax treatment for the PYMES, and to provide the incentives necessary for their strengthening. Once the Legislature approves the new Puerto Rico Economic Development Incentives Act with emphasis in manufacturing and associated sectors, it is deemed necessary to provide small and medium businesses with a Small Business Incentives Act to promote their development in a manner that runs parallel with that of the rest of the productive sectors.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1. – This Act shall be known as the “Puerto Rico Small Business Development Incentives Act.”

Section 2. – Section 1015 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1015. - Normal Tax on Corporations and Partnerships

(a) ...

(b) ...

(1) ...

(2) A tax of twenty-two percent (22%) of the net income derived from operations covered by any tax exemption decree, resolution or grant issued under the 'Puerto Rico Tax Incentive Act,' Act No. 8 of January 24, 1987, as amended, or any other preceding or succeeding similar statute, under the 'Puerto Rico Tourist Incentives Act of 1983,' Act No. 52 of June 2, 1983, or under the 'Puerto Rico Tourist Development Act,' Act No. 78 of September 10, 1993, as amended, or

(3) A Corporation or Partnership whose total income for the taxable year does not exceed five million (5,000,000) dollars shall opt for:

(A) A tax of twenty-five percent (25%), provided that it maintains an average of seven (7) jobs during the taxable year. For the purpose of this subclause, all those individuals, residents of Puerto Rico (other than independent contractors) who work in the corporation on a permanent full-time basis, shall be considered employees. It shall be a requirement for the corporation to maintain an average of seven (7) employees during the taxable year in order to be able to benefit from this tax rate; or

(B) A tax of thirty percent (30%) of the net income subject to regular tax, in the case that the corporation or partnership does not comply with the employment requirement on the above subclause.

(c) In the case of a controlled group of corporations, the tax rates established in subclauses (A) and (B) shall apply exclusively to only one member of the controlled group. For the purposes of this subsection, the provisions and rules of Section 1028 shall be used.

(d) Improper accumulation of surplus or profits.- The surtax on corporations or partnerships which accumulate surplus or profits to avoid the tax on shareholders or partners, shall be that provided in Section 1102.”

Section 3. – Subsection (b) of Section 1016 of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1016. - Surtax on Corporations and Regular Partnerships

(a) ...

(b) Imposition of tax – There shall be levied, collected and paid, for each taxable year upon the surtaxable net income of every corporation or partnership (except corporations and partnerships subject to the tax imposed by Subchapter G, special partnerships subject to Subchapter K, corporations of individuals subject to Subchapter N, and foreign corporations and partnerships not engaged in trade or business in Puerto Rico subject to the tax imposed by Section 1231(a), and corporations and partnerships whose total income from all sources for the taxable year does not exceed five million (5,000,000) dollars and have opted for subclause (A) or (B) of clause (3) of subsection (b) of Section 1015, a surtax in accordance with the following tables:

(1) ...

(2) ...

(3) ...

(c) ...”

Section 4. – A new subclause (E) and (F) are hereby added to clause (1) of subsection (k) of Section 1023 of Act No. 120 of October 31, 1994, as amended, to read as follows:

“Section 1023.– Deductions from Gross Income

(a) ...

(b) ...

...

(k) ...

(1) ...

(A) ...

(B) ...

(C) ...

(D) ...

(E) a corporation or partnership subject to subclauses (A) or (B) of clause (3) of subsection (b) of Section 1015, in lieu of the provisions of the previous subclauses, shall be able to opt to deduct the total cost of the computer system equipment and its installation in the year it was acquired and installed. Equipment previously depreciated by a shareholder or partner of said corporation or partnership, or acquired from an associate, shall not qualify for the acceleration of the allowance for depreciation.

(F) a corporation or partnership subject to subclauses (A) or (B) of clause (3) of subsection (b) of Section 1015, in lieu of the provisions of previous subclauses, shall be able to determine the deduction established in subclause (A) of this clause, using a two-year useful life for the ground transportation equipment, except for automobiles (as defined in subclause (C) of clause (3) of this Section), and for environmental conservation equipment.”

