

Everyone There Will Have Moved Here!

An Overview of the US Federal and Puerto Rican Tax Incentives
for *Bona Fide* Residents of Puerto Rico

By Mark Leeds and Gabriel Hernandez

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The play *West Side Story* focuses on the challenges occasioned by the mid-twentieth century migration of significant numbers of Puerto Rican families to New York City. The plight depicted in the theater was real; the economic situation at the time in Puerto Rico was dire. The government of Puerto Rico, seeking to stem mass emigration, responded with a mix of tax and economic incentives.¹ The response to these tax incentives over the next three decades was spectacular. Puerto Rico was transformed from an impoverished agrarian economy to a technologically advanced industrial country.²

The Federal income tax subsidies supporting Puerto Rico were repealed in 1994. The impact on the economy of Puerto Rico was substantial.³ These changes, coupled with a rise in inexpensive labor elsewhere in the world, caused a prolonged recession in Puerto Rico and the emigration of some of Puerto Rico's best and brightest young people began again. Today, *La Isla del Encanto* is making bold moves to attempt to reverse its negative economic trends and bring individuals (including Puerto Rican nationals who may have left many years before), families, and businesses back to its economy.⁴ The Puerto Rican Department of Economic Development and Commerce (the "DED") has been actively engaged in an information campaign extolling the benefits of relocating one's business and residence to Puerto Rico.⁵ This article explores certain US Federal and Puerto Rican income tax considerations for individuals who may wish to consider relocating to Puerto Rico.

At the current time, the success of Puerto Rico's new laws remains uncertain, but reports suggest that the opportunity is attracting attention.⁶ As analyzed below, however, the Puerto Rican tax incentives must be understood in light of existing US rules, which are very effective in ensuring the integrity of the US tax system on built-in gains and investment income. Concomitantly, Congress has recognized the need for special tax incentives to assist US possessions, including Puerto Rico, in obtaining jobs.⁷ The need for special tax incentives has been attributed to the additional costs imposed by possession status, such as the requirement to use US flagships and the minimum wage standards. These policy statements were reaffirmed by Congress in May 2012.⁸

Overview of 2013 and Future Tax Burdens on US Individuals

At the end of 2012, the House of Representatives followed the Senate in passing H.R. 8, the American Taxpayer Relief Act of 2012 (the "Act"). President Obama

signed this legislation into law on January 2, 2013. Succinctly stated, the Act imposed an income tax increase on top-earning US taxpayers, nudged up the estate tax rate to a maximum of 40% (from 35%), and extended a variety of tax incentives that either had already expired or were set to expire. Tax rates on top-earning individual US taxpayers went up by a significant amount, but triggered beginning at \$400,000. Specifically, for individuals with incomes over \$400,000, beginning in 2013, the highest marginal rate was permanently increased to 39.6%. In addition, the Act imposed a stiff marriage penalty—married couples filing jointly with combined incomes of \$450,000 are subject to the 39.6% rate. For low and moderate income taxpayers, the Act retained the existing rate structure.

The Act, however, does not use the \$400,000 (\$450,000 for married taxpayers filing jointly) thresholds for all purposes. Specifically, the phase-outs for itemized deductions and personal exemptions apply at adjusted gross incomes of \$250,000 for individuals and \$300,000 for joint returns. Also, the Pease limitation on itemized deductions has been reinstated. The Pease limitation reduces most itemized deductions by 3% of the amount by which adjusted gross income exceeds a specified threshold, up to a maximum reduction of 80% of itemized deductions. The thresholds are also going to be adjusted for inflation beginning in 2014. The federal income tax rate on long-term capital gains was increased from 15% to 20% for individuals with incomes of \$400,000 or more (\$450,000 for married couples filing jointly) beginning in 2013. Qualified dividend income remains taxable at the rates applicable to long-term capital gains, and thus at the 20% rate applicable to taxpayers with income of at least \$400,000 (\$450,000 for married couples). Capital gains and other items of net investment income can also be subject to a 3.8% Medicare Tax beginning in 2013.

