

SALT Alert! 2015-27: Puerto Rico Clarifies Indirect Tax Reform and Issues Guidance on Requirement to Install Fiscal Terminals

On September 30, 2015, the governor of Puerto Rico signed into law Act No. 159 ("the Act"), which in part amends the sales and use tax and value added tax provisions of the Internal Revenue Code of Puerto Rico of 2011 ("the "2011 Code"). The Puerto Rico Treasury Department ("PRTD") issued Administrative Determination No. 15-20 ("[AD 15-20](#)") on September 28, 2015 amending the requirement to install, maintain, and update a fiscal terminal. This guidance was followed by Administrative Determination No. 15-21 ("[AD 15-21](#)") on October 5, 2015, which addresses changes introduced by the Act related to taxable services, designated professional services and services rendered to other merchants.

Background

On May 29, 2015, the Governor of Puerto Rico signed into law Act No. 72 that – in combination with Act No. 101 dated July 1, 2015 – added a new Subtitle DDD to the 2011 Code which (1) adopts a 4.5 percent surcharge on Puerto Rico's Commonwealth sales and use tax (known in Spanish as *Impuesto sobre Ventas y Uso* "IVU") and thus effectively increased the Commonwealth IVU rate from 6 percent to 10.5 percent effective July 1, 2015 and (2) adopts a special 4 percent Commonwealth IVU on the provision of designated professional services and business-to-business ("B2B") services effective October 1, 2015.

In addition, the two Acts replace effective April 1, 2016 (or following any extended sunset date of the IVU) the Commonwealth IVU (including the IVU surcharges under Subtitle DDD of the 2011 Code) with a Commonwealth VAT of 6 percent (under a newly created Subtitle DD of the 2011 Code) and a VAT surcharge of 4.5 percent (under Subtitle DDD of the 2011 Code), thus resulting in an effective Commonwealth VAT rate of 10.5 percent. Note that the two Acts did not modify the one percent municipal IVU, which remains applicable to all transactions taxable in Puerto Rico before the Acts were adopted.

Amendments to the IVU Provisions

The PRTD has issued much guidance over the last couple of months on the indirect tax changes in Act. No. 72. The most recent legislation (Act No. 159) is intended to (1) reduce the possibility that the legislative intent behind these indirect tax changes will be inconsistently

interpreted, and (2) amend the law to clarify certain ambiguities in the original reform bill.

Act No. 159 expands the scope of services that are specifically excluded from 4 percent and 11.5 percent IVU to the following services:

- Service charges imposed by financial institutions, interest, and other charges for use of money, but not bank charges, which remain taxable at 11.5 percent;
- Services provided by merchants whose annual volume of business is below \$50,000;
- Services provided between related entities in Puerto Rico;
- Services provided to residents' associations and to residential housing projects of social interest;
- Services provided by an entity outside Puerto Rico to a related entity in Puerto Rico that is a bank or operates under a tax exemption grant;
- Use of intangibles rights;
- Production services provided by any producer in Puerto Rico of radio and television programs or commercials;
- Advertising, promotions, and advertising time in any medium;
- Outsourced services (except designated professional services) under a construction project and outsourced telecommunication services;
- Services provided directly to a merchant by employees of an employment agency, but only with respect to the value of the gross salary paid to the employee of the employment agency;
- Services provided by and to a business entity dedicated to the repair, maintenance, and refurbishment of aircrafts holding a tax exemption grant;
- "Toll manufacturing" or "contract manufacturing" services provided that the service provider obtains a Collection Waiver Certificate;
- Services provided to a merchant located in a free trade zone who is dedicated solely to the storage (including leasing of tanks) or the processing of fuel;
- Maritime, air, or land transportation services, including delivery charges;
- Services provided to bona fide farmers;
- Services provided to public or private entities created by law that are exempt from all types of taxes under their organizational acts;
- Legal representation before the U.S. and Puerto Rico Courts and Governmental Agencies, legal consulting services and notarial services provided by licensed attorneys, but not services that can be provided by other professionals such as financial consulting, lobbying, agency services, and tax consulting services; and
- Designated professional services provided to trade or labor unions.

In relation to the above services, AD 15-21 reminds merchants providing and receiving IVU exempt services of the requirement to indicate the nature of the exemption claimed on [Form SC 2916](#) which must be then kept by the vendor and the buyer.

Moreover, the Act clarifies the application of IVU to services provided by a non-resident person to a person located in Puerto Rico. Effective October 1, 2015, services provided outside Puerto Rico by a nonresident to a person located in Puerto Rico are subject to IVU regardless of where the service is delivered; provided that such service is related directly or indirectly to the operations or activities carried out in Puerto Rico by the recipient. AD 15-21 provides detailed examples on the applicability of the IVU in these instances and reminds taxpayers that where the IVU is not paid on taxable service no deduction from income is allowed for income tax purposes.

The Act also amends the definition of manufacturing plants, machinery and equipment used in manufacturing, and sales price in the context of subcontracted services under a construction project, among others.

