

(H. B. 991)

**(No. 42-2013)**

(Approved June 30, 2013)

## **AN ACT**

To amend subsection (h) of Section 4010.01, amend the provisions of Section 4010.03; add subsections (d) and (e) to Section 4020.08, amend subsection (a) of Section 4041.02, add subsection (g) to Section 4050.06, and add subsection (d) to Section 6043.06 of Act No. 1-2011; in order to expand the situations under which a merchant is considered to be engaged in the sale of taxable items in the Commonwealth of Puerto Rico; and for other purposes.

### **STATEMENT OF MOTIVES**

Improving the economy of the Island and of each one of its constituents is currently one of the compelling interests of the State. It is well known that the fiscal health of the government is undergoing a serious crisis that affects us all. The Island's financial situation has adversely affected not only the people of Puerto Rico, but also local businesses.

The Sales and Use Tax (SUT) on certain use or consumption articles and on certain transactions, business, activities, and occupations has been one of the necessary fiscal measures to ensure the continuity of services offered by the State to its citizens. Thus, as provided in Act No. 1-2011, it is the duty of every merchant engaged in the business of selling taxable items in Puerto Rico, to collect the sales and use tax from its customers and remit it to the Department of the Treasury.

Act No. 1-2011, provides that a merchant is any person engaged in the business of selling taxable items in Puerto Rico and sets forth the circumstances under which it is determined whether a merchant is engaged in the business of selling taxable items on the Island. To reach said determination it is necessary to establish that there is a nexus between the merchant and Puerto Rico pursuant to local and federal constitutional provisions. Only upon complying with these constitutional rules, would Puerto Rico have the authority to require certain businesses that are not physically present in Puerto Rico to comply with the obligations provided in Act No. 1-2011, regarding the collection and remittance of the sales and use tax to the Department of the Treasury.

Furthermore, any transaction involving the acquisition of an article for use in Puerto Rico from a seller that is not a withholding agent under Act No. 1-2011, is subject to the use tax. In said case, even when there is no withholding agent, the customer is required to impose upon himself the use tax and remit the same to the Department of the Treasury. As expected, both Puerto Rico and the states have faced great challenges in implementing this rule. In practice, online sales of businesses without a presence in Puerto Rico have evaded the application of the tax. This situation, in turn, has promoted unfair competition between brick-and-mortar stores and online marketplaces. This Legislative Assembly hereby proposes to balance competition and provide the Department of the Treasury with the tools to require certain businesses that have no physical presence on the Island to act as withholding agents under the provisions on the sales and use tax of Act No.1-2011.

The rules that determine whether or not a minimum contact or nexus with a taxing jurisdiction exists are interpreted by local and federal rules under the due process and interstate commerce clauses.

In *Quill Corp. v. North Dakota*, 504 U.S. 298, (1992), it was held that a business that has no physical presence, outlets, sales representatives, calling lists, or solicitors, does not advertised on radio, television, advertising banners, or newspapers in the state, and whose only contact with the consumers of a taxing state jurisdiction is by post or a common carrier has a minimum contact or nexus with the taxing state jurisdiction under the Due Process Clause of the United States Constitution.

From the due process standpoint, while the efforts of a commercial agent are deemed to be intentionally directed to the residents of other states, it cannot be validly argued that a person's lack of physical presence in the state defeats the jurisdiction that such state may have over said person. In light of *Quill*, the states have endeavored to design their tax laws to assert their right to the taxes applicable to mail orders or online sales. An example of the foregoing is when the imposition of the tax is limited to the person abroad "who enters into an agreement with one or several Puerto Rico residents under which the residents, for a commission or other consideration, directly or indirectly refer potential customers to the person, whether by a link on an Internet website, introduced in person, telemarketing, or otherwise." This Legislative Assembly is convinced that the adoption of this type of rule meets the "minimum contact" constitutional requirement set forth in the due process clause.

Various states of the United States, such as California, Connecticut, Illinois, and New York, among others, have recently adopted statutes that provide for the establishment of a nexus with merchants outside of their jurisdictions if such merchant enters into an agreement with one or several residents of such state under which the residents, for a commission or other consideration, directly or indirectly refer potential customers to the person, whether by a link on an Internet website or otherwise. These statutes are known as "Amazon" or "click trough nexus" laws.

