

## **SALT Alert! 2015-23: Puerto Rico Issues Detailed Guidance on Applicability of Sales and Use Tax to Business-to-Business and Designated Professional Services Effective October 1, 2015**

On August 31, 2015, The Treasury Department of Puerto Rico (“the Department”) issued [Administrative Determination No. 15-17](#) regarding the sales and use tax treatment of designated professional services and business-to-business services effective October 1, 2015.

### **Background**

On May 29, 2015, the Governor of Puerto Rico signed Act No. 72 (the “Act”) increasing the Commonwealth part of the sales and use tax (known in Spanish as *Impuesto sobre Ventas y Uso* “IVU”) from 6 percent to 10.5 percent effective, July 1, 2015. Please note that the municipalities in Puerto Rico also levy IVU at one percent; that levy will remain unchanged. Consequently, the total IVU rate is increasing from 7 percent to 11.5 percent. The Act further provides that on October 1, 2015, business-to-business services (B2B), which are not currently subject to IVU, and designated professional services will be subject to a Commonwealth IVU of four percent. The municipal IVU will however not apply on these services. The expansion of the IVU scope is considered as part of the transition to the new value added tax that should replace the Commonwealth IVU on April 1, 2016.

### **General Taxable Services Subject to IVU at 11.5 Percent**

The term “taxable services” is defined as any service rendered to any person, except services provided by designated professionals and B2B services, unless they are explicitly exempted. As an example, taxable services include, among others, the following services:

- Services provided by barbers, stylists, estheticians, makeup artists, massage therapists and related services;
- Body painting, tattoos and related services;
- Private security services and research (including B2B services, unless provided to residents' associations or co-owners);
- Cleaning, laundry and collected waste (including B2B services, except as provided to residents' associations or co-owners);
- Repair and maintenance services (including B2B services, unless provided to residents' associations or co-owners);

- Installation services for equipment, appliances, and related goods;
- Bank charges for commercial accounts;
- Accounts receivables services (including B2B services);
- Daily lease of motor vehicles (including leases to other retailers);
- Telecommunications services, including cable TV services;
- Decoration services, coordination of events, restaurants, and related services;
- Entertainment services, admission fees and related services; and
- Construction services.

#### **Designated Professional Services Subject to IVU at Four Percent**

The term “designated professional services” is defined as legal services and the following professional services, as regulated by their respective Examining Boards under the Department of the State of Puerto Rico: agronomists; architects and landscape architects; certified public accountants; agents, vendors and real estate companies; professional draftsmen; professional real estate appraisers; geologists; and engineers and surveyors. The levy will also apply to services rendered by a “return, statement or refund claim specialist”, limited to those services related to the preparation or review of returns, statements or refund claims relating to the taxes levied by the Internal Revenue Code of Puerto Rico or the U.S. Internal Revenue Code. The Administrative Determination distinguishes those services provided by a licensed CPA from those provided by a non-licensed accountant. To this end, the example provided by the Administrative Determination states that in the case of a non-licensed accountant the provision of investment consulting services is a taxable service subject to the 11.5 percent IVU. However, the provision of investment consulting services by a licensed CPA is taxable at four percent. The Act provides that legal services are subject to IVU at four percent, but the Puerto Rican legislature is currently considering a bill to modify the taxation of legal services.

#### **Business-to-Business Services Subject to IVU at Four Percent**

The term “business-to-business services” is defined as services rendered to a person engaged in the exercise of a trade or business activity or for the production of income. In other words, these are services rendered between two merchants duly registered in the Merchants' Registration Department. B2B services also include commissions generated by sales agents; i.e., the income from commission fees is considered a payment for services rendered to another merchant subject to four percent IVU, except in the case of insurance commissions, which are exempt. Where a service is provided through a subcontractor, the service provided by the subcontractor to the contractor is also a B2B service.

