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Puerto Rico Tax Planning for U.S. Citizens

Wealth Strategy Insights

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Puerto Rico Taxation: Tax Haven or Tax Headache?

Major Takeaways:

- To qualify as a "bona fide resident" of Puerto Rico, individuals must meet strict residency tests.
- To the extent an individual becomes a bona fide resident, then there is the potential to apply, and pay for, preferential tax treatment on certain income.
- While this treatment can include a 0% tax rate on certain current income, to the extent there are built-in capital gains at the time of the move, those gains may still be taxable in the U.S. unless the individual has been a Puerto Rico resident for over 10 years.
- To qualify for the individual benefits, the income must be received or recognized by 2036.
- Similar to the individual incentives, there are business tax incentives that have their own restrictions and application process.

Overview

Year-round sun and warmth, sand between your toes, zero taxes and you do not have to give up your U.S. citizenship!? Recently, many wealthy U.S. citizens have been flocking to the United States territory of Puerto Rico, with plenty more contemplating the move, in search of just that. Sound too good to be true? It just might be.

While all these individuals will find the year-round sun, warmth, and the sand, not all will find the tax haven they are expecting, because as is always the case with taxes, the devil is in the details.

U.S. and in General Puerto Rico Income Taxation

- U.S. citizens and resident aliens are generally subject to U.S. federal income tax[1] on their worldwide income, including Puerto Rico source income, regardless of their domicile or residency and the source of the income.

- However, U.S. citizens who are "bona fide residents" of Puerto Rico may exclude income from sources within Puerto Rico when calculating their U.S. federal income tax. This exclusion for Puerto Rico source income only covers the U.S. federal income tax and "bona fide residents" of Puerto Rico may still pay Puerto Rico income tax[2] on their Puerto Rico source income.

[1] The top income tax rate in the U.S. is currently 37% and the top long-term capital gains rate is currently 20%.
[2] The top income tax rate in Puerto Rico is currently 33% and the top long-term capital gains rate is currently 15%.

Bona Fide Residency

In order for a U.S. citizen or resident alien to exclude Puerto Rico source income when calculating their U.S. federal income tax, the individual must be a "bona fide resident" of Puerto Rico. An individual is considered a "bona fide resident" of Puerto Rico only if he or she satisfies three (3) tests: (1) The Physical Presence Test, (2) The Tax Home Test, and (3) The Closer Connection Test.

- **Physical Presence Test.** The physical presence test is satisfied for the tax year if the taxpayer meets one (1) of the following conditions:
    1. Was present in Puerto Rico for at least 183 days during the tax year;
    2. Was present in Puerto Rico for at least 549 days during the 3-year period that includes the current tax year and the two (2) immediately preceding tax years. During each year of the 3-year period, the taxpayer must be present in Puerto Rico for at least 60 days;
    3. Was present in the United States for no more than 90 days during the tax year;
    4. Had earned income in the United States of no more than a total of $3,000 and was present for more days in Puerto Rico than in the United States during the tax year; or
    5. Had no significant connection to the United States during the tax year.
- **The Tax Home Test.** The tax home test is satisfied if the taxpayer did not have a tax home outside of Puerto Rico during any part of the tax year. A taxpayer's tax home is considered to be his or her primary or regular place of employment, regardless of where the taxpayer resides. If the taxpayer does not have a primary or regular place of employment, his or her tax home is considered to be his or her regular place of abode "in a real and substantial sense."
- **Closer Connection Test.** The closer connection test is generally a subjective facts and circumstances test to prove that the taxpayer has an aggregate closer connection to Puerto Rico than to the United States or any other foreign country[3]. The factors that the IRS considers when determining whether an individual has maintained a closer connection to Puerto Rico than the U.S. during the tax year can include, but is not limited to, the following:

    - Where the individual's permanent home is located;
    - Where the individual's immediate family lives;
    - Where the individual's personal belongings, such as cars, furniture, clothing, and jewelry, are stored;
    - Where organizations that the individual is affiliated with, whether professional, cultural, social, religious, or political, are located;
    - Where the individual's principal bank is located;
    - Where the individual conducts business;
    - The jurisdiction where the individual holds a driver's license;
    - The jurisdiction where the individual is registered to vote; and
    - Which country the individual puts down as their country of residence on official forms.

