Business and Taxation Guide to Puerto Rico
Preface

This guide was prepared in April 2012 by Aquino, De Córdova, Alfaro & Co., LLP, a firm of Certified Public Accountants based in San Juan, Puerto Rico. The firm is a correspondent member of Praxity and member of the American Institute of Certified Public Accountants.

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The primary objective of Aquino, De Córdova, Alfaro & Co., LLP is to provide clients with the highest quality of accounting, auditing, tax, financial and managerial advisory, and technology information consulting services. The firm has proven experience in providing services to businesses, government and public sector organisations in Puerto Rico and the Caribbean.

The firm has clients in a broad range of industries. These include construction, real estate development, retail, wholesale, agriculture, mortgage banking, automobile dealers, insurance, government, health care institutions, manufacturers, as well as service organisations.

Developments in tax legislation are rapid. The information given in this guide reflects the tax legislation in Puerto Rico as of January 2012. Before taking specific decisions, it’s recommended that professional advice and guidance be sought.

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This guide is intended as a general guide only and should not be acted upon without further advice.
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1. General information

1.1 Opportunities and possible obstacles for foreign investors

Puerto Rico has one of the most dynamic economies in the Caribbean region. Plantation sugar production dominated Puerto Rico’s economy until the 1940s. Industry has surpassed agriculture as the primary sector for economic activity and income. Key factors worth considering by foreign investors include:

- Encouraged by duty free access to the U.S. and by tax incentives, U.S. firms have invested heavily in Puerto Rico since the 1950s.
- U.S. minimum wage laws apply.
- Dairy production and other livestock products have overtaken sugar production as the main source of income in the agricultural sector.
- As a result of these movements, Puerto Rico’s economy has shifted labour from agriculture to manufacturing, service and tourism.

Puerto Rico’s manufacturing sector has shifted from the original labour-intensive industries, such as the manufacturing of food, tobacco, leather, and apparel products, to more capital-intensive industries, such as pharmaceuticals, chemicals, machinery, and electronics.

The percentage of manufacturing employment by industry group is:

- Chemical and allied products - 18.2%
- Apparel and other textile products - 15.5%
- Electronic - 15.2%
- Food and related products - 13.2%
- Instruments and related products - 9.8%
- Paper and related products - 4.7%
- All other manufacturing 23.3%.

1.2 Area and population

Puerto Rico, officially the Commonwealth of Puerto Rico, is an unincorporated territory of the United States. It is located in the north-eastern Caribbean, east of the Dominican Republic and west of both the United States Virgin Islands and the British Virgin Islands.

Puerto Rico comprises an archipelago that includes the main island of Puerto Rico and a number of smaller islands, the largest of which are Vieques and Culebra. The main island of Puerto Rico is the smallest by land area of the Greater Antilles. However, it ranks third in population among that group of four islands, which also include Cuba, Hispaniola (Dominican Republic and Haiti), and Jamaica. Due to its location, Puerto Rico enjoys a tropical climate and also experiences the Atlantic hurricane season.

According to the census of 2010, Puerto Rico has a population of about 3.8 million.

1.3 Government and law

The Commonwealth of Puerto Rico is a semi-autonomous territory of the United States. Puerto Rico has a republican form of government, subject to the United States of America jurisdiction and sovereignty. The President of the United States is the head of state. The government of Puerto Rico is composed of three branches - executive, legislative and judicial.
Puerto Rico has 78 municipalities. Each municipality has a mayor and a municipal legislature elected for a four year term.

Although Puerto Ricans are U.S. citizens, residents pay no federal income tax on their Puerto Rico sourced income, nor can they vote in presidential elections. As citizens, Puerto Ricans do not require a visa to travel, live and/or work in the U.S.

1.4 Economic situation

Despite its relatively small geographical area and limited availability of natural resources, Puerto Rico's productivity is exceptionally high, with the highest nominal GDP per capita in Latin America (US$ 24,229 in 2010. In addition, Puerto Rico has the second most competitive economy among Ibero-American states, only being surpassed by Chile, according to the latest World Economic Forum's Global Competitiveness Report. The commonwealth has modern infrastructure, a large public sector and an institutional framework guided by the regulations of U.S. federal agencies, most of which have an active and continued presence in the archipelago.

The financial sector accounted for 5.75% of Puerto Rico’s Gross National Product (GNP) in 2010 and is fully integrated into the U.S. financial system.

Puerto Rico currently holds a BBB+, Stable rating from Standard & Poor’s.

1.5 Currency

The monetary unit used in Puerto Rico is the U.S. dollar ($), often abbreviated as US$ to distinguish from other dollar denominated currencies. The International Standards Organization (ISO) currency code is USD. One dollar is divided into 100 cents.
2. Regulation of foreign investment

Puerto Rico does not impose controls on currency exchange. Consequently, a foreign investor or exporter is not restrained from repatriating the capital or profits generated from a business or investment. This is subject to the withholding tax required by the Code.

However, since Puerto Rico is part of the United States, there are several U.S. requirements that must be complied with. For example, the Bank Secrecy Act of 1970, also called the Currency and Foreign Transactions Reporting Act of 1970, stipulates anyone who transports monetary instruments with a value in excess of US$10,000 into or out of the U.S. on a single occasion must make a report to the U.S. Treasury. The ‘monetary instruments’ that must be reported include:

- Coins or currency of any country
- Bank cheques, traveller’s cheques, money orders or investment securities that exist in either bearer form or another monetary form that will pass title upon delivery
- All other negotiable instruments, with the exception of warehouse receipts or bills of lading that exist in bearer form.

Bank cheques, traveller’s cheques or money orders that have been made payable to the order of a named person and lack the necessary endorsement for negotiability are excluded. Any transfer of funds through normal banking channels is also exempt.

The federal government restricts foreign investments in transportation, utilities, banking, communication, finance, nuclear energy and defence.

