



International Tax

Puerto Rico Tax Alert

12 June 2015

Tax reform enacted

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The governor of Puerto Rico enacted a law on 29 May 2015 (Puerto Rico House Bill No. 2482, enacted as Act 72 of 2015 (Act 72-2015)) that makes significant changes to the 2011 Internal Revenue Code. The amendments include certain income tax measures, an increase in the sales and use tax (SUT) rate and the introduction of a value added tax (VAT) regime, along with transitional measures that apply to the SUT. The following is a summary of the most relevant measures introduced by Act 72-2015. Unless otherwise noted, the new measures apply for taxable years beginning after 31 December 2014. The senate is expected to submit a bill with technical amendments in the near future that would clarify certain provisions.

Corporate income tax

In addition to the regular income tax, corporations are subject to the alternative minimum tax (AMT). The AMT is equal to the excess of the "tentative minimum tax" over the regular income tax. The tentative minimum tax is the higher of 30% of the alternative minimum net income, or the sum of the following items:

- 20% of amounts paid or incurred to a related party, or costs allocated from a head office to a Puerto Rico branch, if those expenses are not subject to Puerto Rico income tax or withholding tax in the year in which paid or incurred; and
- The amount resulting from applying the applicable rate to the value of purchases of personal property from related persons, or to the personal property transferred from a home office to a Puerto Rico branch. The reform increases the applicable rate from 2% to the following:

If the purchaser of personal property has gross receipts derived from the operation of a business or industry in Puerto Rico of:	Tax rate
At least USD 10 million, but less than USD 500 million	2.5%
At least USD 500 million, but less than USD 1.5 billion	3%
At least USD 1.5 billion, but less than USD 2 billion	3.5%
At least USD 2 billion, but less than USD 2.75 billion	4.5%
USD 2.75 billion or more	6.5%

Waivers related to the calculation of the tentative minimum tax that previously were granted by the Secretary of the Treasury remain effective for the taxable

years granted. However, the Secretary may not approve waivers for taxable years commencing after 31 December 2014.

AMT net operating losses (NOLs): The deduction for NOLs carried over from prior years is further limited from 80% to 70% of alternative minimum taxable income.

NOL deductions: The deduction for NOLs carried over from prior years is further limited from 90% to 80% of the net taxable income.

Payments made to nonresident related parties or costs allocated by a head office to a Puerto Rico branch that are not subject to Puerto Rico income tax may not be deducted in determining the NOLs.

The distributable share of NOLs of shareholders or partners in a corporation of individuals, special partnerships or partnerships that may be claimed against the distributable share of net income of other corporations of individuals, special partnerships or partnerships now is limited to 80% (previously 100% of the losses could be claimed) of the distributable share of net income.

Capital losses: Losses from the sale or exchange of capital assets may offset only 80% of the gains from the sale or exchange of capital assets (reduced from 90%).

Individual income tax

Regular income tax: Although the tax rates did not change, the tax brackets are modified and the net taxable income subject to each marginal tax rate is increased (e.g. the top marginal tax rate of 33% applies to income over USD 62,750, rather than income over USD 67,250). In addition, for net taxable income exceeding USD 500,000, the tax liability increases by 5% (but not to exceed USD 8,895), plus 33% of the personal and dependents exemption.

Special tax on self-employed individuals: The 2% special tax on self-employed individuals is repealed.

Capital losses: Losses from the sale or exchange of capital assets no longer are limited to offsetting a maximum of 90% of capital gains from the sale or exchange of capital assets; however, capital losses continue to be limited to the lesser of net taxable income or USD 1,000.

NOL carryovers: If an individual incurs NOLs from a trade or business for three consecutive tax years, the amount of NOLs that may be carried over from the third year is limited to 50% of the loss incurred in that year.

Charitable contributions: Charitable contributions to certain nonprofit organizations will be deductible only if the organization is qualified by the Secretary. To be qualified, the organization now must demonstrate that it renders services in Puerto Rico.

Other income tax measures

Nondeductible expenses: The 51% disallowance remains for payments made to a nonresident related party or costs allocated by a head office to a Puerto Rico branch, and taxpayers still may request a waiver of the disallowance from the

Secretary. If a waiver is granted, the deductible amount in calculating net taxable income is now limited to 60% of the total expenses for which the waiver was granted. The nonallowable portion is subject to the 20% AMT.

Partnerships, special partnerships and corporations of individuals may request a waiver of the 51% disallowance for payments made to a 50%-or-more partner or shareholder. If granted, the deductible amount is limited to 60% of the allowable expenses for which the waiver was granted.

Under a new measure, amounts paid for services rendered by a nonresident are not deductible if the Puerto Rico recipient has not paid SUT (or VAT, after 1 April 2016) on such services.

Additionally, depreciation expenses are not deductible if the SUT (or VAT, after 1 April 2016) has not been paid on the taxable goods.