Section 5. – To add new paragraphs (iii) and (iv) to subclause (B) of clause (1) of subsection (a) of Section 1023 of Act No. 120 of October 31, 1994, as amended, to read as follows:

“Section 1023. –Deductions from Gross Income

On computing net income, the following shall be allowed as deductions:

(a) Expenses.–

(1) Trade or Business Expenses.–

(A) In general. All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses, including the amount expended for meals, lodging, and entertainment while away from home in the pursuit of a trade or business, except those amounts considered sumptuous or superfluous under the circumstances, and in conformity to the limit established in Section 1024(e); and rentals or other payments required to be a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he/she has no equity. Provided, further, that a partner of a special partnership or shareholder of a corporation of individuals shall not be considered to be carrying on a trade or business merely by reason of his/her holding of an interest in a special partnership or corporation of individuals. See subsection (k)(3)(D), (E) and (F) of this Section in connection with the deduction for expenses in automobile leasing.

(B) ...

(i) ...

(ii) ...

(iii) in the case of an individual carrying on any trade or business, he/she shall be entitled to a fifty percent (50%) deduction on gross income for the self-employment federal tax paid to the Internal Revenue Service on the income reported for the same taxable year.

(iv) in the case of an individual carrying on his/her own trade or business whose gross income does not exceed five hundred thousand (500,000) dollars, shall be able to deduct the cost of health insurance, individual and family, as an expense of his/her trade or business, provided that said health insurance covers all employees, if any. In the case of those individuals opting for the provisions herein, they shall not be able to include the expense paid for health insurance under Section 1023 (aa)(2)(P).”

Section 6.– Extension of the provisions of the “Compensation System for Work-Related Accidents Act” to certain business owners.

The first paragraph of Section 2 and Section 38 of Act No. 45 of April 18, 1935, as amended, are hereby amended to read as follows:

“Section 2.– The provisions of this Act shall apply to all workers and employees working for their employers to whom the following paragraph refers, who suffer injuries, are disabled or lose their lives by reason of accidents caused by any act or function inherent to their work or

employment, when such accidents happen in the course of said work or employment and as a consequence thereof or due to diseases or death caused by their trade, as specified in the following Section. The provisions of this Act shall also apply to any owner of a business or trade, or any individual employer working full-time in said business or trade whose gross income does not exceed one million (1,000,000) dollars. Specifically excepted from this provision are those workers or employees whose labor is of an accidental or casual nature and is not included in the business, trade, profession or occupation of his employer.

The premium to be imposed for the risks involved with the job performed by the owner of the business, trade or the individual employer to which the previous paragraph makes reference, shall be determined through the regulations promulgated to such effect by the Administrator of the Puerto Rico State Insurance Fund Corporation.

When the owner to which the first paragraph of this provision refers suffers any injury or disease in the workplace, he/she shall submit a claim of the case within the term provided by law, using the forms of the State Insurance Fund Corporation to such effect. Said form shall be filled out under oath and include the name and address of the claimant, the insurance policy number, the circumstances under which the alleged accident or disease occurred, the date, hour and place, as well as the name and address of the witnesses, if any, and the signature of the claimant, among other things. The submittal of said report is required to receive medical-hospital services and all other benefits granted by Law, with the exception of emergency treatment.

Any owner of a business or trade that opts for the benefits of this Act when the injury or condition suffered is not related to his/her work shall be compelled to reimburse the State Insurance Fund Corporation for the expenses incurred.

...”

Section 38. – ‘Worker’ or ‘employee’ shall be understood to mean any person in the service of any individual, partnership or corporation regularly employing workers covered under the provisions of this Act, including the owner of an individual business or trade working on a full-time basis in said business or trade whose gross income does not exceed one million (1,000,000) dollars a year.”

Section 7. – Requirement of Audited Financial Statements Enclosed with Personal Property Tax Return.

Sections 6.02(a) and 6.02(c) of Act No. 83 of August 30, 1991, as amended, are hereby amended to read as follows:

“(a) Persons subject to payment of personal property taxes.

...

In the case of corporations whose gross income exceeds three million (3,000,000) dollars, the tax return shall be sworn by the President, Vice-President or any other chief executive official, or by the Treasurer or Vice-Treasurer, and in the case of a partnership by a managing partner.

(b) ...

