



Tax



Taxpayers



Municipal
license

Business Economic Activity as a proposed new parameter of a Municipality's tax jurisdiction

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Taxpayers engaged in trade or business within the jurisdiction of a Puerto Rico municipality, providing any services for profit, selling any goods, or performing any type of business; are generally subject to the payment of municipal license taxes.

In recent days, the Municipal License Tax has been gaining attention as the recently proposed senate bill 532 seeks to redefine the basis used by the taxpayer to determine the volume of business attributable to each municipality regardless of whether the entity has a physical presence, commercial establishment, or main office within the jurisdiction of a Puerto Rico municipality. Considering the potential implications of proposed changes, this article discusses the general concepts of Municipal License, including its requirements and taxation.

What is Municipal License

The Municipal License is a license issued to authorize a business to operate within the jurisdiction of a municipality in Puerto Rico. Two licenses are issued during the year according to the fiscal year of the government, which ends on June 30. As a result, if a business starts operations anytime between July to December, it must request a municipal license that covers said semester of the current year and a second license that approves business operations from January to June of the next year. The tax imposed by each municipality to issue a municipal license is based upon the volume of business attributable to the taxpayer.

Pro tip: It is recommended businesses start operations at the beginning of the semester to maximize the use of the municipal license granted during the first semester generally granted exempt of payment if requested timely.

Who is responsible for paying Municipal License Tax?

Any taxpayer engaged in a trade or business within the jurisdiction of a Puerto Rico municipality, providing any services for profit, selling any goods, or performing any type of business; shall be subject to the payment of municipal license taxes, unless otherwise stated on Act 107 of August 14, 2020, as amended, known as the "Puerto Rico Municipal Code"

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(hereinafter "Code"). Services rendered as an employee are not subject to municipal license tax.

Exemptions

There are some businesses and/or types of economic activity that enjoy a total exemption status regarding the municipal license tax. Some of these include: the sale of agricultural products sold directly by the farmer, financial businesses with a volume of business less than \$5,000 dollars, nonprofit sports clubs and nonprofit civic or social organizations.

Pro tip: Some municipalities charge a minimum administrative fee of \$25 to issue a Municipal Tax License or Compliance Certification. In case of entities with no tax liability or with volume of business less than \$5,000 that would prefer to have a License displayed on their business, the taxpayer may file a declaration with a minimum tax of \$25 to obtain the certificate.

How to request Municipal License?

When a new business is established, among other requirements, it is necessary notify to the Director of Finance of such municipality within the first 30 days of operations. The Director of Finance will extend a provisional license, generally exempt of payment, for the semester in which the company commences operations. If the business fails to register within the first 30 days, the first semester's tax exemption would be lost, and fines and misdemeanor charges may be applied as per the Code.

Pro tip: Certain complementary documents must be submitted at the time of the register with the Municipality, including use permit, certificate of incorporation, merchant registration certificate, employer identification number letter, among others. It is encouraged to contact the corresponding Municipality beforehand to discuss any additional information needed to register the business.

After the initial registry and provisional license issuance, businesses must submit Form OCAM PAO1 Volume of Business Declaration to compute and pay the corresponding municipal tax to receive the Municipal License for the next period. The due date for filing and payment is 5 workdays after April 15 of every taxable year. Taxpayers can request a six-month extension for filing the tax return with the municipality. The extension only covers the taxpayer's responsibility to file the return and does not extend the payment date.

Pro tip: The municipal license tax is payable in two installments on July 15 and January 15. However, if the total amount is paid on or before the return filing date a 5% discount is granted.

How is the tax calculated?

The tax is calculated by using as basis the volume of business made as of year-end of the previous accounting year and applying the municipality's tax rate applicable to the type of business according to its annual volume of business. The maximum tax rate that a municipality can impose is .5% for non-financial businesses and 1.5% for financial businesses. In case, the taxpayer has presence in multiple municipalities the volume of business is allocated to each municipality in which the taxpayer holds a permanent or temporary place of business. If the volume of business cannot be clearly adjudicated to each municipality, the volume of business will be prorated using the average square feet for all buildings on each municipality.

