



TAX REFORM

Income Tax Withholding at Source on Services Rendered in Puerto Rico - Amendments Made by Act 257-2018 and Communications by the Puerto Rico Treasury Department

By: **William Sánchez-Pabón**

On December 10, 2018, the Governor of Puerto Rico signed House Bill Number 1544 (“HB 1544”) into law, Act 257-2018, which amends several provisions of the Puerto Rico Internal Revenue Code of 2011, as amended (the “Code”). This bulletin discusses the most significant changes to the income tax withholding at source on services rendered by a resident of Puerto Rico, including several publications issued by the Puerto Rico Treasury Department (“PRTD”) related to the changes imposed by Act 257-2018.

Amendments by Act 257-2018 (effective January 1, 2019)

Act 257-2018 amended several provisions related to the income tax withholding at source on payments made for services rendered by residents of Puerto Rico. The changes include an increase to the income tax withholding rate, new services subject to income tax withholding, amendments to provisions regarding exempted amounts, as well as services, and modification to the full and partial waivers of income tax withholding. Below we summarize the most important changes regarding these matters.

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Income tax withholding rate – Effective on January 1, 2019, the income tax withholding at source on payments made on services rendered by residents of Puerto Rico increased from 7% to 10%.

New services subject to income tax withholding – Act 257-2018 provides that the payments of commissions to agents on insurance premiums will now be subject to withholding, the same as the agent of the eligible carriers.

Exemptions from income tax withholding –

- Reduces the exemption on income tax withholding on the first \$1,500 paid during the calendar year to \$500.
- Requires the payer of services not subject to withholding (such as: insurance premiums, lease or sale of tangible personal property or real estate, sale of newspapers, magazines and other publications, hiring radio or television time) to report the amounts paid in an informative declaration for services not subject to withholding (i.e. Form 480.6A).
- Provides that the payments made to clinical laboratories are exempt from income tax withholding at source.
- Clarifies that the income tax withholding exemption for construction contractors does not apply to services such as architectural, engineering, design, consulting, electricians, plumbers, painters, maintenance personnel, person providing labor services, security and other services of similar nature. Those services are subject to income tax withholding at source.
- Reduces the exemption term granted for new service operations rendered by any entity (which includes corporations and pass-through entities) and individuals from the first three years to only the first year. However, a Waiver Certificate from Withholding at Source for Services Rendered (“Withholding Waiver Certificate”) to avoid withholding for later years may still be requested, subject to certain requirements.
- Provides an exemption from the income tax withholding on the

payments made by a partnership, special partnership or corporation of individuals dedicated to the rendering of services subject to withholding to an individual that is a partner, shareholder or owner of said entity for services rendered by said individual to the entity. Only a payer that has filed the required informative returns, may claim these payments as operating expenses on its Puerto Rico income tax return. (Payers under the accrual method or with a fiscal year end must submit a reconciliation).

Income Tax Withholding Waiver Certificates (Form SC 2755) – Act 257-2018 provides additional persons which may request a Waiver Certificate. Entities that are up-to-date with their tax responsibilities and submit with their return the required Agreed Upon Procedures Report or audited financial statements will be subject to an income tax withholding of 6% on payments received after December 31, 2018. However, if that entity had sales of \$1,000,000 or more and submitted with its income tax return an audited financial statement, such entity will not be subject to income tax withholding at source on the payments for services rendered.