(c) Revised tax returns and tax returns enclosed with financial statements audited by certified public accountants.– Every corporation, except for non-profit corporations and without capital stock, and/or for corporations whose volume of business does not exceed three million

(3,000,000) dollars a year, must submit their tax return revised by a certified public accountant licensed by the Commonwealth of Puerto Rico enclosed with financial statements (balance sheet, income and expense statement, cash-flow statement and the corresponding notations to the financial statements) corresponding to the corporation's last year of operations.”

Section 8.— Requirement of Audited Financial Statements Enclosed with the Income Tax Return:

Section 1018(c) of Act No. 120 of October 31, 1994, as amended, is hereby amended to read as follows:

“Section 1018. —

...

(c) Income statement.— For the purposes of this Section, the term ‘income statement’ means, with regard to any taxable year, a financial statement showing the results of the operations of the corporation or partnership, including an insurance company, for said taxable year, which shall include a balance sheet and a cash-flow statement. Said statements shall be prepared according to generally accepted accounting principles and shall be audited by a certified public accountant licensed to practice in Puerto Rico, except that this last requirement shall not apply to non-profit corporations or those without capital stock, nor to for-profit corporations or partnerships whose volume of business does not exceed three million (3,000,000) dollars a year.”

Section 9.— Requirement of Audited Financial Statements for Business Volume Tax Returns.

Sections 10(a)(i) and 10(a)(ii) of Act No. 113 of July 10, 1974, as amended, are hereby amended to read as follows:

“(a) Date for statement. –

(1) General rule. On or before the effective date of this Act, any person, or his/her authorized agent, subject to the payment of the license tax shall be bound to file a statement of the volume of business, as provided in Sections 651 through 652y of this title, on or before five (5) working days subsequent to April 15 of each taxable year.

Any person, or his/her authorized agent, subject to the payment of the license tax shall be bound to file, under oath taken before any municipal or Commonwealth of Puerto Rico official duly authorized therefor, a statement on the form or model established by the Commissioner of Municipal Affairs through regulations approved to such effect. If the business volume of the person subject to the payment of license tax does not exceed three million (3,000,000) dollars.

(i) Sales volumes of less than three million (3,000,000) dollars a year.–

A copy of the pages or supplements in which the gross income and operating expenses ...

...

...

...

...

(ii) Sales volume in excess of three million (3,000,000) dollars a year.–

Financial statements audited by a certified public accountant licensed by the Commonwealth of Puerto Rico for the purposes of Sections ...

...

...

...

...”

Section 10.– Requirement of Audited Financial Statements for Corporations’ Annual Report.

Section 15.01 (A)(1) of August 10, 1995, is hereby amended to read as follows:

“1. A balance sheet prepared in accordance with generally accepted accounting principles showing the financial condition of the corporation at the close of its operations, duly audited by a certified public accountant licensed by the Commonwealth, who is neither a stockholder nor employee of such corporation, together with the corresponding opinion of such certified public accountant.

It shall not be necessary for the report required by this Section to be audited by a certified public accountant in the case of nonprofit and non-capital stock corporations or for-profit corporations whose volume of business does not exceed three million (3,000,000) dollars; provided, that such report must then be sworn before a notary public or an officer empowered by the laws of the Commonwealth of Puerto Rico to administer oaths.”

Section 11.— This Act shall take effect immediately after its approval, except for the provisions of Sections 2, 3, and 5, which shall apply to taxable years commenced after December 31, 2008.

CERTIFICATION

I hereby certify to the Secretary of State that the following **Act No. 147 (Substitute for H. B. 4351 (Conference))** of the **7th Session of the 15th Legislature** of Puerto Rico:

AN ACT to create the new “Puerto Rico Small Business Development Incentives Act”; to amend Section 1015 of Act No. 120 of October 31, 1994, as amended; to amend subsection (b) of Section 1016 of Act No. 120 of October 31, 1994, as amended, for the purpose of exempting certain corporations from payment of surtax on net income; to add a new subclause (E) and (F) to clause (1) of subsection (k) of Section 1023 of Act No. 120 of October 31, 1994, as amended, in order to allow a corporation or partnership to opt for a deduction of the total cost of computer system equipment and the installation thereof for the year in which it was acquired and installed, and to allow this type of taxpayer to have a deduction for two (2) years of the total cost of transportation and environmental conservation equipment; etc.

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 30th of October of 2009.

Solange I. De Lahongrais, Esq.
Director