

September 13, 2013 [www.mcvpr.com](http://www.mcvpr.com)**TAX ALERT*****Application of the Sales and Use Tax to Certain Services***

Act 40-2013 ("Act 40") amended the Puerto Rico Internal Revenue Code of 2011 (the "Code") to exclude various services from the sales and use tax ("SUT") business-to-business exemption. Consequently, as of July 1, 2013, such services are subject to the SUT, unless otherwise covered by another SUT exemption.

**A. Business-to-Business Exemption**

On July 2, 2013, the Puerto Rico Treasury Department ("Treasury") issued Internal Revenue Circular Letter No. 13-04 ("CL 13-04") to expand on the scope of the business-to-business services exemption as a result of the amendment to Section 4010.01(nn) of the Code. In CL 13-04, Treasury indicates that the following services will not be exempt under the business to business exemption:

1. Bank charges
2. Collection services
3. Security services
4. Cleaning services
5. Laundry services
6. Real and personal tangible property repair and maintenance services (non-capitalized)
7. Telecommunication services
8. Waste management services

If the service rendered by one merchant to another is not one of the services listed in items No. 1 through No. 8 above, the service will continue to be exempt from the SUT under the business-to-business services exemption.

1. Merchants with Annual Volume of Business not exceeding \$50,000

Services provided by merchants with an annual volume of business not exceeding \$50,000 are exempt from SUT. On July 23, 2013, Treasury issued Internal Revenue Circular Letter No. 13-09 to ("CL 13-09") to clarify the scope of the SUT exemption on services provided by these merchants and establish that even if services are rendered between businesses and listed in items No. 1 through No. 8 above, they will be exempt if rendered by merchants with an annual volume of business not exceeding \$50,000.

CL 13-09 further provides that a merchant acquiring repair services that are related to its business exempt under Section 4010.01(nn)(2)(H) of the Code (*i.e.*, acquired from a merchant which annual volume of business does not exceed \$50,000), will not be required to remit the SUT on such services to Treasury. Such merchants will have to remit the SUT (as use tax, see Section A.2. below) on such repair services, if rendered by a merchant with a volume of business exceeding \$50,000.

## 2. SUT on Repair and Maintenance Services

On August 20, 2013, Treasury issued Internal Revenue Circular Letter No. 13-13 to (“CL 13-13”) to: (1) define and clarify which services are considered repair and maintenance services for SUT purposes; (2) inform the services that will be subject to use tax (instead of sales tax) by the merchant receiving the services; (3) clarify the application of the SUT business-to-business exemption with respect to non-capitalized repair services; and (4) clarify the SUT impact on subcontracted repair and maintenance services.

### a. Non-Capitalized Repair Services

Non-capitalized repair and maintenance services on tangible personal property or real property as defined in Sections 4010.01(gg) and (hh) of the Code, respectively (“Property”), will be subject to the SUT. CL 13-13 clarifies that capitalized maintenance and repair services on Property refer to services that are accounted as an improvement on Property and eventually subject to depreciation.

### b. Repair vs Maintenance Services

CL 13-13 defines “repair” as the action or result of fixing a thing, object, apparatus or any other material artifact, but limited to Property.

Removal of machinery and equipment or other tangible personal property and the demolition of real property, will not be deemed repair services for SUT purposes.

CL 13-13 defines “maintenance” as the operations and care necessary for the adequate functioning of a thing, object, apparatus or any other material artifact, but limited to Property. As provided in CL 13-13, the following services will be considered cleaning services rather than maintenance services for SUT purposes: (1) landscaping, golf courses and other green areas conservation services; and (2) pool, jacuzzi, whirlpool or hot tub maintenance services.

Treasury also determined that computer software maintenance services, such as patches installation, upgrades, troubleshooting or a combination of such services and validation and inspection of machinery, equipment, elevators or fire systems, will not be considered maintenance services for SUT purposes. Consequently, such services should still eligible for the business-to-business exemption.

Treasury further determined that repair and maintenance services with respect to vehicles and vessels as defined in Section 3020.08 and 3020.09 of the Code, respectively, will be exempt from the SUT.

### c. SUT Payment Obligation on Repair Services

As mentioned above, Act 40 amended Section 4020.05 of the Code to, effective July 1, 2013, relieve merchants providing **repair** services from collecting the SUT when such services are rendered to a registered merchant and the service is related to such merchant's business. In response to doubts as to whether such treatment applied to **maintenance** services as well, CL 13-13 clarifies that it applies solely with respect to repair services. Merchants providing maintenance services will have to collect, deduct and withhold the SUT on such services.

As to the filing obligation of merchants providing repair services, which SUT must be remitted to Treasury by the merchant to whom the service is being rendered, CL 13-13 indicates that such services must be reported as exempt services in the Monthly Sales and Use Tax Return, Form AS 2915.1, by the merchant providing the same. As to the merchant to whom the services are being rendered, the SUT to be paid to Treasury must be reported as an item subject to use tax in the Monthly Sales and Use Tax Return, Form AS 2915.1.

CL 13-13 further indicates that when a person receives an invoice for repair services in which there is no breakdown between the cost of the services and the cost of the parts used providing the services (if any), such person shall pay the SUT (as use tax) on the total amount invoiced. If, on the other hand, the invoice separately states the cost of the service and the cost of the parts used in rendering the service, the SUT will be due (to be paid by the merchant acquiring the repair service as use tax) only with respect to the amount invoiced for the services.

d. SUT on Repair Services Provided by a Subcontractor

CL 13-13 determines that when a merchant enters into a contract with another merchant ("Contractor") to receive a repair or maintenance service and such service is provided by a subcontractor of the Contractor, the SUT will be paid by the merchant to whom the service is ultimately rendered. The services rendered by the subcontractor to the Contractor will be exempt from the SUT under the business-to-business exemption, if the procedure to document such a transaction is followed.