[3] Other U.S. territories are not treated as the United States or a foreign country for these purposes.

Source of Income Rules in General

Assuming a U.S. citizen or resident alien satisfies the three (3) residency tests and is considered a "bona fide resident" of Puerto Rico, his or her Puerto Rico source income will not be subject to U.S. federal income tax. But what exactly is Puerto Rico source income?

The chart below provides the general sourcing rules, and some specific examples, for common types of income, including those most applicable to individuals looking to benefit from Puerto Rico's tax incentives.

Income Type	General Sourcing Rule	Source of Income	Subject to U.S. Income Tax for a Bona Fide Resident of Puerto Rico?
Interest Income	**Location of the Payor.**		
- Interest from the United States or one of the 50 states or a political subdivision thereof		U.S.	Yes
- Interest from a U.S. corporation or U.S. individual		U.S.	Yes
- Interest from the Commonwealth of Puerto Rico or Puerto Rico individual		Puerto Rico	No
- Interest from a Puerto Rico branch of a U.S. bank or savings institution		Puerto Rico	No
- Interest from a Bahamian corporation or individual		Bahamas	Yes
Dividend Income	**Location of the Payor.**		
- Dividend from a U.S. corporation		U.S.	Yes
- Dividend from a Puerto Rico corporation		Puerto Rico	No
- Dividend from a Bahamian corporation		Bahamas	Yes
Gain on the Sale of Assets	**Selling taxpayer's country of residence** [1,2]		
- Taxpayer domiciled in the U.S. sells appreciated publicly traded stock		U.S.	N/A
- Bona fide resident of Puerto Rico sells real property in the U.S.		U.S.	Yes
- Bona fide resident of Puerto Rico sells real property in the Bahamas		Bahamas	Yes
- Bona fide resident of Puerto Rico sells appreciated publicly traded stock he/she acquired after being a resident of Puerto Rico		Puerto Rico	No
- Bona fide resident of Puerto Rico sells appreciated publicly traded stock he/she acquired in the U.S. immediately after relocating to Puerto Rico		U.S.	Yes
- Bona fide resident of Puerto Rico sells appreciated publicly traded stock he/she acquired in the U.S. after being in Puerto Rico for 5 years[3]		U.S. and Puerto Rico[5]	Partially[5]
- Bona fide resident of Puerto Rico sells appreciated personal property (other than publicly traded stock) he/she acquired in the U.S. after being in Puerto Rico for 5 years [4]		U.S. and Puerto Rico[5]	Partially[5]
- Bona fide resident of Puerto Rico sells appreciated publicly traded stock he/she acquired in the U.S. after being in Puerto Rico for 10 years[6]		Puerto Rico	No
- Bona fide resident of Puerto Rico sells appreciated personal property (other than publicly traded stock) he/she acquired in the U.S. after being in Puerto Rico for 10 years[6]		Puerto Rico	No

