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TAX ALERT

Additional Changes to the Sales and Use Tax and its Administration

On January 24, 2014, the Governor of Puerto Rico signed House Bills 1591 and 1593, which became Acts 18-2014 and 19-2014, respectively, effective February 1, 2014.

In general, Act 18-2014 changes the municipal and state portions of the sales and use tax, and establishes a Municipal Administration Fund (FAM, for its Spanish acronym) to be administered by the Governmental Development Bank for Puerto Rico (GDB). Act 19-2014 provides for the creation of the Municipal Financing Corporation (COFIM, for its Spanish acronym), a public corporation affiliated to GDB with the authority to issue bonds and to implement financing mechanisms for the payment and refinancing of all or part of the obligations of the municipalities that are repaid or guaranteed with the collections of the municipal sales and use tax.

Effective February 1, 2014, the municipal portion of the sales and use tax is reduced from 1.5% to 1%, but the state portion of the sales and use tax is increased from 5.5% to 6%. Thus, the total sales and use tax (state and municipal portions) remains at a 7% rate. Because deposit obligations had already been set at 6% to the Puerto Rico Treasury Department and 1% to municipalities, as applicable, the changes are not expected to have immediate effects on merchant compliance. However, effective July 1, 2014, food and food ingredients as defined in Section 4010.01(a) of the Puerto Rico Internal Revenue Code of 2011, as amended, will be subject to a municipal sales and use tax of 1% (regardless of whether the municipality has enacted an ordinance for such purpose). Such tax is currently imposed discretionarily by means of a municipal ordinance.

Act 18-2014 generally provides that the FAM will assist municipalities to secure the repayment of their debts, to manage their budgeted expenses, and to finance any activity or project. The FAM will receive an initial funding amount of \$43,440,184. Effective on July 1, 2014, the FAM will be funded by 0.5% of the state sales and use tax collections once the Puerto Rico Government makes the annual statutory deposit to the Puerto Rico Sales Tax Financing Corporation (COFINA, for its Spanish acronym). The FAM will be distributed among the municipalities based on a predetermined formula provided by Act 18-2014.

Effective July 1, 2014, municipalities are required to collect the 1% municipal sales and use tax either directly or using a designated fiduciary. Act 19-2014 provides that COFIM will designate a fiduciary to transfer the collections of the municipal sales and use tax to the Municipal Redemption Fund of COFIM (MRF), a fund created to repay the bonds and loans issued by COFIM for the benefit of municipalities. Special rules apply to municipalities that elect not to participate in the FAM and/or the MRF.

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

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