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The Puerto Rico Cannabis Industry

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With the May 2015 Executive Order legalizing medical marijuana in Puerto Rico, the government created the most profitable tax environment in the U.S. for the cannabis industry Puerto Rico, a territory of the U.S. since 1898. Because Puerto Rico is not a state, federal taxes do not apply to income generated by individuals or corporations within the Commonwealth. Puerto Rico corporations are treated, for federal tax purposes, as foreign corporations and are not generally subject to U.S. corporate taxes. Individual bona-fide residents of Puerto Rico are not subject to federal taxes on income derived from Puerto Rican sources.

Putting Cannabis Businesses Out of the Reach of 280e

Section 280e of the IRS tax code is a measure passed by Congress in 1982 so that businesses who are “trafficking in controlled substances” that are prohibited by federal law may not utilize many tax deductions and credits available to other businesses, such as deductions for rent and employee-related expenses. That means a marijuana business owner can pay an effective tax rate as high as 70 percent as opposed to the more typical 30 percent rate.

High federal tax accompanied with state taxes make it very difficult to make a successful and profitable business in the cannabis industry. Imagine not having to pay that 70 percent tax, or even 30 percent, just zero. That can only happen in Puerto Rico.

Where is the Catch? The State Taxes Must be High. The Answer is No.

In order to bolster the manufacturing sector as well as other strategic areas, the Island Government has created an aggressive economic and tax incentives program with the purpose of helping operations on the island become more profitable to companies that manufacture here. Below are some of the tax benefits offered under Act No. 73 of 2008, known as the Economic Incentives Act for the Development of Puerto Rico:

- 4% income tax on industrial development income
- 0% to 1% tax rate on income for pioneer or novelty products manufactured in PR
- Up to 50% tax credit on purchases of products manufactured or recycled locally
- Up to \$5,000 for each job created during 1st year of operation
- Up to 50% tax credit on Research and Development activities
- Special deductions on investments from structures, machinery and equipment
- Marketing incentives program available to qualified PRIDCO-promoted companies whose sales are greater than \$100,000 per year

A. Tax Incentives

Tax rates

*More information on the PRIDCO incentives can be found here: <http://www.pridco.com/>



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- 4% income tax on industrial development income
- 0% to 1% tax rate on income for pioneer or novel products manufactured in PR

Tax credits

- 25% tax credit for the purchase of products manufactured in Puerto Rico
- Up to \$5,000 credit for each job created during the first year of operations
- 50% tax credit for investments in research and development, clinical trials, toxicology tests, infrastructure, renewable energy, and intangible property
- 50% credit for investments in machinery and equipment for the generation with renewable resources and for the efficient use of energy
- 50% of the investment in made in the acquisition of an equity interests or of the operational assets of an exempted business that is in the process of closing operations in Puerto Rico, to continue operating it, up to \$8,000,000

Research & Development Incentives

- Eligible researchers/scientists residing in Puerto Rico can receive a tax exemption of up to \$195,000 on income generated from qualified federal research grants or up to \$250,000 if the research is conducted within the Science District
- Firms can receive a 50% tax credit for eligible investments in research and development, clinical trials, toxicology test, and any other qualified intangible property
- Scientific or industrial R&D laboratories pay a fixed 4% corporate income tax rate
- 0 to 1% income tax rate for “Pioneer” Activities
- Puerto Rico-based firms providing export services such as: environmental, technological, scientific, information technology or engineering consulting services pay a 4 % corporate income tax rate or a 3% corporate tax rate if 90% or more of its gross income comes from the export of services.

B. Job Creation Incentives

To help defray a portion of the initial costs associated with the hiring of new employees, PRIDCO offers cash incentives for each employment position created. The amount of the incentive is determined based on several factors, including the average salaries to be paid to the new employees and the importance of the project to the economy of Puerto Rico. These incentives, paid on a reimbursement basis, can be used to cover operating expenses and capital investments needed to support the company’s principal operations. Additionally, PRIDCO will require a commitment to create and retain the employment positions for a period not less than 3 years.

Basic Incentive for Job Creation

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Companies that are promoted by PRIDCO, including both local and non-local businesses that meet their commitments related to job creation and retention, receive a basic incentive payment for each employee hired. The incentive is \$400 per employee for new businesses and \$250 per employee for existing business expansions. The company will receive an orientation from PRIDCO and must submit, within a year from the promotion date, certain information for evaluation.

