



Cash Basis method of accounting for the construction industry

August 17, 2020

The Puerto Rico Treasury Department issued Administrative Determination 20-19 with the purpose of clarifying the mechanism available for merchants engaged in the construction industry to request a change in their accounting method to Cash Basis for purposes of the Puerto Rico Sales and Use Tax (“SUT”). This change is a result of the amendment to Section 4041.01 of the Puerto Rico Internal Revenue Code after the approval of Act 40 of April 16, 2020 (“Act 40-2020”).

Through AD 20-19 the Puerto Rico Treasury Department achieves two objectives:

1. define the merchants engaged in the construction industry to which the amendment introduced by Act 40-2020 applies.
2. establish the process so that said merchants can choose the cash basis method of accounting for purposes of the Puerto Rico Sales and Use Tax as of July 1, 2020.

On this regard, the following are two essential terms for the construction industry:

1. construction services - means the process of building, fabricating, or developing a structure, with cement, bricks, wood, or any other construction material. The construction service includes the labor performed to be able to build or manufacture a structure when such labor is included in a construction contract for a structure that includes both the labor and the materials to be used in said construction.
2. construction project - Paragraph (c) of Article 4210.01(c)-23 of the Regulation defines the term “Construction Project” as a project for the construction of a commercial, tourist, industrial or residential development for which it is required to submit a location query, consultation of construction, preliminary project, preliminary development or a construction permit in an Autonomous Municipality, the Planning Board or OGP, as appropriate.

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The Puerto Rico Treasury Department determines that any merchant whose Merchant Registration Certificate includes one or more of the North American Industry Classification System (“NAICS”) codes indicated in the attached list (“eligible NAICS Codes”), will be considered a merchant dedicated to the construction industry in construction projects and will be allowed to choose the cash basis method of accounting when remitting the SUT as of July 1, 2020.

Revenues requirement

To be considered an eligible merchant, at least eighty (80) percent of the gross income derived during the three (3) taxable years prior to the date of election of change in method, constitutes income related to an eligible NAICS code.

For merchants engaged in the sale of tangible personal property, the gross income from the eligible NAICS Codes will not include the gross income derived from any sale of tangible personal property that is for resale.

If the merchant has not been operating for all the previous three years, the required 80% will be calculated based on the period that it has been operating. If you are a merchant who has not started operations yet, the required 80% will be calculated based on an estimate of sales for the next 12 months.

Furthermore, eligible merchants must keep available in their records for six (6) years, evidence of having met the requirement that their gross income consists substantially of income related to the NAICS codes that make them an eligible merchant.

Election of Cash Basis for Sales and Use Tax purposes:

Any merchant that was operating as of June 30, 2020, who qualifies and decides to change its accounting method, will not have to request a “ruling” from the Puerto Rico Treasury Department to complete the change. The change must be made through the Unified System of Internal Revenue (“SURI by its Spanish acronym) after June 30, 2020 but before the monthly SUT filing corresponding to the month for which the change will be effective. The merchant must follow the steps below:

1. access the SURI account
2. select the “Sales and Use” account
3. enter to the menu identified as “I Want To”
4. complete the information required by the system and in the accounting method select “Cash Basis”
5. press “Submit”

Merchants who start operations after July 2020, must select the cash basis method of accounting at the time of completing their registration for the Sales and Use account in SURI.

Once the cash basis method is selected (new or existing merchant), any subsequent change of accounting method must be through a ruling request to the Puerto Rico Treasury Department.

Effect of change to Cash Basis method of accounting:

The eligible merchant who decides to change its accounting method to the cash basis method must maintain a reconciliation of the payments received after the change is effective, and that are attributable to periods prior to the change and under the previous accounting method.

The merchant will only report those transactions for which they receive the payment during the month. Amounts invoiced that have not been collected in the same period will be included in the SUT Monthly Return of the month in which the payment is received.

The Puerto Rico Treasury Department determined that in the case where the owner of the project makes a withholding under the contract (“retainer”), the SUT corresponding to the amount withheld must be deposited when said withholding is released and the merchant receives the SUT applicable to it. However, if the SUT corresponding to the retained amount is advanced, then the merchant must remit it when he receives the advance of the SUT.

NAICS Codes whose use is allowed for cash basis method of accounting for the Puerto Rico Sales and Use Tax:

#	Code	Description
1	23611	Residential Building Construction
2	23621	Industrial Building Construction
3	23622	Commercial and Institutional Building Construction
4	23711	Water and Sewer Line and Related Structures Construction
5	23712	Oil and Gas Pipeline and Related Structures Construction
6	23713	Power and Communication Line and Related Structures Construction
7	23731	Highway, Street, and Bridge Construction
8	23799	Other Heavy and Civil Engineering Construction
9	23811	Poured Concrete Foundation and Structure Contractors
10	23812	Structural Steel and Precast Concrete Contractors
11	23813	Framing Contractors
12	23814	Masonry Contractors
13	23815	Glass and Glazing Contractors
14	23816	Roofing Contractors
15	23817	Siding Contractors
16	23819	Other Foundation, Structure, and Building Exterior Contractors
17	23821	Electrical Contractors and Other Wiring Installation Contractors
18	23822	Plumbing, Heating, and Air-Conditioning Contractors
19	23829	Other Building Equipment Contractors
20	23831	Drywall and Insulation Contractors
21	23832	Painting and Wall Covering Contractors
22	23833	Flooring Contractors
23	23834	Tile and Terrazzo Contractors
24	23835	Finish Carpentry Contractors
25	23839	Other Building Finishing Contractors
26	32731	Cement Manufacturing
27	32732	Ready-Mix Concrete Manufacturing
28	32739	Other Concrete Product Manufacturing
29	42331	Lumber, Plywood, Millwork, and Wood Panel Merchant Wholesalers
30	42332	Brick, Stone, and Related Construction Material Merchant Wholesalers
31	42333	Roofing, Siding, and Insulation Material Merchant Wholesalers
32	42339	Other Construction Material Merchant Wholesalers

NAICS Codes whose use is allowed for cash basis method of accounting for the Puerto Rico Sales and Use Tax (cont'd):

#	Code	Description
33	42351	Metal Service Centers and Other Metal Merchant Wholesalers
34	42352	Coal and Other Mineral and Ore Merchant Wholesalers
35	42361	Electrical Apparatus and Equipment, Wiring Supplies, and Related Equipment Merchant Wholesalers
36	42371	Hardware Merchant Wholesalers
37	42372	Plumbing and Heating Equipment and Supplies (Hydronics) Merchant Wholesalers
38	42381	Construction and Mining (except Oil Well) Machinery and Equipment Merchant Wholesalers
39	42461	Plastics Materials and Basic Forms and Shapes Merchant Wholesalers
40	42495	Paint, Varnish, and Supplies Merchant Wholesalers
41	44221	Floor Covering Stores
42	44413	Hardware Stores
43	44419	Other Building Material Dealers
44	54134	Drafting Services
45	54135	Building Inspection Services
46	54141	Interior Design Services
47	54142	Industrial Design Services
48	54143	Graphic Design Services
49	54162	Environmental Consulting Services

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