

**Report to Congress Pursuant to Pub. L. 116-93
Regarding Interaction of Certain
Puerto Rico and U.S. Tax Laws**

In the legislative history of the Consolidated Appropriations Act, 2020 (Pub. L. 116-93), the House Committee on Appropriations (the Committee) provided as follows:

Tax Avoidance.—The Committee is concerned by the interplay between new territorial tax laws (Puerto Rico Acts 20 and 22 of 2012) and section 933 of the U.S. [Internal Revenue] Code that enables tax avoidance and denies revenues to Federal, state, and territorial governments, including Puerto Rico. Therefore, the Committee directs the IRS to submit a report within 180 days of enactment of this Act that provides the number of individuals and businesses that have relocated from each state and the District of Columbia to Puerto Rico since 2012 and have been granted tax exemptions under Puerto Rico Acts 20 and 22. The report should include the amount of Federal taxes paid by such individuals and businesses by type of tax and jurisdiction of former residences during each of the five years prior to their move. In addition, the Committee directs the IRS to publish a report in a user-friendly format with possible options and policies that would minimize the revenue losses to the Federal, state, and territorial governments.¹

The Puerto Rico statutes referred to by the Committee are the “Act to Promote the Export of Services,” enacted by the Puerto Rico legislature on January 20, 2012 (also known as Act 20), and the “Act to Promote the Relocation of Individual Investors to Puerto Rico,” enacted on January 17, 2012 (also known as Act 22).² This report provides the data requested by the Committee to the extent it is available to the Internal Revenue Service (IRS). This report also addresses tax administration options relating to the interplay of § 933 of the Internal Revenue Code (the Code) and Acts 20 and 22.³

¹ H.R. Rep. No. 116-122 at 24 (Jun. 19, 2019). This House committee report accompanied H.R. 3351 (Financial Services and General Government Appropriations Act, 2020), a limited appropriations bill that was combined with others into a consolidated appropriations bill, H.R. 1158, and enacted into law as the Consolidated Appropriations Act, 2020 (Pub. L. 116-93, enacted December 20, 2019). The Joint Explanatory Statement released in connection with the Consolidated Appropriations Act, 2020 indicated that all requirements of H.R. Rep. No. 116-122 are to be complied with, further providing that when the House or Senate has directed submission of a report, that report is to be submitted to the Committees on Appropriations of the House and Senate. See Joint Explanatory Statement, Division C, at <https://rules.house.gov/bill/116/hr-1158-sa>.

² On July 1, 2019, the Governor of Puerto Rico signed into law Act 60-2019, also known as the Puerto Rico Tax Incentives Code, which consolidated dozens of tax decrees, incentives, subsidies and tax benefits in a single statute, effective January 1, 2020. Acts 20 and 22 were among the incentive provisions that were consolidated into Act 60-2019. Notwithstanding this consolidation, Acts 20 and 22 are still commonly referred to by their original designations and in this report will be referred to as Act 20 and Act 22.

³ The IRS has addressed the request for such options in this report rather than in a separate report. The IRS is amenable to consulting with the Committee on any specific further public outreach it considers appropriate.

I. Requested Data Regarding Puerto Rico Acts 20 and 22

At this time, the IRS has not obtained complete data from Puerto Rico's Department of Economic Development and Commerce (DDEC) or Hacienda (the Puerto Rico tax agency) relating to Acts 20 and 22 beneficiaries. Therefore, the IRS cannot provide complete responses to the request for statistics in H.R. Rep. No. 116-122.⁴ In January 2020, in the course of gathering information for this report, the IRS requested information from Puerto Rico concerning the beneficiaries of Acts 20 and 22. The IRS received partial information from Puerto Rico in March 2020.⁵

Based on data received from Hacienda and drawn from the DDEC's public website for the years 2012 through 2019, Puerto Rico granted Act 20 benefits to 1,924 applicants (comprised of corporations, LLCs, partnerships, and other types

⁴ The Puerto Rico government has included some basic statistical data in its general informational publications regarding Acts 20 and 22. See *2015 Act 20 and 22 Economic Impact Study*, available at https://estadisticas.pr/files/BibliotecaVirtual/estadisticas/biblioteca/DDEC_Act_20_22_Economic_Impact_Study_2015.pdf;

2016 Update: Economic Assessment Act 20/22 Summary of Results, available at

<http://www.estudiotecnicos.com/projects/act2022update/Presentacion-update-DDEC-20-22-final.pdf>;

2017 Puerto Rico Tax Expenditure Report, available at

http://www.hacienda.pr.gov/sites/default/files/comunicaciones/puerto_rico_tax_expenditure_report_2017_version_final_septiembre_2019.pdf;