However, the following B2B services are explicitly excluded from the definition of B2B services and are thus subject to IVU at 11.5 percent and not 4 percent: (1) bank charges, but limited to charges and fees that financial institutions charge their business customers for demand account management and other types of deposit accounts to cover specific transaction costs and to cover costs to exceed present limits; (2) account collection services; (3) security services, including armored services and private investigations, except security services provided to homeowner or condominium associations; (4) cleaning services, except

cleaning services provided to resident or condominium association; (5) laundry services; (6) repair and maintenance services (non-capitalizable) for real property and tangible personal property, except those services provided to resident or condominium associations; (7) telecommunications services; (8) waste pickup services, except waste pickup services provided to resident or condominium associations; and (9) ordinary leasing of motor vehicles.

The Administrative Determination also provides detailed guidance on the IVU treatment applicable to repair and maintenance services; bank charges; telecommunication services, services between related entities, combined transactions (i.e., transactions that include two or more services subject to different IVU rates), and expense reimbursements.

### **Exemptions**

The following services remain exempt or excluded from IVU:

- Services provided to the Commonwealth Puerto Rico or the Government of the United States;
- Leases of real property that is the principal residence of the tenant, student housing or commercial lease;
- Child and elderly care services;
- Funeral services not to exceed \$ 4,000;
- Export of services, even when the service is provided in Puerto Rico;
- Educational services;
- Interest and other charges for the use of money;
- Insurance commissions and services;
- Healthcare services;
- Services rendered by persons whose annual turnover (i.e., gross receipts) does not exceed \$ 50,000;
- Services between members of a group of controlled corporations, when the entity providing the service and the entity receiving the service are engaged in business in Puerto Rico;
- Services provided by the Electric Power Authority (ESA) and the Aqueduct and Sewer Authority (AAA);
- Services provided to residents' associations or condo owners; and
- Services provided by housing cooperatives.

### **Obligation to Collect, Remit and Pay IVU**

In general, merchants registered in Puerto Rico will be responsible for the collection and remittance of the IVU. However, services provided by merchants whose gross receipts does not exceed \$50,000 remain exempt from IVU. Merchants, except those providing designated professional services, must ensure that the Merchant Registration Certificate indicates he is a merchant with gross receipts of less than \$50,000. The aggregate gross receipts generated during the preceding completed taxable year are taken into consideration to determine if the merchant's gross receipts falls under the \$50,000 threshold. Special rules are applicable for persons belonging to a controlled group and persons with less than a year of operation.

The Act provides that if a person located in Puerto Rico receives services, including taxable services, designated professional services or B2B services from a person not resident or not engaged in trade or business in Puerto Rico, the person liable to pay the tax on such services will be the person receiving the service in Puerto Rico, regardless of where the service has been delivered. Consequently, effective October 1, 2015, persons located in Puerto Rico will be required to pay the Commonwealth IVU at 10.5 percent on general taxable services and Commonwealth IVU at 4 percent on designated professional services and B2B services directly to the Treasury Department, where those services are provided by nonresidents. The Administrative Determination provides that the applicable rate depends on the type of service, highlighting that for the purpose of this provision a service will be considered B2B or a designated professional service even though the nonresident service provider is not registered in the Merchant Register or is not licensed by the government of Puerto Rico. The Administrative Determination further highlights that the \$50,000 threshold exemption does not apply in the case of services provided by nonresidents to residents. Moreover, the Administrative Determination states that any income withholding tax applicable on services received from nonresidents is applicable on the amount billed for the services, excluding IVU and reimbursed expenses. Notably, the IVU is only applicable if the services are related to the Puerto Rico operations. If the services are only partially related to the Puerto Rico operations, then an allocation must be made to determine the corresponding tax amount.

The Administrative Determination also states that any person who is exempt from paying IVU must complete and submit to the vendor a Certificate for Exempt Purchases (Model SC 2916). These persons include among others the government of Puerto Rico, the U.S. government, and housing cooperatives. The Administrative Determination further highlights that merchant resellers may not take a credit of the four percent IVU paid on designated professional services and B2B services against IVU collected on their sales. .

