

October 13, 2015

Tax Update

Amendments to the Puerto Rico Internal Revenue Code of 2011 Introduced by Act 159-2015

Act 159-2015 (“Act 159”) became law on September 30, 2015. Act 159, which includes technical amendments to the Puerto Rico Internal Revenue Code of 2011, as amended (the “Code”), also introduces substantive changes to the Code, principally in connection with the sales and use tax provisions (the “SUT”) effective on October 1, 2015. Below is a summary of the most important changes.

Income Taxes

Related-Party Charges

Act 159 clarifies that waivers to exclude payments to a related party or costs allocated from a “home office” to the Puerto Rico branch (“Related-Party Charges”) from the Alternative Minimum Tax computation must be submitted during the first taxable year for which the exclusion will apply and only for a 3-year period after which the taxpayer may submit another request. In addition, entities subject to the provisions of Act 55-1933 (Banks Law) and those organized or authorized under the National Bank Law will be eligible to obtain a waiver covering 100% of their Related-Party Charges.

Special Tax on Dividend Distributions and Deemed Dividends

Similar to the amnesty provisions that were in effect up to June 30, 2015, any dividend distribution made during the period of October 1 through December 31, 2015 will be subject to a special tax of 8% on the total amount received by the shareholder. Any corporation may designate as a deemed dividend any amount up to its total accumulated earnings and profits and prepay the special tax during the same period and subject to the same reduced tax rates as actual dividend distributions made. Entities subject to the tentative minimum tax personal property component provisions are not eligible to benefit from the foregoing provisions.

Accounting Method for Construction Contracts

Act 159 amends Section 1040.06 of the Code to provide that entities engaged in real estate development will be treated as having income derived from long-term contracts and will be allowed to determine their income based on the percentage-of-completion method or any other method authorized by the Secretary of the Treasury (“Secretary”) through regulations, circular letters or administrative determination.

On September 24, 2015, the Puerto Rico Department of the Treasury issued [Administrative Determination No. 15-19](#) indicating that entities engaged in real estate development that on the effective date of the Code use different long-term



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contract accounting methods for financial reporting and tax purposes, can continue to do so only with respect to projects in construction as of the last day of taxable year 2015. Regarding projects commencing construction during taxable year 2016 and subsequent taxable years, the long-term contract accounting method used for tax purposes must be the same as that used for financial reporting purposes or any other method authorized by the Secretary through regulations, circular letters or administrative determinations.

New Puerto Rico TV Programming Credit

Act 159 adds Section 1051.14 to the Code to create an income tax credit for the purchase or transmission of television programming undertaken in Puerto Rico. The credit is available to any channel that purchases or transmits programming undertaken in Puerto Rico by independent producers employing at least 90% of Puerto Rico resident artists. The credit will be for 15% of the expenses incurred by the channel in the acquisition of such programming for the taxable year in which it is claimed.

Additional Supplemental Information to Income Tax Return

Act 159 amends Section 1061.15 of the Code to provide that the supplemental information required pursuant to Act 163-2013 shall establish the following:

- Regarding merchants that are withholding agents and report exempt sales either in the regular Monthly Sales and Use Tax Return (Form SC 2915 A) or the new Monthly Sales and Use Tax Return Applicable to Services Rendered to Other Merchants and Designated Professional Services (Form SC 2915 F), that such exempt sales have been properly claimed; and
- Regarding merchants that report auto-consumption in their Monthly Sales and Use Tax Return (Form SC 2915 A), that such auto-consumption has been properly declared and paid.

Non-Profits

Act 159 amends Sections 1101.01 and 1102.06 of the Code to impose additional requirements on non-profit entities seeking income tax exemption. As amended, the Code specifically provides that an entity will not be exempt from income taxation unless it demonstrates to the satisfaction of the Secretary that it serves a public interest. In this context, a rebuttable presumption that the entity serves a private interest is established.

The amendments introduced by Act 159 also add as a reason for revoking a non-profit's income tax exemption the fact that the entity incurs in the following type of expenses: extravagant, not clearly related to the exempt purposes of the organization, those that represent a for-profit motive by directors, officials and employees and those related to their personal expenses. Incurring in those types of expenses is also specifically classified as a prohibited transaction.

