



June 7, 2021

# I.R.C. 937(a): Residency

*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:
  - Identify and apply the three tests used to analyze whether an individual is a bona fide resident of Puerto Rico pursuant to I.R.C 937(a)



## Acronyms

- ❖ BFR - Bona Fide Resident
- ❖ IRC - Internal Revenue Code
- ❖ PR - Puerto Rico
- ❖ AJCA - American Jobs Creation Act



# Bona Fide Resident

- ❖ This unit discusses how to determine if an individual is a bona fide resident of a U.S. territory under IRC 937 for tax years ending after October 22, 2004, which for most taxpayers would be the calendar year ended December 31, 2005
- ❖ The pre-section 937 rules for determining bona fide residency status are not covered in this unit. Under the prior rules, bona fide residency status was determined pursuant to a facts-and-circumstances test



## I.R.C. 937(a): Bona Fide Resident

- ❖ Under section 937(a), as enacted by the AJCA of 2004, and Treas. Reg. § 1.937-1(c), an individual generally will be considered a “bona fide resident” of Puerto Rico only if he or she satisfies all three of the following conditions-
  - (1) He or she is physically present in Puerto Rico for 183 days during the taxable year (Physical Presence Test);
  - (2) He or she does not have a tax home (determined under the principles of section 911(d)(3) without regard to the second sentence) outside the Puerto Rico during the taxable year (Tax Home Test); and
  - (3) He or she does not have a closer connection (determined under the principles of section 7701(b)(3)(B)(ii)) to the United States or a foreign country than to Puerto Rico (Closer Connection Test)



## Bona Fide Resident: Physical Presence Test

- ❖ Physical Presence Test – The individual must be present in the relevant territory for at least 183 days during the taxable year. See IRC 937(a)(1) and Treas. Reg. 1.937-1(c)(i)
- ❖ The regulations provide several alternatives to the 183-day requirement for purposes of satisfying the physical presence test. See Treas. Reg. 1.937-1(c)(ii)-(v).
- ❖ Accordingly, taxpayers meet the presence test for the tax year if they meet one of the following alternative presence test:
  - ii) was present in Puerto Rico for at least 549 days during the three-year period consisting of the taxable year and the two immediately preceding years, provided that the individual was also present in Puerto Rico for at least 60 days during each taxable year of the period;



## Bona Fide Resident: Physical Presence Test (cont'd)

- iii) was present in one of the 50 states or the District of Columbia for no more than 90 days during the taxable year;
- iv) spends more days in Puerto Rico than in one of the 50 states or the District of Columbia and has earned income in one of those jurisdictions that does not exceed a certain threshold; or
- v) no significant connection to one of the 50 states or the District of Columbia during the taxable year
  - The term “significant connection” is generally defined to include a permanent home, voter registration, spouse, or minor child in the United States. See Treas. Reg. 1.937-1(c)(5)





## Bona Fide Resident: Physical Presence Test (cont'd-2)

- ❖ Days of Presence - Generally, individuals are treated as being present in Puerto Rico on any day that they are physically present in Puerto Rico at any time during the day. (I.R.C. § 7701(b)(7)(A)). If during a single day, they were physically present in the U.S. and Puerto Rico, that day is counted as a day in Puerto Rico.



## Bona Fide Resident: Physical Presence Test (cont'd-3)

- ❖ Days of Presence - The following days count as days of presence in Puerto Rico for purposes of the presence test.
  - Days outside Puerto Rico to receive or to accompany on a full-time basis a parent, spouse or child who is receiving qualified medical treatment. Qualified medical treatment is defined as treatment provided by a physician that involves a period of inpatient care (requiring overnight stay) in a hospital or hospice or a temporary period of inpatient care (requiring overnight stay) in a residential medical care facility for medical necessary rehabilitation.
  - Days outside Puerto Rico because individuals left or were unable to return to Puerto Rico during any 14-day period within which a major disaster occurred in Puerto Rico that was declared a disaster area by the president.



