

# Value Added Tax Proposal

## TAX ALERT

February 2015

On February 11, 2015, the Puerto Rico House of Representatives filed House Bill No. 2329 (the "Bill") which proposes to enact a new Internal Revenue Code of 2015 and provides transitory provisions to repeal the Internal Revenue Code of 2011, as amended (the "2011 Code"). The Bill is an administration bill and it is expected to be seriously considered for approval. Among other things, the Bill proposes to substitute the current sales and use tax system for a value added tax system. Below is a summary of the value added tax provisions included in the Bill. A summary of the income tax provisions under the proposed new Internal Revenue Code of 2015 will be addressed in a separate newsletter.

### Transitional Rules

From **April 1, 2015 through December 31, 2015**, the sales and use tax provisions under the 2011 Code will remain effective, except that:

- A tax of **16%** will apply on the sale and use of taxable items, as defined under the 2011 Code;
- The municipal sales and use tax portion will be eliminated;
- The term "sales tax" and "use tax" will be substituted by "value added tax";
- The credit available to resellers with Reseller's Certificate for the tax paid on purchases of merchandise for resale can be claimed up to a 100% of the tax liability for a period (instead of being limited to a 75% of the liability for such period); and,
- The following exemptions will be eliminated: funeral services; uniforms, materials and text books; and the exemption on solar energy equipments.

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*The rate of sales and use tax under the 2011 Code is proposed to increase from 7% to 16% effective on April 1, 2015.*

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*The sales and use tax reseller's credit will increase from 75% to 100% of the tax liability effective April 1, 2015 through December 31, 2015.*

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- In retail sales, the receipts, invoices or any other evidence of the sale, must show the sales price of the good or service together with its corresponding tax (and not segregated). This requirement will apply 30 days from the approval of the Bill.
- Certain transitional rules will apply to goods and services contracts and bids executed or awarded prior to April 1, 2015.

### *Value Added Tax General Rate*

**After December 31, 2015**, the provisions of the value added tax ("VAT") under the proposed Internal Revenue Code of 2015 will apply.

- In general, a VAT of **16%** will apply to the value of taxable transactions. A "taxable transaction" includes the following:
  - The introduction or importation of goods to Puerto Rico, with certain exceptions (e.g., goods introduced into a Foreign Trade Zone);
  - The sale or transfer of goods and the performance of services in Puerto Rico by a merchant in exchange for value or consideration;
  - The performance of a service by a nonresident person to a person in Puerto Rico which will be considered rendered in Puerto Rico by the person receiving such service; or,
  - A combined transaction.

### *Zero Rated Transactions*

- The following taxable transactions will be subject to a VAT of **zero rate (0%)**:
  - The sale of goods for exportation
  - Exports of services; except services related to activities in Puerto Rico and to the advice, counsel, or lobbying regarding Puerto Rico laws and regulations, among other exceptions; and
  - The importations of items to be used in manufacturing (raw materials and machinery and equipment) by a Manufacturing Plant that possesses a Certificate of Exemption on Importations for Eligible Manufacturing Plants.

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*The value added tax of 16% under the proposed new Internal Revenue Code of 2015 will commence on January 1, 2016.*

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### Exemptions

- The following taxable transactions will be **exempt** from VAT:
  - The rendering of financial services by financial businesses, including insurance companies, except bank charges;
  - The sale and importation of prescription-only medicines and items for treatment of health conditions;
  - The sale of equipment and items that make up for physical or physiological deficiencies to persons with disabilities;
  - The sale of any good or service paid by Medicare, Medicaid, and the health insurance card of the Government of Puerto Rico;
  - Sale of goods and services to the Government of the US, any of the States, the District of Columbia, and Puerto Rico;
  - The sale and importation of gasoline, aviation fuel, gas oil or diesel oil, crude oil, unfinished oils and end products derived from oil, and any other hydrocarbons mixture, except propane gas and its derivatives or gases of similar nature;
  - The rent or lease of property subject to the room tax imposed by the Puerto Rico Tourism Company.
  - The sale and importation of food and food ingredients;
  - Purchases with Nutritional Assistance Program (PAN) and WIC funds;
  - Sale of real property;
  - Lease of real property which constitutes the principal residence of the lessee or student or seniors citizen's lodging;
  - The transfer of goods and services rendered by non-profit entities without exchange for value or consideration;
  - The sale of machinery, medical-surgical material, articles, equipment and technology to, and the importation of such goods to be used exclusively for the performance of healthcare services for humans by, a Hospital Unit that possesses a Certificate of Exempt Purchases; with certain exceptions;
  - Sale of goods to, and the importation of goods by, a merchant in a tourism business that possess a Certificate of Exempt Purchases, with certain exceptions;
  - The sale and importation of items for farming to bonafide farmers;
  - The occasional sale by churches and religious organizations; and,
  - The sale and importation of motor vehicles.