Limitations on Scope of Closing Agreements

Act 159 amends Section 6051.07 of the Code to provide that the Secretary is prohibited from agreeing to any of the following in a closing agreement:

1. accept, after June 30, 2016, payment for future taxes that are not owed by the taxpayer at the time of execution of the closing agreement;
2. apply preferential rates or rates lower than those established in the Code or

any applicable special legislation to a transaction covered by a closing agreement;

3. apply deductions or credits that are not allowed by the Code or any applicable special legislation;
4. classify as an overpayment or apply as an overpayment an amount that does not consist of taxes previously paid;
5. extend statutes of limitations, except as permitted in the Code;
6. waive interest or surcharges, except as permitted in the Code;
7. modify the tax basis or amount of gain derived in the sale of assets in a manner contrary to what is established in the Code;
8. exempt from the requirement to file tax returns, unless the return forms part of and is included with, the closing agreement; or
9. execute agreements covering areas or matters for which he or she is not expressly authorized to exercise his or her discretion.

Payment Options Required to be Provided by Licensed Professionals and Corporations

As indicated in our Legal Update of April 14, 2015, Act 42-2015 (“Act 42”) was enacted to require any natural or juridical person that provides services for which a license or legal authorization is required to provide its clients with at least 2 options of payment. Among the payment options contemplated by Act 42 are credit or debit cards, cash, checks, certified checks, money orders, electronic transfer of funds, internet payments and direct payments.

Act 159 amends Act 42 to require that at least one of the 2 payment options provided be credit or debit cards, electronic transfer of funds, internet payments or direct payments.

Sales and Use Tax

Pursuant to Act 159, for taxable events occurred after October 1, 2015, persons located in Puerto Rico receiving services from non-resident persons, regardless of the location where the service is rendered, are responsible for the payment of the applicable SUT, to the extent that such service is directly or indirectly related to the operations or services carried out in Puerto Rico by the recipient of the service. The municipal portion of the SUT, however, will not apply.

Act 159 also amends the definition of the terms designated professional services, taxable services and services rendered to other merchants to exclude certain services from the tax. Please note that [Administrative Determination No. 15-21](#) of October 5, 2015 further provides guidance and restrictions in connection with exempted services, which have been taken into consideration below.

In connection with *designated professional services*, exclusions include the following services, subject to certain limitations:

1. Services rendered by a person with an annual volume of business that does not exceed \$50,000;
2. Certain legal services (mainly litigation and notarial work), except those services that can be provided by other professionals (i.e. business

- consulting, human resources consulting, tax consulting, lobbying and procurement services);
3. Services rendered between merchants in Puerto Rico that are part of a same controlled group of corporations or a related group of entities;
 4. Services rendered by a merchant outside Puerto Rico to a tax exempt entity under Act 73-2008, Act 83-2010, Act 20-2012, Act 55 -1933 (Banks Law) or the National Bank Law (including predecessor and successor laws), provided that both the provider and recipient of the service are part of a controlled group of corporations or a related group of entities;
 5. Services rendered to homeowners' associations, councils of unit owners or proprietary associations and certain housing unions, provided that at least 85% of its units are used for residential purposes;
 6. Services provided to certain social interest housing projects;
 7. Services rendered to an entity with a tax grant under Act 73-2008 (or predecessor or successor law) that is engaged in the repair, maintenance and commissioning of airships;
 8. Services rendered to a person exclusively engaged in the storage (including leasing of tanks) or processing of gasoline, jet fuel, aviation fuel, gas oil, diesel oil, crude oil, unfinished oils and end products derived from oil and other hydrocarbons mixture, provided that the storage and handling of the fuel is undertaken in a Foreign Trade Zone;
 9. Services rendered to bona fide farmers;
 10. Services rendered to certain workers' unions and
 11. Services rendered to any public or private entity whose organic law exempts it from all taxes.

The definition of the term *taxable services* is also amended to further exclude the following services, subject to certain limitations:

1. Services rendered to homeowners' associations, councils of unit owners or proprietary associations and certain housing unions, provided that at least 85% of its units are used for residential purposes;
2. Services provided to certain social interest housing projects;
3. Services rendered by a merchant outside Puerto Rico to a tax exempt entity under Act 73-2008, Act 83-2010, Act 20-2012, Act 55 -1933 (Banks Law) or the National Bank Law (including predecessor and successor laws), provided that both the provider and recipient of the service are part of a controlled group of corporations or a related group of entities;
4. Right to use intangibles;
5. Production services, rendered by any producer of commercials or radio and television programs;
6. Publicity and promotions services and advertising space in any media, including commissions and fees on such services, as well as payments for the production of content of electronic and digital media in Puerto Rico;
7. Subcontracted services rendered in connection with construction projects and telecommunication services;
8. Services directly rendered to a merchant by employees of an employment agency;
9. Airships repair, maintenance and commissioning services rendered by an entity with a tax grant under Act 73-2008 (or predecessor or successor law) ;
10. Toll manufacturing and contract manufacturing services;
11. Services rendered to an entity with a tax grant under Act 73-2008 (or predecessor or successor law) that is engaged in the repair, maintenance and commissioning of airships;
12. Services rendered to a person exclusively engaged in the storage (including leasing of tanks) or processing of gasoline, jet fuel, aviation fuel, gas oil, diesel oil, crude oil, unfinished oils and end products derived from

- oil and other hydrocarbons mixture, provided that the storage and handling of the fuel is done in a Foreign Trade Zone;
13. Maritime, air and land transportation services;
 14. Services rendered to bona fide farmers and
 15. Services rendered to any public or private entity whose organic law exempts it from all taxes.