## Bona Fide Resident: Physical Presence Test (cont'd-4)

- ❖ Days of Presence - The following days count as days of presence in Puerto Rico for purposes of the presence test.
  - Days outside Puerto Rico because individuals left or were unable to return to Puerto Rico during any period for which a mandatory evacuation order was in effect for the area in Puerto Rico which their place of abode is located.



## Bona Fide Resident: Physical Presence Test (cont'd-5)

- ❖ Days of Presence - The following days do NOT count as days of presence in the U.S. for purposes of the presence test.
  - Days in the U.S. for less than 24 hours when traveling between two places outside the U.S.
  - Days temporarily present in the U.S. as a professional athlete to compete in a charitable sports event.
  - Days temporarily present in the U.S. as a full-time student.
  - Days in the U.S. serving as an elected representative of Puerto Rico or serving full time as an elected or appointed official or employee of the government of Puerto Rico or its political subdivisions.



## Bona Fide Resident: Physical Presence Test (cont'd-6)

- ❖ If the individual is present in two territories, the day is counted as a day of presence in the territory where the individual's tax home is located.



# Bona Fide Resident: Tax Home Test

## ❖ Tax Home Test

- Under the tax home test, to be a bona fide resident an individual generally cannot have a tax home outside of Puerto Rico during any part of the taxable year. (See IRC 937(a)(2) and Treas. Reg. 1.937-1(d)).
- Generally, an individual's tax home is in the area where his primary place of business or duty post is located, regardless of where he maintains a family home. The location of an individual's tax home often depends on whether a work assignment is temporary or indefinite. If, however, a new work assignment is for an indefinite period, the new place of employment may be the tax home (I.R.C. § 911(d)(3); Treas. Reg. §. §1.911-2(b)).



# Bona Fide Resident: Tax Home Test (cont'd)

## ❖ Tax Home Test

- If an individual does not have a regular or principal place of business or the individual is not engaged in carrying on any trade or business within the meaning of IRC 162(a), his or her tax home is his or her regular place of abode in a real and substantial sense.
- If the individual does not fit either of the above, he or she is considered an itinerant, and the individual's tax home is wherever the individual works.
- An exception to the tax home test may apply for the tax year a person moved to or from Puerto Rico.



# Bona Fide Resident: Tax Home Test (cont'd-2)

## ❖ Exceptions

- Students: Disregard days temporarily in the United States as a student.
- Government Officials: Disregard days in the United States serving as an elected representative of the relevant territory, or serving full time as an elected or appointed official or employee of the government of the territory or any of its political subdivisions.
- Seafarers: An individual is not considered to have a tax home outside the relevant territory solely because the individual is employed on ships or other seafaring vessels used predominantly in local waters (within three miles of the relevant territory) or international waters. A vessel is considered predominantly used in those waters if that amount of time exceeds the aggregate amount of time in territorial waters of the United States, another U.S. territory, and any foreign country.





# Bona Fide Resident: Closer Connection Test

## ❖ Closer Connection Test

- Individuals meet the closer connection test if they do not have a closer connection to the U.S. or a foreign country than to Puerto Rico. See IRC 937(a)(2).
- Whether a person has a “closer connection” to the United States or a foreign country is determined under the principles of IRC 7701(b)(3)(B)(ii) and Treas. Reg. 301.7701(b)-2(d).
- The person’s connections to Puerto Rico are compared to the aggregate of the person’s connections with the United States and foreign countries.
- An individual must satisfy the closer connection test for the entire taxable year.
- An exception to the closer connection test may apply for the tax year a person moved to or from Puerto Rico.



# Bona Fide Resident: Closer Connection Test (cont'd)

## ❖ Closer Connection Test

- A person will be considered to have a closer connection to the United States or a foreign country than to the territory if the individual has maintained more significant contacts with the United States or the foreign country.
- Whether the individual has maintained more significant contacts is determined under a facts-and-circumstances test. See Treas. Reg. 301.7701(b)-2(d).



