



June 7, 2021

Introduction to Puerto Rico for Acts 20/22

Presented by:

ACCI Branch 7



Front Matter Items

- ❖ [The IRS Mission Statement](#)
- ❖ [14 General Principles of Ethical Conduct for Federal Employees](#)
- ❖ [Your Rights as a Taxpayer](#)



Course Objectives

- ❖ At the end of this course, you will be able to:
 - Explain the requirements and benefits of Puerto Rico Act 20
 - Explain the requirements and benefits of Puerto Rico Act 22



Acronyms

- ❖ CFC: Controlled Foreign Corporation
- ❖ GILTI: Global Intangible Low-Taxed Income
- ❖ BFR: Bona fide Resident
- ❖ WEIIC: Withholding Exchange & International Compliance
- ❖ PR: Puerto Rico



Background – U.S. Taxation of Puerto Rico Residents

- ❖ The US income tax treatment of Puerto Rican residents is unique
- ❖ US citizens pay tax on worldwide income, regardless of where they live.
- ❖ That is unless they are residents of Puerto Rico – A US citizen residing in PR is not subject to US income tax on Puerto Rican source income only
- ❖ Similarly, if a US citizen owns a CFC, it must pay tax on the CFC's subpart F income and GILTI income
- ❖ That is unless the US citizen resides in PR – in which case the owner is not subject to US tax on subpart F income and GILTI income on CFC's Puerto Rican source income only



Puerto Rico Act 20 – The Export Services Act

- ❖ Applies to PR companies that provide services inside PR to customers based outside PR:
 - Company can qualify for 4% corporate tax rate on income from these services and No income tax on distributions
- ❖ Generally, seeks to attract U.S. high net worth business providers to become “bona fide residents” (BFRs) of PR and operate their business in PR:
 - U.S. citizens that become BFRs of PR can avoid U.S. GILTI and subpart F income inclusion rules with respect to business income
- ❖ Generally availed of by financial services (hedge fund managers) and consulting, but PR also is targeting U.S.-based advertising firms, computer development firms, and call centers



Example

- Example:** U.S. citizen hedge fund manager that operates a financial or consulting services business through a corporate entity (foreign or domestic) and draws a salary. Services are provided by phone/internet to customers around world. Citizen physically moves and relocates business to Puerto Rico and becomes BFR

	US based	PR bona fide resident
Business income rate	21% rate if domestic corporation 21% (subpart F income) or up to 13.125% (GILTI) if a CFC	4% (to PR; 0% to US)
Dividend income rate	23.8%	0%
Tax on employment income	37% top rate	33% top rate (to PR; 0% to US)



Puerto Rico Act 22 – Individual Investors Act

- ❖ PR: Full tax exemption for BFRs on certain financial income, including interest, dividends, and capital gains, on Puerto Rican related income
- ❖ Benefits generally limited to buying Puerto Rican real estate and investing in Puerto Rican businesses
- ❖ Gain on U.S. individual's stock/bonds/other investment assets generally also can benefit
- ❖ Gain attributable to pre-move period, subject to either 5 or 15% tax
- ❖ Targets high net worth U.S. individuals willing to become BFRs



Puerto Rico Act 22 – Individual Investors Act (cont'd)

- ❖ U.S.: Puerto Rican related income of BFRs generally also exempt from U.S. income tax
- ❖ Income from US sources or other non-Puerto Rican sources is NOT exempt from U.S. tax. Therefore, income (e.g., dividends/interest) from U.S. portfolio securities or U.S. real estate not eligible for benefits
- ❖ Capital gain from sale of stocks/bonds/other investment assets held before moving to PR eligible for U.S. tax exemption after 10 years
- ❖ Alternatively, can elect to mark-to-market on date of move, or to prorate portion of gain pre-BFR status



Example

- ❑ **Typical example:** Silicon Valley startup founder owns highly appreciated stock in US-based business. Moves to PR.

