



THE POWER OF BEING UNDERSTOOD

SOUTH DAKOTA V. WAYFAIR AND PROPOSED REGULATION ISSUED BY PRTD

Year 2018 Issue #5

Introduction

On June 21, 2018, the United States Supreme Court issued its decision in *South Dakota v. Wayfair*, which reversed the "physical presence rule" established by *Quill v. North Dakota* in 1992, which barred States from imposing sales tax collection requirements on out-of-state sellers. With the *Wayfair* decision, now the States have the possibility to impose collection and remittance requirements of the sales tax to out-of-state merchants based solely on their economic presence in a State.

In the case of Puerto Rico, the *Wayfair* decision supports the applicability of Act 25 of April 29, 2017 ("Act 25-2017") and its Proposed Regulation, which amended certain provisions of the Puerto Rico Internal Revenue Code of 2011 ("PR Code"), with respect to the substantial nexus requirements for Sales and Use Tax purposes, and also imposes certain compliance requirements on merchants who have established substantial nexus with Puerto Rico under the new rules.

Federal Case Law: *South Dakota v. Wayfair*

Under previous case law, *Quill Corp. v. North Dakota*, a State could not require a business with no physical presence in said State to collect its sales tax (commonly referred to as the "*Quill* standard"). In the *Wayfair* case, the South Dakota Legislature enacted a law requiring out-of-state (i.e., no physical presence) sellers to collect and remit sales tax "as if the seller had a physical presence in the State", if said sellers, on an annual basis, deliver more than \$100,000 of goods or services into the State or engage in 200 or more separate transactions for the delivery of goods or services into the State.

Top online retailers with no physical presence in South Dakota were not complying with collecting the State's sales tax. Thus, South Dakota filed suit in state court, seeking a declaration that the law's requirements were valid. The South Dakota Circuit Court annulled the State's law. Subsequently, the Supreme Court of South Dakota sustained the decision of the Circuit Court. However, on June 21, 2018, the US Supreme Court overruled the physical presence requirement, reversing the *Quill* standard. The US Supreme Court based its decision on the grounds that *Quill* standard was unsound and incorrect since it established a judicially created tax shelter for businesses that limit their physical presence in a State but sell their goods and services to the State's customers, providing out-of-state sellers an advantage that ended up in significant revenue losses to the States.

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With the *Wayfair* decision, now States are free to enact their own sales tax nexus provisions. That is the case of Puerto Rico, which enacted Act 25–2017 to amend the “substantial nexus” definition for Sales and Use Tax purposes to include merchants with no physical presence in Puerto Rico under certain circumstances.

Puerto Rico Proposed Regulation: Substantial Nexus Rule for Sales and Use Tax

On April 2, 2018, the Puerto Rico Treasury Department (“PRTD”) issued proposed regulation pursuant to Act 25–2017, which amended certain Sales and Use Tax (“SUT”) provisions of the PR Code. The proposed regulation modifies the definition of substantial nexus for SUT purposes and imposes certain compliance requirements to those merchants who have nexus with Puerto Rico under the new rules.

Act 25–2017 amended Section 4010.01(h)(6) of the PR Code to expand the scope of the definition of “substantial nexus” for SUT purposes. Under the new approach, the following activities carried out in the ordinary course of business, in a continuous and recurring manner, may create substantial nexus with Puerto Rico even if the merchant has no physical presence:

1. Granting sales contracts;
2. Direct marketing and solicitation; and
3. Sales dispatched by mail (i.e., internet sales) to customers in Puerto Rico

Substantial Nexus with Puerto Rico

In the particular case of internet sales, said activity shall be considered continuous, recurrent, and in the ordinary course of business if:

1. The merchant has a gross volume of business from sources within Puerto Rico of fifty thousand dollars (\$50,000) or more, or
2. Carried out at least two hundred (200) sales transactions to customers in Puerto Rico during the taxable year.

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For this purpose, if a merchant is a member of a controlled group, the determination as to whether the merchant has nexus with Puerto Rico must consider the aggregate volume of business of all the members of the controlled group.