Incentive for Job Creation and Location

In addition to the basic incentive above, companies that are promoted by PRIDCO can receive a location-based incentive for job creation outside of the San Juan metropolitan area. This incentive will be available for local and non-local businesses, and it depends on the geographical location of the company and the quantity of persons that will be employed.

Job Retention Incentives

In some instances, PRIDCO provides economic assistance to businesses for the retention of their employees. Examples of some of the instances in which these incentives can be extended include:

- Established companies (in PR) that have never received any incentives from PRIDCO and in need of financial assistance to support expansion projects;
- Established companies that have received incentives from PRIDCO, that have met their commitments for prior incentives and that need financial assistance to support business expansions or retraining of its personnel; and
- For companies that need financial assistance to support a turnaround plan. The amount provided is determined after reviewing the company's business plan (turnaround plan for those companies in distress) and its financial condition.
- Additionally, PRIDCO will require a commitment to retain the employment positions for which an incentive was extended, for a period not less than 3 years.

Training Incentives

Recognizing the importance of having a well-trained work force, PRIDCO offers a variety of incentives and service programs to assist companies in funding training initiatives.

All eligible companies that have an interest in covering the development and training of their employees will be eligible for this incentive. PRIDCO will refund to a maximum of \$6,000.00 per training or workshop. The commitment of the eligible company will be to remain in operation for a minimum of three (3) years as well as comply with all the requirements of the incentives contract.

C. Incentives for Infrastructure Development and Industrial Building Improvements

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PRIDCO offers financial assistance, paid on a reimbursement basis, to assist companies with infrastructure and capital improvements to the facilities leased to PRIDCO. Eligible investments include: electrical substations, power generators, fire control systems, among others. If the company operates in a privately owned building, the same financial assistance will apply, however, with certain limitations and other terms and conditions.

The company will receive an orientation from PRIDCO and must submit certain information for evaluation by PRIDCO, including project drawings, specifications, cost estimates, agency approvals, and any other document required for the installation or construction of the improvements. The application for this incentive must be prepared and certified by a Licensed Engineer or Architect.

Incentives for Machinery and Equipment

To support start-up or expansion projects, or to assist companies achieve operational improvements through new technology, PRIDCO offers incentives to contribute a portion of the investment. Incentives will be given to eligible businesses that have the interest to develop new projects requiring the purchase and installation of machinery and equipment. The company will reimburse 50% of the cost of machinery and equipment, up to a maximum of \$50,000.00. The eligible company's commitment will be to keep operating for a minimum of three (3) consecutive years as well as comply with all the requirements of the incentives contract.

Incentives for Projects of Strategic Importance

In some occasions, PRIDCO may provide additional incentives for businesses that are of strategic importance to the Island's economy. These incentives may be tailored to a company's specific needs and will require a commitment to maintain operations for a specific time or retain a certain number of employees, among other.

Companies that are promoted by PRIDCO that execute projects that have extraordinary importance for the economy of Puerto Rico—i.e., because they create and maintain a large number or high quality jobs, promote new technology, transfer technology business knowledge, or are otherwise considered highly meritorious by the Executive Director and the Board of Directors of PRIDCO—may be eligible for these incentives. The company will receive an orientation from PRIDCO and must submit certain information for evaluation by PRIDCO and approval by PRIDCO's Board of Directors.

Incentive for Industries located in Vieques and Culebra

To support the creation and retention of jobs in the island municipalities of Vieques and Culebra, PRIDCO offers additional economic assistance to incentivize companies to establish operations in these Islands.

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Companies that are promoted by PRIDCO may be eligible for a cash incentive of up to \$100,000 for establishing and operating a business in Vieques or Culebra. The incentive can be used for maritime, land, and aerial transportation of raw materials and finished products, including labor costs, tolls, and other expenses related to transportation, based on an evaluation by PRIDCO. The eligible company may request the incentive at the end of each trimester, after the commencement of operations has been certified, or at the end of the fiscal year, whichever is more convenient. The application must include detailed costs. The commitments will be formalized through a contract.

Incentive for Maritime Transportation (Small & Medium Enterprises)

To incentivize the distribution of products and services to foreign markets and to the mainland U.S., PRIDCO offers up to 20% of the transportation costs of each container shipped from Puerto Rico to one of three principal ports (Santo Domingo, Panama, Jacksonville, U.S.) up to \$2,000.

Quality Control and Certification Incentives

PRIDCO will reimburse 50% of the total investment up to a maximum of \$20,000.00. The incentive to be granted to the eligible company (through reimbursement) will be divided into two phases: (1) 50% to a maximum of \$20,00.00 for the stages of evaluation, training and improvements to the processes of the operation, (2) 50% of the cost up to a maximum of \$15,000.00 for the registration process.