With this measure, we adopt the necessary rules to strike a balance between the local market and online marketplaces, thus achieving equal conditions for both markets in connection with the sale of taxable items, since both markets must comply with the provisions of Act No. 1-2011. This statute does not impose a new tax, but rather requires business selling taxable products online in Puerto Rico to meet the obligations imposed under Act No. 1-2011 as withholding agents.

The approval of this measure shall entail approximately twenty million dollars (\$20,000,000) in revenues to the treasury as a result of the sales and use tax on online taxable sales within the first year of its implementation. To achieve an effective oversight of this statute, the necessary rules to provide the Department of the Treasury with the appropriate tools to enforce this Act are adopted herein.

***BE IT ENACTED BY THE LEGISLATIVE ASSEMBLY OF PUERTO RICO:***

Section 1.- Subsection (h) of Section 4010.01 of Act No. 1-2011, as amended, is hereby amended to read as follows:

“Section 4010.01.— General Definitions

For purposes of this part, the following terms, words, and phrases shall have the general meaning expressed below, except when the context clearly indicates otherwise:

(a) ...

(h) Merchant or Retailer.— Any person engaged in the business of selling taxable items within Puerto Rico, including any wholesaler. For purposes of this section, a person shall be deemed to be engaged in the business of selling taxable items in the Government of Puerto Rico when:

(1) The person maintains establishments or offices in Puerto Rico; or maintains or uses in Puerto Rico directly or through a subsidiary or affiliate, an office, distribution facility, salesroom, or an office, warehouse or other establishment operated by any person other than a transportation business or common carrier acting in such capacity; or

(2) the person has employees, independent contractors, direct or indirect representatives, or agents in Puerto Rico who solicit business or conduct business transactions on behalf or for the benefit of said person.

For purposes of this paragraph, a person is presumed to have independent contractors, representatives, or agents in Puerto Rico who solicit business or conduct business transactions on behalf or for the benefit of said person, if the person enters into an agreement under which a third party, for a commission or other consideration, directly or indirectly refers potential customers to the person, whether by a link, on an Internet website, or by an in-person oral presentation, telemarketing, or otherwise. The provisions of this paragraph shall apply if the cumulative gross receipts from sales by the person to customers in Puerto Rico, which were referred to the person by all independent contractors, representatives, or agents in Puerto Rico with whom the person has this type of an agreement, are in excess of ten thousand dollars (\$10,000) during the preceding twelve (12) months.

The presumption provided herein may be rebutted by proof that the independent contractors, representatives, or agents in Puerto Rico with whom the person has the agreement described above, did not engage in any solicitation activity in Puerto Rico during the preceding twelve (12) months that are sufficient to establish a substantial nexus in Puerto Rico. The Secretary shall prescribe by regulations, circular letter, or administrative determination the form and manner in which the presumption established herein may be rebutted; or

(3) the person owns tangible personal or real property located in Puerto Rico; or

(4) a merchant, including one considered as ‘affiliated’ to said person that is subject to the jurisdiction of the Commonwealth of Puerto Rico with respect to the sales and use tax imposed under this Subtitle for being engaged in the business of selling taxable items in Puerto Rico, conducts any of the following for the benefit or on behalf of said person:

(A) the merchant sells a line of products similar to the line of products sold by the person and does it under the same or a similar business name of the person.

(B) the merchant uses his employees or his facilities in Puerto Rico to advertise, promote, or facilitate the sales of the person to customers in Puerto Rico;

(C) the merchant maintains in Puerto Rico an office, distribution facility, warehouse or storage place, or other similar place of business to facilitate the delivery or provision, as applicable, of taxable items sold by the person to customers in Puerto Rico;

(D) the merchant uses trademarks or service marks, or trade names in Puerto Rico that are the same or substantially similar to those used by the person;

(E) the merchant delivers, installs, assembles, or renders maintenance services to the person’s customers in Puerto Rico in connection with the taxable items sold by the person to customers in Puerto Rico;

(F) the merchant facilitates the delivery of tangible personal property sold to the customers’ of the person located in Puerto Rico, allowing such customers to pick up tangible personal property at an office, distribution facility, warehouse, or other similar place of business maintained by the merchant in Puerto

Rico or receives in his facilities the merchandise returned by the person's customers who bought said merchandise directly from the person; or

(G) the merchant engages in other activities in Puerto Rico that are substantially associated with the person's capacity to establish and maintain a market in Puerto Rico for the person's sales.