## Bona Fide Resident: Closer Connection Test (cont'd-2)

- ❖ The following is a nonexclusive list of factors to be taken into consideration:
  - The location of the individual's permanent home (whether a house, apartment, or furnished room; whether owned or rented; and whether available at all times, continuously, but not solely for stays of short duration).
  - The location of the individual's family. This is often a very important factor, but it may not always be. The test can be satisfied even if the individual's spouse resides in the United States or a foreign country.
  - The location of the individual's personal belongings, such as automobiles, furniture, clothing, and jewelry owned by the individual and his or her family.



## Bona Fide Resident: Closer Connection Test (cont'd-3)

- ❖ The following is a nonexclusive list of factors to be taken into consideration:
  - The location of social, political, cultural, or religious organizations with which the individual has a current relationship.
  - The location where the individual conducts his or her routine personal banking activities.
  - The location where the individual conducts business activities (other than those that constitute the individual's tax home).
  - The location of the jurisdiction in which the individual holds a driver's license.
  - The location of the jurisdiction in which the individual votes.
  - The location of residence designated by the individual on forms and documents.
  - The types of official forms and documents filed by the individual.



## Bona Fide Resident: Year of Move

- ❖ There are special rules regarding the “tax home” and “closer connection” tests for the year an individual moves to a Puerto Rico. See Treas. Reg. 1.937-1(f)(1).
- ❖ Individuals will be deemed to satisfy the tax home and closer connection tests in the year of move to a U.S. territory if they meet all of the following:
  - The individual was not a bona fide resident of the territory in any of the three tax years immediately preceding the year of the move,
  - The individual does not have tax home outside the territory, or a closer connection to the United States or a foreign country than to the territory, for any of the last 183 days of the year of move and
  - The individual is bona fide resident of the territory for the three tax years immediately following the year of move.



## Act 22: Puerto Rico Resident

- ❖ Act 22 provides income tax benefits to new individual residents who are defined in Section 2 of the act as, “A resident individual, as defined in Section 1010.01(a)(3) of the [Internal Revenue Code for a New Puerto Rico], who has not been a resident of Puerto Rico during the six (6) years preceding the effective date of this Act and becomes a Resident of Puerto Rico not later than the tax year ending on December 31<sup>st</sup>, 2035.”



## Act 22: Puerto Rico Resident (cont'd)

- ❖ Section 1010.01(a)(30) defines a resident individual as “an individual who is domiciled in Puerto Rico. It shall be presumed that an individual is a resident of Puerto Rico if he has been present in Puerto Rico for a period of one hundred and eighty-three (183) days during the calendar year. The Secretary shall establish by regulation to that effect the factors to be considered in determining domicile for purposes of this paragraph.”



## Act 22: Puerto Rico Resident (cont'd-2)

- ❖ The definition of a Puerto Rico “resident” for purposes of Puerto Rico’s tax code differs from the definition of “bona fide resident” for purposes of the U.S. Internal Revenue Code.
- ❖ Under Section 937, individuals must satisfy three tests to be deemed a BFR: (1) presence test; (2) closer connection test; and (3) tax home test.





## Act 22: Puerto Rico Resident (cont'd-3)

- ❖ To be a Puerto Rico resident under Puerto Rico's tax code, an individual need only satisfy a presence test, but that test differs from the IRC presence test.
  - An individual is not required to satisfy a closer connection test or tax home test.



# Relief for Foreign Individuals Stranded in the U.S.

- ❖ Section 7701(b)(3) includes “substantial presence test” to determine if a person is a U.S. resident.
  - Test counts days present in the U.S. in the current year and each of the preceding two years to determine if specified number of days met.
- ❖ Persons who are U.S. residents are taxed in the U.S. on their worldwide income.
- ❖ Additional days of presence in the U.S. also can prevent qualification for income tax treaty benefits for certain personal services income.



