



## Recent Tax Developments from the Puerto Rico Treasury Department and the Municipal Revenue Collection Center

By: Carlos R. González-Martínez

### SALES TAX TEMPORARY EXEMPTION

As explained in our Special Bulletin of The Tax Advisor issued on June 18, 2020, the Governor of Puerto Rico, as a reaction to try to help businesses affected by the pandemic, signed Act 57-2020 on June 14, 2020 providing various economic measures to subsidize part of the current tax and economic burdens of these merchants. Among other benefits, Act 57-2020 provided for a temporary exemption of the sales tax of 4% for services rendered to other businesses and on designated professional services for the months of April, May, and June 2020 (the “Temporary Period”). There has been concern as to how this exemption would apply in practice, particularly when Act 57-2020 applied retroactively to months which sales and use tax returns had been filed and for which the sales tax had been already charged to customers on invoices that had been sent. Other concerns include invoices issued for the Temporary Period which included the sales tax and have already been collected. On July 16, 2020, the Puerto Rico Treasury Department (“Treasury Department”) issued Circular Letter for Internal Revenue No. 20-33 (“CL 20-33”) to provide guidance regarding the application of the 4% sales tax exemption for the Temporary Period.

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**[www.alvatax.com](http://www.alvatax.com)** or contact one of our Tax Professionals for an appointment:

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**E. [taxadvisors@alvatax.com](mailto:taxadvisors@alvatax.com)**

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CL 20-33 clarifies that, regardless of the accounting method used (i.e. accrual or cash basis) by the taxpayer, the **services billed during the Temporary Period** will be the ones exempt from the 4% sales tax on services. In other words, the sales tax exemption will apply only to the invoices prepared and dated within the Temporary Period.

In the case of a merchant who billed its services during the Temporary Period, including the 4% sales tax in the invoice, and reported and remitted the sales tax with its monthly tax return, it will be allowed to amend its monthly tax return to report such sales as exempt. The amendment of these monthly sales tax returns should result in a tax credit to be reflected on such merchant's sales and use tax account within SURI. Other merchants who did not pay the tax but would like to report the service sales during the Temporary Period as exempt, may also amend the monthly sales tax returns. However, to amend these returns and claim the applicable credit, the merchant must include the following documents:

1. Evidence that the sales tax already collected from clients for the amounts previously billed during the Temporary Period was returned to the client;
2. In the case of accrual basis merchants who have not received the payment for the invoices issued during the Temporary Period with the 4% sales tax, evidence that a revised invoice has been sent to the clients eliminating the 4% sales tax. The revised invoice must include the following wording with respect to the adjustment to eliminate the 4% sales tax: "Exención Temporera de IVU de 4% Ley 57-2020", that can be translated to "Temporary 4% Sales Tax Exemption Act 57-2020"; and
3. Confirmation of receipt from the clients who were billed the 4% sales tax during the Temporary Period, that they either were reimbursed the 4% sales tax paid for those invoices or that they received a revised invoice eliminating the 4% sales tax previously billed.

To support the amendment and claim the credit, the above mentioned documents must be uploaded into the SURI account of each merchant, using the link "Send a message" under the menu of "I want to" on the user's main page. Under "Send a message", you should choose "Sales and use tax" as the type of account and then select the period that you want to amend "April 30, 2020", "May 31, 2020" or "June 30, 2020". You should select "tax returns" in the category and "Amend return" in the type. In the reason you should select "Other" and in the subject of the message you should write: "Evidencia Ley 57-2020 – IVU de 4%", that can be translated as "Evidence Act 57-2020 – Sales tax of 4%".

Act 57-2020 provided for the possibility of an extension of the temporary sales tax exemption for an additional three-month period of exemption, at the discretion of the Secretary of the Treasury. However, the CL 20-33 clarifies that the temporary exemption of the sales tax of 4% for services rendered to other businesses and designated professional services will not be extended and will only cover the services billed during April, May and June 2020.

### ATBA Comments:

Most merchants that provide services had already prepared and sent invoices to their customers for at least April and May 2020 when Act 57-2020 was signed. By that time, some may have already filed their monthly sales tax return for those invoices including the 4% sales tax and may have even paid the applicable tax. CL 20-33 provides an opportunity to recover the tax paid as a credit for those merchants who paid the tax related to the invoices issued during the Temporary Period with the 4% tax. However, CL 20-33 also imposes a responsibility to the merchants to effectively communicate with their clients and follow several steps to document such amendment, including uploading certain evidence at SURI to properly reflect those service sales as exempt. Please note that taxpayers must be able to demonstrate that all the required steps were completed to reflect the sales as exempt for the Temporary Period. We are ready to assist in developing a strategy to comply with the necessary steps and to design the appropriate documents to enable the approval of the sales tax credit and the filing of the amended return by the Treasury Department. Should you need assistance with the amended monthly sales

## ABOUT THE AUTHOR

### Carlos R. González Martínez

**Carlos** is a Member at Alvarado Tax & Business Advisors LLC (ATBA) and has over twenty five years of experience in the corporate and individual tax advisory area with various international firms and industries. He provides corporate tax services for clients in telecommunications, manufacturing, service and retailing industries, and also is the Operations Manager for the Tax Resolution and Outsourcing Services divisions.

Prior to joining ATBA, Carlos had a seven-year-plus career with Puerto Rico Telephone Company (PRTC) as Executive Tax Advisor in charge of the corporate tax division, and a three-year career with Caribe General Electric as Tax Manager. Prior to that, he worked for ten years in public accounting firms, including experience in both audit and tax, with KPMG, Price Waterhouse LLP's Corporate Tax Practice and Arthur Andersen's Tax Practice. While at PRTC, Carlos was the project leader and successfully implemented the new sales and use tax rules, modifying more than ten different systems and affecting the operating guidelines of fourteen departments.