Tax credit moratorium: The moratorium with respect to the use of certain tax credits is extended to 31 December 2017.

Large taxpayers: Taxpayers with a volume of business exceeding USD 50 million and that do business in certain sectors (commercial and private banks, trust companies, brokerage firms, insurance companies and telecommunications companies) are required to file their income tax returns at the tax office designated by the Secretary, or electronically in some cases. Failure to comply will result in the imposition of penalties.

Sales and use tax

The SUT will continue to apply until 31 March 2016; the new VAT will apply after that date. As from 1 July 2015, the SUT rate will increase from 7% to 10.5% (the municipal SUT will remain unchanged at 1%, for a total SUT of 11.5%).

The following services will be subject to the 10.5% SUT:

- Bank charges levied on business clients by financial institutions for the management of deposit accounts;
- Collection services;
- Security services, including armored services and private investigation services;
- Cleaning and laundry services;
- Repair and maintenance services;
- Telecommunications services;
- Waste disposal services; and
- Daily rentals of motor vehicles.

Sales of taxable items covered by contracts or bids executed before 1 July 2015 are subject to the 7% SUT with respect to taxable items acquired within 12 months or before the expiration of the contract, whichever comes first. If the contract involves taxable services, the payment must be made before 1 July 2015 for the 7% SUT rate to apply.

Services rendered by a merchant to another merchant or to a person engaged in a trade or business (B2B services) and designated professional services will be subject to a new 4% SUT that will apply during the period from 1 October 2015 to 31 March 2016. Designated professional services are services provided by architects, engineers, agronomists, certified public accountants and services

rendered by persons duly registered as “specialists” with the Puerto Rico Treasury Department, among others. The municipal SUT will not be imposed on services subject to the 4% SUT.

The following services are exempt from the SUT:

- Services rendered by the government (including sewage services);
- Education services (including tuition);
- Interest and other charges for the use of money, and service charges established by financial institutions;
- Insurance services and commissions;
- Health and hospital medical services;
- Services rendered by a person whose annual volume of business does not exceed USD 50,000; and
- Services rendered by members of a controlled group of corporations or related entities, provided the entities are engaged in a trade or business in Puerto Rico.

Where services are provided by a nonresident to a person in Puerto Rico, the recipient of the services is responsible for paying the SUT.

Value added tax

A VAT regime will apply as from 1 April 2016. VAT will be payable at a standard rate of 10.5% on the supply of taxable goods or services by a trader, the provision of services by a nonresident person to a person in Puerto Rico and combined transactions, and on imports.

The following supplies will be zero-rated:

- Sales of goods for export;
- Services for export;
- Sales of raw materials and equipment to be used by a manufacturing plant that holds a manufacturer’s exemption certificate.

The following supplies of goods and services will be exempt from VAT:

- Financial services, except those on which bank charges apply, and insurance services;
- Sales of prescription medicines;
- Sales of articles and equipment to assist with physical or physiological deficiencies;
- Sales or services that are paid or reimbursed by Medicare, Medicaid or Puerto Rico government health insurance;
- Sales of gas, aviation fuel, gas oil, diesel oil, crude oil, end products and derivatives from oil and other hydrocarbon mixtures to which excise tax applies;
- Sales of food and food ingredients;
- Sales of machinery, medical and surgical instruments, items, equipment and technology to a hospital unit for health services, provided the hospital unit holds a certificate for exempt purchases;
- Agriculture items imported or sold to bona fide farmers certified by the Department of Agriculture;
- Sales of goods to a merchant in the tourist business for use in the tourism sector;

- Sales of textbooks;
- Sales of vehicles, boats and heavy equipment subject to excise tax;
- Leases of property subject to the room occupancy tax set by the Tourism Company of Puerto Rico;
- Commercial leases and leases of real property that constitutes the principal residence of the lessor;
- Sales of real property;
- Intangibles;
- Goods introduced into a foreign trade zone;
- Money, stocks, bonds, notes and other securities and obligations;
- Educational and child care services;
- Health and hospital services;
- Services rendered by the government;
- Shipping services; and
- Services rendered by members of a controlled group of corporations or related entities, provided the entities are engaged in a trade or business in Puerto Rico.

VAT compliance

Payment: The purchaser will be responsible for the payment of VAT on the supply of goods or services by a Puerto Rico merchant; the supplier will be the withholding agent. Where services are provided by a nonresident, the recipient of the services will pay the VAT. The VAT on imports will be paid by the importer.

All merchants that sell goods or provide services will be required to collect the VAT as withholding agents, unless the purchaser is a merchant that holds a certificate of exempt purchases or a certificate for manufacturing plants.

