IRS to Get Serious on Puerto Rico Tax Abuses

June 20, 2024

Almost two years ago, we **informed** you that the IRS was ramping up its investigations into those claiming bona fide residency in Puerto Rico. The Service announced an audit campaign targeting taxpayers claiming the tax benefits under Acts 20 and 22, now combined under Act 60. Under the current legislation, bona fide island residents can reduce their effective tax rate to 4% for most income earned on the island and fully eliminate all income tax on capital gains. Since the incentive was instituted, it is estimated that more than 5,000 mainland millionaires and billionaires have moved to Puerto Rico.

However, until this point, the IRS has been slow in committing the resources needed to conduct examinations under the audit campaign. The initiative was supposed to have included audits, outreach to those who recently moved to the island, and informal notification reminders regarding compliance responsibilities. Yet it is estimated that fewer than two dozen inquiries have been made since 2021.

Due to the lack of action, the Senate Finance Committee, along with members of Congress, is working with the IRS to finally commit the resources needed to audit those claiming to be Puerto Rico bona fide residents. The concern is that certain taxpayers receiving the benefits either do not abide by the Internal Revenue Code tests used to establish residency or mischaracterize income earned on the mainland as Puerto Rico-sourced.

If you've moved to Puerto Rico under the incentive tax program, now is the time to review your residency factors to ensure your presence on the island meets the law's requirements. With the IRS crackdown now starting in earnest, establishing a comprehensive bona fide residency plan is the best way to support your tax position and retain your tax exemption. If you have questions or would like more information, please contact ***Alan Goldenberg****, Principal and Leader of the State and Local Taxation (SALT) and Tax Controversy groups,* ***Gwayne Lai****, Partner in the International Tax Services group, or your Anchin Relationship Partner.*