Income Type	General Sourcing Rule	Source of Income	Subject to U.S. Income Tax for a Bona Fide Resident of Puerto Rico?
Defined Contribution Retirement Plan Income - Contribution Portion (both employee and employer) **Defined Contribution Retirement Income - Earnings Portion**	**Where the labor or personal services were performed when the contributions were made.** **Based on how the plan is funded and the location of the payor.**		
- In a plan funded through a trust fund, with a U.S. trust		U.S.	Yes
- In a plan funded through a trust fund, with a Puerto Rico trust		Puerto Rico	No
- In a plan funded through a life insurance or annuity contract, when the issuer of the contract is a U.S. insurance company		U.S.	Yes
- In a plan funded through a life insurance or annuity contract, when the issuer of the contract is a Puerto Rico insurance company		Puerto Rico	No
- In a plan funded through a life insurance or annuity contract, when the issuer of the contract is a Puerto Rico branch of a U.S. insurance company		U.S.	Yes
Deferred Compensation Income - Contribution Portion **Deferred Compensation Income - Earnings Portion**	**Where the labor or personal services were performed.** **Based on the type of income the earnings represent and sourced accordingly, which is generally the location of the payor.**		
FOOTNOTES:			
(1) This rule covers the disposition of investments and other personal property, but not the sale of real property, which is generally sourced to its physical location.			
(2) A U.S. territory, including Puerto Rico, is treated as a foreign country for purposes of sourcing gain from the sale of personal property. The foreign tax home will be ignored, however, and sourced to the U.S. if the individual does not actually pay to the foreign country an income tax of at least 10% of the gain derived from the sale. In Notice 89-40, the IRS announced that it would waive this 10% foreign tax requirement for U.S. citizens and resident aliens who are bona fide residents of Puerto Rico for the entire taxable year in which the sale takes place.			
(3) The IRS allows taxpayers to elect to source to Puerto Rico some portion of taxable gain attributable to appreciation occurring during their residence in Puerto Rico. If the election is not made, the entire gain will be sourced to the U.S. If the election is made, the gain will be allocated between the U.S. and Puerto Rico. For marketable securities, the allocation is made by reference to the market value of the securities at the close of the market on the first day the taxpayer becomes a bona fide resident of Puerto Rico.			
(4) The IRS allows taxpayers to elect to source to Puerto Rico some portion of taxable gain attributable to appreciation occurring during their residence in Puerto Rico. If the election is not made, the entire gain will be sourced to the U.S. If the election is made, the gain will be allocated between the U.S. and Puerto Rico. For personal property other than marketable securities (based on current law, this would include cryptocurrency), the appreciation is spread ratably over the taxpayer's entire holding period, regardless of where the taxpayer resided when the appreciation in value occurred.			
(5) Assuming the sourcing allocation election is made.			
(6) In an exception to the exception, all existing unrealized gain on personal property will become Puerto Rico source income once the former U.S. person has been a bona fide resident of Puerto Rico for 10 years or more.			

Puerto Rico Tax Incentives for Individuals

For bona fide residents of Puerto Rico, the standard Puerto Rico income tax regime has a top income tax rate of 33% and a top long-term capital gains rate of 15%. However, bona fide residents that qualify as "resident individual investors" are eligible to receive certain income tax incentives which deviate from the standard income tax rates mentioned above.

- **Tax Incentives.**

"Resident individual investors" are granted three (3) primary tax incentives, which depend on the specific type of income received or recognized by the taxpayer.

- **Dividend Income.** For Puerto Rico source dividend income, "resident individual investors" receive a 100% tax exemption from Puerto Rico income taxes on such income. And as highlighted above, since the taxpayer is a bona fide resident of Puerto Rico and the income is Puerto Rico source, this dividend income will not be subject to U.S. income tax as well. This incentive is applicable to dividend income received prior to January 1, 2036.

- **Interest Income.** Similar to dividend income, Puerto Rico source interest income received by a "resident individual investor" prior to January 1, 2036, will also receive a 100% tax exemption from both Puerto Rico and U.S. income tax.

- **Capital Gain Income.** The tax incentives for a "resident individual investor's" capital gain income depends on when the taxpayer acquired and disposed of the asset, when the appreciation on the asset occurred, and the type and location of the asset.

- Gain recognized on personal property acquired <u>after</u> the individual became a bona fide resident of Puerto Rico (and thus had no built-in appreciation from the US prior to moving to Puerto Rico) and disposed of prior to January 1, 2036, will receive a 100% tax exemption from Puerto Rico taxes. And as highlighted above, since the taxpayer is a bona fide resident of Puerto Rico and the gain is on assets other than real property located outside of Puerto Rico, the capital gain income will be sourced to Puerto Rico and will not be subject to U.S. income tax as a result. This exemption applies to both short-term and long-term gains. The exemption will not, however, apply to gain on the sale of real property located outside of Puerto Rico, as that income will not be sourced to Puerto Rico.