The federal government also prohibits foreign ownership in certain types of property, such as land under federal control, broadcast licenses or aircraft registered in the U.S. Despite these statutory controls, the U.S. policy towards foreign investment is basically open, as it has traditionally been in the past. In addition, many of the restrictions placed on the non-U.S. investor can be bypassed through the creation of a U.S. entity incorporated under the laws of its states.
3. Government incentives

Puerto Rico, one of the fastest growing manufacturing locations worldwide, adopts a proactive attitude towards foreign investment and, in general, provides a regulatory framework to attract direct foreign investment. Several Economic Incentives Acts offering attractive economic and tax incentives are available to investors:

3.1 Economic Incentives for the Development of Puerto Rico Act (Act No. 73)


Act No. 73 provides a wide array of tax incentives and credits that enable local and foreign companies to operate successfully in Puerto Rico enjoying the benefits of operating within a U.S. jurisdiction, while taking advantage of a foreign tax structure. The following businesses are among those eligible for the tax benefits provided by Act No. 73:

- Any permanent industrial unit that provides for the production of a manufactured product on a commercial scale
- Any industrial unit that otherwise fails to qualify as a manufacturer with respect to commercial scale production, but qualifies for export activities only
- Rendering of ‘key supplier’ services critical to the production process of an exempt business engaged in manufacturing operations, that forms part of certain high economic impact clusters (e.g., specialist warehousing, logistics, training, and engineering of projects, quality control and validation)
- Certain designated services conducted on a commercial scale for markets outside of Puerto Rico, for example distribution centres, corporate headquarters and trading companies
- Strategic projects, such as cleaning, recovery, conversion and restoration of closed landfills, construction of water dams, construction of plants for the generation of energy at low cost or mass transit systems
- Licensing of intangible property
- Industrial units for the production of energy using coal, natural gas or renewable sources
- Activities of partial and total recycling
- Value added activities located in Las Americas, Roosevelt Roads, and the ports of Mayaguez, Yabucoa, San Juan and Guayama, among others
- Software development
- Assembly of energy generating equipment using renewable resources
- Investigation, development, manufacturing and transportation of satellites, and data processing centres, excluding telephone services and radio and TV broadcasting
- Any industrial unit for the production of bottled purified water (only tax credits are available for this specific industry)
- Construction of affordable housing and self-sustained house projects - the term ‘self-sustained’ means that it has the capacity to supply its own utilities (electricity and water) and its own waste disposal.

Some of the key features provided for in Act No. 73 include:

- 4% fixed income tax rate
- Pioneer industries rate 0% or 1% income tax
- Combined floor of 3% for local business
- Credit of up to US$5,000 per job created during the first year of operation, if the operation is located in the municipalities of Vieques and Culebra
- Up to 50% credit for qualifying Research & Development (R&D) expenses
- Credit for the purchase of locally manufactured products
- Up to 10% credit for industrial energy consumption
- Special deductions for investment in structures, machinery and equipment
- Infrastructure incentives
- Statutory relief for personal and real property tax, as well as municipal tax
- Distributions of dividends or partnership profits out of IDI are exempt from income tax
- Training incentives.

Additionally, a 12% tax must be withheld from royalties paid to non-residents of Puerto Rico for the use of intangibles, such as patents, special formulas or know how. Alternatively, exempt businesses may opt for 8% income tax rate and 2% withholding tax rate on royalties, subject to prior approval from the Secretary of Economic Development.

All businesses eligible for the tax benefits provided for by Act No. 73 will enjoy an exemption period of 15 years, regardless of the location of the exempt business. The exempt business will be able to establish additional industrial units, as part of the operations covered by the grant, in any municipality, without having to request a new tax grant.

### 3.2 Puerto Rico Tourism Development Act of 2010 (Act No. 74)

On 10 July 2010, the Governor signed into law the **Puerto Rico Tourism Development Act of 2010** (2010 TDA or Act No. 74), which replaced the Puerto Rico Tourism Development Act of 1993, and now provides new tourism incentives and is the principal instrument for the country’s tourism incentive programme.

The 2010 TDA continues to offer eligible tourist businesses tax benefits with regard to:

- Income tax
- Property tax
- Certain municipal excise
- Gross receipts
- License tax and sales and use tax.

The 2010 TDA provides specific withholding tax rules on the payment of royalties, ranging from 2.9% to 12%. Investors in an exempt business are also entitled to certain tax credits. The exemptions generally include:

- 90% income tax exemption (100% if the tourism activity is located in Vieques or Culebra)
- 90% property tax and gross receipt or volume of business exemption
- 100% sales and use tax exemption on articles used in a tourism activity.

These exemptions can be applied over a period of 10 years, extendible for a further 10-years. Tourist businesses that have agreed exemptions under prior tourism incentives acts may renegotiate their decrees under the 2010 TDA, upon meeting certain conditions.

Some of the favourable benefits provided for in Act No. 74 include:

- Income from the tourist activity is not subject to an alternative minimum tax of individuals
- The tax basis of a partner’s interest in a special partnership exempt under any of the tourism incentives laws, including the 2010 TDA, may be increased by the partnership’s debts - for
taxable years commencing after 31 December 2011, this increase in tax basis treatment will apply to all special partnerships

- Income derived from the operation of passenger cruise ships by foreign corporations or partnerships will be treated as derived entirely from sources outside of Puerto Rico.
- Income from casino operation will be considered as tourism income (although not entitled to tax exemption) for purposes of the 70% gross income test required for a corporation or partnership to qualify for the special partnership pass-through status.
- Nautical tourism businesses electing special partnership status will only have to comply with the requirement that 70% of its gross income is derived from the operation of that activity. This means that they do not have to meet the otherwise applicable 70% Puerto Rico source gross income test.
4. Business organisations available to foreigners

 Investors wishing to establish and conduct business in Puerto Rico must first decide the type of entity that will best serve their purposes. Puerto Rico Corporate and Tax Laws provide for and legally recognise several options, among them:

- Wholly owned subsidiary organised in Puerto Rico (also known as a domestic corporation)
- Branch of a foreign corporation
- Foreign subsidiary not organised in Puerto Rico
- Limited Liability Company
- Limited Liability Partnership.
5. Setting up and running business organisations

5.1 Process for registration and licensing business entities

5.1.1 Foreign corporation

Under the **Puerto Rico General Corporation Law of 2009**, a foreign corporation may request a certificate to do business in Puerto Rico by filing with the Department of State the following information:

1. The name of the foreign corporation
2. The name and jurisdiction in which the corporation was incorporated
3. The date of incorporation and term of the legal entity
4. Physical address of its principal office
5. The address of its office in Puerto Rico and the name of the resident agent
6. Names and addresses of the corporation’s officers and directors
7. A report of the corporation’s assets and liabilities
8. Description of the business to be conducted in Puerto Rico, plus a statement indicating that the corporation is authorised to conduct this business in its place of incorporation.

