

June 28, 2002

INTERNAL REVENUE CIRCULAR LETTER NO. 02-09

SUBJECT: WITHHOLDING ON PAYMENTS FOR SERVICES RENDERED

Section 1143 of the Puerto Rico Internal Revenue Code of 1994, as amended (Code) and Regulation No. 5619 of said Section (Regulation) provide that the Government of the Commonwealth of Puerto Rico and every person, natural or juridical, that in the conduct of a trade or business or for the production of income in Puerto Rico makes payments to individuals, corporations or partnerships for services rendered shall deduct and withhold at source a seven percent (7%) of such payments.

Act No. 81 of June 10, 2002 (Act) amended Section 1143 of the Code to establish that, commencing July 1, 2002, every payment made for services rendered received by an individual shall be subject to the withholding at source of seven percent (7%). Therefore, according to the provisions of the Act, commencing July 1, 2002, the waiver of the withholding of the five percent (5%) granted to individuals that were current with their tax obligation is revoked.

In the same manner, every payment for services rendered received by a corporation or partnership after June 30, 2002 will be subject to a withholding of seven percent (7%). However, if the corporation or partnership is current in their tax obligation, all the payments received after that date for the services rendered shall be subject to a withholding of three percent (3%). Therefore, commencing on July 1, 2002, the Total Waiver for Corporations and Partnerships that were current with their tax obligation is revoked.

Notwithstanding, the Act maintained and, in turn, modified certain exclusions provided by Section 1143(b) of the Code, to the effect that the obligation to deduct and withhold does not apply in the following situations:

- a. the first \$1,500 paid during the calendar year to the person who rendered the service;

- b. payments made to hospitals; clinics that offer hospitalization services, without including those essentially offering ambulatory services; homes for terminally ill patients; homes for the elderly and institutions for the handicap. Laboratory services rendered by medical laboratories are not exempt from withholding, except in the case such services are rendered by laboratories that form an integral part of a hospital or clinic;
- c. payments made to organizations that are exempt under the provisions of Section 1101 of the Code;
- d. payments of commissions made to direct sales persons for the sale of consumer products. The term "direct sales person" means an individual who:
 - i. is engaged in the sale (or sale solicitation) of consumer products to any buyer on the basis of a purchase-sale agreement, commission for deposit, or any similar agreement, for the resale (by the purchaser or any other person) in the home or other place that is not a retail sales establishment, or
 - ii. is engaged in the sale (or sale solicitation) of consumer products in the home or other place that is not a retail sales establishment;
- e. payments made to contractors or subcontractors for the construction of projects. The term "construction projects" does not include services of architecture, engineering, design, consulting, or other professional services of a similar nature. In the case that a contract includes those services, the invoice shall segregate the amount of the services, so that the withholding may be limited solely to the amount of the services subject to withholding. If no such specification is separately made for the amount of the services the withholding shall apply to the total amount of the payment.

The term "construction project" is the skill or process of constructing, building, or erecting any building or structure such as bridges, houses, roads, buildings, sidewalks, or sewers, and improvements or developments of the land, whether for profit or not, among others. Also, shall be considered as construction projects the installations made as an integral or complementary part of said structures such as installations of electrical, telephone, and plumbing facilities;

- f. payments for services rendered by nonresident individuals or foreign corporations or partnerships not engaged in a trade or business in Puerto Rico that are subject to withholding under Sections 1147 and 1150 of the Code;
- g. payments of salaries subject to withholding under Section 1141 of the Code;
- h. payments made to the Government of Commonwealth of Puerto Rico, its agencies, public corporations, and political subdivisions;
- i. payments for services to individuals, corporations and partnerships during the first three (3) years of the commencement of an activity of providing services. This exemption may be enjoyed only once by a taxpayer;
- j. payments for services to a bona fide farmer who complies with the requirements for the deduction provided in Section 1023(s) of the Code or in any other provision of an equivalent special law;
- k. payments made directly, or through agents, representatives, or intermediaries, to an eligible carrier. The term "eligible carrier" means a person whose principal trade of business is air transportation as defined by the United States of America laws or treaties, maritime cargo or passenger transportation, or the telephone communications service between Puerto Rico and any point outside Puerto Rico. A foreign corporation or partnership shall qualify as an eligible carrier if the principal trade or business carried on by such corporation or partnership in Puerto Rico is air transportation, as defined by the laws or treaties of the United States of America, or maritime cargo or passenger transportation;
- l. payments made by an eligible carrier to nonprofit entities, for the purpose of carrying out accounting, registration, reporting and collection of air or maritime transportation tickets sales, and other related services on behalf of or for the benefit of such eligible carrier;
- m. payments for ecclesiastic services rendered by priests or other ministers of the Godspeed who are duly authorized or ordained, including Hebrews rabies.