VAT Changes

The Act clarifies the definition of the following terms: exported articles; manufacturing equipment; goods used for the treatment of health conditions; manufacturing plant; exported services; designated professional services; and services provided to residents' associations.

In addition, the Act excludes from the scope of VAT the following transactions:

- Services provided between related entities in Puerto Rico;
- Use of intangible rights;
- Services provided by a related entity outside Puerto Rico to an entity in Puerto Rico that operates under a tax exemption grant; and
- Maritime, air, or land transportation services, including delivery charges.

The Act adds the following transactions to the list of exempt transactions (*i.e.*, the vendor does not charge VAT, but is not allowed to recover VAT incurred on expenses relating to these transactions):

- Sale of articles and agriculture services to bona fide farmers;
- Legal representation before the U.S. and Puerto Rico Courts and Governmental Agencies, legal consulting services and notarial services provided by licensed attorneys;
- Services provided to residents' associations and to residential housing projects of social interest;
- Retail sales (including to other merchants) of electric solar equipment;
- Repair, maintenance and refurbishment of aircraft by a person holding a tax exemption grant;
- "Toll manufacturing" and "contract manufacturing" services provided the service provider obtains a Collection Waiver Certificate;
- Annual dues paid to time shares or vacation clubs;
- Services provided to a merchant located in a free trade zone who is dedicated solely to the storage (including leasing of tanks) or the processing of fuel;
- Generation and sales of electricity on a commercial scale;

- Services provided to a business entity dedicated to the repair, maintenance, and refurbishment of aircraft holding a tax exemption grant; and
- Services provided to public or private entities created by law that are exempt from all types of taxes under their organizational acts.

The Act further creates a new Subchapter F in the 2011 Code, which adopts administrative penalties and interest provisions for purposes of the VAT. The penalties cover all administrative obligations under the VAT including: registration, disclosure of registration certificates, submission of returns, payments of VAT, issuance of tax receipts, and fraudulent application of exemptions and VAT credits.

Requirement to Install a Fiscal Terminal

Pursuant to [Informative Bulletin No. 15-14](#) issued on September 28, 2015, Puerto Rico has eliminated the sales and use tax lottery effective September 29, 2015 with the last draw. The IVU lottery program will be replaced by a new IVU audit system. Under this system, the requirements for acquiring, installing, and maintaining fiscal terminals that transmit information from a merchant's transactions to the PRTD will be modified. The new program will allow integration and analysis of the data provided by merchants through the fiscal terminals with the data reported on the tax returns and through the Merchants Integrated Portal (PICO) online system.

Under Section 4030.01(a)(3) of the 2011 Code, the Secretary of the Treasury may require periodic inspection of fiscal terminals to ensure proper compliance and collection of IVU. Administrative Determination 15-20 (AD 15-20) (1) sets forth the changes in requirements for a merchant required to install, maintain, and update a fiscal terminal in each of its outlets; (2) establishes the process to be followed by those merchants who currently own fiscal terminals; and (3) determines the penalties that apply for failure to comply with these procedures.

Effective October 30, 2015, merchants whose total annual sales volume exceed \$125,000 will be required to install, maintain, and update a fiscal terminal in each of their sales points that meets the requirements set out previously in Regulation No. 8049 dated July 21, 2011. AD 15-20 provides a list of merchants that are exempt from this requirement, including: designated professional services providers subject to IVU at four percent; IVU exempt persons such as government agencies, financial service providers, and educational service providers; remote vendors (e.g., merchants performing transactions by mail, the internet, or by phone); and establishments that only use the credit payment method (i.e., billing/deferred payment).

On October 5, 2015, the PRTD issued [Tax Policy Circular No. 15-13](#), which establishes the content requirements for all receipts generated by a fiscal terminal. Among these changes, the IVU Lotto number code was replaced by a control number.

Effective October 29, 2015, fiscal terminals which are provided by PRTD will no longer be operational. Merchants who currently have a fiscal terminal provided by PRTD and are required to install, maintain, and update a fiscal terminal under AD 15-20 will have until October 30,

2015 to acquire and install a new fiscal terminal provided by one of the vendors certified by PRTD.

AD 15-20 emphasizes that even if a merchant is not required to maintain a fiscal terminal, the merchant must comply with requirements to file IVU returns and pay the tax using the PRTD's online portal, PICO. Failure to comply with the requirement to install, maintain, and update a fiscal terminal may result in administrative fines of up to \$20,000.

Next Steps

Taxpayers with activities in Puerto Rico should review Act. No. 159 and ascertain whether they are affected by the tax changes discussed above. In addition, merchants must determine whether they are required to purchase tax terminals under AD 15-20.

For more information on Act No. 72 or Act No. 159 and Administrative Determination 15-20, please contact [Carlos A. Molina](#) at (787) 622-5311, [Jeremy Gray](#) at (267) 256-3497, or [Leah Durner](#) at (202) 533-5542.

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