Certain businesses have their own specific rules. For example, gas stations determine their volume of business by the amount of gasoline gallons sold multiplied by the maximum benefit allowed by law, while others like telecommunication businesses determine their volume of business according to the invoicing, installations and other services performed per municipality.

There are cases when a taxpayer does not operate throughout the whole year, in which case the volume of business made is annualized and declared. Some of these situations where the taxpayer doesn't have operations for the whole year, include:

- restarting operations – The volume of business made through the year is annualized and declared.
- temporary cease of operations – This applies when the taxpayer ceases operations temporarily, but for no more than 5 years, and has notified the municipality's Finance Director on or before 30 days have passed since the beginning of the semester. Once operations resume the volume of business made will be annualized and declared.
- transfer of operations – This applies when the taxpayer transfers its operations from one municipality to another. The taxpayer shall notify the municipality's Finance Director on or before 30 days have passed since the beginning of the next semester. If the Finance Director from the previous municipality certifies that the taxpayer is current and in compliance the new municipality will take into consideration the license paid on the previous municipality.
- permanent cease of operations – This applies when the taxpayer permanently closes and ceases operations in a municipality. In these cases, the taxpayer shall notify the municipality in writing and not operate elsewhere.

Pro tip: A cease of operation letter shall be presented to the municipality with the intention to cease operations within 30 days after the end of operations. The letter must include the Municipal Tax License Certificate and evidence of the canceled Merchant Registration Certificate.

Senate Bill 532 – Economic activity versus physical presence

Article 7.200 of the Code defines "volume of business" as all gross income derived from any service, the sale of any good or any other industry that takes place where the taxpayer's principal office is located or wherever the taxpayer holds a temporary venue to make sales or perform business, including warehouses, branches, or otherwise conducts business. The Code defines "gross income" as all income from any source that is attributable to the operations that take place in the municipalities.

Senate Bill 532 filed on August 17, 2021 (the "Bill"), seeks to amend Code article 7.200(a)(1) and (h). It introduces two main changes: (i) amplify the Volume of Business definition to tax economic activity conducted in a municipality and (ii) redefine the rules to **calculate the volume of business attribution for businesses operating in multiple municipalities**.

- volume of business definition

Under the Bill, the general rule that defines the Volume of Business attributable to a municipality would be expanded to include all gross income derived from **economic activity in any municipality, regardless of having any physical presence in the municipality**. This change would untether the municipality's ability to impose a tax and a filing requirement to taxpayers based on having physical presence within their jurisdiction. Instead, it will be based on "economic activity", an undefined and broad term that could be interpreted as any type of sale or service provided in any municipality.

- allocation of volume of business

The second proposed change to article 7.200 intends to change the rule for allocating the volume of business among multiple municipalities. This change would use the volume of business attributable to the economic activity in any municipality as the basis for the tax computation when the taxpayer has no physical presence within the municipality. Under the proposed new rules, volume of business attributed to a municipality based on "economic activity" is subtracted from the volume of business declared on the municipalities where the taxpayer has physical presence.

The driving motive for the proposed changes is to provide a more equitable distribution in the allocation of the Volume of Business among the municipalities of Puerto Rico. According to the Bill, physical presence within a municipality is a restriction that disadvantages municipalities that house fewer businesses or less developed infrastructure.

What does this mean to the taxpayer?

The Bill raises questions about the implications these changes could have on businesses for filing purposes. The proposed Bill does not clearly define "economic activity." This shift in the basis for allocation may ultimately result in higher compliance costs to the taxpayer for preparing returns and record keeping. It may also lead to differences in interpretation of the act that could create clashing positions between the municipalities regarding their right to collect the tax.

Municipalities would also have to rethink how their filing processes would allow a nonregistered taxpayer to submit returns and pay the corresponding taxes without being cumbersome for both the taxpayer and the agency. We will keep you posted on further legislative actions with respect to the Bill.

We are committed to keeping you up to date with all tax-related developments. Please contact our Tax Department should additional information be required regarding this or any other tax issue. We will be glad to assist you.



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