The provisions of this paragraph shall not apply if it is shown that the activities of the merchant in Puerto Rico do not establish a substantial nexus in Puerto Rico; or

(5) the person enters into an agreement with one or several residents of Puerto Rico under which such residents, for a commission or other consideration, directly or indirectly refer potential customers to the person, whether by a link on an Internet website, or by an in-person oral presentation, telemarketing, or otherwise. The provisions of this paragraph shall apply if the cumulative gross receipts from sales by the person to customers in Puerto Rico, who are referred to the person by all of the residents with whom the person has this type of an agreement, are in excess of ten thousand dollars (\$10,000) during the preceding twelve (12) months.

On the contrary, the provisions of this paragraph shall not apply, if proof that the residents with whom the person has reached the agreement described above, did not engage in any solicitation activities in Puerto Rico during the preceding twelve (12) months that are sufficient to establish a substantial nexus in Puerto Rico. The Secretary shall prescribe by regulations, circular letter, or administrative determination the form and manner in which the presumption established herein may be rebutted; or

(6) the person establishes a substantial nexus in Puerto Rico, including, but not limited to the execution of sales contracts in Puerto Rico, direct marketing or mail or radio orders, the distribution of unsolicited catalogs through computers, television, or other electronic media, or advertising on magazines or newspapers or other media; or

(7) through an agreement or reciprocity with another jurisdiction of the United States, and such jurisdiction uses its authority to tax and its jurisdiction over the person in support of the authority of Puerto Rico; or

(8) the person agrees, expressly or implicitly, to the taxation imposed by this part, or

(9) the person, other than a transportation business, common carrier or third party intermediary acting in such capacity, imports or causes to be imported tangible personal property from any state or foreign country for sale in Puerto Rico by a link on an Internet website for use, consumption, or distribution in Puerto Rico, or storage for use or consumption in Puerto Rico; or

(10) the person has a sufficient connection of some sort or a relationship with Puerto Rico or its residents, other than those described in paragraphs (1) through (9) of this subsection, for purposes of establishing a substantial nexus in Puerto Rico to impose on the person the responsibility of collecting the sales and use tax fixed by this part.

For purposes of the provisions of this subsection, the term ‘affiliate’ means any merchant who is a member of the same ‘controlled group’ of corporations of which the person is a member, as defined under Section 1010.04 of this Code; is a ‘related person’ of the person or is part of a ‘group of related entities’ of the person as defined in Section 1010.05 of this Code; or any merchant that, notwithstanding its form of organization, bears the same ownership relationship to the person as a corporation that is a component member of the same



‘controlled group’ of corporations as the person. In addition, the term ‘affiliate’ includes the parties that are part of an affiliate program, which consists of an agreement under which a third party in Puerto Rico includes a link on its Internet website, and the link directs the user to the website of the other party. The third party receives a commission if the user completes his purchase in the website of the other party.

Beginning July 1, 2013, any Puerto Rico resident who, on said or on a later date, is an affiliate or enters into an affiliate program with a person who prior to the agreement was not subject to Subtitle D of this Code, shall notify such agreement to the Department of the Treasury at the time and in the manner prescribed by the Secretary through regulations, circular letter, information bulletin, or general administrative determination. Noncompliance with this requirement shall entail the fines and penalties provided in Subchapter C of Subtitle F of the Code.

(i) ...”

Section 2.— Section 4010.03 of Act No. 1-2011, as amended, is hereby amended to read as follows:

“Section 4010.03.— Rulemaking Authority

The Secretary shall be empowered to promulgate those rules and regulations related to the imposition, exemption, interpretation, administration, and collection of the sales and use tax fixed in this Subtitle. The Secretary shall be required to promulgate rules and regulations as are necessary to conform the provisions of this Code to the rules applicable to merchants subject to this Code under paragraphs (2), (4), (5), (6), (9), and (10) of subsection (h) of Section 4010.01. In addition, the Secretary shall adopt regulations to conform the provisions of this Subtitle D to the applicable local and federal constitutional rules.”

Section 3.— New subsections (d) and (e) are hereby added to Section 4020.08 of Act No. 1-2011, as amended, to read as follows:

“Section 4020.08.— Collection of the Sales Tax on Mail Orders

(a) ...

(d) For purposes of this Subtitle, the term ‘mail order’ means the sale of tangible personal property by mail order, Internet, or other communication media, to a merchant who receives the order outside of Puerto Rico and ships the tangible personal property or causes the tangible personal property to be shipped, whether by mail or not, from any place within or without Puerto Rico, to a person in Puerto Rico, whether or not he is the person who ordered the tangible personal property.

