

September 11, 2015

## Tax Update

### *Treasury Issues Guidance on the Applicability of Sales and Use Tax to Services*

When the sales and use tax (“SUT”) was first implemented in 2006, business-to-business services (“B2B Services”) were exempt, subject to compliance with certain documentation requirements. Act 40-2013 amended the Puerto Rico Internal Revenue Code of 2011, as amended (“Code”), to make certain B2B Services subject to the SUT (“Taxable B2B Services”).

As a result of the enactment of Act 72-2015 on May 29, 2015 (“Act 72”), effective July 1, 2015, Taxable B2B Services became generally subject to a total combined SUT rate of 11.5% (10.5% state level and 1% municipal level (“11.5% Basic SUT”). In addition, Act 72 amended the Code to impose a new 4% state level SUT on Services Rendered to other Merchants (essentially B2B Services other than Taxable B2B Services) and Designated Professional Services starting on October 1, 2015 (“4% Special SUT”).

On August 31, 2015, the Puerto Rico Treasury Department (“Treasury”) issued Administrative Determination No. 15-17 (“AD 15-17”) providing guidance with respect to the application of the SUT on Designated Professional Services and Services Rendered to other Merchants.

As mentioned in our [Legal Update](#) of September 8, 2015, Senate Bill 1433 (“SB 1433”), approved by the Puerto Rico Senate on August 24, 2015 and, with amendments, by the House of Representatives on June 25, 2015, proposes to further modify certain SUT provisions of the Code. Close monitoring of SB 1433 is recommended to determine the effects of its proposals on operations as of October 1, 2015.

Below we summarize the most significant provisions of AD 15-17, which are effective as of October 1, 2015.

### Definitions

#### Taxable Services – Subject to 11.5% Basic SUT

Taxable Services includes any service rendered to any person, except for Designated Professional Services, Services Rendered to Other Merchants, and exempt services.

#### Designated Professional Services – Subject to 4% Special SUT

Designated Professional Services includes services rendered by agronomists, architects and landscape architects, CPA’s, brokers, realtors and real estate companies, professional draftsmen, real estate appraisers, geologists, engineers and surveyors (“Designated Professionals”). Effective from October 1, 2015,



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Designated Professional Services includes services related to the preparation of tax returns and refund claims when rendered by persons duly registered as “specialists” with Treasury.

Designated Professional Services also includes services rendered by Designated Professionals to other colleagues or Designated Professional Services’ firms, when the Designated Professional is hired as an independent contractor and not as an employee. In these cases, the Designated Professional who renders the service shall collect a 4% Special SUT for the services rendered to other colleagues or Designated Professional Services’ firm, unless said Designated Professional is exempt from collecting the SUT because it has an aggregate volume of business of \$50,000 or less.

Merchants that provide Designated Professional Services must update their Merchant’s Registration Certificate by September 30, 2015 following the guidelines established by Treasury in Tax Policy Circular Letter No. 15-12 (“CL 15-12”). You may access CL 15-12 (in Spanish) [here](#).

#### Services Rendered to other Merchants – Subject to 4% Special SUT

Services Rendered to other Merchants includes commissions generated by a merchant on a sale (regardless of whether the item sold is taxable or not). Note, however, that insurance commissions and commissions earned by an employee will be exempt from the 4% Special SUT.

Services rendered by subcontractors to contractors constitute a Service Rendered to other Merchant. Note that those services are currently exempt B2B Services as confirmed in Treasury’s Administrative Determination 15-09.

#### Exemptions

The following services are exempt from both the 11.5 Basic SUT and the 4% Special SUT:

- services provided to the Commonwealth of Puerto Rico or to the Government of the United States;
- real property leases that constitute the tenant’s primary residence, student housing or commercial lease;
- certain child and elder care services;
- funeral services up to \$4,000;
- export of services, even if the service is rendered in Puerto Rico;
- educational services, including childcare;
- interest and other charges for the use of money;
- insurance services and commissions;
- services rendered by a person whose annual volume of business does not exceed \$50,000;
- health or medical-hospital services;
- services rendered between members of a controlled group of corporations or related entities if both the entity that provides the service and the entity that receives the service, are engaged in a trade or for business or for the production of income in Puerto Rico;
- services rendered by the Puerto Rico Electric Power Authority and the Puerto Rico Aqueduct and Sewer Authority;
- services rendered to associations of residents or associations of condominiums or associations of property owners, including social interest residential housing projects that receive federal or state rental subsidies; and
- services rendered to housing cooperatives as organized under Act 239-

2004.

Every person claiming exemption shall complete and provide Treasury Form SC 2916 "Certificate for Exempt Purchases (Tangible Personal Property and Exempt Services)", to the merchant that rendered the service in order to document the exempt nature of the transaction.

## **Taxation of Services Rendered to other Merchants and Designated Professional Services**

### In general

Unless otherwise indicated in the Code, AD 15-17 or any subsequent Treasury publication, effective as of October 1, 2015, all B2B Services will be subject to the 4% Special SUT applicable to Services Rendered to other Merchants, provided that the services are rendered between merchants registered in Treasury's Merchants' Registry.