Notwithstanding these substantial tax increases on individuals with incomes over \$400,000, President Obama has been pressing Congress to consider additional “revenue options.”⁹ The 2013 federal income tax increases, coupled with the prospects for additional tax increases in the near term, has increased the attractiveness of jurisdictions with more moderate tax burdens. As discussed below, Puerto Rico is such a place—at least for the time being. Puerto Rico offers the additional advantage of US citizens not being required to give up their US citizenship.¹⁰

The Puerto Rican Tax Rules for US Individuals Who Become Residents of Puerto Rico

In January 2012, Puerto Rico passed Act No. 22 of 2012 (“Act No. 22”). Act No. 22 contains numerous incentives to encourage individuals to relocate to Puerto Rico. The law provides the following benefits to new Puerto Rico *bona fide* residents on qualified investments (more on who qualifies as a new *bona fide* resident below): (i) 100% tax exemption from Puerto Rico income taxes on all dividends; (ii) 100% tax exemption from Puerto Rico income taxes on all interest; and (iii) 100% tax exemption from Puerto Rico income taxes on all long-term capital gains accrued after the individual becomes a *bona fide* resident of Puerto Rico. The new resident must not have been a resident of Puerto Rico at any time during the 15-year period preceding the effective date of Act No. 22, which period would be from January 16, 1997 through January 16, 2012.

Other complementary laws were enacted in 2012, mainly:

1. The Export Services Act (Act 20 of 2012), which provides for 4% maximum tax rate on income related to services for exportation provided by new Export Services businesses in Puerto Rico.
2. The International Financial Center Regulatory Act (Act 273 of 2012), with the objective of making Puerto Rico an international banking and financial center by providing tax incentives (mainly, a 4% income tax rate) for new banking and financial activity in Puerto Rico that is done for clients outside of Puerto Rico.

There is a process in place whereby an individual files an application for a Puerto Rico tax decree prior to relocation which would serve as a contract guaranteeing the incentives through 2035 from any subsequent changes in local legislation. It should be noted that these efforts are not dissimilar to the Federal government allocating tax credits to stimulate certain types of economic activity (recent examples being renewable energy initiatives), or what states have often done: providing tax holidays to companies to move their factories.

US Individuals Who Become *Bona Fide* Residents of Puerto Rico

In general, a US individual remains subject to full Federal income tax regardless of where (s)he is domiciled.¹¹ The US Internal Revenue Code of 1986, as amended (the “Code”), however, provides special rules for an “individual who is a *bona fide*

resident” of Puerto Rico.¹² Under these special rules, income from sources within Puerto Rico is not included in gross income and is not subject to US federal income tax.¹³ Thus, there are two levels of inquiries for US individuals who relocate to Puerto Rico. First, is the individual a *bona fide* resident of Puerto Rico? If so, what items of income can be included in his or her Puerto Rican income and thereby excluded from US income?

BONA FIDE RESIDENTS OF PUERTO RICO

An individual is considered to be a *bona fide* resident of Puerto Rico if three tests are met. The first test is mostly mechanical. The individual must be present for at least 183 days during the taxable year in Puerto Rico (the “presence test”).¹⁴ Second, the individual must not have a tax home outside of Puerto Rico during the taxable year.¹⁵ Third, the individual must not have a “closer connection” to the United States or a foreign country than to Puerto Rico during the taxable year.¹⁶ Special rules are provided for the year of the move from the United States to Puerto Rico.

The Presence Test

The mechanical 183-day presence test is loosened by Treasury Regulations. Under these regulations, an individual will be considered to meet the presence test if one of five tests is met:¹⁷

1. The individual was present in Puerto Rico for at least 183 days during the taxable year;
2. The individual was present in Puerto Rico for at least 549 days during the 3-year period consisting of the current taxable year and two immediately preceding taxable years, provided that the individual was present in Puerto Rico for at least 60 days during each of those years;¹⁸
3. The individual was present in the United States for no more than 90 days during the taxable year;
4. During the taxable year, the individual had earned income (meaning wages, salary, professional fees and compensation for personal services actually rendered) of less than \$3,000 and was present for more days in Puerto Rico than the United States; or
5. The individual had no significant connection to the United States during the taxable year.

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The importance of keeping a diary to establish presence cannot be underestimated.¹⁹ In addition, a taxpayer should pay for personal items with a credit card. The credit card statement can be used to establish his or her whereabouts on a given day.

