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TAX ALERT

Puerto Rico Treasury Issues New Guidance on Sales and Use Tax Applicable to Services

On August 31, 2015, the Puerto Rico Treasury Department (“Treasury”) issued [Administrative Determination No. 15-17](#) (“AD 15-17”) to provide guidance on the application of the sales and use tax (“SUT”) to Taxable Services, Designated Professional Services, and Services Rendered to other Merchants after the enactment of the Tax Reform legislation, Act No. 72-2015, as amended (“Act 72”).

As discussed in our [second Tax Alert of June 3, 2015](#), Act 72 (i) increased the combined SUT rate from 7% to 11.5% (10.5% state portion and 1% municipal portion) applicable to Taxable Services effective July 1, 2015, and (ii) imposed a 4% SUT on Designated Professional Services and Services Rendered to other Merchants that were not subject to the SUT, effective October 1, 2015. The 1% municipal SUT will not apply to services subject to the 4% SUT.

Note that with the enactment of Act 101-2015, the 4.5% SUT increase and the 4% SUT imposed on Designated Professional Services and Services Rendered to other Merchants were carved out from Subtitle D of the Puerto Rico Internal Revenue Code of 2011 (“Code”), and were codified in a new Subtitle DDD as a 4.5% SUT surcharge and as a 4% tax, respectively. Accordingly, the guidance provided in AD 15-17 is based on two different consumption taxes referred to as the 4% Special SUT and the 11.5% Basic SUT (i.e., 6% state portion + 4.5% SUT surcharge + 1% municipal portion).

We highlight most of the issues clarified in AD 15-17, as follows:

A. Definitions

1. Taxable Services Subject to 11.5% Basic SUT

- “Taxable Services” includes, with certain exceptions, services rendered to any person, except for Designated Professional Services and Services Rendered to other Merchants.

2. Designated Professional Services Subject to 4% Special SUT

- “Designated Professional Services” includes legal services and services rendered by professionals duly licensed by the various P.R. Examination Boards and, effective October 1, 2015, it will also include services rendered by tax return specialists, as defined in the Code.
- This term includes services rendered by designated professionals as independent contractors to other designated professionals.
- Note that the P.R. Legislature is presently considering a bill that would modify the 4% Special SUT applicable to legal services.

3. Services Rendered to other Merchants Subject to 4% Special SUT

- “Services Rendered to other Merchants” are services rendered to a person engaged in business or for the production of income, except for services that were subject to the 7% SUT prior to July 1, 2015, and are now subject to the 11.5% Basic SUT. In general, these are services rendered between two merchants duly registered in Treasury’s Merchants Registry.
- These services include certain commissions generated by a merchant on a sale (regardless of whether the item is taxable or exempt from the 11.5% Basic or the 4% Special SUT).

B. Exemptions

- A list of services exempt from both the 11.5% Basic SUT and the 4% Special SUT is provided.

C. Taxation of Services Rendered to other Merchants and Designated Professional Services

- Services covered by the business to business (“B-2-B”) exemption generally will be subject to the 4% Special SUT applicable to Services Rendered to other Merchants.
- Taxable Services, Designated Professional Services, and Services Rendered to Other Merchants rendered by a nonresident person to a person located in P.R., **regardless of where the service is rendered**, will be subject to the 11.5% Basic or the 4% Special SUT.
- The SUT applicable to the following services is discussed: 1) repair and maintenance services, 2) bank charges, and 3) telecommunication services.

D. Collection, Remittance and Payment of the SUT

1. Exemption for Merchants with a Volume of Business of \$50,000 or Less

- Services rendered by merchants with a volume of business of \$50,000 or less will be exempt from the 4% Special and 11.5% Basic SUT. For this purpose, the aggregate volume of business generated by the merchant during the previous taxable year that ends no later than August 31, 2015 will be considered as volume of business when determining if it exceeds \$50,000. Special rules are provided for the computation of the volume of business when the merchant is a member or a controlled group of entities.