Once a merchant establishes nexus with Puerto Rico based on the above rules, it shall have the obligation to register in the Merchant's Registry of the PRTD and obtain a Merchant's Certificate in Puerto Rico. Said merchant must maintain a valid Merchant's Certificate until it ceases the activities that created nexus with Puerto Rico. However, the requirement to register as a merchant with the PRTD does not necessarily create a withholding obligation.

SUT Withholding Rules

According to the proposed regulation, the following withholding rules will be applicable to those merchants engaged in the online sales business, **who have established substantial nexus with Puerto Rico for SUT purposes**:

1. Any merchant engaged in the online sales business, whose only contact with Puerto Rico is that the buyer is a resident of Puerto Rico, shall be classified as a Non-Withholding Agent for SUT purposes.
2. Any merchant engaged in the online sales business that has physical presence in Puerto Rico, including but not limited to: (i) having a commercial location or office, (ii) having employees, contractors, representative or agents, or (iii) being owner of tangible personal property or real estate in Puerto Rico, shall be considered a Withholding Agent for SUT purposes.

Withholding Agents shall be responsible for collecting and remitting the SUT to the PRTD, as well as reporting the corresponding sales in the Monthly Sales and Use Tax Return. Nonetheless, a merchant with no physical presence in Puerto Rico who has been classified as a Non-Withholding Agent may voluntarily request the PRTD, through the filing of a Closing Agreement, to become a Withholding Agent.

Non-Withholding Agents shall not be responsible for collecting and remitting the SUT, however, said merchants will be subject to certain notification requirements established by the PRTD.

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Notification Requirements to Non-Withholding Agents

A. Invoice Notification to Puerto Rico Buyers

Non-Withholding Agent merchants must provide to its Puerto Rico customers a notification in writing stating the following:

1. That the sale may be subject to SUT in Puerto Rico, and
2. That it is the purchaser's responsibility to declare and pay the applicable SUT to the PRTD.

This notification must be included in every sale invoice or receipt. Failure to comply with this notification requirement could lead to the imposition of penalties in the amount of \$100 for each failure.

B. Quarterly Notifications to the Puerto Rico Treasury Department

Non-Withholding Agents are required to file quarterly notices (due by the last day of the month following the quarter end) to the PRTD to inform purchases made by Puerto Rico buyers. Said notice should include the following information:

1. Seller's name and address,
2. Purchaser's name and delivery address,
3. Purchases' dates,
4. Value of purchase and description, and
5. Whether the purchase is exempt or taxable

Failure to comply with this notification requirement could lead to the imposition of penalties in the amount of \$5,000 for each failure.

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C. Annual Notification to Puerto Rico Customers

Non-Withholding Agents are required to provide an annual notice to all its Puerto Rico customers on or before January 31 of each year. Said notice must include the following information:

1. Seller's name and address,
2. Purchaser's name and delivery address,
3. Purchases' dates,
4. Value of purchase and description, and
5. Whether the purchase is exempt or taxable

Failure to comply with this notification requirement could lead to the imposition of penalties in the amount of \$500 for each failure.

Up to date, the PRTD has not pronounced with respect to the *Wayfair* decision, neither has published any amendments to the Proposed Regulation. We will continue monitoring any changes with respect to this matter.

At RSM Puerto Rico we are available to advise our clients about the impact of the *Wayfair* decision and the Proposed Regulation issued by the PRTD on their business. Please contact your tax advisor with any questions.

Reminders & Due Dates

- September 10, 2018 – Monthly Declaration of Imports
- September 10, 2018 – Monthly Excise Tax Return
- September 10, 2018 – Deposit of Income Tax withheld on payments for services rendered
- September 17, 2018 – Extended due date of the Puerto Rico Pass-Through Entity Informative Income Tax Return
- September 17, 2018 – Extended due date of the United States Return of Partnership Income
- September 17, 2018 – Deposit of Income Tax withheld on salaries of those employers classified as monthly depositors
- September 20, 2018 – Monthly Sales & Use Tax Return

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