2018 Economic Development Plan Executive Summary, available at

<https://www.ddec.pr.gov/wp-content/uploads/2018/12/PDEI.pdf>;

2019 Performance of Incentives Program, available at

https://www.ddec.pr.gov/wp-content/uploads/2019/11/Performance_of_Incentives_Report-Act_20_and_Act_22.pdf;

2019 Update: Economic Assessment Act 20/22 Summary of Results, available at

<http://www.estudiotecnicos.com/projects/act2022update2019/2019-Summary-results.pdf>;

⁵ Upon request to Hacienda for background information on approved applications, DDEC responded that it has the information but indicated that it could not provide the information absent the receipt of an official subpoena requiring production. Except where information is needed in connection with a specific taxpayer case, the IRS generally does not have the legal authority to compel production (via an IRS summons) of comprehensive information. It may be possible for Congress to obtain such information from DDEC, e.g., through the issuance of an investigative subpoena, a direct congressional request to the oversight board established under the Puerto Rico Oversight, Management, and Economic Stability Act of 2016 (PROMESA), or a request to the U.S. Government Accountability Office.

of juridical persons). The following table shows the number of entities granted Act 20 benefits during each of the years 2012 through 2019:

Year	Number of Act 20 Beneficiaries
2012	32
2013	49
2014	120
2015	153
2016	251
2017	157
2018	579 ⁶
2019	583
Total	1,924

Hacienda provided Employer Identification Numbers (EINs) for approximately 80 percent (1,541) of the 1,924 entities. For 1,482 of these 1,541 entities, no IRS filing history was found for the years prior to the date the DDEC granted Act 20 benefits to the entity. The absence of IRS filing history is consistent with the observation that most of these entities had EINs with a prefix of “66,” which generally indicates that the location of the employer, reporting entity, or the servicing IRS District Office is in Puerto Rico. Thus, these entities appear to have been newly formed to do business in Puerto Rico.

Of the 59 remaining entities that have a filing history with the IRS prior to the grant of Act 20 benefits, the IRS conducted a search in its databases to determine how much federal income taxes they paid in the five years prior to the year the DDEC granted Act 20 benefits. Upon a closer look at this smaller population, the IRS observed that the number of entities reporting income taxes paid was insignificant. A factor that could account for this circumstance is that a newly formed entity will still be in the start-up phase of operations and thus not profitable, with the result that such entities would not have a liability to pay federal income taxes in those years.

⁶ The dramatic increase in the numbers of decrees between 2017 and 2018 was the result of multiple factors, including an increase in DDEC’s approval rate, legislative changes, promotional efforts, and the impact of Hurricane María on approvals in late 2017. See *2019 Performance of Incentives Program*, available at https://www.ddec.pr.gov/wp-content/uploads/2019/11/Performance_of_Incentives_Report-Act_20_and_Act_22.pdf, at p.6.

As to Act 22 benefits, during the years 2012-2019, the DDEC granted such benefits to 2,331 individuals who had established residence in Puerto Rico. The following table shows the number of individuals granted Act 22 benefits during each of the years 2012 through 2019:

Year	Number of Act 22 Beneficiaries
2012	17
2013	107
2014	253
2015	253
2016	346
2017	300
2018	637 ⁷
2019	418
Total	2,331

The information in the table below was derived from the information that Hacienda obtained from the DDEC's public website and provided to the IRS with respect to the 2,331 individuals who obtained Act 22 benefits, along with additional identifying information provided by Hacienda relating to a portion of these 2,331 beneficiaries. Using this data, the IRS conducted a search in IRS databases to determine how much federal income taxes the Act 22 beneficiaries paid in the five years prior to the year such benefits were granted to them by the DDEC. The IRS used address information listed on federal income tax returns to determine the state of former residence of Act 22 beneficiaries prior to moving to

⁷ As with Act 20, it is likely that the large number of decrees approved in 2018 was in part a result of the impact of Hurricane María on approvals in late 2017. See *2019 Performance of Incentives Program*, available at https://www.ddec.pr.gov/wp-content/uploads/2019/11/Performance_of_Incentives_Report-Act_20_and_Act_22.pdf, at p.14.