5.1.2 Certificate of existence

When filing the request for incorporation, the corporation **must** include a certificate of existence (or similar document) issued by the Secretary of State or other officer maintaining the custody of the corporate register in the place of incorporation. If the certificate is in a foreign language, a translation with a sworn statement of the translator must accompany the request. A foreign corporation conducting business in Puerto Rico without obtaining this certificate of authorisation cannot initiate court proceedings in Puerto Rico.

5.1.3 Business transactions

Under the General Corporation Law the following transactions do not constitute business transactions in the Commonwealth of Puerto Rico:

1. To claim, defend, or settle any judicial proceeding
2. Carrying out meetings of the board of directors or of stockholders or other activities related with internal matters of the corporation
3. Holding bank accounts
4. Maintaining agencies or offices for the transfer, exchange or inscription of the securities of the corporation or maintaining fiduciaries or depositors with respect to such securities
5. Selling through independent contractors
6. Soliciting or obtaining orders through the post office or through employees or agents or in other manners, if the acceptance of the orders outside of Puerto Rico takes place before the contractual obligation
7. Creation or acquisition of debts, mortgages, or guarantees of personal or real property
8. The guarantee or collection of debts or execution of mortgages or guarantees in the properties being guaranteed
9. Holding the title of personal and real property
10. Performance of a sole transaction, which is completed within a 30-day term and is not one of a series of transactions of the same nature.
6. Corporate tax and social charges

6.1 General introduction

In general, Puerto Rico corporations are required to comply with certain filing requirements with different government agencies. For ease of use, we have divided this guide according to the filings required by law and the different governmental agencies. See from sections 6.6 for details.

In general, corporations (including branches of foreign corporations) engaged in business in Puerto Rico or deriving income which is effectively connected with the conduct of a trade or business in Puerto Rico are subject to corporate income tax.

When the corporations’ volume of business exceeds US$ 3,000,000 for any taxable year, it must file a financial statement showing assets and liabilities effectively connected with its trade or business in Puerto Rico alongside the corresponding tax return.

- The financial statements must be accompanied with an ‘Accountants Report’ issued by a certified public accountant (CPA) licensed in Puerto Rico, reporting the audit of such financial statements pursuant to generally accepted auditing rules.
- All corporations authorised to conduct business in Puerto Rico must keep and maintain in Puerto Rico the accounting books and records detailing its Puerto Rican operations.
- It is important to note that any taxes paid in Puerto Rico by a foreign corporation may generally be available as a foreign tax credit in the U.S. Accordingly, double taxation is generally avoided.

The following sections detail the corporate income tax rates and the income tax implications of conducting business in Puerto Rico for specific business entities.

6.2 Tax Rates

Regular Tax - 20%

PLUS

Surtax:

- 5% if net income subject to the surtax does not exceed US$1,750,000
- 10% for net income, subject to the surtax in excess of US$1,750,000, plus US$87,500

The maximum income tax rate is 30%.

6.3 Puerto Rican Corporation

A domestic corporation determines its taxable income, taking into consideration all items of income on a worldwide basis, regardless of whether the income is or is not effectively connected to the conduct of a trade or a business in Puerto Rico.

A domestic corporation is allowed to deduct all of its ordinary and necessary business expenses. In addition, a domestic corporation is entitled to deduct in its Puerto Rican income tax return a reasonable allocation of overhead expenses incurred by the parent company or any affiliate in a foreign country or the United States, providing they are related to the corporations’ operations in Puerto Rico.

6.3.1 Normal-tax net income
Under the new *Puerto Rico Internal Revenue Code* (PRIRC) a flat tax rate of 20% on the 'normal-tax net income' of a corporation applies. The 'normal-tax net income' continues to be total net income minus the dividend-received deduction. Also, the surtax continues to apply to the 'surtax net income', which is normal-tax net income less the allowed surtax credit. The surtax credit increased from US$ 25,000 to US$ 750,000 under the new PRIRC.

Furthermore, a 10% withholding tax is applied to dividend distributions.

### 6.3.2 Alternative Minimum Tax (AMT)

In addition to the regular corporate tax rates, the new PRIRC provides for the collection of taxes from entities if they benefit from deferrals and exclusions. This means that corporations may be subject to an Alternative Minimum Tax (AMT). The AMT, which under new PRIRC was reduced from 22% to 20%, is based on the alternative minimum net income, which is the regular taxable income adjusted by certain timing differences and book income adjustments. The AMT is only triggered in instances in which the AMT is higher than the regular tax. Under certain conditions the AMT can be credited against subsequent years.

### 6.3.3 Capital gains

In the case of the flat rate for long-term capital gains, the new PRIRC provides a special tax rate of 15%, instead of taxing capital assets at the ordinary rates.

### 6.4 Branches of a foreign corporation

#### 6.4.1 Regular tax

A branch of a non-Puerto Rican corporation will be subject to regular income taxes in a manner similar to a domestic corporation.

When determining taxable income, the branch must take into consideration items of income effectively connected with the conduct of a trade or business in Puerto Rico. The branch is allowed to deduct the expenses directly allocable to the Puerto Rican business. In addition, a reasonable apportionment of expenses not directly related to any item of income is allowed as a deduction.

Some expenses incurred by the branch directly, or allocated, may not be allowable for deduction for Puerto Rico tax purposes. These expenses, include, but are not limited to:

- Insurance premiums paid to unauthorised insurers
- Contributions to non-qualified pension plans
- Interest expenses - the company must calculate the allowable portion of interest expense by the methods provided by the new PRIRC.