## Relief for Foreign Individuals Stranded in the U.S. (cont'd)

- ❖ Revenue Procedure 2020-20 provides relief on these issues.
  - Allows certain “eligible individuals” to exclude up to 60 consecutive days that the taxpayer is physically present in the U.S. for purposes of the substantial presence test.
- ❖ This period of up to 60 days must start on or after February 1, 2020, and on or before April 1, 2020.
- ❖ Revenue Procedure 2020-20 also provides procedures to exclude these days for purposes of determining treaty benefits for income from certain personal services performed in the U.S.



## Relevant Sources

- ❖ IRC 162(a)
- ❖ IRC 911(d)
- ❖ IRC 937(a)
- ❖ IRC 7701(b)(7)
- ❖ Treas. Reg. 1.937-1
- ❖ Treas. Reg. 301.7701(b)-2
- ❖ Treas. Reg. 301.7701(b)-3
- ❖ IRM 3.21.3.3.6(2) – U.S. Territories – General information
- ❖ IRM 21.8.1.5.2.1 – Bona Fide Residency Rules
- ❖ Pub. 570, Tax Guide for Individuals with Income from U.S. Possessions
- ❖ TD 9248 - Explanation of Provisions and Summary of Comments, Section III, Closer Connection Test



## Course Summary

- ❖ You are now able to:
  - Identify and apply the three tests used to analyze whether an individual is a bona fide resident of Puerto Rico pursuant to I.R.C 937(a).



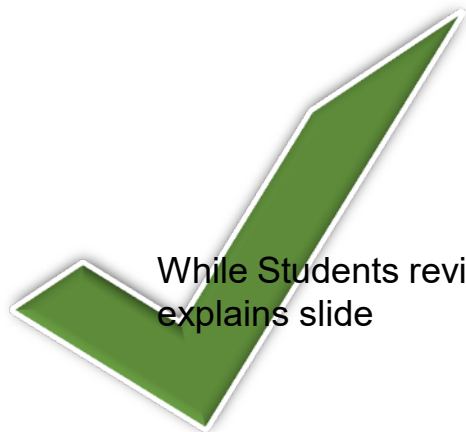
# Questions?





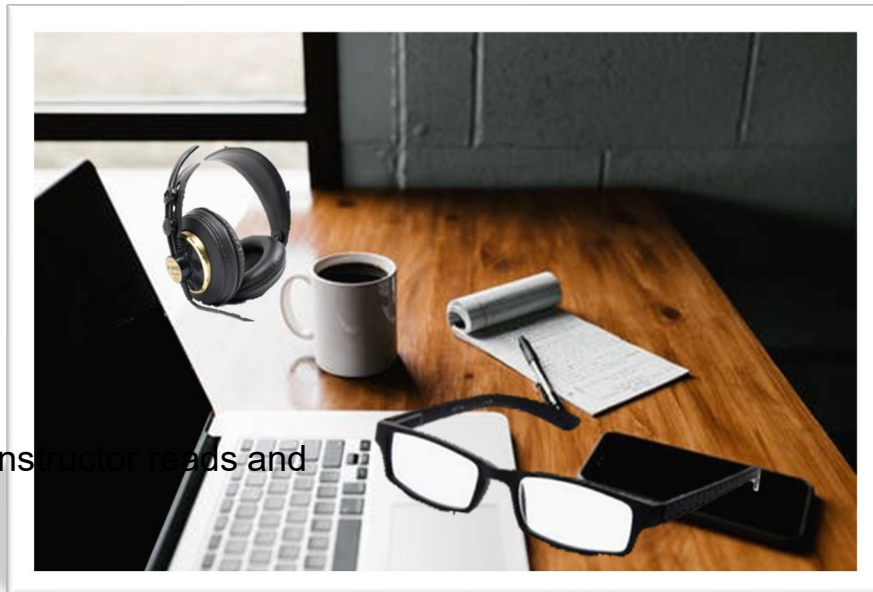
# Let's Take a Break

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