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IRS Targets High-Income Individuals Illegally Claiming Puerto Rico's Tax Benefits.

The Internal Revenue Service ("IRS") Commissioner Danny Werfel stated that the Agency is taking "swift and aggressive action" to strengthen enforcement efforts against high-income individuals. As part of these enforcement efforts, the IRS identified approximately 100 individuals, including crypto traders and fund managers suspected of illegally claiming Puerto Rico's tax benefits. According to the IRS, the enforcement efforts will include both civil audits and criminal investigations.

For taxpayers not in compliance with Puerto Rico Act 60 (formerly Acts 20 and 22) requirements, they must act swiftly to take corrective action. In July of this year, Puerto Rico's Secretary of Economic Development and Commerce stated he is actively cooperating with the IRS in their efforts to identify individuals that are abusing Puerto Rico's tax benefits.

On January 27, 2021, the IRS announced its compliance campaign that focused on Puerto Rico Act 60 ("Act 60"). Act 60 consolidated various tax decrees, incentives, subsidies, and benefits, including Acts 20 and 22. Acts 20 and 22 were intended to incentivize investment in Puerto Rico, promote the exportation of services from companies and individuals providing such services and attract high net-worth individuals to Puerto Rico.

Taxpayers that meet the requirements of Act 60 are eligible to receive significant tax savings. For example, Act 60 offers a corporate tax rate of 4% to Puerto Rico domiciled companies that export services performed in Puerto Rico to people or companies outside of the territory. Similarly, high net-worth individuals may qualify for a total exemption from Puerto Rico income taxes on all interest and dividends realized after the individual becomes a bona fide resident of Puerto Rico.

Puerto Rico is a United States territory (and generally subject to all US federal laws); however, for federal tax purposes, Puerto Rico is treated as a "foreign country." The Internal Revenue Code ("Code") states that US citizens and resident aliens are taxed on worldwide income; however, section 933 provides an exception to this general rule. Residents of Puerto Rico receive special tax treatment for Puerto Rico sourced income.

The IRS's new campaign targets taxpayers who have claimed benefits through Puerto Rico Act 60 without meeting the requirements of section 933, Residence and Source Rules Involving Possessions. Consequently, the IRS has identified certain individuals who may be excluding income subject to US tax on a filed US income tax return or failing to file and report income subject to US tax. As such, the IRS campaign will also address those individuals who have met the requirements of section 933 but may be erroneously reporting US source income as Puerto Rico source income in order to avoid US taxation.

To enhance voluntary compliance with the tax laws, the IRS partners with foreign jurisdictions, federal, state and municipal governmental agencies. These partnerships often involve some type of formal agreement such as a Memorandum of Understanding ("MOU") or Tax Coordination Agreement ("TCA") that allows for the exchange of taxpayer data. Article 4 of the TCA between the

US and the Commonwealth of Puerto Rico allows for the exchange of information to administer and enforce the tax laws of the respective jurisdiction.

In this IRS campaign the IRS will utilize various methods to detect noncompliance, including examinations and outreach via soft letters. Consequently, it is reasonable to assume the IRS has started identifying those individuals who may fall under the scope of this audit campaign.

Taxpayers should review their reporting positions and, if appropriate, consider correcting past non-compliance before the IRS comes to their door. We have experience advising clients through a variety of IRS controversy matters including voluntary disclosures, civil audits and criminal investigations. Similarly, we are well versed in evaluating Puerto Rico-specific tax issues.

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