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GUIDE

DOING BUSINESS IN PUERTO RICO FOR A US OR FOREIGN ENTITY



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Puerto Rico Tax Compliance Guide

By TCG, Torres CPA Group, CifrasPR, Torres & Soto Tax

Torres CPA Group is a Certified Public Accounting Firm that has been offering Audit, Tax, Consulting, and Financial Outsourcing services for over 38 years. If you require any further information or help, please do not hesitate to contact us. We assist in Accounting, Payroll, and Tax Compliance.

Understanding the Puerto Rico tax system and its interrelation with the United States is crucial for individuals and entities doing business in Puerto Rico. Puerto Rico is not a state; it's a territory, with its own business, tax, and Payroll laws and regulations.

The following White Paper is designed to give an insight on Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing a business in the Island. Nonetheless, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Certain exclusions and exemptions may apply, and when specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico and to obtain appropriate accounting and legal advice.

It is understood that the following overview does not constitute any formal rendering of either legal, accounting, tax, or professional services. If legal advice or other assistance is required, an attorney, CPA or tax adviser should be consulted.

In accordance with IRS Circular requirements, you are advised that any discussion of tax issues in these materials is not intended or written to be used and cannot be used to avoid penalties imposed under Internal Revenue Code, as amended or to promote, market, or recommend to another party any transaction or matter addressed herein.

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A US entity register as Doing Business in Puerto Rico

All entity doing business in Puerto Rico, including USA entity register as USA Foreign entity in Puerto Rico or Domestic entity, is required to comply with:

Business Compliance Requirements

Books and records

An entity engaged in business in Puerto Rico must keep and maintain accounting records and supporting documents. Such documents will clearly show the financial condition and results of operations in Puerto Rico.

Sale and Use Taxes

A Sale and Use Tax of eleven and a half percent (11.5%) (SUT) apply on sales of tangible personal property, taxable services, admission rights and combined transactions, subject to certain exclusions and exemptions, state and municipal filing.

Designated professional services and business-to-business services (B2B) are subject to a SUT of four percent (4%).

A merchant is required to collect the said tax as a withholding agent responsible for the payment of the Sales and Use Tax. He is also required to file a Monthly Sales and Use Tax Return, no later than the twentieth (20th) day of the following month in which the taxes were collected or in which the transaction subject to the tax took place. If amount due is over \$2,000 bi-monthly may be require.

Self-imposed IVU (reverse charge)

Applicable IVU will be Self-imposed by the business in Puerto Rico who receives the services from a non-resident or entity not engaged in trade or business in Puerto Rico, and is responsible for sending the IVU payment to the Treasury Department with the Monthly Sale and Use Tax Return applicable to Services on or before the 20TH of the next month following of making the payment or receiving the services.

Otherwise, you cannot claim the deduction as an item of expenditure for those services in the Income Tax Return.

Withholding to Resident Recipients

Payments made by any person in business equal or more than \$500 to another person (individual or entity) for services performed within Puerto Rico are subject to a ten percent (10%) withholding. Any in-kind payment is considered a payment for these purposes. Payments of fixed or recurrent payments providers as internet, telecommunication, cable insurance, pensions, rent, compensation, promotion, advertising, marketing, royalties, do not require withholding but require year end informative in order to take them as a taxable deduction.

The amount withheld should be deposited at the Puerto Rico Treasury Department on or before the fifteenth (15) day of the month following the close of the month in which the tax was deducted, subject to certain exclusions and exemptions. The amount withheld or deposited will be credited against their income tax liability.

Businesses should file an annual reconciliation statement for payments made to each service provider on or before February 28 of the following calendar year when the services were rendered. A copy of the report, equivalent to US IRS form 1099, should be given to the service provider.

Such statement must include: the provider's name, address, E.I.N., telephone number, the amount received and the corresponding tax withheld. Failure to comply with the withholdings or filing returns would make payments of the services none deductible for tax purposes, the merchant would be liable for the amount not retained, and could also result in penalties.

Withholding to Non-resident Recipients

Withholding of income tax at source is required to be made on payments to nonresidents to the extent that they constitute gross income from sources within Puerto Rico individuals, rates vary based on provider's tax status.

The amount withheld should be deposited at the Puerto Rico Treasury Department on or before the fifteenth (15 th) day of the month following the close of the month in which the tax was deducted.

Failure to comply with the withholdings or filing returns would make payments of the services none deductible for tax purposes, the merchant would be liable for the amount not retained, and could also result in penalties.