(e) A person engaged in the mail-order business and deemed to be engaged in the sale of taxable items in Puerto Rico in accordance with Section 4010.01(h) of the Code, shall be considered a merchant subject to the requirement of this Subtitle.”

Section 4.— Subsection (a) of Section 4041.02 of Act No. 1-2011, as amended, is hereby amended to read as follows:

“Section 4041.02.— Monthly Sales and Use Tax Return

(a) In General.— In order to determine the amount of the sales tax to be paid under this Subtitle, all merchants must file a monthly sales and use tax return and, except as provided through regulations pursuant to Section 4042.03 of this Subtitle, shall remit to the Secretary the sales tax not later than the tenth (10<sup>th</sup>) day of the month following the month on which said taxes were collected, using the forms prepared and supplied by the Secretary. Said return shall show, separately for each municipality, the leases, admissions, gross sales, or purchases, as the case may be, that may arise from all taxable leases, admissions, sales or purchases, deposits of the sales tax, credits during the preceding month, and any other information the Secretary may require through regulations. This paragraph shall

not apply to merchants subject to this Subtitle under Section 4020.08(d) of this Code. Said merchants shall be subject to the provisions prescribed by the Secretary through regulations, circular letter, information bulletin, general administrative determination or communication.

(b) ...”

Section 5.- A new Subsection (g) is hereby added to Section 4050.06 of Act No. 1-2011, as amended, to read as follows:

“Section 4050.06.– Special Disposition of Funds

(a) ...

(g) The Department of the Treasury shall collect the municipal sales and use tax attributable to sales of merchants subject to the provisions of this Code under paragraphs (2), (4), (5), (6), (9), and (10) of subsection (h) of Section 4010.01 and distribute said revenues to the municipalities according to a reasonable formula that may be prescribed by the Secretary through regulations or by means of an agreement between the Secretary and the municipalities.”

Section 6.– A new Subsection (d) is hereby added to Section 6043.06 of Act No. 1-2011, as amended, to read as follows:

“Section 6043.06.– Penalties for Violating other Provisions

(a) ...

(d) Any merchant or person who fails to comply with the notifications required under subsection (h) of Section 4010.01 shall be guilty of, in addition to any other penalty provided in this Code and any offense set forth in this Code or the Penal Code, a penalty of up to twenty thousand dollars (\$20,000) for each violation, except for reasonable cause.”

Section 7.— Rulemaking Authority and Publicity.

(a) Within a term not to exceed ninety (90) days as of the approval of this Act, the Secretary of the Department of the Treasury shall adopt regulations as are necessary to implement the provisions of this Act, including, but not limited to, regulations to conform the provisions of Subtitle D of Act No. 1-2011, with the provisions of this Act in order to comply with the applicable local and federal constitutional rules.

(b) The Department of the Treasury shall keep in its website a webpage with all the necessary information and technology in English and in Spanish in order to facilitate merchants' compliance with this Act.”

Section 8.— Severability Clause

If any article, section, subsection, paragraph, subparagraph, clause, phrase, or part of this Act were held to be unconstitutional by a court with jurisdiction, said holding shall not affect, impair or invalidate the remaining provisions of this Act. The effect of said holding shall be limited to the article, section, subsection, paragraph, subparagraph, clause, phrase, or part thereof thus held to be null or unconstitutional.

Section 9.— Effectiveness

This Act shall take effect immediately after its approval; however, its provisions shall become effective ninety (90) days after the approval thereof.

## CERTIFICATION

I hereby certify to the Secretary of State that the following **Act No. 42-2013 (H. B. 991)** of the **1<sup>st</sup> Regular Session** of the **17<sup>th</sup> Legislative Assembly of Puerto Rico**:

**AN ACT** to amend subsection (h) of Section 4010.01, amend the provisions of Section 4010.03; add subsections (d) and (e) to Section 4020.08, amend subsection (a) of Section 4041.02, add subsection (g) to Section 4050.06, and add subsection (d) to Section 6043.06 of Act No. 1-2011; in order to expand the situations under which a merchant is considered to be engaged in the sale of taxable items in the Commonwealth of Puerto Rico; and for other purposes.

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, on this 18<sup>th</sup> day of April, 2018.

Orlando Pagán-Ramírez  
Director