#### 6.4.2 Deductions and credits

A foreign corporation can receive the benefit of deductions and credits allowable only if it complies with all of the following requirements:

1. It files (or plans to file) a true and accurate return of its total income, which is effectively connected with the conduct of a trade or business within Puerto Rico. This must be done in the manner prescribed, and must include all of the information that the Secretary of the Treasury may deem necessary for the calculation of the deductions and credits.
2. It shall keep available at all times the accounting books containing the operations of branches or divisions in Puerto Rico, including all pertinent documents evidencing such deductions and the basis used for the apportionment and allocation of deductions to income that is effectively connected with the conduct of a trade or business.

3. When the volume of business exceeds US$ 3,000,000, the income tax return and other returns must be accompanied with financial statements detailing the assets and liabilities effectively connected with its trade or business in Puerto Rico and which reflect the results of operations of the corporation for the taxable year. A balance sheet and a statement of sources and uses of funds must accompany this. The financial statements must be accompanied with an ‘Accountants Report’ issued by a certified public accountant (CPA) licensed in Puerto Rico, reporting the audit of such financial statements pursuant to generally accepted auditing rules.

6.4.3 Capital gains

A special tax rate of 15% is imposed on net long-term capital gains.

6.4.4 Branch profit tax

The purpose of a branch profit tax (BPT) is to treat the remittances of funds to the home office as dividends. A foreign corporation is not subject to BPT in a taxable year if, for the current and two preceding taxable years, at least 80% of its gross income was effectively connected with a Puerto Rican trade or business.

The BPT generally represents a 10% tax upon the ‘dividend equivalent amount’ or DEA. The BPT would be imposed if the earnings and profits derived by the branch are not reinvested in Puerto Rico as of the end of the taxable year. Determining the amount invested or reinvested is done by comparing the net equity at the end of the taxable year and the net equity at the beginning of the forthcoming taxable year.

The branches’ BPT, as well as the income tax burden, may be reduced through the reasonable allocation and apportionment of overhead expenses that are related to the branches’ Puerto Rican operation.

6.5 Foreign subsidiary

6.5.1 Regular income tax

A foreign corporation conducting business in Puerto Rico will also be taxed at the regular income tax rates. Also, net long-term capital gains are taxed at a special rate of 15%.

6.5.2 Branch Profit Tax (BPT)

A foreign corporation is subject to the BPT provision unless the foreign subsidiary derives 80% or more of its income from its operation/s in Puerto Rico.

Depending on the circumstances, a Puerto Rico subsidiary may offer investors a more favourable effective tax rate position when compared with the Branch or Foreign Corporation options. In the Puerto Rico subsidiary scenario there is no 10% BPT or withholding on foreign subsidiary dividends imposed on a branch engaged in trade or business in Puerto Rico unless dividends are actually paid by the subsidiary.

6.6 Statutory reports
Outlined here are the different reports that corporations must file by law and the corresponding government agency.

6.6.1 Corporate taxes

The following must be filed with the Puerto Rico Treasury Department (PRTD):

**Taxpayer Account Number**

Every company must use a pre-assigned taxpayer account number when filing the required returns and reports. The number used in Puerto Rico corporate tax returns is the same as the Federal Employer Identification Number (FEIN) assigned by the United States Internal Revenue Service (IRS). If the company is operating as a branch of a foreign corporation, then for Puerto Rico tax purposes, the same FEIN assigned to the foreign corporation is used.

Upon receiving this number from the IRS, the company must inform the PRTD of the assigned number, using Form SC-4809. This number should be used in all documents filed with the PRTD relating to tax matters.

**Corporation Income Tax (CIT) returns**

All corporations conducting business in Puerto Rico are required to file the Puerto Rico Corporation Income Tax Return (Form 480.20) on or before the 15th day of the fourth month following the close of the taxable year. Any unpaid tax is due when return is filed.

A 90-day extension to file the return is available. This can be obtained by filing a Request for Extension of Time to File the Income Tax Return (Form SC 2644) with the PRTD on or before the due date of the original return. However, this extension does not extend the time for payment.

The following must be filed with the Puerto Rico Department of State:

A corporation authorized to conduct business in Puerto Rico is required to file an Annual Corporation Report with the Department of State on or before 15 April in each year. A US$ 150 annual fee is payable when filing the report.

The new requirements of the General Corporation Act requires that commencing in taxable year 2010 and thereafter, the filing of the Annual Corporation Report and the payment of the US$ 150 filing fee must be made electronically. The US$ 150 filing fee must be paid by 15 April, either with the annual report or within the agreed report filing extension time.

All reports must be certified by a Puerto Rican licensed CPA if the total volume of Puerto Rican operational business exceeds US$ 3,000,000.

6.6.2 Personal property tax

The following must be filed with the Puerto Rico Municipal Revenue Collection Center

All corporations that own personal property located in Puerto Rico are required to file the Puerto Rico Personal Property Tax Return (Form AS 29-I) on or before 15 May following the assessment date on 1 January of each year. Any tax due must be paid within the extension period and a 5% discount can be claimed when the tax is paid.

The tax on personal property is self-assessed. Every person required to pay the tax must include on the return all taxable personal property and determine the tax due. Some examples of personal property include, but are not limited to:
- Cash in hand (includes petty cash and deposits in transit)
- Inventory for resale
- Materials and supplies
- Furniture and fixtures
- Movable machinery and equipment.

The tax is calculated from the taxable basis (determined depending on the type of property) at the applicable tax rates of the municipality in Puerto Rico where the property is located.

6.6.3 Municipality taxes

Volume of Business Declaration (Municipal License Tax)

Corporations establishing operations in Puerto Rico have 30 days from the commencement of operations to register with the Director of Finance in the municipality from which the operations are being conducted. The commencement of operations refers to the establishment of an office, warehouse, or branch in any of the municipalities of the Commonwealth of Puerto Rico. In fact, the establishment of a facility is the conclusive event in determining whether a particular municipality has the power to levy taxes over the volume of business generated by any entity in the particular municipality.

