

Tax Alert: Guidelines and applicability of IVU to B2B and DP services

On August 31, 2015, the Puerto Rico Department of Treasury (“PRTD”) released Administrative Determination 15-17 (“AD 15-17”) to establish guidelines for the applicability of sales and use tax (“SUT”) on services rendered by a merchant to other registered merchants (“B2B”), as well as on services rendered by designated professionals (“DP”).

Previously, the Puerto Rico Internal Revenue Code (“Code”) was amended by Act 72-2015 to increase the SUT rate from 7% to 11.5% (a combined state and municipal SUT) on taxable services (hereinafter named “Basic SUT”) and to impose a new special tax of 4% (municipal tax of 1% does not apply) for services rendered from October 1, 2015 thru March 31, 2016 (hereinafter called “Special SUT”). Said Special SUT is applicable to services rendered either as B2B or by DP.

Following is a summary of the guidelines:

I. Definitions

- (a) **Taxable services subject to Basic SUT** means: Services rendered to any person, except DP or B2B (with certain exceptions¹), and by a tax return specialist.

¹ Taxable services are those that are currently subject to 11.5% even when rendered to other business (i.e. collection services, bank charges, security services. etc.)

DISCLAIMER: This update and its content do not constitute advice. Clients should not act solely on the basis of the material contained in this publication. It is intended for information purposes only and should not be regarded as specific advice. In addition, advice from proper consultant should be obtained prior to taking action on any issue dealt with this update.

© 2015 Kevane Grant Thornton LLP All rights reserved.
 Kevane Grant Thornton LLP is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. Services are delivered by the member firms. GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions. Please visit www.kevane.com for further details.

- b) **DP subject to Special SUT** means: legal services and professional services regulated by their respective Examining Boards under the Puerto Rico Department of State. Also, starting on October 1, 2015, tax return specialists will be included under such term. It should be noted that with regards to services rendered by tax return specialists, only services related to the preparation of returns and claims of refund are considered DP. Please note that the Puerto Rico Legislature is presently considering a proposed amendment to modify the tax imposed on legal services. The PRTD clarifies on AD 15-17 that if the provider of the services has a volume of business of \$50,000 or less, the service will continue to be exempt.

- c) **B2B subject to Special SUT** means: Services between two duly registered merchants. The commissions generated from sales of items (either taxable or not) and services rendered by a subcontractor to a contractor, are considered as B2B services.



Contact us
 For assistance in this matter, please contact us via maria.rivera@pr.gt.com or javier.ovola@pr.gt.com



Adding true value means exceeding our clients' expectations, anticipating their needs and being proactive and innovative in the accounting profession.

Through the **Kevane Grant Thornton business and tax application for mobile devices** you will have access to our Alerts, Tax News and other related matters, plus a customized tax calendar for individuals, businesses and other entities, thus providing an excellent tool to manage filing and payment due dates with government agencies in Puerto Rico.

Download for free the application. Available for iPhone, Motorola and all tablets.



Follow us on and

September 17, 2015

Notwithstanding, certain bank charges, collection services, security services, cleaning, laundry and waste collections services, non capitalizable repair and maintenance services, telecommunication services and operating leases of motor vehicles are excluded from B2B services pursuant to Section 4010.01(nn)(2) of the Code and shall be taxed under the Basic SUT.

II. Exemptions

AD 15-17 provides a list of services that remain exempt for Basic SUT purposes (e.g. services provided by the government of PR or United States, educational services, interest and other charges for the use of money, etc.). It also states that these exemptions and exclusion are applicable to both the B2B services and the DP services.

III. Determination

A. Taxation on services rendered to a duly registered merchant as well as on services rendered by designated professionals

Services rendered after October 1, 2015 by DP and B2B will be subject to the Special SUT, provided that these are not covered by any exemption or exclusion. This means that all services covered by the B2B exemption will now be subject taxed at a 4%.

Also, services rendered by a non-resident to a PR resident shall be subject to Basic SUT or Special SUT, as applicable.

In order to clarify, AD 15-17 discusses the following transactions:

- ✓ **Repair and Maintenance Services:**
Circular Letter (“CL”) 13-13

enumerates which services have been covered for B2B exemption and are therefore subject to Special SUT. Those services include: repair and maintenance of motor vehicles, software maintenance such as patches, upgrades, troubleshooting, capitalizable repairs, inspections of equipment and machinery, lifts or fire system.

- ✓ **Bank Charges:** AD 13-16
enumerates which bank charges are exempt for SUT purposes. Therefore, since such bank charges are exempt for SUT, they will also be exempt for Special SUT.

- ✓ **Telecommunication Services:**
Pursuant to Section 4010.01(kk)(2), certain telecommunication services are excluded for the definition of telecommunication services, except if those services are rendered to a duly registered merchant, in which case shall be subject to Special SUT. Internet access and regulatory charges are exempt for both, Basic and Special SUT.



B. Collection, remission and payment

In this section, the AD 15-17 discusses aspects related to the collection, remittance and payment of the Special SUT. It provides special attention to the following:

- 1-** Special SUT shall be collected, remitted and paid according to Subtitle D of the Code. However, if the service provider has a volume of business of \$50,000 or less², then the service remains exempt. There will be no duty to collect and pay the tax.
- 2-** In the case of services provided by a non-resident to a person in PR, the person responsible for the payment of the SUT is the person that receives the service in PR. The applicable tax rate depends of the type of service received. If the service is a B2B (even if the provider is not registered) or a DP, the applicable rate is 4%. However, if the services are originally not covered under such exemption, the applicable rate is 11.5%. Please note that the services provided by a non-resident are not covered by the exemption in the case of merchants with an annual volume of business of \$50,000 or less.
- 3-** In the case of services rendered between members of a controlled group (as defined in Section 1010.04) or related entities (as defined in section 1010.05 of the Code), the services (either taxable or not) shall be exempt if both entities are engaged in trade or business in Puerto Rico as well as duly registered.