2. Services Rendered by a Non-Resident Person to a Person in P.R.

- If a person located in P.R. receives Taxable Services, Designated Professional Services or Services Rendered to other Merchants from a non-resident person or a person not engaged in business in P.R. (“Non-Resident”), the person responsible for the payment of the Basic SUT or the 4% Special SUT will be the person that receives the service in P.R., **regardless of where the service is rendered.**
- The service will be considered as Services Rendered to other Merchants if the Non-Resident service provider is a merchant, even if not registered in the Merchants’ Registry.
- The 1% municipal portion of the SUT will not apply to services rendered outside P.R. by the Non-Resident subject to the 4% Special SUT or the 10.5% Basic SUT.
- If the service provider is a professional listed in the definition of Designated Professional Services, the service will be considered as a Designated Professional Service even if said Non-Resident professional does not have a license duly issued by a P.R. Examination Board.
- The 10.5% Basic or the 4% Special SUT will apply only to services directly or indirectly related to the P.R. operations of the recipient of the services. If the services are not directly or indirectly related to the P.R. operations of the recipient of the services, the 10.5% Basic or the 4% Special SUT will not apply. If the services are related to operations in P.R. and outside P.R., then the service will be subject to the SUT in the same proportion that the service relates to the P.R. operations.
- The services rendered by the Non-Resident to the person located in P.R. will not be subject to the \$50,000 business volume threshold that would render such services exempt from the 10.5% Basic or the 4% Special SUT. As such, the person that receives the service will have to remit the applicable SUT even if the Non-Resident service provider has a volume of business of \$50,000 or less.

3. Services Rendered between Related Entities

- In the case of members of a “Controlled Group” or of “Related Entities,” if both are merchants engaged in business in P.R. and are registered in the Merchants’ Registry, then Taxable Services, Designated Professional Services, and Services Rendered to other Merchants will be exempt from payment of the Basic or the 4% Special SUT; if the service provider is a Non-Resident, then the service will be subject to the 10.5% Basic or the 4% Special SUT, as discussed in D.2. above.

4. Bundled Transactions

- The applicable SUT rate will be determined based on the real object of the transaction.

5. Exempt Purchases Certificate

- Any person exempt from the 4% Special SUT (i.e. government, resident associations, etc.) must provide Form SC 2916 "Exempt Purchase Certificate (Tangible Personal Property and Exempt Services)" to the merchant that rendered the service to document the exempt nature of the transaction.

6. Billing: Breakdown of Reimbursable Items and Expenses

- Service providers must provide clients with invoices containing a breakdown of the different services rendered and the reimbursable expenses.
- The following reimbursable expenses itemized in the invoice will not be subject to the 4% Special SUT: (1) expenses incurred, including the 4% Special SUT paid, in the purchase of tangible personal property used as part of the services rendered; and (2) expenses directly allocated to the service rendered, which are paid by the service provider and claimed to the client as reimbursable expenses, such as fees paid to a governmental agency, and mail stamps or private courier.
- The following items will not be considered reimbursable expenses and will be subject to the applicable SUT: (1) additional charges that are not directly related to the service rendered, such as "out of pocket expenses" or "administrative recovery fees" that are not itemized in the invoice; (2) expenses indirectly related to the services rendered, even if such expenses are itemized in the invoice; (3) services rendered by employees; (4) subcontracted services or services rendered by other merchants; and (4) SUT paid for the subcontracted services or on services rendered by other merchants.

7. Accounting Method

- In general, merchants must remit the 4% Special and 11.5% Basic SUT using the same accounting method they use in their income tax returns.
- Merchants that provide Designated Professional Services ("Designated Professionals") may elect the cash receipts accounting method for SUT remittance purposes effective on October 1, 2015.
- Designated Professionals must elect the accounting method in Special SUT Monthly Return for the month of October 2015. Failure to timely make this election will result in the automatic application of the same accounting method used for income tax purposes in the income tax returns.
- After making the initial election, merchants that wish to change the accounting method must request a ruling from Treasury.

8. Credit for Taxes Paid by a Reseller Merchant

- A merchant that holds a Reseller Certificate cannot claim a credit for the 4% Special SUT paid for services. The credit can be claimed only for the Basic SUT paid on the purchase or import of tangible personal property for resale.

9. Interplay with the Income Tax Withholding Requirement on the Payment for Services

- The 7% income tax that must be withheld on payments for services rendered in P.R. applies only to the amount charged for the services, excluding the applicable SUT paid on such services and any reimbursable items and expenses.