A declaration of the volume of business, based on the same year as that used to prepare the income tax return, must be filed on or within five working days after 15 April in each year. This declaration must be filed with each municipality in which the corporation operates. An extension for filing this declaration may be obtained.

The municipal license tax rates for non-financial services range from .20% to .50%. Even though the declaration follows the government fiscal year, the volume of business is based on the same year that is used to prepare the income tax return.

6.6.3 Other requirements

Merchants and Business Mandatory Registry

Pursuant to the amended Act No. 171 dated 12 August 2000 (Act No. 171), all persons, natural or legal, operating a business in Puerto Rico must register with the Puerto Rico Trade Company. For these purposes, a company is registered upon completion of the corresponding economic census form, for which there is no filing fee. Failure to file this form, however, may result in an administrative fine based on the business gross income according to the regulations of Act No. 171.

6.7 Tax withholdings

The following must be filed with the Puerto Rico Treasury Department

6.7.1 Withholding to non-resident recipients

A withholding of income tax at source is required to be made on payments to non-resident individuals, or non-resident fiduciaries, or foreign corporations and foreign partnerships, not engaged in trade or business within Puerto Rico for:

- Interest
- Rent
- Salaries/wages
- Participation in a partnership
- Profits
- Commissions
- Premiums, annuities, remuneration, compensation, dividends, or other fixed or determinable, annual or periodical gains
- Profits and income.

This is only to the extent that these items constitute gross income from sources within Puerto Rico. The company is required to withhold and deduct a tax at the following rates:

- Puerto Rico non-resident individuals that are citizens of the United States – 20%, except on dividends
- Puerto Rico non-resident individuals (non-U.S. citizens) – 29%, except on dividends and interest paid to non-related persons
- Puerto Rico non-resident fiduciaries - 29%
- Foreign corporations and partnerships not engaged in trade or business within Puerto Rico (as a general rule) - 29%
- Dividend payments to foreign corporations and partnerships not engaged in trade or business within Puerto Rico - 10%
- Sales of property by non-resident aliens - 29%
- Dividend payments from corporations and partnerships engaged in the operations of hotel, manufacturing or shipping businesses, or industrial development income - 10%.

The amount withheld should be deposited with Form 480.9A with the Secretary of the Treasury (Secretary) on or before the 15th day of the month following the close of the month in which the tax was deducted.

6.7.2 Withholding to Puerto Rico resident recipients (back-up withholding)

In general, payments made in excess of US$ 1,500 to another person (natural or legal) for services performed within Puerto Rico are subject to a 7% withholding.

The following are several examples of payments exempt from this requirement:

- Payments for services rendered by non-resident individuals or foreign corporations or partnerships that are not involved in an industry or business in Puerto Rico that are subject to other withholding requirements
- Payment for services exempt under any of the Puerto Rico Industrial Tax Incentives Laws
- Payments made to the Government of Puerto Rico, including its agencies, instrumentalities, public corporations and political subdivisions.

In the event that payments include both, services and other activities (for example, travel expenses, machinery and spare parts), the service provider should segregate the amounts on the bill in order for the recipient to determine the appropriate withholding amount. No withholding should be made on that portion of a payment, which does not represent compensation for services rendered.

6.7.3 Important considerations for corporations subject to withholding

The PRIRC provides that the payments made to a corporation during the first three years of operations will not be subject to withholding taxes. However, certain filing requirements with the Puerto Rico government must be met.

After these three years, a partial ‘Waiver of Withholding Certificate’ (waiver certificate) can be obtained from the PRTD if the taxpayer has filed all of the returns and has no outstanding debts with the PRTD.
The partial waiver certificate reduces the taxpayers’ withholding tax liability from 7% to 3% withholding. The certificate must be obtained annually and applies to the entire calendar year in which it is granted. Additionally, there is a total waiver certificate available to corporations that have reported a loss, and to corporations that are required to file certified audited financial statements with their returns, providing that they are in good standing with the PRTD.

Businesses that are subject to the withholding can claim a credit against the tax liability for the amounts withheld during the year. The amounts withheld are considered estimated tax payments made at the time of the withholding or tax prepayments.

6.7.4 Annual Informative Returns

All taxpayers must report non-wage payments (interest, rents, premiums, remuneration, etc.) of US$ 500 or more made to any individuals or corporations, as well as dividends of US$ 500 or more. In addition, the corporation must report all withholding of the 7% tax (see section 6.7.3) made during the year for services received. These reports are made on a calendar-year basis and should be filed on or before 28 February in the next calendar year. The following informative returns must be filed where applicable:

- **Form 480.6A** – to report the following items on which tax withholding was not required:
  - other compensation in excess of US$ 500 which is not included in Form 499 R-2/W-2 PR and
  - personal services rendered totalling US$ 500 or more.

- **Form 480.6B** – to report the following items on which tax withholding was required:
  - dividends
  - personal services rendered
  - interest on bank accounts, and
  - certificates of deposit.

- **Form 480.6B1** – annual reconciliation statement of income subject to withholding.

An Annual Informative Return (Form 480.5) must be used to summarise the informative returns (Forms 480.6A, 480.6B, and 480.6C (see section 6.7.5) and remit these returns to the PRTD. This summary declaration must be delivered on or before 28 February following the end of the calendar year for which they are being submitted. When filing five or more informative returns it is important to note that the taxpayer must file the returns electronically.

Every person required to deduct and withhold taxes on the payments listed above, other than services rendered, must pay and deposit the tax on or before the 15th day following the month in which the taxes were withheld. The deposit must be made using Form 480.9 (Payment of Income Tax Withheld) and filed at any Internal Revenue Collections Office.

6.7.5 Annual return of income tax withheld at source (non-resident taxpayers)

As a general rule, all persons, in whatever capacity, that control the payment of profits, gains, salaries and wages, among others, to any non-resident individual or corporation not engaged in a trade or a business in Puerto Rico on items constituting gross income from sources within Puerto Rico should deduct and withhold an amount equal to:

- 29% if the recipient is an foreign non-resident (alien)
- 20% if the recipient is a U.S. citizen
- Where the recipient is a foreign corporation, the withholding should be 29%.
The taxpayer must withhold taxes on payments made to non-resident taxpayers during each calendar year.