Also, if the services are provided by a member of a controlled group or related entity not engaged in trade or business in Puerto Rico, those services shall be subject to Special SUT. In this case, the entity engaged in trade or business in PR is the responsible for the payment of SUT.

- 4- Mixed Transactions:** Transaction composed of two or more services subject to different taxable rates, where: (1) one of them is essential to providing the other service, (2) was provided exclusively in relation to this service and (3) the goal is to provide specifically that service. In this case, the applicable rate will be the one applicable to the type of service which is the real reason for the transaction. Meaning that if the final objective is providing a B2B service, the applicable rate will be 4%.
- 5-** Any person entitled to buy taxable items without paying tax shall provide to the seller a Certificate for Exempt Purchases (Form SC 2916). Those include agencies or instrumentalities of the Commonwealth of Puerto Rico or United States government, associations of residents or condominiums, housing cooperative associations or social interest housing projects.
- 6- Billing:** Every service provider should detail the invoice to show the services rendered separately from the reimbursed expenses. In this case, the amounts that represent the reimbursed expenses shall not be subject to Special SUT. Please be aware that additional

² Volume of Business means the aggregate volume generated during the prior taxable year which concluded on or before August 31, 2015.

charges, such as “*out of pocket*” or “*administrative fees*”, indirectly related to the service, and services rendered by employees, shall not be treated as reimbursed expenses.

7- Accounting Method: Pursuant to Section 4041.01 of the Code, every merchant shall use the same accounting method used to report its income on the income tax return. Notwithstanding, a transition rule applies for merchants engaged in providing DP services, which are allowed to use basic cash method for SUT purposes, regardless of the method used for income tax returns. Please note that the election should be made with the monthly SUT return for October 2015, which is due on or before November 20, 2015.



Also, the PRTD issued on June 24, 2015, AD 15-10 to clarifies that the services rendered before October 1, 2015 as B2B, as well as by DP, shall not be subject to Special SUT, as long as the invoice is issued and sent to client no later than October 20, 2015. If the services are

rendered after September 30, 2015 or billed after October 20, 2015, they shall be subject to Special SUT.

8- Credit for taxes paid by a reseller

merchant: The amount of credit that a reseller is entitled to take should not include any portion related with the Special SUT paid, although has been paid for the reseller.

9- Withholding of income tax at source on payment for services

rendered: Pursuant to Section 1062.03 of the Code, every person, natural or juridical, that is engaged in trade or business in PR, shall deduct, withhold and pay 7% on the amount paid to a service provider. The merchant who pays for a service must only deduct and withhold 7% on the amount that represents billed services, excluding SUT and reimbursed expenses. On the other hand, the service provider shall collect and remit the SUT.

10- It establishes a new Monthly return to remit the Special SUT. Such return shall be filed and the corresponding tax liability paid by electronic means, through the following

link: <https://comerciantes.hacienda.pr.gov>
/

Merchants who have the duty to file the Declaration of Imports (Form SC 2915 D) and/or Monthly Sales and Use Tax Return (Form SC 2915 A), shall also file a Monthly Special SUT return, whenever it provides DP or B2B services.

Those merchants that do not have access to the internet or a computer, may visit any of the district offices of the Sales and

Use Tax Bureau, where computers will be available for completing the filing process.

11- Every merchant engaged in providing DP services, must update its Merchant's Registry Certificate, according to the process established in CL 15-12.

12- Preexisting contracts to provide services to other merchants and designated professional services:

Pursuant to Sections 4070.01(c) or (d) of the Code and CL 15-11 and 15-10, as applicable, the services provided as B2B or by a DP, as part of a preexisting contract, shall be exempt for the Special SUT (for a period of twelve months or the term of the contract, whichever is lesser), as long as it has been granted before July 1, 2015 and covered by a written authorization from the Secretary of the Treasury. Both the service provider and recipient of the service should request a certification and/or qualification of the contract no later than September 30, 2015. Please pay attention to due dates and process established on CL 15-10 and 15-11.

13- CL 13-16 clarifies that businesses covered by a tax grant decree under special legislation, will be subject to the SUT payment on services that are not covered by B2B. Some of those entities were covered under Acts 73-2008, 168-1968, 74-2010, etc. Starting on October 1, 2015, such entities will be subject to the Special SUT on services received, previously covered by B2B exemption.

Please note that entities engaged in the operation of air transportation services and covered under the provisions of

Act 135-1945, will be exempt from the Basic SUT and Special SUT on goods and services acquired.

14- Previous publications issued by PRTD, with regards to the applicability of the SUT on taxable services will remain valid as long as they are not incompatible with the Code, as amended, and with the current AD. Those publications include: **CL** 13-04, 13-09, 13-13, 13-14, 13-16; **AD** 13-13, 13-16 and 15-09.

Any publication issued by PRTD indicating that the services covered under B2B exemption were exempt, will be understood to be amended to indicate that will now be subject to Special SUT.

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