

Tax Alert: Value Added Tax vs. Sales and Use Tax in Puerto Rico

The government of Puerto Rico is working on the draft of a new tax reform that will have a direct impact in the Sales and Use Tax (known by its Spanish acronym “IVU”). The reform proposal will rest on the Value Added Tax (known by its Spanish acronym “IVA”) as the main source of collection, which represents a shift from taxing productivity to a tax based on consumption.

The following information compares the general tax structure under both systems:

Value Added Tax (“IVA”)

Generally, the IVA is a tax that is levied at each stage in the chain of production and distribution from raw materials to the final sale based on the value added at each stage.

It is expected that IVA will apply to most goods and services except for the following:

- exported goods and services
- financial services
- rental Housing

Normally, the amount of IVA that the user pays is based on the cost of the product and is allowed to claim a credit for the IVA that has been paid before.

The following example presents the results with a hypothetical IVA tax rate of 10%:

1. A manufacturer pays \$110 for raw materials. This includes \$100 for the cost of the raw material plus an IVA of 10%. The raw material supplier remits \$10 to the

Puerto Rico Treasury Department (“PRTD”).

2. The manufacturer establishes a fix price of \$150 for the assembled personal property, which will be subject to IVA ($\$150 \times 10\% = \15). The retailer pays \$165 for the merchandise including the IVA. The manufacturer is allowed to claim a credit from the IVA that he paid to the supplier and remits \$5 to the PRTD (calculated as $\$150 \times 10\% = \$15 - \$10 = \5).
3. Finally, the retailer establishes a fix price of \$200 for the personal property and sells it to a consumer for \$220, which already includes the IVA. The retailer remits \$5 to the PRTD (calculated as $\$200 \times 10\% = \$20 - \$15 = \5). It is allowed to claim a credit from the IVA that he paid to the manufacturer.

Sales and Use Tax (“IVU”)

Under the IVU, the tax is collected at the end consumer’s point of purchase and on imports of tangible personal property into Puerto Rico.

Every merchant engaged in any business that sells taxable items is responsible to collect the IVU as a withholding agent.



Contact us

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The IVU rate is 7% and in general applies to the following items with certain exceptions:

- tangible personal property
- taxable services
- admission rights
- bundled transactions

The following example was prepared using the current IVU tax rate of 7%:

1. The manufacturer purchases \$100 worth of raw materials from the supplier. However, a manufacturer is exempt from the payment of IVU on the purchase of raw materials.
2. The manufacturer sells the personal property to a retailer for \$150. The retailer is subject to an IVU payment in the amount of \$10.50 (calculated as $\$150 \times 7\% = \10.50). However, if the retailer has the Reseller Certificate, it may claim a credit for the IVU paid on the purchase of taxable items for resale. The credit is limited to 75% of the liability on the sales tax return.
3. The retailer sells the personal property to a consumer for \$200. The consumer is subject to an IVU payment in the amount of \$14 (calculated as $\$200 \times 7\% = \14).

The Tax Reform Bill is expected to be filed during the month of February. As part of our commitment to keep you up-to-date with recent developments, we will issue Tax Alerts with the proposed changes as soon as the information becomes available.



Please contact our Tax Department should you require additional information regarding this or any other tax issue; we will be glad to assist you.

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