- **Form 480.6C** must be prepared for each non-resident individual, and for each foreign corporation or partnership not engaged in trade or a business in Puerto Rico, from which the company withheld tax at source for salaries, wages, compensation, sale of property, dividends, royalties, interest, rents, etc. Form 480.6C must be given to the taxpayer and submitted to the PRTD no later than 15 April following the calendar year for which the payments were made.

- **Form 480.31** (Deposit of Income Tax Withheld at Source to Non-residents) is due on the 15th day of the month following that in which the withholding is made. Form 480.31 must be filed when the amount withheld exceeds US$ 200. If the withholding is US$ 200 or less, the payments must be deposited on or before 15 April in the following year.

- Form 480.30 (Puerto Rico Non-residents Annual Return of Income Tax Withheld at Source) must be filed on or before 15 April, summarising all of the Forms 480.31 filed during the previous year.

### 6.8 Payroll taxes

The following payroll taxes must be filed with the Puerto Rico Treasury Department

#### 6.8.1 Income tax withholding

Every employer that pays a wage to one or more employees is responsible for withholding income taxes and depositing them with the PRTD.

#### 6.8.2 Wage limitation and rates

Withholding rates or amounts are subject to the:

- Personal exemption and credit for dependents claimed in the Withholding Exemption Certificate (Form 499 R-4)
- Payroll period
- Wages paid.

There is no wage limitation for withholding.

#### 6.8.3 Payroll quarterly returns

An employer must report in the Employer’s Quarterly Return of Income Tax Withheld (Form 499 R-1B) the salaries paid and the income tax deducted and withheld periodically on a quarterly basis. These must be filed annually for the months ending:

- 31 March – filed by 30 April
- 30 June – filed by 31 July
- 30 September – filed by 31 October
- 31 December – filed by 31 January.

The quarterly return must be filed by the last day of the month following the close of each of the quarters, as indicated above.

#### 6.8.4 Payment of income tax
Deposits are made either on a monthly or two-week basis. An employer’s deposit schedule for a calendar year is determined based on the total taxes reported on Form 499 R-1B in the previous four quarters. The payment must be deposited at any of the authorised depository commercial banks using Form 499 R-1A and the cheque must be payable to that bank.

Employers in Puerto Rico must use Form 499 R-2/W-2PR to report the Puerto Rico income tax withheld to the PRTD and the social security tax withheld to the Social Security Administration at the end of the calendar year. Copy A of Form 499 R-2/W-2PR should be filed together with Form 499 R-3 (Reconciliation Statement) with the PRTD no later than 31 January. It is essential to note that when filing five or more informative returns, the forms must be filed electronically.

6.9 Social Security contributions

Under the Federal Insurance Contributions Act (FICA), Social Security and Medicare taxes are imposed on wages or salaries received by individual employees to fund retirement and medical benefits paid by the federal government. The federal social security tax is applicable in Puerto Rico on the same wage basis and tax rates as in the United States. These contributions must be filed with the United States Internal Revenue Service.

It is essential to note that FICA tax is imposed on compensation for services performed within the United States, regardless of the citizenship or residency of the employee or employer. Consequently, in the absence of an exception, non-resident alien employees who perform services in the United States or Puerto Rico are subject to FICA tax.

The following social security tax withholdings apply in circumstances where an employer has one or more employees:

6.9.1 Social security tax rates

Social security tax is a combination of the Old Age, Survivors, and Disability Insurance Tax (OASDI) and the Hospitalization Insurance Tax (HI). The rate for 2011 is 7.65% for employers and 5.65% (only for 2011) for employees.

- The OASDI rate is 4.20% on the first US$ 106,800 paid (including contributions to 401(k) plans, which are includible in gross income for the purpose of determining social security tax withholding) during the calendar year to an employee by the employer.
- The HI rate is 1.45% of the employee’s actual earnings.

Any compensation in excess of the US$ 106,800 wage basis, which is paid to the employee by the same employer, is not subject to the OASDI portion of the social security taxes. The maximum social security tax that an employer will pay on wages earned during 2011 is US$ 6,324 for the OASDI portion. There is no limit imposed for the HI portion.

6.9.2 Filing social security tax returns

An employer must report in Form 941 PR its combined employer and employee social security taxes (FICA) periodically on a quarterly basis for each of the quarters ending:

- 31 March – filed by 30 April
- 30 June – filed by 31 July
- 30 September – filed by 31 October
- 31 December – filed by 31 January.
These quarterly social security tax returns must be filed by the last day of the month following the close of each of the quarters, as indicated above.

6.9.3 Payment of social security tax

Payments are made either on a monthly or two-weekly basis. An employer’s deposit schedule for a calendar year is determined based on the total taxes reported on Form 941-PR or 941-E in the previous four-quarters. Each November, the IRS notifies taxpayers what their deposit status will be for the following calendar year.

6.10 Other social taxes

The following taxes apply to every employer that employs one or more employees in Puerto Rico.

6.10.1 Federal Unemployment Tax Act (FUTA)

The tax rate of 6.2% is applied to the first US$ 7,000 paid to an employee by an employer during the calendar year. Compensation in excess of US$ 7,000 paid to the employee by the same employer is not subject to the tax.

A gross credit is allowable for the tax paid to the Commonwealth of Puerto Rico, providing the full amount is paid on time and does not exceed 5.4% of the federal tax paid.

This means that the total FUTA tax payable by an employer who has paid Puerto Rico unemployment tax in full is 0.8% of taxable wages (6.2% tax rate less 5.4% full credit).

On or before the last day of the month following each calendar quarter, an employer should deposit with an authorised commercial bank or a Federal Reserve Bank the tax due for that quarter, accompanied with Form 8109, if the amount exceeds US$ 500. If less than US$ 500, it does not have to be deposited, but must be added to the FUTA deposit for the next quarter. Cheques or money orders for this tax payment should be made payable to the bank with which the deposit is made.