Carlos has a BBA major in Accounting from the University of Puerto Rico. He is a member of the Puerto Rico Society of Certified Public Accountants and the American Institute of Certified Public Accountants.

tax return, we may also assist in the preparation of the amended form and uploading the documents required.

### EXTENSION OF ESTIMATED PERSONAL PROPERTY TAX

Due to the situation with the COVID-19, and most recently, due to the effects of tropical storm Isaias, many governmental agencies

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extended the filing due dates of tax returns, reports, and certain payments through the end of July and the first week of August. Last week, the Municipal Revenue Collection Center issued Administrative Order No. 2020-12 ("AO 2020-12") to extend the due date for depositing the first installment of the 2020 personal property tax.

The AO 2020-12 establishes that the first estimated tax installment's due date for the 2020 personal property tax will be September 15, 2020. Please note that the rest of the estimated tax installments remained unaltered. Such other deposits are due on November 16, 2020 (second installment), February 15, 2021 (third installment) and May 17, 2021 (fourth and last installment).

### CHANGE OF ACCOUNTING METHOD ALLOWED FOR SALES TAX PURPOSES TO THE CONSTRUCTION INDUSTRY

On July 30, 2020, the Treasury Department issued Administrative Determination No. 20-19 ("AD 20-19") to establish a procedure to comply with the amendment of Act 40-2020, which allows merchants dedicated to the construction of commercial, industrial or residential projects to use the cash basis method of accounting for reporting the sales tax on their construction services beginning on July 1, 2020.

In the case of merchants engaged in the construction business, the percentage of completion is the method typically used to determine the net income of the operations. Also, the Puerto Rico Internal Revenue Code of 2011, as amended, limits the use of the cash basis method to taxpayers that do not have inventories and whose average gross revenues for the last three years of operations is \$3 million or less. Before the amendment of Act 40-2020, most merchants, including those engaged in construction, were required to follow for sales tax purposes, the same accounting method used for income tax purposes. AD 20-19 provides guidance for the implementation of the

above-mentioned amendment to ease the process for merchants engaged in the construction industry to report the sales tax under the cash basis method.

AD 20-19 provides information regarding the NAICS Codes that will qualify to be considered as a merchant dedicated to construction. Also, it establishes that to qualify for the use of the cash basis method for sales tax purposes, 80% or more of the average gross revenues for the last three years before the date of election of the cash basis method for sales tax purposes, should have come from the construction business identified with the NAICS Codes provided in this administrative determination. AD 20-19 also provides special rules for merchants that have operated for less than three years, or those who are commencing operations during the current year.

One of the most important details of AD 20-19 is that it eliminates the need to submit a ruling request to the Secretary of the Treasury for this change in method. However, it establishes the following alternate method to request such change:

1. The request must be made through the merchant's SURI sales and use tax account; and
2. Such request must be submitted after June 30, 2020, but before the filing of the monthly sales tax return for the month in which it will be effective.

Therefore, if a merchant is interested in having the election effective beginning on July 1, 2020, such request must be submitted through SURI by August 20, 2020 and before filing the monthly sales tax return for July, which is also due on that date.

If the merchant decides later to change the accounting method for sales tax purposes, a determination must be requested from the Secretary of the Treasury as provided by Circular Letter of Tax Policy No. 16-09 ("CL TP 16-09"). (AD 20-19 references the Internal Revenue Circular Letter No. 16-09, we believe that there is an error in the reference since CL TP 16-09, is the communication that establishes the procedures to request formal responses and determinations from the Secretary of the Treasury.)

## Key Contacts at Alvarado Tax & Business Advisors LLC

### **Juan Alvarado-Zayas, Esq., CPA**

Managing Member  
787-620-7730  
jalvarado@alvatax.com

### **Juan Zaragoza-Gómez, CPA**

Member  
787-620-7740  
jzaragoza@alvatax.com

### **Felipe Mariani-Franco, CPA**

Member  
787-620-7736  
fmariani@alvatax.com

### **Sandra Marie Torres- Martínez, CPA**

Member  
787-620-7728  
storres@alvatax.com

### **Edgardo Sanabria-Valentín, CPA**

Member  
787-999-3015  
esanabria@alvatax.com

### **Carlos R. González-Martínez, CPA**

Member  
787-620-7739  
cgonzalez@alvatax.com

### **César De Jesús-Umpierre, CPA**

Member  
787-620-7734  
cdejesus@alvatax.com

### **Rosirma García-Rivera, CPA**

Member  
787-620-7733  
rgarcia@alvatax.com

Finally, AD 20-19 requires merchants electing the change to the cash basis method to maintain a reconciliation of the amounts billed and collected on a monthly basis that clearly reflects the amounts being reported in the monthly sales tax returns. This is to avoid the duplication of sales reported and support the fact that the sales tax is being paid solely for the amounts collected.

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### ATBA Comments:

For merchants engaged in the construction business, this change represents an important cash flow opportunity. We can assist in designing a reconciliation spreadsheet that appropriately documents and supports the amounts previously billed, those collected and those to be reported in the monthly sales tax returns going forward. Should you need assistance or if you have any questions with this election, give us a call.

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### Alvarado Tax & Business Advisors LLC

104 Acuarela Marginal Street  
Martinez Nadal Expressway  
Guaynabo PR 00969

PO Box 195598  
San Juan PR 00919-5598

T. 787.999.4400  
F. 787.999.4646

E. [taxadvisors@alvatax.com](mailto:taxadvisors@alvatax.com)  
[www.alvatax.com](http://www.alvatax.com)  
[www.taxand.com](http://www.taxand.com)

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