3. SUT on Waste Management Services

On August 20, 2013, Treasury issued Internal Revenue Administrative Determination No. 13-13 ("AD 13-13") to indicate that, for SUT purposes, the term "waste management services" includes:

- a. Rental of containers or any other object in which waste is stored for recycling or disposal
  
  
  
  
  
  
  
  
  
  
- b. Collection, transportation, disposal and shredding of waste, including:
  - i. solid
  - ii. liquid
  - iii. bio-medic

- iv. industrial
  - v. toxic
  - vi. recycling materials such as metal, aluminum, crystal, paper and carton, among others.
- c. Administrative charges in connection with waste collection and disposal services; and
- d. Any combination of the above.

AD 13-13 further determines that (i) service charges from dumping sites or (ii) any other service that is not a waste collection service listed on items No. 1 through No. 4 above, including materials necessary to provide the applicable service, will not be subject to the SUT if they are properly identified in the invoice issued by the service provider.

#### **B. SUT on Services Generally**

On August 22, 2013, Treasury issued Internal Revenue Circular Letter No. 13-14 to (“CL 13-14”) to clarify the SUT treatment on services provided by one merchant to another merchant and services provided to persons that are not merchants.

All services are taxable for SUT purposes, unless otherwise specifically exempt. Per CL13-14, the following services are always exempt:

1. designated professional services: agronomists, architects and landscape architects, CPA’s, brokers, realtors and real estate companies, lawyers, professional draftsmen, real estate appraisers, geologists, engineers and surveyors;
2. interest and other charges for the use of the money (except charges for commercial accounts);
3. health and hospital services (veterinary services are included);
4. services rendered by the Commonwealth of Puerto Rico;
5. education, including tuition costs;
6. insurance services and commissions;
7. services rendered by a tax specialist for the preparation of state and federal tax returns only;
8. services rendered by persons with annual business volume not exceeding \$50,000;
9. Funeral services up to \$4,000;
10. Daycare centers licensed by the Department of the Family but limited to the basic tuition and monthly charges; and
11. Real property rental if the property constitutes the tenant’s principal residence or the property is leased for commercial purposes or student lodging.

CL 13-14 emphasizes the following differences in the SUT treatment of services rendered to merchants and persons that are not merchants:

1. Automobile repair and maintenance services are taxable to non-merchants, but exempt when rendered to a merchant;
2. Bank charges are not taxable to non-merchants, but bank charges for the management of merchants’ demand accounts and other deposit accounts are taxable; and
3. Daily rental of a motor vehicle is a taxable service to non-merchants, but exempt for merchants.

#### **C. SUT on Services Acquired by Entities under Tax Incentives Acts**

On August 27, 2013, Treasury issued Internal Revenue Circular Letter No. 13-16 (“CL 13-16”) to clarify that all merchants, including entities covered under a tax incentives grant under any of the special acts listed in CL 13-06 (“Special Acts”), will be subject to the SUT on the services acquired that are not covered under the business-to-business exemption.

The Special Acts include Act 73-2008, also known as the “Puerto Rico Economic Development Incentives Act,” Act 74-2010, also known as the Puerto Rico Tourism Development Act of 2010” and Act 83-2010, also known as the “Puerto Rico Green Energy Incentives Act,” among others.

With the exception of Act No. 135 of May 9, 1945, also known as the “Air Transport Act” (“Act 135”), none of the Special Acts provide a SUT exemption with respect to services acquired by the entity which operations are covered thereunder. Rather, and if the Special Act so provides, a SUT exemption is available with respect to certain tangible personal property specifically listed in the relevant act.

CL 13-06 further clarifies that entities engaged in air transport that are covered by the exemption provided by Act 135, will be exempt from the SUT with respect to goods and services acquired to undertake the air transport operations.

#### **D. SUT on Daily Rental of a Motor Vehicle**

Treasury’s Internal Revenue Informative Bulletin No. 13-07 of July 2, 2013, indicates that an ordinary motor vehicle’s lease (“operating lease”) that is considered a “daily rental of a motor vehicle” will be considered a taxable service and will be subject to the SUT as provided by Section 4010.01(nn) of the Code, unless otherwise exempt.

On August 29, 2013, Treasury also issued Internal Revenue Circular Letter No. 13-17 to (“CL 13-17”) to define the term “daily rental of a motor vehicle” for purposes of Section 4010.01(nn) of the Code. CL 13-17 defines the term “motor vehicle” as to include automobiles, propellers, ATV vehicles, motorcycles, buses, trucks (as defined in Section 3020.08 of the Code) and heavy equipment (as defined in Section 3010.01(a)(18) of the Code).

In addition, CL 13-17 defines the term “daily rental” as the rental which fare is determined based on (i) the date and hour of the rental, (ii) the place in which the motor vehicle will be tendered, (iii) the type of motor vehicle, (iv) the driver’s age and (iv) the date the motor vehicle is returned to the rental company. Ordinarily, this type of rental is short term, with a duration that may range from a day to various months, but the price to be paid for the rental is based on 24-hour periods.

Treasury also determined in CL 13-17 that the following charges will be subject to the SUT when related to a daily rental of a motor vehicle:

1. Time and mileage;
2. Car and booster seats;
3. Global positioning system (GPS);
4. Under age driver; and
5. Additional driver.

CL 13-17 further clarifies that additional charges that do not constitute the rendering of a service such as insurance, gasoline, vehicle damages, tolls and airport fees, will not be subject to the SUT.

For updates on this matter, you may contact any of the attorneys of our Tax Practice Group listed below:

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