On or before 31 January, every employer must file an unemployment tax return (Form 940 PR) and pay any amount due in full. There is a 10-day grace period for filing providing all deposits have been properly made.

6.10.2 Unemployment insurance and disability benefits

An unemployment insurance and disability employer account number must be requested from the Puerto Rico Department of Labor and Human Resources.

Disability Benefits Act

The Disability Benefits Act requires that employers offer compulsory insurance that covers employees if they are temporarily unable to work due to injury or sickness.

The Disability Benefits Act imposes a tax of 0.6% on the first US$ 9,000 earned during the calendar year by each employee. The employer contributes 0.3% and the employee contributes 0.3%. The employees’ contribution must be withheld from their wages. Any additional compensation paid by the same employer in that year, which exceeds the US$ 9,000 wage base, is not subject to tax.

Every employer must prepare the return (Form PR-UI-10) and pay the full amount of the tax due on a quarterly basis ending:
Puerto Rico unemployment insurance tax

Unemployment insurance provides economic relief to employees who lose their jobs for reasons beyond their control, and who are capable and available to work.

Each employer’s tax rate is based using a reserve proportion (ratio) as of the calculation date (30 June) and the balance in the unemployment fund. The law provides for eight rate schedules with basic rates ranging from 1% to 5.4%. The tax is imposed over the first US$ 7,000 of wages paid during the calendar year by the employer to an employee.

Every employer must prepare the return (Form PR-UI-10) and pay the full amount of the tax due on a quarterly basis ending:

- 31 March – filed by 30 April
- 30 June – filed by 31 July
- 30 September – filed by 31 October
- 31 December – filed by 31 January.

The quarterly return must be filed by the last day of the month following the close of each of the quarters, as indicated above.

Form PR-UI-10 is used for reporting the unemployment insurance and disability tax. However, the payments should be made using two cheques - one for the Unemployment Insurance Contribution, and the other for the Disability Benefits Contribution. Both cheques must be made payable to the order of the Secretary of the PRTD and remitted to the Puerto Rico Department of Labor and Human Resources together with Form PR-UI-10.

6.10.3 Chauffeurs’ Social Security

The Chauffeurs’ Social Security is a social security plan for persons in Puerto Rico who, as an integral part of their job, regularly operates a motor vehicle.

The employer should withhold 50 cents weekly from the wages paid to each driver, and contribute an additional 30 cents. This tax is in addition to the regular social security tax.

This contribution applies to every employer that employs one or more drivers. Covered employees (chauffeurs) are not subject to the disability tax – see section 6.10.2.

The tax withheld, together with the employer’s contribution, should be paid no later than 15 days after the last day of each calendar quarter with Form TSCH-1. The cheque should be made payable to the Secretary of the PRTD and should be remitted to the Puerto Rico Department of Labor and Human Resources, Bureau of Chauffeurs' Social Security.

6.10.4 Workmen’s Accident Compensation Insurance
The Workmen's Accident Compensation Act establishes a compulsory insurance programme covering all employees from job-related accidents. It is provided by the Puerto Rico State Insurance Fund Corporation. To apply for a workmen's compensation policy, the taxpayer must complete and file Form CFSE-661 (Solicitud de Póliza de Seguro Obrero).

The rates vary depending upon the different types of labour performed by the employees. Rates are revised every year. The tax is payable by the employer only.

The tax is imposed on total wages paid by the employer to an employee during the government’s fiscal year (from 1 July to 30 June). Every employer should file, no later than 20 July annually, a statement (Payroll Statement - Form FSE 693) indicating the number of employees, kind of occupation, and the wages paid during the preceding fiscal year.

The tax is usually paid in two instalments upon notice mailed to the employer. Cheques or payments should be made to the Puerto Rico State Insurance Fund Corporation.

6.10.5 Christmas Bonus Act

Although not a payroll tax, the law requires employers to pay additional remuneration to certain employees.

As a general rule, every employee who has worked at least 700 hours between 1 October and 30 September (the base period), is entitled to the bonus. The amount to be paid is 6% of the employee’s wages (up to US$ 10,000) up to a maximum of US$ 600 each. The payment must be made during the first 15 days of December following the end of the period. The aggregate of Christmas bonuses that must be paid by an employer cannot exceed 15% of the annual profit earned during the base period. If the business has 15 employees or less, the amount to be paid is 3% of the employees’ wages (up to US$ 10,000) up to a maximum of US$ 300 each.

Any employer who does not pay a bonus because he/she suffered an operating loss during the base period must notify the Secretary of Labor and Human Resources of that fact by 30 November following the close of the base period. The notice must be accompanied by a general balance sheet, and profit and loss statement, attested by a CPA, for the base period.

Penalties may be imposed on employers for failure to comply with the Christmas Bonus Act rules.
7. Personal taxation

7.1 Residency

The new Puerto Rico Internal Revenue Code (PRIRC) defines the term ‘resident individual’ as an individual who is domiciled in Puerto Rico. Furthermore, it is presumed that an individual is a resident of Puerto Rico if he/she has been present in Puerto Rico for a period of 183 days or more during the calendar year.

However, the factors to determine domicile in Puerto Rico are based on the facts and circumstances of each individual. Generally, residence guidelines for U.S. tax purposes are followed in determining residency for Puerto Rico tax purposes (see U.S. tax and business guide for details).

Pursuant to the American Jobs Creation Act of 2004 (Act of 2004), Section 937 was enacted to define the term of a bona fide resident of Puerto Rico and a U.S. possession. Furthermore, the Act of 2004 made substantial changes to the provisions dealing with the residency requirements under Section 933. Now, in order for taxpayers to qualify as a Puerto Rico bona fide resident, the taxpayer must meet the three bona fide residency tests:

1. The Presence Test
2. The Tax Home Test and
3. The Closer Connection Test of Section 937.

Generally, and based on Act of 2004, if a taxpayer meets these three bona fide residency tests, he/she may be considered a resident of Puerto Rico even though he/she may be employed in the U.S. or any foreign country. These are:

1. Employee has not got a significant connection to the U.S. or a foreign country - his/her permanent home is in Puerto Rico (Presence Test).
2. His/her tax domicile, regular or main place of business is Puerto Rico (Tax Home Test).
3. The employee does not have a closer connection to the U.S. or foreign country. He/she has more significant contacts with the U.S. possession (Puerto Rico) than with the U.S. or foreign country (Closer Connection Test).