Detailed rules are provided for undertaking the day count necessary to determine compliance with the presence test. An individual is considered present on any day that (s)he is physically present in Puerto Rico (no minimum amount of time during that day must be satisfied).²⁰ An individual is considered present in Puerto Rico even if (s)he is outside of Puerto Rico to accompany “on a full-time basis” a parent, spouse or child for certain medical treatment.²¹ Concomitantly, if the individual is present in the United States because (s)he accompanied a parent, spouse or child to the US for specified medical care, his or her presence in the US for such purpose is not counted as a day spent in the United States.²² In addition, an individual is considered to be in Puerto Rico (x) if his or her ability to return to Puerto Rico is prevented due to a major disaster or (y) during a period in which an evacuation order is in effect for the individual's home.²³ Under a tie-breaker rule, if an individual is present in the United States and Puerto Rico on the same day, that day is counted as a day present in Puerto Rico.²⁴

As noted above, even if an individual fails each of the four mechanical presence tests, (s)he can still satisfy the presence test if (s)he has no significant connection to the US. An individual is considered to have a significant connection to the United States if one of three tests are met:²⁵

1. The individual has a permanent home in the US;
2. The individual has a current voter registration in any political subdivision of the US; or
3. The individual has a spouse or child under the age of 18 whose principal place of residence is in the United States unless the child is living in the US with a custodial parent under a custodial decree or the child is in the US as a student.

A permanent home includes a furnished room or an apartment that may be either owned or rented.²⁶ If the place is not occupied for long durations (as opposed to short durations), it is considered a permanent home. Special rules for long durations are provided for properties that the individual own but rents out. Under these special rules, the rental property can be treated as a non-permanent

home if the taxpayer does not use any portion of it as a residence during the taxable year.²⁷

The Tax Home Test

Applicable regulations provide that a person's tax home is considered to be located at his or her "regular or principal place of business."²⁸ If, due to the nature of an individual's occupation (or because the individual does not carry on a trade or business), the individual does not have a regular or principal place of business, then the person's tax home is his or her regular place of residence.²⁹ A tax home must be maintained for the entire taxable year.³⁰

As can readily be seen, in order for an individual to be successful in establishing that (s)he is a *bona fide* resident of Puerto Rico, that person must relocate a substantial portion of his or her business activities to Puerto Rico. In the context of investment management activities, it is likely that satisfaction of this test would require a migration of a substantial portion of the trading and research functions to Puerto Rico. Since the test does not require places of business to be located outside of Puerto Rico, it should be possible to locate middle- and back-office functions outside of Puerto Rico and still satisfy the tax home test. In addition, if an individual desires to retain a US residence following the move to Puerto Rico, the tax home test should not prohibit such a retention, provided that the principal business office is related to Puerto Rico. As discussed immediately below, however, such a choice may bear on whether the individual has satisfied the closer connection test.

The Closer Connection Test

The closer connection test is a facts and circumstance test. Specifically, an individual is considered to have a closer connection to Puerto Rico than elsewhere if (s)he maintains more significant contacts with Puerto Rico than the United States.³¹ Nine non-exclusive factors are listed as relevant to the determination as to whether an individual maintains a closer connection to Puerto Rico than elsewhere:³²

- (i) The location of the individual's permanent home (determined in the same manner as under the presence test³³);
- (ii) The location of the individual's family;

- (iii) The location of personal belongings, such as automobiles, furniture, clothing and jewelry owned by the individual and his or her family;³⁴
- (iv) The location of social, political, cultural or religious organizations with which the individual has a current relationship;
- (v) The location where the individual conducts his or her routine personal banking activities;
- (vi) The location where the individual conducts business activities (other than those that constitute the individual's tax home);
- (vii) The location of the jurisdiction in which the individual holds a driver's license;
- (viii) The location of the jurisdiction in which the individual votes; and
- (ix) The country of residence designated by the individual on forms and documents.

In addition, an individual must be considered to possess a closer connection to Puerto Rico than to the United States or a foreign country *for the entire taxable year*.