Finally, the definition of the term *services rendered to other merchants* is also amended to further exclude the following services, subject to certain limitations:

1. Services rendered to homeowners' associations, councils of unit owners or proprietary associations and certain housing unions, provided that at least 85% of its units are used for residential purposes;
2. Services provided to certain social interest housing projects;
3. Production services, rendered by any producer of commercials or radio and television programs;
4. Right to use intangibles;
5. Publicity and promotions services and advertising space in any media, including commissions and fees on such services, as well as payments for the production of content of electronic and digital media in Puerto Rico;
6. Subcontracted services rendered in connection with construction projects and telecommunication services;
7. Services directly rendered to a merchant by employees of an employment agency;
8. Services rendered between merchants in Puerto Rico that are part of a same controlled group of corporations or a related group of entities;
9. Services rendered by a merchant outside Puerto Rico to a tax exempt entity under Act 73-2008, Act 83-2010, Act 20-2012, Act 55-1933 (Banks Law) or the National Bank Law (including predecessor and successor laws), provided that both the provider and recipient of the service are part of a controlled group of corporations or a related group of entities;
10. Airships repair, maintenance and commissioning services rendered by an entity with a tax grant under Act 73-2008 (or predecessor or successor law);
11. Toll manufacturing and contract manufacturing services;
12. Services rendered to an entity with a tax grant under Act 73-2008 (or predecessor or successor law) that is engaged in the repair, maintenance and commissioning of airships;
13. Maritime, air and land transportation services;
14. Services rendered to a person exclusively engaged in the storage (including leasing of tanks) or processing of gasoline, jet fuel, aviation fuel, gas oil, diesel oil, crude oil, unfinished oils and end products derived from oil and other hydrocarbons mixture, provided that the storage and handling of the fuel is done in a Foreign Trade Zone;
15. Services rendered to bona fide farmers and
16. Services rendered to any public or private entity whose organic law exempts it from all taxes.

Value Added Tax

Act 159 amended certain provisions of Subtitle DD of the Code which contains the value added tax ("VAT") provisions currently scheduled to become effective on April 1, 2016. Among other amendments, Act 159 added certain additional exclusions from the term services, including the following:

1. The right to use intangibles;
2. Services rendered by a merchant outside Puerto Rico to a tax exempt entity under Act 73-2008, Act 83-2010, Act 20-2012, Act 55 of May 12, 1933

(Banks Law) or the National Bank Law (including predecessor and successor laws), provided that both the provider and recipient of the service are part of a controlled group of corporations or a related group of entities and

3. Services rendered to any public or private entity whose organic law exempts it from all taxes.

In addition, Act 159 includes the following additional exemptions from the VAT, subject to certain limitations:

1. The sale of articles and services to bona fide farmers;
2. Certain legal services (mainly litigation and notarial work), except those services that can be provided by other professionals (i.e. business consulting, human resources consulting, tax consulting, lobbying and procurement services);
3. Services rendered to homeowners' associations, councils of unit owners or proprietary associations and certain housing unions, provided that at least 85% of its units are used for residential purposes;
4. Services provided to certain social interest housing projects;
5. The retail sale of electric power equipment;
6. Airships repair, maintenance and commissioning services rendered by an entity with a tax grant under Act 73-2008 (or predecessor or successor law);
7. Toll manufacturing and contract manufacturing services;
8. Maintenance fees paid under timeshare or vacation club ownership plans;
9. Services rendered to a person exclusively engaged in the storage (including leasing of tanks) or processing of gasoline, jet fuel, aviation fuel, gas oil, diesel oil, crude oil, unfinished oils and end products derived from oil and other hydrocarbons mixture, provided that the storage and handling of the fuel is done in a Foreign Trade Zone;
10. Services rendered to a merchant engaged in the generation and sale of electric power on a commercial scale;
11. Services rendered to an entity with a tax grant under Act 73-2008 (or predecessor or successor law) that is engaged in the repair, maintenance and commissioning of airships and
12. Services rendered to any public or private entity whose organic law exempts it from all taxes.

Act 159 also adds to the Code a new section of administrative fines and penalties in connection with noncompliance with the VAT provisions.

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