10. Special SUT Monthly Return

- The new Special SUT Monthly Return applies to Designated Professional Services or Services Rendered to other Merchants. It must be filed electronically no later than the 20th day of the month following the month in which the 4% Special SUT is collected.
- The first Special SUT Monthly Return will be for the month of October 2015 and must be filed no later than November 20, 2015.
- Merchants required to file a Declaration of Imports (Form AS 2970.1), Tax on Import Monthly Return (Form AS 2915.1 D), and SUT Monthly Return (Form AS 2915.1 A) that render Designated Professional Services or Services to other Merchants during any given month, must also file the Special SUT Monthly Return.
- Merchants that receive Designated Professional Services or services rendered from Non-Resident merchants are also required to file the Special SUT Monthly Return.

11. Update of Merchants Registration for Professionals

- Merchants that provide Designated Professional Services must update their Merchant Registration Certificate in conformity with Treasury Tax Policy Circular Letter No. 15-12 ([See here](#)).

12. Pre-existing Contracts for Services Rendered to other Merchants or Designated Professional Services

- As mentioned in our [Tax Alert of June 26, 2015](#), pre-existing contracts as of June 30, 2015 for Designated Professional Services or for Services Rendered to other Merchants that meet certain requirements are exempt from the 4% Special SUT until the earlier of the termination of the 12-month period commencing after September 30, 2015 or the expiration of the agreement.
- Merchants required to file the SUT Monthly Return will report the earned income for services rendered under the pre-existing contract in the SUT Monthly Return as exempt income. Merchants that render Designated Professional Services that are not required to report the earned income in the SUT Monthly Return will report the earned income from the services rendered under the pre-existing contract as exempt income in the Special SUT Monthly Return.

13. Taxpayers Covered by Tax Exemption Grants or Concessions

- Entities that hold tax exemption grants or concessions issued under Act 73-2008 (Industrial Incentives), Act 168-1968 (Hospital Facilities) or Act 74-2010 (Tourism Development), among others, are subject to the 4% Special SUT on Designated Professional Services or Services Rendered by other Merchants.
- Entities engaged in air transportation covered by Act 135 of May 9, 1945 are exempt from the 11.5% Basic and the 4% Special SUT on goods and services purchased for the air transportation business.

14. Treasury Publications Related to the SUT Applicable to Taxable Services Rendered to Merchants

- Treasury publications regarding the SUT applicable to Taxable Services rendered to merchants will remain in effect, provided they are not inconsistent with Act 72, AD 15-17, and any subsequent publications.
- Any publication issued by Treasury that provides that any service is exempt from the SUT due to the applicability of the B-2-B exemption will be considered amended to provide that the 4% Special SUT is applicable as long as it is not inconsistent with Act 72, AD 15-17, or other subsequent publications.

E. Effectiveness

- The determinations in AD 15-17 are effective on and after October 1, 2015.
- AD 15-17 is based on current statutory provisions. The P.R. Legislature is considering several bills that would amend SUT provisions which, if approved, may require that AD 15-17 be modified.

For updates on this matter, you may contact any of the attorneys of our Tax Practice Group listed below:

Isis Carballo	787-250-5691	ici@mcvpr.com
Yamary González	787-250-5687	yg@mcvpr.com
Roberto L. Cabañas	787-250-5611	rlc@mcvpr.com
Rubén Muñiz	787-250-2623	rm@mcvpr.com
Lillian Toro-Mojica	787-250-2608	ltm@mcvpr.com
Edwin O. Figueroa	787-250-5690	eof@mcvpr.com
Esteban R. Bengoa	787-250-5626	erb@mcvpr.com
Mariana G. Contreras	787-250-5607	mcg@mcvpr.com
Rafael Fernández-Suárez	787-250-5629	rf@mcvpr.com
Leyla González	787-250-5696	lqi@mcvpr.com
Carlos J. Villafañe	787-250-5609	cv@mcvpr.com
Raquel Calzadilla	787-250-5649	rcrx@mcvpr.com
Mayleen Santiago-Garcés	787-250-2616	msg@mcvpr.com
Dalina Sumner	787-250-5622	ds@mcvpr.com