An example illustrates the application of the closer connection test to an investment manager.³⁵ In the example, a fund manager with two teenage children in high school relocates to Puerto Rico, but his wife and children remain in the US to complete high school.³⁶ The manager regularly travels back to the US to visit his wife and children, conduct business and take vacations. While he rents an apartment in Puerto Rico, he co-owns a home in the US with his wife where she and their children live. The manager joins the Puerto Rico Chamber of Commerce, but has current social, political, cultural and religious affiliations in the US, receives personal correspondence in the US, including brokerage and bank statements. He also has substantial personal effects at the US residence, remains registered to vote in the US and holds a US driver's license. On these facts, the example concludes that the fund manager has a closer connection to the US.

For individuals concerned about satisfaction of the closer connection test, there is an established body of law in an analogous area. The issue as to whether an individual has a closer connection to Puerto Rico than the United States bears a striking resemblance to the issue as to whether an individual who has relocated from New York State remains subject to tax in New York on the basis that such individual is a New York domiciliary. A person's domicile is the principal establishment to which he intends to return whenever absent.³⁷ New York courts have addressed a substantial number of real-life issues presented by persons who seek to change their domicile that have direct resonance on the closer connection test:

1. Under New York law, an individual is not considered to have changed his domicile by establishing significant ties to a new location if he continues to maintain significant ties to New York.³⁸
2. If the individual retains the original home, (s)he should make substantial efforts to sell such home because such efforts validate that the individual intends to abandon the prior home.³⁹ It may be possible to establish that a former primary residence has become a vacation home or hotel substitute, but this might be very difficult to prove in a given case.⁴⁰
3. If a business is maintained in the United States, the individual may be considered to have a closer connection to the United States than Puerto Rico if the individual maintains considerable and continuous contact with that business through telephone and electronic/computer contact.⁴¹

The NYS Audit Guidelines also note certain additional factors that would support an individual's assertion that (s)he has a closer connection to Puerto Rico than the United States. All invoices, financial data and correspondence should be addressed to the Puerto Rico address. Safe-deposit boxes should not be maintained in the United States, but should be maintained in Puerto Rico. Automobile, boat and airplane registrations should show the Puerto Rico address. Legal documents, such as wills and divorce decrees, should show the Puerto Rico address of the individual who has redomiciled to Puerto Rico. The NYS Guidelines treat the following items as "nonfactors" of domicile: (i) where a will is probated, (ii) passive interests in partnerships, (iii) bank account locations, (iv) contributions to political causes, and (v) where the individual's tax return is prepared.

CERTAIN SPECIAL RULES FOR THE YEAR OF THE MOVE TO PUERTO RICO

Special rules apply to determine whether the tax home test and the closer connection test are satisfied during the taxable year during which the individual relocates to Puerto Rico. An individual is eligible to take advantage of the special rules if three tests are met.⁴² First, the individual must not have been a *bona fide* resident of Puerto Rico during each of the three taxable years preceding the year of the move. Second, during the second half of the year of the move, the individual must not have had a tax home in, or closer connection to, the United States or a foreign country than Puerto Rico. Last, the individual must be a *bona fide* resident of Puerto Rico for each of the three years following the year of the move to Puerto Rico. If each of these tests are met, the individual will be considered to have satisfied the tax home and closer connection requirements for the year of the relocation.

INCOME ELIGIBLE TO BE EXEMPT FROM UNITED STATES FEDERAL INCOME TAX

There seems to be a common misperception that once an individual has become a *bona fide* resident of Puerto Rico, all income earned by such individual escapes US federal income tax. The exception, however, is not this broad. Specifically, Code § 933(1) limits the exemption to “income derived from sources with Puerto Rico.” Applicable regulations provide detailed rules on when income will be considered to have been derived from Puerto Rican sources.⁴³

As a starting point—and luckily for tax practitioners—is that the normal source rules contained in Code §§ 861 through 865 apply *mutatis mutandis* in determining whether income is from sources within Puerto Rico. Accordingly, the source of investment income, such as interest and dividends, retains its US-source income status when paid by US corporations to a *bona fide* resident of Puerto Rico.⁴⁴ Since this income is US-source income, not Puerto Rican-source income, it remains subject to full federal income tax in the hands of a *bona fide* resident of Puerto Rico. In addition, even if investment income is derived in connection with the conduct of a trade or business in Puerto Rico, such income retains its character as US-source income.⁴⁵ All income earned in connection with the conduct of a trade or business in the United States is treated as US-source income as well.⁴⁶