	US resident	PR bona fide resident
Dividends	23.8%	20%
Capital gains	23.8%	<ul style="list-style-type: none"> • 5% on pre-move gain (0% on remaining gain) if wait 10 years • Alternatively, 23.8% on pre-move gain, and 0% on remaining gain • If securities acquired after move to PR, full exemption on gain

- Same benefits are not possible moving to non-territories (e.g., Switzerland) due to U.S. expatriation/exit tax rules, and would require giving up US passport



Summary of Non-Compliance

- ❖ Some taxpayers are taking advantage of tax incentives offered under Puerto Rico Act 22 by:
 - Erroneously claiming bona fide residency in Puerto Rico and excluding income subject to US tax on a filed US income tax return or failing to file and report income subject to US tax
 - Establishing bona fide residency in Puerto Rico but erroneously reporting US source income as Puerto Rico source and not filing US return to avoid US tax
 - Not complying with IRC Section 937, *Residence and Source Rules Involving Possessions*, including look-back rules

- ❖ IRS Report to Congress Pursuant to Pub. L. 116-93 Regarding Interaction of Certain Puerto Rico and U.S. Tax Laws



How the Issue was Identified

- ❖ Highlighted in multiple media outlets
- ❖ Promoters actively soliciting clients and distributing promotional material
- ❖ IIC field team in Puerto Rico submitted campaign proposal



Goals/Intended Compliance Outcomes

- ❖ Reduce non-compliance by individuals incorrectly using Act 22 to reduce or eliminate US tax
- ❖ For tax years 2012-2019, 2331 individuals were granted benefits



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Campaign: External Announcement

This campaign addresses taxpayers who have claimed benefits through Puerto Rico Act 22, “Act to Promote the Relocation of Individual Investors to Puerto Rico”, without meeting the requirements of IRC Section 937, *Residence and Source Rules Involving Possessions*. As a result, these individuals may be excluding income subject to US tax on a filed US income tax return or failing to file and report income subject to US tax. This campaign will also address those individuals who have met the requirements of IRC Section 937 but may be erroneously reporting US source income as Puerto Rico source income in order to avoid US taxation. The objective of this campaign is to address noncompliance in this area through a variety of treatment streams including examinations, outreach and soft letters.



Campaign: Internal Announcement

Puerto Rico Act 22, “Act to Promote the Relocation of Individual Investors to Puerto Rico”, provides an exemption from Puerto Rican income tax for certain interest and dividends sourced in Puerto Rico and provides reduced income tax rates for individuals who newly establish residence in Puerto Rico.

Under IRC § 933, bona fide residents of Puerto Rico (as defined under IRC § 937) exclude Puerto Rico-source income from U.S. income tax. Such individuals are subject to US income tax and file an income tax return with the IRS only to the extent they have US or other non-Puerto Rico source income to report.

Some individuals who are benefitting from Act 22 may be improperly excluding income subject to US tax on a filed US income tax return or failing to file and report income subject to US tax. Some individuals may erroneously treat certain capital gains on property acquired while a US resident as Puerto Rico source income. This campaign will address noncompliance in this area through a variety of treatment streams including examinations, outreach and soft letters.



Puerto Rico Act 60

- ❖ On July 1, 2019, the Governor of Puerto Rico signed into law Act 60-2019, also known as the Puerto Rico Tax Incentives Code, which consolidated dozens of tax decrees, incentives, subsidies and tax benefits in a single statute, effective January 1, 2020. Acts 20 and 22 were among the incentive provisions that were consolidated into Act 60-2019. Notwithstanding this consolidation, Acts 20 and 22 are still commonly referred to by their original designations.
- ❖ The benefits from Act 22 (Act to Promote the Relocation of Individual Investors to Puerto Rico) are in effect until December 31, 2035.



Collaboration to Support Campaign

- ❖ Criminal Investigation
- ❖ Data Analytics
- ❖ WEIIC
 - Planning and Special Programs
 - Revenue Agents
 - Practice Network
 - Territory 4 - Soft Letters
- ❖ Counsel



Course Summary

- ❖ You are now able to:
 - Explain the requirements and benefits of Puerto Rico Act 20
 - Explain the requirements and benefits of Puerto Rico Act 22



Questions?