Furthermore, it provides certain circumstances where the Secretary may exempt the payer from the requirement to make an income tax withholding to payee. Among those are:

- A corporation or partnership with substantial net operating losses that is within the first three (3) years of operations of an economic activity. For these purposes, the fact that a taxpayer has carried out the same economic activity in another jurisdiction or has carried out another economic activity in or outside of Puerto Rico will **not** be taken into consideration.
- A qualified physician, as defined in Act 14-2017, to whom a tax exemption grant under said Act has been issued and is in effect. Also, total Withholding Waiver Certificates will be issued to medical services businesses, as defined under Act 14-2017, that are taxable as pass-through entities, when all shareholders, partners or owners are qualified physicians who have a valid tax exemption grant in force under said Act.
- A person that filed his income tax return for the previous taxable year

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Before joining ATBA, William worked for five years as a Controller in the sales and distribution industry. Prior to that, he worked in the audit and tax departments of other local accounting firms in San Juan and in the tax department of the Puerto Rico Telephone Company. William also worked as an experienced staff tax associate of Andersen’s Tax and Business Advisory Service Practice in San Juan until 2002. William joined Andersen in 2000.

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reflecting a net loss in his operations in Puerto Rico and has not been subject to Alternate Basic Tax or Alternative Minimum Tax for any of the last three (3) years, may now also request a Total Withholding Waiver Certificate. However, the Secretary may deny this relief to a person who has reflected losses in operations for more than three (3) consecutive taxable years.

Quarterly Returns – A quarterly return that details the payments made and reconciliates the tax withheld and remitted during the quarter is now required. This return will be due on or before the last day of the month following the quarters

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closing on March 31, June 30, September 30 and December 31. The Secretary may require that this quarterly return be submitted only by electronic means.

Communications by the PRTD

Process to Request a Withholding Waiver Certificate – On December 4, 2018, the PRTD issued Circular Letter 18-15 (“CC 18-15”) to outline the process for requesting Withholding Waiver Certificates for calendar year 2019. According to CC 18-15, taxpayers that meet the requirements for an automatic waiver will receive the same through their accounts at the *Internal Revenue Unified System* (known by its Spanish Acronym as “SURI”).

New or existing businesses that do not receive an automatic Withholding Waiver Certificate when they understand that one should be applicable for them, must submit a request by either electronic means through their SURI account or in person at any of the Taxpayer’s Service Centers of the PRTD.

Correction on the Income Tax Withholding Rate of Partial Withholding Waiver Certificates – On December 31, 2018, the PRTD issued Internal Revenue Informative Bulletin 18-24 (“IB 18-24”) to inform taxpayers that, the Partial Withholding Waiver Certificates currently being issued by the PRTD reflect the previous applicable rate of 3%, instead of the current 6% partial withholding rate. Therefore, withholding agents that process payments to service providers who have submitted a partial withholding waiver for taxable year 2019 are instructed to withhold the applicable 6% even when the partial withholding waiver reflects a withholding rate of 3%. According to IB 18-24, the PRTD is working on updating the new applicable rate on its systems.

New Informative Declarations – On October 30, 2018, the PRTD issued the Internal Revenue Informative Bulletin Number 18-18 (“IB 18-18”) to notify the

publication of the new Withholding Statements and Informative Declarations and the changes made to such forms for the calendar year 2018, to integrate the changes proposed, at that moment, under Act 257. **Please note that there are several changes that are optional for 2018 but their compliance will be enforced by the PRTD for the calendar year 2019.**

As informed on the Internal Revenue Informative Bulletin Number 18-16 (“IB 18-16”), all Withholding Statements and Informative Declarations will be filed electronically through SURI. This change in the filing platform took effect on December 10, 2018.

In connection with the new Withholding Statements and Informative Declarations for 2018, all forms are available, only for informative purposes, through the PRTD’s website www.hacienda.pr.gov.

ATBA Comments

Even though for the calendar year 2018 there are certain reporting requirements that will be optional, all payors must make the necessary adjustments to be able to comply with such requirements for payments made during calendar year 2019. For example, payments made during January 2019 will be subject to the increased withholding and payment limits of 10% and \$500, respectively, regardless if the payment relates to an invoice for services rendered during December 2018.

In addition, compliance with the new reporting requirements is extremely important for the payor to be able to claim these payments as operating expenses on their income tax returns. At ATBA we have experienced tax professionals that can assist you with these reporting requirements and other related tax matters.

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