Puerto Rico. After combining these sources of data, the IRS was able to obtain information on 647 Act 22 beneficiaries, as indicated in the following table:

Jurisdiction	Number of Act 22 Beneficiaries	Federal Income Taxes Paid in the Five Years Prior to Relocation to Puerto Rico⁸
California	34	\$14,095,068
Florida	51	\$55,542,376
New Jersey	13	\$11,394,710
Nevada	10	\$2,942,857
New York	32	\$27,907,020
Puerto Rico ⁹	166	\$252,256,178
Texas	23	\$86,837,955
Unknown ¹⁰	223	\$29,317,344
31 other states with fewer than 10 beneficiaries ¹¹	95	\$77,684,604
Total	647	\$557,978,112

The 647 individuals for whom specific identifying information was provided represent slightly more than 25 percent of the entire population (27.75 percent) of the 2,331 individuals granted Act 22 benefits. This subset of the population collectively paid \$557,978,112 in federal income taxes in the five years prior to relocating to Puerto Rico. Because Hacienda did not provide the IRS with the methodology it used to locate and identify the 647 individuals in the subset, the IRS is unable to determine whether these individuals were randomly chosen or otherwise represent a statistically significant grouping that would allow extrapolation to the entire population of 2,331 Act 22 beneficiaries so as to be fairly representative of data with respect to that total population.

⁸ When determining the jurisdiction of former residence based on the data available, the IRS assumed aggregated taxes paid in the year prior to the individual's application for Act 22 benefits. For example, if an individual lived in two different states during the five years prior to the individual's application for Act 22 benefits, the individual's five-year aggregate of taxes paid was identified entirely to the jurisdiction of residence in the year immediately preceding the move to Puerto Rico, with no taxes identified to the other jurisdiction of residence within the five-year period of look-back.

⁹ The U.S. income tax filing history of these 166 Puerto Rico individuals indicates that 35 moved from California, 26 from Florida, 10 from Nevada, 13 from New York, 14 from Texas, and 68 from 24 other states with fewer than 10 individuals.

¹⁰ For these 223 individuals, their jurisdiction of residence before the year of move to Puerto Rico was not known.

¹¹ Because of § 6103 confidentiality restrictions, this table does not specify states of former residence for Act 22 beneficiaries where there were fewer than 10 beneficiaries from the state.

II. Policy and Related Tax Administration Considerations

The U.S. and Puerto Rico tax laws whose interaction is of concern to the Committee may be summarized very generally as follows:

Under § 933 of the Code, bona fide residents (as defined under § 937(a)) of Puerto Rico exclude Puerto Rico-source income from their U.S. income tax base (§ 933 exclusion).¹² Such individuals are subject to U.S. income tax and file an income tax return with the IRS only to the extent they have U.S. or other non-Puerto Rico-source income to report. A bona fide resident who has only Puerto Rico-source income is only required to file a Puerto Rico income tax return with Hacienda and generally is not required to file a federal income tax return with the IRS.

In general, § 937(b)(1) provides that rules similar to the rules for determining whether income is from sources within the United States or is effectively connected with the conduct of a trade or business within the United States apply for determining whether income is from sources within a U.S. territory or effectively connected with a U.S. territory business. Sections 861 and 862 provide that income from financial investments, like interest and dividends, is generally sourced based on the payor's residence (or in some cases by the location of the payor's activities). Under § 937(b) and the regulations thereunder, whether gain (or loss) from the sale or exchange of personal property -- tangible or intangible (e.g., stocks and bonds) -- is considered to be from sources within a U.S. territory is generally determined under § 865. Section 865 provides that if an item of personal property is not part of a U.S. trade or business and is either personal-use property or investment property, the source of the gain from the disposition of that property will generally be based on the seller's residence. However, if the gain is from property disposed of within the 10-year period after the individual becomes a bona fide resident of a U.S. territory, a special rule provides generally that the gain is not treated as territory-source income (except that the taxpayer can elect to treat as territory-source the portion of any gain attributable to the period after becoming a bona fide resident). Treas. Reg. § 1.937-2(f)(1). Accordingly, in the case of a bona fide resident of Puerto Rico, such gains are not excluded from U.S. taxable income under § 933.

In general terms, Act 20 applies to Puerto Rico businesses that perform services inside Puerto Rico for customers based outside of Puerto Rico. Eligible businesses can qualify for a 4-percent fixed Puerto Rico corporate tax rate on

¹² Puerto Rico is not the only U.S. territory for which the Internal Revenue Code provides a statutory exclusion mechanism to coordinate the federal income tax base with the territorial income tax base. For example, with respect to American Samoa, see § 931 (excluding income from sources in American Samoa from U.S. gross income of bona fide residents of the territory). Guam and the Commonwealth of the Northern Mariana Islands will also become subject to the § 931 exclusion at such time as they enter into implementing agreements with the United States (as American Samoa has done). Pub. L. 99-514, §1271(b) (1986).

income derived from these services and no Puerto Rico income tax on distributions, and certain businesses providing services of strategic importance to the economic and social interests of Puerto Rico can qualify for a 3-percent fixed Puerto Rico income tax rate on income derived from the export of services. Act 22 exempts from Puerto Rico income tax certain interest and dividends sourced in Puerto Rico and provides reduced income tax rates for individuals who newly establish residence in Puerto Rico and derive long-term capital gains from the sale of certain property.

