



# **PUERTO RICO: INCOME, ESTATE, AND GIFT TAX ISSUES**

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Arianne Plasencia, DLA Piper LLP  
arianne.plasencia@dlapiper.com

# Puerto Rico Income Tax System

- When used in the Code in a geographical sense, the “United States” includes only the 50 states and the District of Columbia. Code Section 7701(a)(9).
- Not a “mirror” Code jurisdiction.
- Worldwide taxation for Puerto Rico residents.
- Puerto Rico-Source Income (“PRSI”) taxation for nonresidents (including U.S. citizens).
- Foreign Tax Credit provided for U.S. federal taxes on U.S.-Source Income (“USSI”).
- Taxation based on domicile in Puerto Rico.
  - U.S. federal taxation is based on bona fide residency.
- Act 20 and Act 22 incentives for businesses and their shareholders who move to Puerto Rico.

# Bona Fide Resident of Puerto Rico

- Code Section 937
  - Must be present *in Puerto Rico* for at least 183 days; and
  - May not have a *tax home* outside of Puerto Rico.
    - Code Section 911 “tax home” definition.
  - May not have a *closer connection* to the United States or a foreign country than to Puerto Rico.
- If a bona fide resident of Puerto Rico *for the entire year*, the U.S. will not impose federal taxation on PRSI. Code Section 933.
  - The Code does not require that Puerto Rico impose a tax on PRSI for the Section 933 exclusion to apply. *Pledger v. Commissioner*.
  - PRSI does not include income from services performed in Puerto Rico as an employee for the U.S. government or an agency thereof.
  - **Does not exempt non-PRSI from U.S. federal taxation!**

## Bona Fide Resident of Puerto Rico (continued)

- Special rules for year of move *to* Puerto Rico and year of move *from* Puerto Rico.
- No Code Section 911 exclusion for U.S. citizen resident in Puerto Rico.
- Code Section 877A does not apply on move to Puerto Rico.
- Entities are generally *not* considered bona fide residents of Puerto Rico.
  - Exception for certain corporations deriving USSI. Regs. Section 1.881-5(f)(4)(i)(B).
    - 10% withholding on U.S. source dividends.
  - Trusts cannot claim bona fide residency in Puerto Rico.

# U.S. Federal Reporting Requirements that Apply to Certain Bona Fide Residents of Puerto Rico

- Form 8898: Statement for Individuals who Begin or End Bona Fide Residency in U.S. possession
- Fin Cen 114 (FBAR)
  - Puerto Rico residents who are U.S. citizens or green card holders must file if they have foreign accounts.
    - Includes entities organized in Puerto Rico.
  - Puerto Rico considered part of the United States for purposes of determining “foreign” account.
- Form 8938
  - Puerto Rico considered “foreign” for purposes of determining “foreign financial assets”
  - But bona fide resident who is a U.S. citizen or green card holder must file Form 8938 to report foreign financial assets (except for assets located in Puerto Rico).

# U.S. Federal Reporting Requirements that Apply to Certain Bona Fide Residents of Puerto Rico (continued)

- Form 3520 and Form 3520-A
  - Puerto Rico trusts are considered foreign trusts.
  - Code Section 679: Foreign trust with U.S. grantor and U.S. beneficiary or beneficiaries is treated as grantor trust.
  - Throwback rules apply with respect to distributions from a foreign non-grantor trust.
- If a bona fide resident of Puerto Rico is a U.S. citizen or green card holder and owns assets outside of the United States, s/he would be subject to the same reporting and anti-deferral rules as other U.S. citizens.
  - Doesn't apply to many Puerto Rico entities, which are otherwise considered foreign for U.S. tax purposes. Regs. Sections 1.6038-2(d)(2)(i); 1.957-3.
- Eligibility for OVDP and Streamlined Programs.
  - Days in Puerto Rico should not count as days in the United States for Streamlined Foreign Offshore Option.

# U.S. Federal Reporting Requirements that Apply to U.S. Persons (who are not bona fide residents of Puerto Rico) with Investments in Puerto Rico

- Puerto Rican companies are considered “foreign” for purposes of CFC and PFIC rules.
- A Puerto Rican LLC must make a Form 8832 election to be treated as a pass-through entity. Otherwise, it is treated as a corporation by default.
  - Puerto Rico has series LLCs. Prop. Regs. Section 301.7701-1 do not apply to Puerto Rico series outside of the insurance context.
- Forms 926, 5471, 8621, 8865, 8858, and 8938 could apply to a Puerto Rican company depending on the structure.
- Qualified Dividends treatment for dividends from Puerto Rican companies, but does not apply to PFICs.
- U.S. Trade or Business and ECI issues.

# Gift and Estate Tax Issues

- U.S. citizens who are bona fide Puerto Rico residents and who acquired their citizenship solely by birth in Puerto Rico or by virtue of their residence in Puerto Rico are not subject to the U.S. federal estate tax or gift tax on their worldwide assets. Code Section 2209
  - However, they are subject to U.S. federal estate and gift tax on certain assets located in the United States.
  - Treated as nonresident aliens for U.S. federal estate and gift tax purposes.
    - \$60,000 estate tax exclusion
  - Does not apply to a bona fide Puerto Rico resident who is domiciled in U.S.
- U.S. citizens who acquired their U.S. citizenship outside of Puerto Rico are subject U.S. federal estate tax or gift tax on their worldwide assets.
  - \$5.49 million lifetime exclusion
- Puerto Rico also has a gift tax and an estate tax.
- Puerto Rico is a forced heirship and community property jurisdiction.



# CRS, FATCA, and U.S. Tax Treaties

- Puerto Rico is not considered “foreign” for FATCA.
  - Puerto Rico FIs are generally treated as U.S. withholding agents.
- Puerto Rico is not a signatory to CRS.
  - Financial institutions in Puerto Rico are Non-participating FIs.
- Puerto Rico is generally not considered part of the United States with respect to an income tax or transfer tax treaty signed between the United States and another country.
  - Limitation of Benefits and residency rules generally exclude bona fide residents and companies organized in Puerto Rico.
  - No Tax Treaties between Puerto Rico and any foreign country.
  - But see 1990 Protocol to the Spain-US Income Tax Treaty, Paragraph 3.