Employer's Tax Requirements in Puerto Rico

An employer is a person or organization for whom a worker performs services as an employee. Employers are required to withhold, to report and pay employment taxes on wages paid.

Definition of source employment income is generally treated as a Puerto Rican sourced compensation when the individual performs the services while physically located in Puerto Rico. The source is not determined by where the wages are paid from, but rather by where the services are performed.

An employer is subject to the reporting and withholding requirements covered under the Pay-As-You-Go (PAYG) system.

FICA

The United States provisions of the FICA or Social Security and Medicare requirements apply to Puerto Rico employers and employees as well. The employee tax must be withheld by the employer from the employees' wages and is paid through deposits. Generally, an employer is a monthly depositor for the entire calendar year if the aggregate amount of employment taxes reported for the look-back period is \$50,000 or less. Under the monthly deposit schedule, FICA deposit is due by the fifteenth (15th) day of the following month.

FUTA

The Federal Unemployment Tax Act provisions also apply in Puerto Rico. The tax is imposed on persons who employ one or more individuals for a portion of a day in each of 20 weeks in the current or preceding calendar year, or who pay in the aggregate \$1,500 or more in wages within a calendar quarter of the current or previous calendar year.

The FUTA tax liability is computed after credit for the Puerto Rico unemployment tax on the first \$7,000 of wages paid to an employee each calendar year. No monthly deposit is required if the tax liability is \$500 or less.

Final payment and return must be filed on January 31st.

Fica and Futa filing for US entities register to do business in PR and have the same EIN for USA and PR operations, will include Puerto Rico Employees in the USA filing

Income Tax Withheld on Salaries and Wages base on Puerto Rico withholding rulings and tables.

An employer is required to withhold income tax at source on salaries and wages paid to its employees performing services in Puerto Rico. The PR withholding rates depend on the personal exemption and credits for dependents claimed in Puerto Rico withholding exemption certificate, which each employee is required to complete. The Puerto Rico Treasury Department publishes tables that determine the amount of tax to be withheld.

Withheld taxes should be deposited monthly together with a monthly return (monthly deposit of income tax withheld) to PR Treasury (Hacienda). Unless withholdings have not exceeded \$500.00, payment should be made along with an Employer's Quarterly Return of Income Tax Withheld return, on or before April 30, July 31, October 31 and January 31 of each year.

If withholding for the look back (prior 12 months ended June 30) period is over \$50,000, deposits should be made semi-weekly.

The Puerto Rico equivalent of the U.S. Form W2 is the 499R2/W2PR (Withholding Statement), and must be filed for each employee.

An Annual reconciliation statement of Form 499R2/W2PR and tax withheld should be filed to the Puerto Rico Treasury Department on or before January 31st of each year.

Form W3PR shall be filed with the Social Security Administration no later than the last day of February following the end of the calendar year for which the withholding was performed, including the 499R2/W2PR Form

Puerto Rico Unemployment Tax

Each employer must pay the Puerto Rico Unemployment tax on the first \$7,000 of annual wages paid and may be credited against the Federal Unemployment tax. The tax is to be paid quarterly on the last day of the calendar month following each calendar quarter payable to the Secretary of the Treasury of Puerto Rico.

Puerto Rico Disability Benefits Tax

Disability Insurance tax is imposed on the first \$9,000 of wages and salaries paid during the calendar year. This provides compensation to workers for wage loss resulting from disability caused by sickness or accident not related to their employment. Both employer and employee share the tax burden evenly. Employees subject to the Chauffeur Social Security Tax are not

subject to this tax. This tax should be paid in the same manner as the Unemployment Tax; however, a private plan may substitute it.

Chauffeur's Social Security

If the employer hires non-executive employees who are required or permitted to operate motor vehicles as an integral and regular part of their jobs, chauffeur's social security must be paid instead of the Puerto Rico Disability Insurance Tax.

Quarterly returns are required to be filed no later than the fifteenth (15 th) day after the last day of each calendar quarter, payable to the Puerto Rico Secretary of the Department of Labor and Human Resources, Bureau of Chauffeurs Social Security.

Workmen's Accident Compensation Insurance

Workmen's Compensation Insurance provides compensation for accidents incidental to or as a consequence of employment. This is **compulsory insurance** that is obtained from the Puerto Rico State Insurance Fund Corporation. Without it, you as an employer would have to personally liability on any claim.

All employees of a business, including executive officers, are required to be covered by this insurance. Generally, it is paid in two installments upon notice mailed to the employer by the State Insurance Fund.

Businesses are required to file, no later than July 20th of every year, indicating the number of employees, occupation, and the wages paid during the preceding July 1 to June 30.