



ACT 178 RUM INCENTIVES IN PUERTO RICO

On December 1, 2010, Puerto Rico enacted Act No. 178 of 2010, which provides additional benefits to rum producers in Puerto Rico as part of the Federal Rum Excise Tax Cover-Over Program. These incentives are in addition to tax exemptions and tax credits available to certain rum distilleries under Act No. 73, known as the "Economic Incentives for the Development of Puerto Rico Act" ("Act 73"), as described herein.

Eligibility

To avail from the benefits under the Federal Rum Excise Tax Cover-Over Program, the rum must be bottled in Puerto Rico and sold in the U.S. mainland. Also, rum exported should be aged in Puerto Rico at least one year in oak barrels, unless a waiver by the Secretary of the Puerto Rico Treasury is provided.

Federal Rum Excise Tax Cover-Over Program

Section 6053.01(l) of the Puerto Rico Internal Revenue Code of 2011, as amended, provides a rebate to the rum industry of up to 25% of the amounts received from the Government of the United States by concept of the tax imposed to rum transported from Puerto Rico to the United States and sold to consumers in the United States, known as the Federal Rum Excise Tax Cover-Over Program. This section also gives the Governor of Puerto Rico the discretion to increase up to 46% the percentage of the monies to be set aside to support the local rum industry by Executive Order. On June 27, 2012 the Governor of Puerto Rico signed Executive Order OE-2012-30 so stating.

Under the Federal Rum Excise Tax Cover-Over Program, the Government of Puerto Rico currently receives a refund of \$13.25 per proof gallon from the \$13.50 excise tax that is imposed upon every proof gallon of rum sold in the U.S. These funds are used to provide incentives to the Puerto Rico rum industry, based on their marketing and promotional expenditures. Currently, Puerto Rico is offering rum manufacturers incentives worth 46% of the rum rebate revenue generated from branded rum sales and 25% from bulk rum sales. Furthermore, the Government of Puerto Rico provides an additional 11% for bulk rum sales to be used as an incentive for the benefit of the third-party purchaser of bulk rum. In return, rum producers that have currently signed agreements with the Government of Puerto Rico have agreed to maintain a minimum level of production in Puerto Rico for a period of twenty years.

Tax Exemptions

Rum manufacturers that establish operations in Puerto Rico may benefit from Act 73, which provides the following incentives:

- 4% income tax rate;
- 12% fixed income tax rate, withheld at source, on royalties paid to foreign entities with respect to intangible property used in the exempt business;
- 100% tax exemption on dividend distributions;
- 4% fixed income tax rate on gains derived from the sale of ownership interests or substantially all the assets of the exempt business, in lieu of any other Puerto Rico income tax imposed on such gains;
- 90% tax exemption from personal property taxes. The taxable portion will be subject to the regular tax rate, that currently can be up to 8.83%; therefore, after considering the 90% exemption, the effective tax rate would be up to 0.883%;
- 90% tax exemption from real property taxes. The taxable portion will be subject to the regular tax rate, that currently can be up to 10.83%; therefore, after considering the 90% exemption, the effective tax rate would be up to 1.083%;
- 60% tax exemption on municipal license taxes, with the first 3 semesters being 100% exempt. Any taxable portion will be subject to the regular tax rate, that currently can be up to 0.5%; therefore, after considering the 60% exemption, the effective tax rate would be up to 0.02%;
- 100% tax exemption on municipal construction taxes;
- 100% tax exemption on excise taxes and sales and use tax on raw material and certain machinery and equipment used in the production process; and
- Accelerated depreciation – 100% first-year bonus depreciation, with ability to carry over to subsequent tax years until exhausted.

Tax Credits

Act 73 also provides various tax credits, including:

- 25% tax credit on purchases of products manufactured in Puerto Rico;
- 35% tax credit on purchases of products manufactured in Puerto Rico made from recycled materials;
- Tax credit for job creation during the first year of operations that ranges from \$1,000 per job created in an industrial area



of intermediate development (as determined by the Office of Industrial Tax Exemption) to \$2,500 for jobs created in an industrial area of low development. In the case of businesses established in the municipalities of Vieques and Culebra, this tax credit is \$5,000 per job;

- 50% tax credit on eligible research and development activity costs; and
- 12% tax credit for royalties paid to foreign entities with respect to intangible property used in the exempt business.

- **Incentives for Rum Producers in Puerto Rico;**
- **Export Services Incentives Act;**
- **Individual Investors Act;**
- **Tax Exemptions for Scientists;**
- **Incentives for business activity performed in Vieques and Culebra; and**
- **Puerto Rico Housing Incentives.**

Tax Exemption Decree

To benefit from Act 73, the rum distiller needs to submit an application with the Office of Industrial Tax Exemption of Puerto Rico to obtain a tax exemption decree that will provide full detail of tax rates and conditions of the concession, and will be considered a contract between the Government of Puerto Rico and the rum distiller. Once the rum distiller obtains the tax exemption decree, the benefits granted will be secured during the term of the decree, irrespective of any changes in the applicable Puerto Rico tax laws. The term of the decree will be 15 years. However, the rum distiller can benefit from a “flexible exemption” for income taxes – that is, the rum distiller can decide whether its income will be covered by the exemption on a particular taxable year. If it chooses not to be covered by the exemption on a particular year, the rum distiller may extend for one additional year its exemption period.

Puerto Rico Income Taxes

An exempt business under Act 73 operating in Puerto Rico by means of a Puerto Rico entity should not be subject to any taxes (such as a dividend tax, tollgate tax or other similar taxes) on its income from its eligible activities in Puerto Rico, other than the Puerto Rico fixed income tax rate established in the tax decree, regardless if said income is distributed or retained by the entity. Upon repatriation, the distributed income would be subject to the tax imposed by the jurisdiction in which the owners of the Puerto Rico entity reside, if any.

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For more information on the various incentives provided under the Puerto Rico laws, please visit

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and access our incentives alerts on the following topics:

- **Tourism Development Act;**
- **Municipal Economic Development and Tourism Incentives Act;**
- **Cruise Industry Incentives Act;**
- **Film Industry Incentives Act;**
- **Green Energy Incentives Act;**
- **Economic Incentives for the Development of Puerto Rico Act;**

