

Special Instructions For Bona Fide Residents Of Puerto Rico Who Must File A U.S. Individual Income Tax Return (Form 1040)

If you are a bona fide resident of Puerto Rico who will file a U.S. Federal Income Tax Return, Form 1040, and claim an exclusion for income earned in Puerto Rico, you will have to make certain adjustments on your return. These special instructions explain the adjustments, and how to make them on your return.

Bona Fide Residents of Puerto Rico: Generally, you are a bona fide resident of Puerto Rico if during the tax year, you:

- Meet the presence test
- Do not have a tax home outside Puerto Rico, and
- Do not have a closer connection to the United States or to a foreign country than to Puerto Rico.

Publication 570 discusses these requirements and provides information on the special rules that apply in the year you are moving to or from Puerto Rico.

American Opportunity Tax Credit

Bona fide residents of Puerto Rico will receive the refundable part of this credit from the Puerto Rico Treasury Department.

Who Must File

In general, section 933 of the U.S. Internal Revenue Code requires that U.S. citizens who are bona fide residents of Puerto Rico during the entire taxable year, but who receive income from sources outside Puerto Rico and/or receive income as a civilian or military employee of the U.S. Government in Puerto Rico, must file a U.S. Federal income tax return. The income you receive from Puerto Rican sources is not subject to U.S. income tax. Because some of the income is exempt (under Code section 933) a part of the itemized deductions or a part of the standard deduction amount on your U.S. return must be allocated to that exempt income. This computation must be made before you can determine if you must file a U.S. tax return, because the minimum income level at which you must file a return is based on the standard deduction for your particular filing status. Use the following worksheet to modify standard deduction and to determine if you have to file a U.S. income tax return:

1. Enter STANDARD DEDUCTION	
If your filing status is (see caution below)	_____
Single	under 65 enter \$12,000 _____
	65 or older enter \$13,600 _____
Married filing jointly	both under 65 enter \$24,000 _____
	one 65 or older enter \$25,300 _____
	both 65 or older enter \$26,600 _____
Head of household	under 65 enter \$18,000 _____
	65 or older enter \$19,600 _____
Qualifying widow(er) with dependent child	under 65 enter \$24,000 _____
	65 or older enter \$25,300 _____

CAUTION: If someone can claim you as a dependent, enter amount from the Standard Deduction Worksheet in the instructions for Form 1040.

2. Allowable portion of STANDARD DEDUCTION	
a. Gross income subject to U.S. tax (include taxable social security benefits); use Worksheet 1 of Pub. 915 to compute your taxable social security benefits)	_____
b. Total gross income from all sources (including exempt P.R. Income)	_____
c. Divide line 2a by line 2b	_____
d. Multiply STANDARD DEDUCTION (line 1) by line 2c	_____

You must file a return if your gross income subject to U.S. tax (line 2a) is equal to or more than line 2d. If you are married filing a separate return, you must file a return if your gross income subject to U.S. tax is equal to or more than 0.

Source Of Income

The source of income is important in determining if the income may be excluded under section 933 of the Internal Revenue Code. The table below describes the general rules for determining the source of your income:

Example Of Source Of Income Rules

Item of Income	Factor Determining Source
Salaries and other compensation	Where the service is performed
Social Security Benefits	*U.S. Source income by definition (IRC Sec. 861)
Pensions:	
Contributions	Where services were performed that earned the pension
Investment earnings	Where pension trust is located
Interest	Residence of the payer
Dividends	Location of payer
Rents	Location of property
Royalties:	
Natural resources	Location of property
Patents, copyrights, etc.	Where the property is used
Sale of real property	Location of property
Sale of personal property	**Seller's tax home (<i>but see Special Rules for Gains From Dispositions of Certain Property for exceptions</i>)

* Special Rules

Caution: *Bona Fide Residents of Puerto Rico should use Publication 915 to determine how much of their Social Security Benefits may be taxable.

Caution: **There are special rules for gains from dispositions of certain investment property (for example, stocks, bonds, debt instruments, diamonds, and gold) owned by a U.S. citizen or resident alien prior to becoming a bona fide resident of a possession. For additional details see Publication 570.

Deductions

It is important to remember that deductions which apply to your exempt Puerto Rican income are not deductible on your Federal income tax return. For example, **self employment tax deduction:** If you are a bona fide resident of Puerto Rico and you exclude all of your self-employment income from gross income, you cannot take the deduction for part of *your self-employment tax* on Schedule 1 (Form 1040), line 27, because the deduction is related to excluded income. You must pay self-employment tax on net self-employment earnings of \$400 or more. For more information see Publication 570 "Self Employment Tax Deduction" in chapter 4.

The personal exemption amount is \$0 for tax years beginning 2018 through tax year 2025.

Deductions that do not specifically apply to a particular income item must be allocated between your gross income subject to U.S. tax and your total gross income from all other sources. Examples of deductions that do not definitely apply to a particular type of income are alimony payments and certain itemized deductions (such as medical expenses, charitable contributions, and real estate taxes and mortgage interest on your personal residence). To find the part of the deduction that is allowable, you must apportion those items that do not apply to any specific type of income based on the ratio that your gross income subject to Federal tax bears to gross income from all sources.

