

Are you a Bona Fide Resident of Puerto Rico? Get Ready for An Audit

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Over the last few years, we've talked a lot about the extraordinary tax savings of moving to Puerto Rico (see links to our previous alerts below). Besides the warm weather and island lifestyle, Puerto Rico offers several incentive programs aimed to attract investors and businesses to the island. With tax rates of zero percent for capital gains income and four percent for certain other income, the fascination with Puerto Rico has drawn thousands of mainland U.S. residents to the territory. Of course, their move to Puerto Rico has created, according to some estimates, at least hundreds of millions of dollars in lost tax revenue.

The lost taxes have piqued the interest of Congress, the Treasury Department and the Internal Revenue Service ("IRS"). Back in 2020, the IRS submitted a report to Congress about those taxpayers who relocated to Puerto Rico under Acts 20 and 22. Puerto Rico Act 22 exempts qualifying residents from income taxes on all passive income realized or accrued after an individual becomes a resident of Puerto Rico. Individuals qualifying for Act 22 treatment generally also qualify for an exemption from U.S. income taxation on income derived from sources within Puerto Rico. Similarly, Act 20 applies to businesses, which also benefit from significantly reduced tax rates. The report's findings concluded with what was already known; Act 20 and

Act 22 led to hundreds of millions of dollars of lost U.S. income tax revenue.

In September 2021, the IRS announced a campaign targeting taxpayers who claimed Puerto Rican tax benefits without meeting the requirements of the bona fide residency rules. The IRS claimed that many relocated individuals may be erroneously reporting income as Puerto Rico-sourced income to avoid U.S. taxation. In recent months, the IRS has stepped up enforcement on the island, targeting the now thousands of individuals claiming residency under Act 60, the newly-combined statute that incorporates the former Act 20 and Act 22. The number of on-island IRS agents has more than doubled, and a stronger collaboration and information exchange with the Puerto Rican government has been formed to identify cases of tax evasion.

With increased scrutiny, proper planning is vital to ensure compliance with the bona fide residency requirements. A taxpayer's actual presence on the island, along with their spouse and children and their primary possessions, is a first step. However, beyond that, one must demonstrate that they have a principal place of business on the island and that their subjective association with Puerto Rico is stronger than any other location. In addition, one must file a disclosure with the IRS indicating their status as a bona fide resident.

The IRS audit campaign has only just started in earnest. Taxpayers claiming a move to the island in 2018 and 2019 are the current focus, although the list of years is anticipated to grow rapidly with the growing number of new agents assigned to the initiative. This, coupled with the new infusion of \$40 billion under the Inflation Reduction Act to fund IRS enforcement, undoubtedly means that efforts to recover the millions in lost tax revenues to Puerto Rico will continue well into the future.

If you've recently moved to the island and would like to shore up your residency factors, or if you're planning on moving to Puerto Rico and want to structure a comprehensive bona fide residency plan, please contact [Alan Goldenberg](#), Principal and Leader of the State and Local Taxation and Tax Controversy groups, or your Anchin Relationship Partner.

See our previous alerts for further insights on Act 60:

[Puerto Rico Act 60 Revisited: New Trends and Opportunities Under the Resident Tax Incentive Code - 05/23/2022](#)

[Good Weather, Great Community and the Best Tax Incentives: Why Crypto Traders Are Flooding Into Puerto Rico - 04/08/2022](#)

[Puerto Rico's Latest Guidance: An Important Update for Individual Investors with a Tax Exemption - 03/08/2022](#)

[Puerto Rico Act 60: How You Can Lower Your Federal and State Tax Rates Under the Resident Tax Incentive Code - 07/12/2021](#)