For the first phase, the eligible company will use the given incentive to cover direct costs associated with the system or operational process (i.e. quality control) such as purchase of equipment and machinery, recruitment of personnel for the design of manuals, standards and specifications, recruitment of qualified personnel to provide advice and training, recruitment of technical personnel, recruitment of private or governmental laboratories, acquisition of materials, seminars, and workshops.

For the second phase, the eligible company will use the awarded incentive to cover expenses related to the process of obtaining certification such as training and workshops for training, purchase of materials and equipment related to process improvements required, payment of expenses to consultants and/or temporary assistance, payment of payroll to the staff assigned to the project, and payments associated with the registration and audit company.

The eligible company's commitment is to maintain an operation for a minimum of three (3) years as well as complying with all the requirements of the incentives contract. The eligible company may apply for this incentive only once within a period of 24 months.

Incentives for Vendor Qualification

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All eligible company that wants to provide their products and/or their sterilization services to companies that are required qualifications that ordinarily do not possess will be eligible for this incentive.

If the product or the sterilization service is not critical 10% of the total cost will be refunded. If the product or the sterilization service is fairly critical 15% of the total cost will be refunded. If the product or the sterilization service is highly critical 20% of the total cost will be refunded. The amount to be reimbursed will not exceed \$190,000 per project.

The eligible company's commitment is to remain in operation for a minimum of three (3) years and to comply with all the requirements of the incentives contract.

Incentives for Specialized Systems

Incentives will be granted to eligible businesses that have the interest to develop new projects requiring the purchase and installation of specialized systems (“software”). The eligible company will use the given incentive with the objective of improving the efficiency and productivity of the business. The specialized systems ("software") shall be implemented by local technology companies.

PRIDCO will reimburse 50% of the cost of the machinery and equipment up to a maximum of \$10,000.00. The eligible company's commitment is to keep operating for a minimum of three (3) consecutive years as well as to comply with all the requirements of the incentives contract.

Contact us to learn more about incentives for infrastructure development and industrial building improvements.

D. Incentive for Export Marketing (Small & Medium Enterprises)

Marketing Incentives Program

This matching fund is available to qualified, local, PRIDCO-promoted companies whose sales are greater than \$100,000 per year and whose commencement of operations has been certified. Through this incentive, PRIDCO provides a 50% reimbursement, up to \$50,000, of the costs of marketing activities in markets outside of Puerto Rico. Marketing activities include printed materials, market research, promotional activities, and others. The company must submit the application to PRIDCO for evaluation at least 60 days before the promotional campaign or marketing activity will be carried out.

E. Rent Incentives

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Rent Incentives

Eligible businesses for this incentive are those that have an interest in leasing a PRDICO building for at least five (5) years or those who rented PRDICO buildings that have no debt or are under a payment plan and are in compliance with and still have at least (5) years in the lease or are to renew their contract for at least five (5) years. The evaluation and approval of this incentive will take into consideration the particular circumstances of the eligible company, demand for the property in the market, including payment history, financial situation, among others.

The incentive to be granted will never be greater than 50% of the rent established for the area where the property is located. The incentive should be gradually reduced so that at least on day one (1) of the first month of the sixth (6) year of the lease, the lessee pays 100% of the rent established for the industrial zone. The percentage of rent that is not covered by the incentive will be paid in full by the eligible company, as provided in the lease agreement.

The eligible company's commitment is to comply with the terms and conditions of the lease agreement as well as comply with all the requirements of the incentives contract.

F. Incentives for Investments in Solar Panel Projects

PRIDCO's Solar Incentives Program (SIP) was created to help PRIDCO tenants involved in manufacturing activities meet a portion of their energy needs with clean and affordable solar power. The SIP offers financial incentives that help offset the initial cost of installing a solar energy system or, in the case of third-party financing via a power purchase agreement (PPA), reduce the energy purchase rate or term of the PPA.

This SIP will be funded with \$10,000,000 from the Special Fund for the Economic Development of Puerto Rico. Eligible solar photovoltaic projects of up to five (5) megawatts (MW) are allowed under the SIP, although incentives will be prorated on a one (1) MW basis, as shown in the SIP Handbook

There are more incentives for the industry to take advantage of so, if you are interested in expanding your cannabis business into Puerto Rico, do not hesitate to reach out today. I can be reached directly at walter@hoban.law or waltermarrerom@gmail.com.

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