In certain situations, the operation of Puerto Rico law (in particular Act 22) in conjunction with the § 933 exclusion may have the result that Puerto Rico-source income such as interest, dividends, and capital gains, could be wholly or partially exempt from both U.S. and Puerto Rico income tax. Such a result is not inconsistent with Congress's long-standing recognition of Puerto Rico's autonomy in matters of internal governance, including territorial tax law and policy, as memorialized in the enactment of the Federal Relations Act (Pub. L. 81-600) in 1950 and approval of Puerto Rico's constitution in 1952. Puerto Rico is generally permitted to enact its own income tax laws provided they do not conflict with the U.S. Constitution or statutes, and the territory's legislative process is separate from that of the United States. Similarly, Congress has permitted other U.S. territorial governments to provide special tax rules or incentives to their residents with respect to territory-source income or income effectively connected to the conduct of a trade or business in the territory. See, for example, § 934 of the Internal Revenue Code (applicable to the U.S. Virgin Islands), and § 601 of the Covenant to Establish the Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, Pub. L. 94-241, codified at 48 U.S.C. 1801 et seq. (allowing the territorial government to rebate local territorial income tax on income derived from Northern Mariana Islands sources).

Several commentators have discussed in detail the various interactions that can arise between U.S. tax law and Puerto Rico Acts 20 and 22.¹³ Under the Tax Coordination Agreement between the governments of the United States and the Commonwealth of Puerto Rico (dated May 26, 1989), the IRS is authorized to consult with Hacienda on matters of tax administration, including in compliance

¹³ See e.g., Mark Leeds and Gabriel Hernandez, *U.S. and Puerto Rican Tax Incentives for Bona Fide Residents*, TAX NOTES, May 13, 2013, p. 790; Boris Popov, *Tax Advantages for U.S. Traders of Securities and Commodities Relocating to Puerto Rico*, THE TAX ADVISOR, October 1, 2014, <https://www.thetaxadviser.com/issues/2014/oct/popov-oct14.html>; Lauren Debter, *Treasure Island: Puerto Rico Bids To Become New Age Tax Haven*, FORBES, March 2, 2015, <https://www.forbes.com/sites/laurengensler/2015/02/11/puerto-rico-new-age-tax-haven/#6dc7e34657c9>; Martin A. Sullivan, *New Puerto Rico Investor Breaks Echo Section 936*, TAX NOTES, March 30, 2015, p. 1132; Jason Sampas, *Puerto Rico: America's Tax Haven or Vacation Paradise*, 21 LAW & BUS. REV. AM. 49 (2015), <https://scholar.smu.edu/lbra/vol21/iss1/4>; Fernando Goyco Covas, *Puerto Rico: A Tax Haven for Hedge Fund Managers*, TAX NOTES, August 22, 2016, p. 1131; Jesse Barron, *How Puerto Rico Became a Tax Haven for the Super Rich*, GQ, September 18, 2018, <https://www.gq.com/story/how-puerto-rico-became-tax-haven-for-super-rich>.

matters, and to pursue public outreach to promote wider understanding of the parties' respective tax laws and their interaction. Because of disclosure restrictions and law enforcement sensitivities, the IRS is not permitted to discuss at this time whether any specific taxpayer compliance problems have been identified or whether any compliance initiatives have been contemplated or undertaken in this area.

In response to the Committee's query about options to minimize revenue losses, the IRS will pursue the following:

1. Work with Hacienda to explore the potential to expand the tax information-sharing program between the IRS and Hacienda to require Hacienda to send the IRS on a regular basis a list of taxpayers that newly claim bona fide residency in Puerto Rico or obtain Puerto Rico income tax benefits during the year.
2. Encourage Hacienda to conduct outreach to promote public understanding of the requirements of the § 933 exclusion and the residence and source rules under § 937 (such as the operation of Treas. Reg. § 1.937-2(f)(1)), including in the context of the rules governing eligibility for the benefits of Acts 20 and 22, to ensure that the interaction of these provisions results in appropriate taxation in the United States and Puerto Rico.

Substantive changes to the operative law in this area may require legislation. Legislative options are within the jurisdiction of the Office of Tax Policy of the Treasury Department and would require its analysis and study.