

Puerto Rico adopts VAT tax system and broadens sales and use tax

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In brief

On May 29, 2015, the Governor of Puerto Rico signed into Law House Bill 2482, known as Act 72. Effective July 1, 2015, Act 72 increases the sales and use tax (SUT) rate from 7% to 11.5%. Moreover, starting October 1, 2015, the SUT will have a broader base since certain services to other businesses and designated professional services will be subject to a 4% SUT. In addition, effective April 1, 2016, Act 72 establishes a Value Added Tax (VAT) regime.

In detail

Sales and Use Tax

Act 72 introduces various changes to the SUT and they will be implemented in two phases. The first phase is effective July 1, 2015, and the second phase is effective October 1, 2015. The SUT continues in effect up to March 31, 2016, after which it will be substituted by a Value Added Tax (VAT) pursuant to Act 72.

Changes effective July 1, 2015

The SUT rate increases from 7% to 11.5%, which consists of 10.5% imposed by the Puerto Rico Department of Treasury and 1% imposed by municipalities. The increased rate is applicable to taxable transactions (e.g., importing goods, selling goods, and rendering taxable services), which are defined consistently with current law.

Exempt transactions, such as business to business (B2B) services and designated professional services, remain exempt until September 30, 2015.

The SUT credit limitation of 75% is eliminated, resulting in a possible credit up to a 100% of SUT paid on taxable goods (not applicable to taxable services).

Changes effective October 1, 2015

The B2B exemption and designated professional services are considered taxable services subject to a SUT rate of 4% effective October 1, 2015.

The following services will continue to be exempt:

- interest and other charges for use of money
- services rendered by the Government of Puerto Rico

- education services
- insurance services
- health and hospital services
- related party services

Paying, collecting and remitting the SUT

Effective July 1, 2015, every person that receives a taxable service rendered by a nonresident will be responsible for remitting SUT directly to the Puerto Rico Department of Treasury.

Exclusion for preexisting contracts and auctions

Sales covered by preexisting contracts and auctions executed or granted prior to July 1, 2015, are subject to the SUT rate applicable as of June 30, 2015 (i.e., 7%). This tax rate will remain applicable to taxable transactions pursuant to the preexisting contract or auction

for the 12 months following July 1, 2015, or the term of the contract, whichever is shorter. The Secretary of the Treasury will issue guidelines for the implementation of this exclusion.

Value Added Tax

Effective April 1, 2016, Act 72 replaces the SUT with a Value Added Tax (VAT). Notwithstanding the above, Act 72 also authorizes a newly created commission to evaluate alternatives to the SUT and VAT systems.

Imposition

In general, the VAT will be imposed on taxable transactions currently subject to the SUT (including those new transactions subject to the SUT starting on October 1, 2015).

Taxable transactions subject to the VAT are defined as follows:

- the sale or transfer of goods and the rendering of services in Puerto Rico by a merchant (including business to business services - B2B)
- the rendering of services by a nonresident to a person in Puerto Rico
- bundled transactions.

The VAT rate will be 10.5% and the Municipal SUT (1%) will continue to apply. Nevertheless, the following transactions, even though not considered exempt transactions, will be subject to a 0% VAT rate:

- the sale of goods for export
- the rendering of services for export
- the sale of raw materials, articles and equipment acquired by a manufacturing plant holding an exemption certificate.

Notwithstanding the above, imports for which the Puerto Rico VAT has been collected by the seller won't be

subject to the subsequent payment of VAT by the purchaser. The Secretary is expected to release a publication establishing the process for automatic release of articles at the ports of entry.

VAT exemptions

In general, the following transactions are considered exempt under the new VAT system:

- rendering of certain financial services, except those that result in an imposition of bank charges
- sale and import of prescription drugs and articles for health conditions and treatments
- sale of articles and equipment to assist disabled persons
- sale of goods and services that qualify for reimbursement from Medicare, Medicaid and the health insurance plan of the Puerto Rico Government
- sale of goods and services to the US Government (including any state) and the Puerto Rico Government
- sale of gasoline, fuel and petroleum derivatives and other mix of hydrocarbon products subject to the excise tax
- rent of any property subject to the room occupancy tax imposed by the Puerto Rico Tourism Company
- sale of food and food ingredients
- sale of goods acquired using funds received from Food Stamps or the Special Supplemental Nutrition Program (PAN and WIC, respectively for their Spanish acronyms)
- sale of real property

- rent of real property used as primary residence, student housing or certain elderly homes
- rent of real property used for commercial purposes
- transfer of goods or services rendered by certain non for profit entities
- sale of machinery, medical-surgical material, articles, equipment and technology to (or by) certain hospitals
- agriculture articles sold to bona-fide farmers
- occasional sale of goods by Churches or religious organizations
- rendering of educational and child-care services
- sale of certain goods to merchants engaged in the tourism industry
- sale of printed books
- sale of vehicles, boats, and heavy equipment subject to an excise tax
- the rendering of health services to humans or animals
- the rendering of legal services under a contingency contract in judicial claims related to family cases, among others.

Responsible party for the payment and collection of VAT

Act 72 establishes that the persons responsible for the payment and collection of VAT are as follows:

- **Import transactions.** Person that imports the goods is responsible for payment.
- **Sale of goods.** The buyer is responsible for payment and the seller is responsible for collection and remittance.

- **Services rendered in Puerto Rico by merchant.** The person that receives the service is responsible for payment and the merchant-service provider is responsible for collection and remittance.
- **Services rendered by a nonresident.** The person in Puerto Rico that receives the service is responsible for payment.

Duly certified small merchants (those with less than \$125,000 of gross revenue) are exempt from collecting the VAT.

At the option of the purchasing merchant, the seller is required to issue a document (Fiscal Statement) to the purchaser indicating certain information with respect to taxable transactions within 30 days after the related taxable transaction. The Fiscal Statement is key to claiming credit for VAT paid on the acquisition of taxable items.

Timing for payment of VAT

- **Imports.** VAT on imports must be paid before taking possession of

the goods or merchandise, except when the items are imported by bonded merchants or when items are imported by air carriers, in which cases the VAT must be paid along with the filing of the monthly return on imports.

- **Sales or transfers of goods, rendering of services and bundled transactions.** VAT must be remitted to the Puerto Rico Department of Treasury by the due date of the Monthly VAT Return, which is on the 20th day of the month subsequent to the date on which the tax was imposed.

Credit for VAT paid

Every merchant, except small merchants, may claim a credit for the VAT paid through filing the VAT monthly return.

Overpayments

Merchants will be allowed to claim an overpayment amount up to \$10,000 per month in the VAT's monthly return in the month following the overpayment or any subsequent month, if there is an excess remaining.

Nevertheless, subject to certain restrictions, the merchant would be able to claim a refund for the overpayment amount in excess of \$10,000 in the same month it was generated, if the merchant is considered an eligible merchant, or it is the third consecutive month in which the monthly VAT return reflects an overpayment amount.

Technical amendments

The Puerto Rico Legislature is currently considering technical amendments to Act 72.

The takeaway

Companies transacting business in Puerto Rico should evaluate the impact to their businesses regarding: (1) sales and use tax changes effective on July 1, 2015; (2) sales and use tax changes effective on October 1, 2015; and (3) VAT implementation effective April 1, 2016.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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