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*No credit will be available for the VAT paid on inputs directly or indirectly related to the sale of exempt goods or services.*

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- The Bill does not provide an exemption from VAT for commercial rent, occasional sales or sales of all the assets of the trade or business.

### *Collection and Filing of Returns*

- The person responsible for the payment of the VAT will be:
  - The importer in the case of importation of goods;
  - The purchaser in the case of the sale or transfer of goods and services; except in the case of retail sales; and,
  - The recipient of a service in the case when such service is performed by a nonresident person to a person in Puerto Rico.
- As for the collection, filing of returns, and payment of the VAT:
  - Every merchant that sells a good or renders a service subject to VAT will have the obligation to collect the VAT, except for small merchants with a Small Merchant's Registration Certificate.
    - "Small merchants" are merchants with a gross volume of sales of less than \$75,000 in the immediately prior year. A small merchant with a Small Merchant's Registration Certificate will be required to file a Small Merchants Annual Informative Declaration which is going to be due 60 days after filing the income tax return, including extensions.
  - The filing of the *Declaration of Imports* and the *Tax on Imports Monthly Return*, and the payment rules will be the same as under the sales and use tax provisions of the 2011 Code, including the provisions for Bonded Merchants. The importation will not be subject to VAT if the seller collected the VAT in the sale.
  - There will be a *VAT Monthly Return*, which will have the same filing and payment rules as under the sales and use tax provisions of the 2011 Code, except that a small merchant with a Small Merchant's Registration Certificate will not be required to file this return.

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*The performance of a taxable service by a nonresident person to a person in Puerto Rico will be subject to the payment of VAT by the person receiving such service*

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### *VAT Credit Mechanism*

- A mechanism will be available for merchants to claim a credit for the amount of VAT paid on the purchases of goods and services ("inputs") which are directly or indirectly related to the sale of goods

or services taxable at 16% or at zero rate. No credit will be available for the VAT paid on inputs directly or indirectly related to the sale of exempt goods or services. There are apportionment rules to determine the credit to be claimed on indirect inputs when the merchant has taxable (16% or 0%) and exempt sales.

- In the case of overpayments of more than \$10,000 for a certain period generated due to VAT credits and adjustments claimed, a refund can be requested in the same period such overpayment is generated if merchant is an Eligible Merchant. Said refund must be approved or denied within 30 days and disbursed within 5 days of approval.
  - An Eligible Merchant is defined as a merchant with a volume of sales of more than \$500,000 annually in the three (3) immediately prior years and 80% of his total sales are zero rated (0%).
- As for a non-Eligible Merchant with an overpayment of more than \$10,000 for a certain period, such merchant has to have three (3) consecutive months with overpayments in order to request a refund.
- The VAT paid by a nonresident individual will be refunded if certain requirements are met.

### *Certificates of Registration and Exemption*

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*A Certificate of Exempt Purchases will be issued only to “eligible persons” to be able to acquire or import goods and services exempt from VAT.*

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- The following certificates will be available:
  - *Merchant’s Registration Certificate*: Will have the same rules as under the sales and use tax provisions of the 2011 Code, except for small merchants which will have a *Small Merchant’s Registration Certificate*;
  - *Certificate of Exemption on Importations for Eligible Manufacturing Plants*: Will be required in order to claim the zero rate on the importations of items for manufacturing.
  - *Certificate of Exempt Purchases*: Will be issued only to “eligible persons” to be able to acquire or import goods and services exempt from VAT. Eligible persons that can request this certificate will be: the Government of the US, any of the States, the District of Columbia, and Puerto Rico; any hospital unit; any tourism business; and bonafide farmers.
  - *Certificate of Eligible Merchant*: Will be necessary to be able to claim a refund for an overpayment of more than \$10,000 in the same period it was generated.

**Regressivity Relief**

- The Bill includes a regressivity relief mechanism consisting of periodic payments to be made by the Secretary of the Treasury Department to certain consumers that meet certain eligibility requirements to be determined.

The Bill is currently under evaluation and may be subject to changes during the legislative process.



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