EXAMPLE: You and your spouse, both under 65, are U.S. citizens and bona fide residents of Puerto Rico for the entire year. You file a joint return. This year you earned \$22,500 from Puerto Rican sources and your spouse earned \$67,500 from the U.S. Government. You have \$27,000 of itemized deductions that do not apply to any specific type of income. These are medical expenses (doctor's fees) \$4,000, real estate taxes \$5,000, home mortgage interest of \$12,000, and charitable deductions of \$6,000 (cash contributions). You apportion deductions for your Federal tax return as follows: multiply the deduction to be allocated by a fraction. The numerator of the fraction is your gross income subject to Federal tax and the denominator is your total gross income from all sources (including exempt Puerto Rican income).

$$\text{Formula: } \frac{\text{gross income subject to Federal tax}}{\text{gross income from all sources}} \times \text{deduction} = \text{allowable portion of deduction}$$

SCHEDULE A — Itemized Deductions should be modified as shown in the sample below:

Medical Expenses (doctor's fees)
 $\$67,500 \times \$4,000 = \$3,000$ (Enter on line 1 of Schedule A.)

 \$90,000

Real Estate Taxes
 $\$67,500 \times \$5,000 = \$3,750$ (Enter on line 5b of Schedule A.)

 \$90,000

Home Mortgage Interest
 $\$67,500 \times \$12,000 = \$9,000$ (Enter on line 8 of Schedule A.)

 \$90,000

Charitable deduction (cash contributions)
 $\$67,500 \times \$6,000 = \$4,500$ (Enter on line 14 of Schedule A.)

 \$90,000

NOTE: Enter on Schedule A only the allowable portion of each deduction.

Taxpayers Who Do Not Itemize Deductions

Standard Deduction

The standard deduction and the additional standard deduction for taxpayers who are blind or age 65 or over are deductions that do not apply to any particular type of income. If you do not itemize, they must be apportioned by the ratio that gross income subject to Federal tax bears to gross income from all sources. This adjustment must be made before you enter your standard deduction on line 8 of Form 1040.

Use the following worksheet to apportion the standard deduction.

Worksheet For Puerto Rico Filers With Exempt Income Under Section 933 Who Do Not Itemize Deductions	
1. Enter STANDARD DEDUCTION: If your filing status is	
Single or Married filing separately enter \$12,000.	} _____
Married filing jointly or Qualifying widow(er) enter \$24,000	
Head of Household enter \$18,000.	
CAUTION: If you are 65 or over and/or blind, enter amount from the Standard Deduction Worksheet in the instructions for Form 1040;	
or	
If someone can claim you as a dependent, enter amount from the Standard Deduction Worksheet in the instructions for Form 1040.	
2. Allowable portion of STANDARD DEDUCTION:	
a. Gross income subject to U.S. tax	_____
b. Total gross income from all sources (including exempt P.R. income)	_____
c. Divide line 2a by line 2b	_____
d. Multiply Standard Deduction (line 1) by line 2c and enter this amount on Form 1040, line 8 (allowable portion of STANDARD DEDUCTION).	_____
Write the following above line 8, Form 1040 "Standard Deduction modified due to exempt income under section 933."	

Example: John and Mary are U.S. citizens, under 65, and bona fide residents of Puerto Rico for all of 2018. They file a joint income tax return. During 2018 they received \$15,000 of income from Puerto Rican sources not subject to U.S. income tax; \$20,000 of federal wages subject to U.S. income tax and \$6,000 interest income from a bank account in the U.S. They do not itemize deductions. Line 7 of their Federal tax return, Form 1040, shows \$26,000. They will apportion their standard deduction as follows:

Worksheet For Puerto Rico Filers With Exempt Income Under Section 933 Who Do Not Itemize Deductions

1. Enter STANDARD DEDUCTION for:

Single or Married filing separately enter \$12,000	}	24,000
Married filing jointly or Qualifying widow(er) enter \$24,000		
Head of Household enter \$18,000		

CAUTION: If you are 65 or over and/or blind, enter amount from the Standard Deduction Worksheet in the instructions for Form 1040, as applicable;

or
If someone can claim you as a dependent, enter amount from the Standard Deduction Worksheet in the instructions for Form 1040, as applicable.

2. Allowable portion of STANDARD DEDUCTION:

a. Gross income subject to U.S. tax	26,000
b. Total gross income from all sources (including exempt P.R. income)	41,000
c. Divide line 2a by line 2b6341
d. Multiply Standard Deduction (line 1) by line 2c and enter this amount on Form 1040, line 8 (allowable portion of STANDARD DEDUCTION).	15,218

Write the following above line 8, Form 1040 "Standard Deduction modified due to exempt income under section 933."

Credits

Foreign Tax Credit: If you are claiming a credit for taxes paid or accrued to Puerto Rico and you have income from P.R. sources not taxable on the Federal tax return, you must reduce your foreign taxes paid or accrued by the taxes allocable to exempt income. To find the amount allocable to the exempt income, multiply the taxes paid or accrued to Puerto Rico by a fraction. The numerator of the fraction is the exempt income (under IRC 933) from P.R. sources less deductible expenses allocable to that income. The denominator is the total amount of income subject to P.R. tax less deductible expenses allocable to that income.

Formula to calculate the Reduction in Foreign Taxes:

Formula:
$$\frac{\text{Income from P.R. sources not subject to Federal tax less deductible expenses allocable to that income}}{\text{Total income subject to Puerto Rico tax less deductible expenses allocable to that income}} \times \text{Tax paid or accrued to Puerto Rico}$$

Example: John and Mary are bona fide residents of Puerto Rico filing jointly. John works for the Federal Government and received salary of \$42,000 during 2018. Mary works for private industry and received salary of \$18,000. Total taxes paid to Puerto Rico: \$3,010.

$$\frac{\$18,000}{\$60,000} \times \$3,010 = \$903 = \text{taxes allocable to excluded income. (Enter on Form 1116, Part III, line 12 "Reduction in foreign taxes".)}$$

Reporting a Change in Bona Fide Residence

Beginning in tax year 2001, taxpayers who become or ceased to be bona fide resident of a U.S. possession may need to file IRS Form 8898, Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession. If you are required to file Form 8898 for any tax year and you fail to file it, you may owe a penalty of \$1,000.

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