### **Accounting Methods**

In general, all merchants should use the same accounting method for IVU as they do for income tax purposes. The responsibility for payment of IVU arises at the latest when payment is received. The term "payment" includes cash, receipt of any property or services, and a commitment, written or not, from the customer to satisfy the purchase price plus applicable tax, among other things. Where a merchant uses the accrual method ("accrual basis"), sending the bill to a customer constitutes such a commitment by the customer to satisfy the purchase price plus applicable tax.

However, the Act allows providers of designated professional services to use a cash accounting methodology. Consequently, IVU will become due when payment is received, regardless of the invoice date and the accounting method for income tax purposes. Professionals with an option to use cash or accrual accounting for IVU purposes must choose their method they will utilize when they file their first IVU return, otherwise the Department will assume that the professional uses the same accounting method as for income tax purposes. Merchants who

want to change their accounting method must apply in writing to the Secretary of Treasury.

### **Compliance Obligations**

The Department has created a new monthly IVU return for reporting transactions subject to the special IVU rate of four percent. The new return must be filed electronically through the Department's online portal (PICO) no later than the 20th of the month following the month in which the four percent IVU becomes due. Therefore, the first return for the month of October 2015 must be filed no later than November 20, 2015. The Administrative Determination emphasizes that this constitutes an additional return to the already existing Import Declaration (Form SC 2970), the Monthly Return of Import Tax (Form SC 2915 D), and the general Monthly IVU return (Form SC 2915 A).

Moreover, in accordance with Tax Policy Circular Letter no. 15-12 issued on August 1, 2015, merchants providing designated professional services are required to update their Merchant Registration Certificate. These merchants must update their information electronically on the Department's [website](#) by September 30, 2015. Merchant's that do not comply with this requirement will be subject to a penalty of \$500. Merchants who do not update their information by December 31, 2015 will have their Merchant Registration Certificate canceled automatically. The Department reminds that all merchants must comply with the requirement to be registered in the Merchants' Registry. It should be noted that Inland Revenue Code of Puerto Rico (2011) provides certain penalties for failing to meet this responsibility, such as \$10,000 for failing to register in the Merchant's Registry, \$5,000 for providing false information on registration and \$10,000 for a fraudulent Merchant Registration Certificate, among other penalties.

### **Entities Covered by Tax Exemption Grants**

Effective October 1, 2015, those entities that have obtained a tax exemption grant from the Department will be required to pay the four percent IVU on designated professional services and B2B services. However, those entities operating under a tax exemption grant for air transportation services, will be exempt from the 11.5 percent IVU and the 4 percent IVU on goods and services acquired for carrying out its air transportation services.

### **Transitional Measures**

In accordance with Administrative Determination. No. 15-10 issued on June 24, 2015, designated professional services and B2B services that are provided before October 1, 2015 will not be subject to the IVU at four percent, provided that such services are invoiced no later than October 20, 2015. In addition, transitional measures relating to qualified contracts existing before July 1, 2015 remain applicable.

### **Next Steps**

Taxpayers providing designated professional services or business to business services in Puerto Rico should carefully review their transactions in the Commonwealth and determine whether they may be required to charge IVU at four percent on their sales. Taxpayers are also reminded that there are several measures before the Puerto Rico legislature that could substantially affect the IVU, including the 4 percent

IVU on professional and business services. KPMG professionals can assist companies with preparing for the sales tax changes effective July 1 and October 1, 2015, and ultimately for the implementation of a VAT in 2016.

For more information on Act No. 72 (May 29, 2015) and Administrative Determination 15-17, please contact [Carlos Molina](#) at (787) 622-5311, [Jeremy Gray](#) (267) 256-3497, or [Leah Durner](#) at (202) 533-5542.

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