Vouchers and invoices: Where supplies of goods or services are made by a VAT merchant to another VAT merchant, the purchaser will be able to request that the supplier issue a fiscal voucher within 30 days after receiving the goods or services. A fiscal voucher will not be required if the goods or services are zero rated or sold at retail.

A VAT merchant will be required to issue a debit note to a VAT merchant purchaser if there has been an increase in the value of the sale, and a credit note will have to be issued if there has been a decrease in the value of the sale.

On a retail sale, the VAT merchant will have to issue a receipt separately stating the sales price of the goods and/or services and the VAT.

Time of payment: VAT merchants will have to use the accounting method used for income tax purposes to pay the VAT; however, those providing designated professional services will be able to use the cash basis method. Not-for-profit organizations will have to use the accounting method followed for book purposes.

An accrual method VAT taxpayer will have to pay VAT at the earlier of the following events: issuance of the invoice; receipt of payment; or 30 days after delivery of the goods or completion of the services. When goods are imported into Puerto Rico, VAT will have to be paid at the time the goods enter Puerto Rico and before possession is taken (except for bonded merchants).

VAT returns and declarations: VAT merchants (except those holding a small business registration certificate) will be required to file a monthly VAT return and

pay the corresponding tax by the 20th day of the month following the month of the supply. The monthly VAT return will include total sales subject to VAT, allowable credits and deposits made.

A VAT taxpayer holding a small business registration certificate will be required to file a small business annual information declaration within 60 days of filing the income tax return, including extensions. The declaration will have to include the value of the sales of goods and services supplied during the taxable year.

A person will be required to file a declaration of imports when goods are introduced into Puerto Rico, and a monthly import return before the 10th day of the month following the month of import. (Bonded merchants will have to remit the VAT with this return.) Any outstanding tax resulting from a correction to the declaration of import, or from the introduction of goods by the postal service, electronic transmission or download, will have to be paid with this return.

Credits: A credit will be available for the VAT paid on the acquisition of goods and services that are attributable to taxable transactions (including zero-rated transactions). However, merchants engaged primarily in the supply of unprepared food; prescription drugs, medicines or articles for the treatment of health conditions; or motor vehicles will be able to claim a credit in their monthly return for the VAT paid or accrued on the acquisition of goods and services, up to the total amount of VAT paid or accrued during the month. "Primarily" for these purposes will mean that, during the three taxable years immediately before the current year, an average of 70% or more of the trader's retail sales are attributable to the sale of such goods.

If the VAT is indirectly related to the sale of taxable goods or services, an allocation will be made based on the ratio of taxable sales over total sales, applied to total taxable sales of goods and services, to determine the VAT attributable to the taxable sale of goods and services

A trader that receives services from a nonresident related entity will be allowed to claim a credit for consumption taxes paid in foreign countries. The credit will be able to be claimed against any tax due after the application of applicable adjustments and credits.

Overpayments and refunds: An overpayment of VAT will be calculated as the excess of the adjustments and credits over the VAT on the supply of goods and services made during a month. An overpayment not exceeding USD 10,000 will be carried over until exhausted, and offset against the VAT liability on the VAT returns for the following months. A merchant will be able to request a refund when the overpayment exceeds USD 10,000 and it holds an eligible merchant certificate, or there are three consecutive months of VAT overpayments. Refunds will not be granted for VAT paid by a merchant for services rendered to a person within the same controlled group of corporations or group of related entities if the recipient mainly is engaged in exempt transactions.

VAT registration: Any person doing business in Puerto Rico will be required to register with the merchant registry and obtain a merchant registration certificate. Merchants that are members of a controlled group of corporations or a group of related entities will be permitted to elect to be treated as a single merchant.

A merchant that generates less than USD 125,000 in gross sales during the preceding taxable year will be considered a small merchant. Small merchants are not withholding agents and, thus, will not be required to collect and remit VAT.

Miscellaneous

- A manufacturing plant exemption certificate will allow manufacturers to acquire and import goods used for the manufacturing process at a zero rate.
- An exempt purchase certificate will allow the US government and the Commonwealth of Puerto Rico, hospital units, tourism businesses and bona fide farmers to acquire and import goods and services exempt from VAT.
- A merchant will be considered an “eligible merchant” if its sales exceed USD 500,000 for the three years immediately preceding the date of the certificate request, and 80% of its total sales are subject to a zero rate.

Transitional rules

- Bonds issued for SUT purposes will continue to be valid for VAT purposes, until their expiration dates.
- SUT credits available as of 31 March 2016 may be claimed as credits against VAT. Credits cannot be refunded.
- Tax rulings and closing agreements issued pursuant to SUT provisions of the 2011 Internal Revenue Code or the Puerto Rico Internal Revenue Code of 1994 will continue to be valid for VAT purposes, as long as the VAT provisions are similar to the SUT provisions and the Secretary issues an official acknowledgement indicating the validity of such ruling or agreement for VAT purposes.

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