### Repair and Maintenance Services

Effective as of October 1, 2015, the following services which are currently exempt B2B Services when rendered between merchants registered in Treasury's Merchants' Registry, will be subject to the 4% Special SUT:

- repair and maintenance of automobiles, propellers, ATV vehicles, motorcycles, buses, trucks and heavy equipment;
- removal of machinery and equipment or other tangible personal property and the demolition of real property;
- computer software maintenance services, such as patches installation, upgrades, troubleshooting or a combination of such services;
- inspection and validation of machinery and equipment, elevators or fire systems; and
- capitalized repair services.

Non-capitalized repair services will be subject to the 11.5% Basic SUT. For these purposes, it is presumed that a repair service that does not exceed \$2,500 is a non-capitalized repair service.

The merchant receiving the services shall submit a written representation to the merchant providing the repair service stating that the service constitutes a capitalizable improvement and, therefore, is subject to the 4% Special SUT.

## **Collection, Remittance and Payment of the SUT**

### Services Rendered by a Non-Resident Person to a Person Located in Puerto Rico

When a non-resident person or a person not engaged in a trade or business in Puerto Rico ("Non-Resident") renders services subject to SUT to a resident of Puerto Rico, the person responsible for the payment of the SUT shall be the person receiving the service in Puerto Rico, even if the service is rendered outside of Puerto Rico. The applicable SUT rate will depend on the type of service received. Please note that the 1% municipal SUT is not imposed on services rendered outside of Puerto Rico.

The 10.5% SUT or the 4% Special SUT will apply only to services directly or indirectly related with operations or activities carried out in Puerto Rico. If the service provided by the Non-Resident is partially related to the operations or activities carried out in Puerto Rico by the person receiving the service, then the

service received by such person will be subject to SUT in the same proportion that such service is related to the operations or activities carried out in Puerto Rico by the person who received the service.

### Bundled Transactions

A bundled transaction is a transaction composed of two or more services, subject to different SUT rates, where: (1) one of the services is essential to provide the other service; (2) it is provided exclusively in relation with said service; and (3) the real object of the transaction is specifically the rendering of such service.

In these cases, the applicable SUT rate will be determined based on the service that is the real object of the transaction.

### Billing: Breakdown of Reimbursable Items and Expenses

Every service provider shall itemize in its invoice the different services rendered and the reimbursable expenses, as agreed with the customer. In the event that the reimbursable expenses are itemized in the invoice, the following expenses will not be subject to the 4% Special SUT:

- expenses incurred, including the SUT paid, in the purchase of tangible personal property used as part of the services rendered; and
- expenses directly allocated to the service, which are paid by the service provider and claimed to the customer as reimbursable expenses.

The following items will not be considered reimbursable expenses for purposes of determining the applicable SUT, and, therefore, will be subject to the corresponding SUT provided they are included in the invoice:

- additional charges that are not directly related to the service rendered, such as administrative costs, out of pocket expenses or administrative recovery fees that are not itemized in the invoice. In these cases, such expenses will be subject to the SUT at the same rate applicable to the principal service billed;
- expenses indirectly related to the service rendered, even if such expenses are itemized in the invoice;
- services rendered by employees,
- subcontracted services and services rendered by other merchants, whether or not they are subject to the 11.5% Basic SUT or the 4% Special SUT; and
- the 11.5% Basic SUT or 4% Special SUT paid on the subcontracted services or on services rendered by other merchants to expressly provide for tax pyramiding.

### Accounting Method

As an exception, effective as of October 1, 2015, merchants that provide Designated Professional Services may use the cash receipts accounting method to remit the corresponding SUT to Treasury. That is, merchants that provide Designated Professional Services may elect to remit the 4% Special SUT on the services provided in the month they receive the payment for such services, regardless of when it was invoiced and the accounting method used for purposes of determining their income for income tax purposes.

The Designated Professional who chooses to use the cash basis method of accounting for SUT purposes shall make such election in the Monthly Sales and Use Tax Return Applicable to Services Rendered to Other Merchants and Designated Professional Services (Form SC 2915 F) ("Special SUT Monthly

Return”), discussed below, for the month of October 2015, which shall be filed no later than November 20, 2015.

Treasury’s Administrative Determination No. 15-10, issued on June 24, 2015, provides, as a transitional measure, that Services Rendered to other Merchants and Designated Professional Services rendered prior to October 1, 2015, will not be subject to the 4% Special SUT, provided they are invoiced to the client no later than October 20, 2015. If the services are rendered after September 30, 2015, or if they are invoiced after October 20, 2015, even if they have been rendered prior to October 1, 2015, they will be subject to the 4% Special SUT.

### Special SUT Monthly Return

A new Special SUT Monthly Return is created for Designated Professional Services and/or Services Rendered to other Merchants.

The first Special SUT Monthly Return will be for the month of October 2015 and shall be filed electronically through Treasury’s Merchant’s Integrated Portal, no later than the 20th day of the month following the month in which the 4% Special SUT was collected, i.e., November 20, 2015.

### Publications Issued by Treasury Related to the Application of the SUT to Taxable Services Rendered to Merchants

Any publication issued by Treasury that provides that any service is exempt from the application of the SUT due to the applicability of the B2B Services exemption, will be deemed amended to provide that the 4% Special SUT is applicable as long as it is not inconsistent with the Code, AD 15-17, or other subsequent publications. You may access AD 15-17 (in Spanish) [here](#).

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