The source rules applicable to determining when income is derived from sources within Puerto Rico also contain an anti-abuse rule in the form of an “anti-

conduit” rule.⁴⁷ Under the anti-conduit rule, if income is paid to a *bona fide* resident of Puerto Rico from Puerto Rican sources and the payer of the income (or another person) provides the same consideration to a third person in exchange for US-source income, then the income paid to the *bona fide* resident of Puerto Rico is not treated as Puerto Rican source income. For example, assume that a *bona fide* resident of Puerto Rico (“A”) provides services to a Puerto Rican service recipient (“X”). X provides the same services to a US company (“Y”) for the same consideration that A pays to X, but provides the services in the United States. Under these circumstances, the income that A derives from X will not be considered to be Puerto Rican source income, even if all of the services provided by A are within Puerto Rico.

While capital gains generally are not US-source income when recognized by a nonresident not connected with the conduct of a US trade or business, to the extent that such gains were built-in gains when the non-US person became a *bona fide* resident of Puerto Rico and the disposition takes place within 10 years of the individual becoming a *bona fide* resident of Puerto Rico, such gains remain subject to US federal income tax.⁴⁸ In general, the portion of the gain that is treated as built-in gain is determined based upon the relative holding period of the property.⁴⁹ In the case of marketable securities, however, the portion of the gain that is subject to US federal income is determined by using the closing price of the securities on the first day of the possessions holding period (the date on which the individual became a *bona fide* resident of Puerto Rico).⁵⁰

Savvy investors may attempt to manipulate the source rules by creating a Puerto Rican corporation to hold investments. The idea here is that the dividends and interest paid by the Puerto Rican corporation would be considered to be Puerto Rican source income in the hands of the *bona fide* resident of Puerto Rico. There are, however, substantial limitations on the ability to implement this strategy. First, Puerto Rican corporations are treated as non-US corporations for federal income tax purposes. As a result, dividends paid by US corporations to Puerto Rican corporations are subject to a 10% (or 30%) withholding tax.⁵¹ The higher withholding tax applies unless three conditions satisfied. Specifically, foreign persons must hold less than 25% of the stock of the Puerto Rican corporation, at least 65% of the income of the Puerto Rican corporation must be derived from the conduct of a US trade or business, and no substantial part of the income of the Puerto Rican corporation can be used to satisfy obligations to persons who are not *bona fide* residents of Puerto Rico.⁵²

The US subpart F rules are coordinated with the exclusion for amounts paid to *bona fide* residents of Puerto Rico. Under these coordination rules, a shareholder of a Puerto Rican corporation cannot be treated as a “United States shareholder” if the shareholder is a *bona fide* resident of Puerto Rico and a dividend paid by the corporation would be treated as an item of Puerto Rican source income in the hands of the shareholder.⁵³ While dividends paid by a Puerto Rican corporation would be treated as Puerto Rican-source income under the normal source rule, special source of income rules apply when the shareholder holds at least 10% of the total voting stock of the Puerto Rican corporation.⁵⁴ Under this special source rule, the source of the dividend (and interest) is determined by reference to the source of income of the payer corporation. For example, if only 50% of the income of the Puerto Rican corporation was derived from sources within Puerto Rico, then only 50% of the dividends paid by the corporation would be Puerto Rican-source income. The “look-through” source rules do not apply if 80% of the income of the corporation was derived from sources within Puerto Rico.⁵⁵

The Expatriation Rules Do Not Apply to a Relocation to Puerto Rico

Rules have been in place to prevent tax-motivated expatriations since 1966, when Code § 877 was enacted. Code § 877 caused former US taxpayers who expatriated for tax purposes to remain subject to US tax for a 10-year period. In addition, over time, the rules have been modified several times in order to make it harder and more expensive for people to exit the US tax net. In 1996, Congress enacted what is now Code § 6039G which requires expatriates to identify themselves and register with the IRS by filing IRS Form 8854 or be subject to US tax until they do so. Finally, Congress enacted Code § 877A in 2008. This new section exacts a toll charge at the time of expatriation. Code § 877A requires mark-to-market of assets, and tax paid on the mark-to-market gain upon expatriation. These rules do not apply to a US individual who relocates to Puerto Rico.