When determining the significant contacts under the Closer Connection Test, various factors are considered, including the location of:

- The permanent home
- Family
- Personal belongings
- Routine personal banking activities
- Jurisdiction in which the taxpayer holds a driver’s licence
- Jurisdiction in which the employee votes.

If the individual meets all of the above criteria, he/she should be considered a resident of Puerto Rico and a non-resident of the U.S. or foreign country. As such, he/she would be subject to tax in Puerto Rico on his/her worldwide income. A foreign tax credit (FTC) would be available in Puerto Rico for taxes paid in the U.S. or elsewhere to avoid the double taxation of non-Puerto Rican sourced income.

7.2 Tax rates

Individual income tax rates range from between 7% and 33%.
8. **Double taxation agreements**

Income taxes paid or accrued to the United States and its possessions or to foreign countries during the taxable year may be credited against the Puerto Rican income tax in order to avoid double taxation. As a general rule, only residents are in a position to claim the foreign tax credit against their Puerto Rican tax because, in principle, only they are subject to Puerto Rico taxes on their worldwide gross income. The foreign tax credit is subject to two limitations, a per-country limitation and an overall limitation.
## 9. Sales and use taxes

Act 117 dated 4 July 2006, known as the *Tax Fairness Act*, replaced the existing general excise tax system (for certain items) and introduced a new *Sale and Use Tax* (SUT) regime.

The aggregate sales tax of 7% is divided into a 5.5% commonwealth sales tax and a 1.5% municipal sales tax.

The new PRIRC provides for a sales tax on the sale and on the use, storage, and consumption of taxable items. The new PRIRC defines taxable items as tangible personal property, taxable services, admissions, and other combined transactions. Although services provided are generally taxable, there is an exemption from the sales tax imposition if the services are provided from one business to another and they are both registered with the PRTD Merchant Registry.
10. Portfolio investments for foreigners

Puerto Rico does not restrict the flow of currency into or out of the country.

10.1 Investment of cash

The Code encourages investment of cash by foreigners. It makes interest from funds held on deposit with financial institutions and insurance companies exempt from Puerto Rican taxation, providing such interest is not in effect connected to the conduct of Puerto Rican trade or business by the foreign recipient. As a result, the recipient is not required to report this interest on a tax return. Such income is treated as Puerto Rican source income, which is exempt from the usual 29% withholding tax.

10.2 Investment in Puerto Rican stocks, securities and commodities

Transactions in stocks, securities and commodities made for the account of a foreign investor does not constitute the conduct of a Puerto Rican trade or business, providing the foreign investor is not a broker or a dealer. Consequently, the gains resulting from such transactions are not taxed unless the investor is in Puerto Rico for more than 183 days during the tax year in which the sale occurs. Dividends and interest from Puerto Rican securities are generally subject to the withholding provisions (see section 8), providing the recipient is not a Puerto Rican resident and not engaged in a Puerto Rican trade or business.
11. Trusts

11.1 Administering and running trusts

A fiduciary is a person legally appointed and authorised to hold assets in trust for another person. The fiduciary manages the assets under Puerto Rican law, for the benefit of the other person.

The person holding the property (the trustee) administers the trust under the terms of the governing instrument (a trust declaration or trust agreement) for the benefit of one or more beneficiaries. The trustee becomes the legal owner of the trust property, managing the assets, looking after the equity or property interests of the beneficiaries, rather than for his or her own profit. The trust creator does not necessarily appear as ‘settlor’ in the trust instrument.

For administrative reasons, banks and trust companies are frequently named as sole trustees or co-trustees. The grantor of the trust may appoint himself as the trustee and/or beneficiary of the trust, although this may result in the grantor being treated as the owner of the trust assets for tax purposes.

A trust cannot be revoked without the consent of all the beneficiaries, along with judicial approval, unless the right to revoke has been expressly reserved by the grantor. This means that trusts are sometimes classified as ‘revocable’ or ‘irrevocable’.

11.2 Taxation on trusts

For Puerto Rican income tax purposes, a trust is treated as a separate taxpayer for whom a return must be filed, unless the grantor is treated as the owner of the trust assets because of a reserved interest or control. Trust taxable income is generally calculated in the same manner as an individual resident. The trust generally claims the same deductions (but not exemptions) as an individual.
12. **Practical information**

12.1 Transport

Transportation in Puerto Rico includes a system of roads, highways, freeways, airports, ports and harbours, and railway systems. It is funded primarily with both local and federal government funds.

12.2 Language

The official languages are Spanish and English with Spanish being the primary language adopted in business environments.

12.3 Time relevant to Greenwich Mean Time (GMT)

Puerto Rico standard time is four hours behind Greenwich Mean Time (GMT-4) and Puerto Rico does not observe daylight saving time.

12.4 Business hours

Office hours in Puerto Rico are generally from between 8.00am and 5:00pm, Monday to Friday, although these do vary by businesses and seasons.

12.5 Public holidays

Puerto Rico celebrates all the official holidays of the U.S., as well as a large number of others which are official holidays established by the Commonwealth government. In addition, many municipalities celebrate their own Patron Saint Festivals and festivals honouring cultural icons.

The holidays observed by most businesses and government offices are:

- New Year’s Day – 1 January (or nearest weekday)
- Three Kings Day/Epiphany – 6 January
- Birthday of Eugenio María de Hostos – 11 January
- Martin Luther King Jnr.’s Birthday – third Monday in January
- Presidents Day – third Monday in February
- Good Friday - late March or early April
- Memorial Day – last Monday in May
- Independence Day – July 4 (or nearest weekday)
- Labor Day – first Monday in September
- Columbus Day – second Monday in October
- Veterans Day – 11 November
- Thanksgiving – fourth Thursday in November
- Christmas Day – December 25 (or nearest weekday)