The Treasury Department has been evaluating the procedures related to the Act and its possible effect on the taxpayers. In order that the taxpayers be able to fully comply with the provisions of the Act and with the intention that the same produce the expected

results for which it was enacted, this Department allows **a period of adjustment until July 31, 2002 so that the corporations and partnerships can adapt to the provisions of the Act.** However, said period of adjustment shall not apply to Section 1143(b)(1) of the Code related to the exclusion of withholding of the first \$1,500. Therefore, every Certificate of Total Waiver for Corporations and Partnerships issued by the Department before July 1, 2002 shall be effective until July 31, 2002. The Certificate of Partial Waiver and the Revocation of the Certificate of Total Waiver for Corporations and Partnerships shall be effective commencing August 1, 2002. However, every Certificate of Partial Waiver from Withholding for Individuals issued before July 1, 2002 is hereby revoked.

Furthermore, in order for the implementation of the Act to be agile and effective, this Circular Letter establishes a series of procedures and guidelines that shall govern with respect to the withholding at source imposed by Section 1143 of the Code for payments made commencing July 1, 2002.

The Department will send to the corporations and partnerships that are current in their tax obligations a Certificate of Partial Waiver and a Revocation of the Certificate of Total Waiver from Withholding at Source. Every corporation and partnership that does not receive the same and wishes to obtain it can request it to the Taxpayer Service Office of the Treasury Department as established in Article 1143(a)-1 of the Regulation.

The withholding agents shall not deduct and withhold any tax over the payments made to individuals, corporations and partnerships excluded by Section 1143(b) of the Code as stated before. To those effects, **the withholding agent shall not require the presentation of a total waiver issued by the Treasury Department.** However, the person that renders the services shall present to the withholding agent a copy of a sworn statement indicating name, address, employers account number and a statement that the payment received is exempt from withholding according to the provisions of Section 1143(b) of the Code.

The withholding at source provided under Section 1143(b) of the Code applies only to payments made which represents compensation for services rendered. Any payment that constitutes a reimbursement of cost incurred by the service provider, itemized as such in the invoice, shall not be subject to withholding. This information may be included on an exhibit with the invoice.

The exclusion of the first \$1,500 paid during the calendar year to the person who rendered the service will apply in those cases in which the payments received by the individual, corporation or partnership has not reached this limit at June 30, 2002, as well

Internal Revenue Circular Letter No. 02-09
June 28, 2002
Page 5

as in the case that a person begins to render services to a particular payer commencing July 1, 2002.

On the other hand, the Act provides for the granting of a Total Waiver from Withholding to Corporations and Partnerships on payments for services rendered during the first three (3) years from the commencement of the activity of the rendering of services. Said corporations and partnerships shall request a total waiver in the same manner that individuals and subject, whenever applies, to the provisions of Article 1143(b)(10)-1 of the Regulations. For purposes of this request, it will be understood that a petitioner taxpayer has commenced an activity of rendering of services if such activity has not being developed by another taxpayer during the year prior to the commencement of the activity of the petitioner taxpayer. Said request shall be submitted to the General Consulting Section of the Tax Assistance and Legislation Bureau.

For any explanatory or additional information related to the provisions of this Circular Letter, you can communicate with the Consulting Section of the Tax Assistance and Legislation Bureau at (787) 721-2020 extension 3611 or toll free at (1) (800) 981-9236.

The provisions of this Circular Letter shall be effective on all payments made after June 30, 2002.

Cordially,

Juan A. Flores Galarza
Secretary of Treasury