Concluding Remarks

Puerto Rico Law 22 provides a clear Puerto Rican tax-incentive for investors to consider the arduous process of relocating their personal life and business affairs to Puerto Rico. The benefits of the new Puerto Rican tax regime, however, are substantially tempered by the existing US rules which, except for income that is derived from Puerto Rican sources and capital gains economically attributable to

the holding period during which the individual is a *bona fide* resident of Puerto Rico, continue to apply to *bona fide* residents of Puerto Rico. Hopefully, these extraordinary measures will assist Puerto Rico in its efforts to attract investors and to rebuild the economy of “*La Isla del Encanto*.” ♦

Endnotes

- 1 In response to the dire economic circumstances that led to massive emigration, the Puerto Rican government launched “Operation Bootstrap” in 1948. This operation was designed to encourage private business investment, both local and foreign, to accelerate the island’s industrial development. Local tax holidays were complemented by Federal income tax exemptions for US corporations operating in Puerto Rico. Under section 931 of the Internal Revenue Code of 1954 and successor Section 936 of the Internal Revenue Code of 1986, as amended (the “Code”), a US corporation that derived gross income from the active conduct of a trade or business in Puerto Rico received a Federal income tax credit which, in most cases, eliminated the Federal income tax otherwise due on those earnings. Also, Federal income tax rules allowed the repatriation of those earnings to the US parent company without the imposition of Federal income taxes.
- 2 By 1958, the gross product of Puerto Rico more than doubled, similarly for per capita income according to Baer, Werner (1959) “Puerto Rico: An Evaluation of a Successful Development Program,” *The Quarterly Journal of Economics*, November 2013.
- 3 Code § 936 was repealed in 1994. US Government Accounting Office (2006, May). 2006 Puerto Rico Fiscal Relations with the Federal Government and Economic Trends during the Phase-out of the Possessions Tax Credit (Publication No. GAO-06-541).
- 4 L. Browning and J. Creswell, “Puerto Rico Creates Tax Shelters in Appeal to the Rich,” *The New York Times Dealbook* (March 25, 2013).
- 5 Marino, “Law 22 Attracting Millionaire Investors to Puerto Rico,” *Caribbean Business PR*, Vol. 41, No. 11 (March 28, 2013).
- 6 See Marino, “Puerto Rico Attracting Wealthy Investors, Service Firms” (reporting that 10 wealthy individuals have moved to Puerto Rico since the law changes described herein), *Caribbean Business PR*, Vol. 41, No. 9 (March 14, 2013).
- 7 Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (JCS-10-87), May 4, 1987, pp. 999-1000, available at <http://www.jct.gov/jcs-10-87.pdf>.
- 8 Joint Committee on Taxation, FEDERAL TAX LAW AND ISSUES RELATED TO THE UNITED STATES TERRITORIES (JCX-41-12), May 14, 2012, p. 24 available at <https://www.jct.gov/publications.html?func=showdown&id=4427>.
- 9 See generally, Salant, “McCain Praising Obama Backs Revenue Compromise on Budget,” [REDACTED] (March 23, 2013).
- 10 Under Code § 933, a US citizen who becomes a *bona fide* resident of Puerto Rico (i.e., changes domicile to Puerto Rico) is not subject to Federal income tax on income from Puerto Rico sources. By contrast, under Code § 877A, a US citizen who relinquishes his US citizenship could be subject to income tax on the unrealized appreciation of his/her assets.
- 11 US person includes a citizen or resident of the United States. Code § 7701(a)(30)(A).
- 12 See Code § 933(1) (rules for individuals who are *bona fide* residents of Puerto Rico for an entire taxable year).
- 13 *Id.*
- 14 Code § 937(a)(1).

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- 15 Code § 937(a)(2).
- 16 *Id.*
- 17 Treas. Reg. § 1.937-1(c)(1).
- 18 See Treas. Reg. § 1.937-1(g)(Ex.1).
- 19 State of New York, Department of Taxation and Finance, Income franchise Field Audit Bureau, Nonresident Audit Guidelines, p. 26 (2009) (the "NYS Audit Guidelines").
- 20 Treas. Reg. § 1.937-1(c)(3)(i)(A).
- 21 Treas. Reg. § 1.937-1(c)(3)(i)(B). Detailed documentation requirements apply in order for an individual to be able to take advantage of this rule. See Treas. Reg. § 1.937-1(c)(4)(iii).
- 22 Treas. Reg. § 1.937-1(c)(3)(ii)(A).
- 23 Treas. Reg. § 1.937-1(c)(3)(i)(C).
- 24 Treas. Reg. § 1.937-1(c)(3)(iii)(A). Under a similar rule, if an individual is present in Puerto Rico and another jurisdiction on the same day, the individual is considered to be present in the jurisdiction in which his or her tax home is located. Treas. Reg. § 1.937-1(c)(3)(iii)(B).
- 25 Treas. Reg. § 1.937-1(c)(5)(i).
- 26 Treas. Reg. § 301.7701(b)-2(d)(2).
- 27 Treas. Reg. § 1.937-1(c)(5)(ii)(B).
- 28 Treas. Reg. § 1.937-1(d)(1). See also Treas. Reg. § 301.7701-2(c)(1).
- 29 *Id.*
- 30 Treas. Reg. § 301.7701(b)-2(c)(2).
- 31 See Treas. Reg. § 1.937-1(e)(1), incorporating the rules contained in Treas. Reg. § 301.7701-(b)-2(d).
- 32 Treas. Reg. § 301.7701(b)-2(d)(1). This list contains 10 factors, but the tenth factor is not relevant *vis-à-vis* the relationship between the United States and Puerto Rico.
- 33 Treas. Reg. § 301.7701(b)-2(d)(2). It is worth noting that occasional use of United States business facilities should not cause an individual to have a closer connection to the United States. NYS Audit Guidelines, p. 36.
- 34 Special attention should be paid to specific items of value, such as jewelry, a rare book, art or an antique collection. NYS Audit Guidelines, p. 29. In addition, insurance policies should be amended to state that these items have been moved to Puerto Rico. *Id.* See *Matter of James & Helen Dittrich*, DTA No. 811479.
- 35 Treas. Reg. § 1.937-1(g)(Ex.7).
- 36 The fact that the children remain in the United States in boarding school should not be indicative of a closer connection to the United States. NYS Audit Guidelines, p. 32.
- 37 NYS Audit Guidelines, p. 9.
- 38 *Matter of Rudolph & Loretta Zapka*, DTA No. 804111.
- 39 *Matter of Jack Silverman and Frances Silverman*, DTA No. 802313; *Matter of Minsky v. Tully*, 433 [REDACTED] 2d 276.
- 40 [REDACTED] Audit Guidelines, p. 35.
- 41 *Matter of Herbert L. Kartiganer*, 599 [REDACTED] 2d 312; *Matter of Richard & Jean Gray*, 235 AD 2d 641.
- 42 Treas. Reg. § 1.937-1(f)(1).
- 43 See Treas. Reg. § 1.937-2.

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- 44 Code § 937(b)(1); see Treas. Reg. § 1.861-2(a)(1) (interest paid by a US resident to a non-US person is treated as US-source income); Treas. Reg. § 1.861-3(a)(2) (dividends paid by a US corporation is US-source income).
- 45 Treas. Reg. § 1.937-2(c)(1)(i).
- 46 Treas. Reg. § 1.937-2(c)(1)(ii).
- 47 Treas. Reg. § 1.937-2(c)(2).
- 48 Treas. Reg. § 1.937-2(f)(1)(ii).
- 49 Treas. Reg. § 1.937-2(f)(1)(vi)(B).
- 50 Treas. Reg. § 1.937-2(f)(1)(vi)(A).
- 51 See Code § 881(b)(2).
- 52 Code § 881(b)(2)(A)(ii).
- 53 Code § 957(c)(1).
- 54 Treas. Reg. § 1.937-2(g)(1).
- 55 Treas. Reg. § 1.937-2(g)(1)(ii)(A).

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