- Gain recognized on personal property acquired prior to the individual becoming a bona fide resident of Puerto Rico will be subject to the rules below, examples of which are further outlined in the Appendix :
    1. Built in gain that existed <u>prior</u> to coming to Puerto Rico and recognized <u>prior</u> to being a bona fide resident of Puerto Rico for 10 years or more will be subject to both Puerto Rico and U.S. income tax[4], with some relief from double taxation provided by tax credits.
    2. Built in gain that existed <u>prior</u> to coming to Puerto Rico and recognized (i) <u>after</u> being a bona fide resident for 10 years or more and (ii) <u>before</u> January 1, 2036, will be taxed at a 5% rate in Puerto Rico and will <u>not</u> be subject to U.S. income tax.

[4] As referenced in the sourcing chart, for personal property other than marketable securities, when determining what is U.S. source income the taxpayer can elect to have the appreciation on such assets spread ratably over the taxpayer's entire holding period, regardless of where the taxpayer resided when the appreciation in value occurred. Any gain allocated to the U.S. under this election will be U.S source income and subject to U.S. income tax.

3. The appreciation on marketable securities that occurs after coming to Puerto Rico that is recognized (i) prior to being a bona fide resident of Puerto Rico for 10 years or more and (ii) before January 1, 2036, will receive a 100% exemption from Puerto Rico taxes and will not be subject to U.S. income tax (assuming the taxpayers elects to make the appreciation Puerto Rico Source Income for U.S. income tax purposes).
4. The appreciation on marketable securities that occurs after coming to Puerto Rico that is recognized (i) after being a bona fide resident of Puerto Rico for 10 years or more and (ii) before January 1, 2036, will receive a 100% exemption from Puerto Rico taxes and will not be subject to U.S. income tax.
5. The appreciation on personal property other than marketable securities that occurs after coming to Puerto Rico that is recognized (i) prior to being a bona fide resident of Puerto Rico for 10 years or more and (ii) before January 1, 2036, will receive a 100% exemption from Puerto Rico taxes but may be at least partially subject to U.S. income tax (assuming the taxpayer elects to make a portion of the appreciation Puerto Rico source income for U.S. income tax purposes).
6. The appreciation on assets other than marketable securities that occurs after coming to Puerto Rico that is recognized (i) after being a bona fide resident of Puerto Rico for 10 years or more and (ii) before January 1, 2036, will receive a 100% exemption from Puerto Rico taxes and will not be subject to U.S. income tax.

Becoming A "Resident Individual Investor"

In order to receive the tax incentives described above, an individual must be considered a "resident individual investor." To be considered a "resident individual investor" an individual must pass certain residency tests, in addition to complying with certain administrative requirements.

- **Residency Tests:**
    1. The individual must be domiciled in Puerto Rico by having a physical presence in Puerto Rico for at least 183 days during the taxable year for the tax exemption decree (described below) to be effective.
    2. The individual cannot have been a resident of Puerto Rico for the ten (10) years prior to January 1, 2020.
    3. The individual must purchase residential property in Puerto Rico within the first two (2) years after obtaining the tax exemption decree (described below).

- **Administrative Requirements.** Resident individual investors must also apply for and obtain a tax exemption decree from the Office of Industrial Tax Exemption, which is a division of the Department of Economic Development and Commerce of Puerto Rico. To obtain access to the approved and signed tax exemption decree, the individual must:
    1. Pay a one-time $5,000 application fee.
    2. Pay a one-time $100 acceptance fee.
    3. File an annual report with the Puerto Rico government with an annual filing fee of $5,000.
    4. Make an annual $10,000 donation to nonprofit entities operating in Puerto Rico, which are not controlled by the tax exemption decree holder or his/her descendants or ascendants.

To be clear, a U.S. citizen just moving to Puerto Rico does not automatically qualify for the tax incentives described above. They must also comply with the residency tests and administrative requirements. In addition, as currently legislated, these tax incentives will sunset on December 31, 2035. After this date, individuals who took advantage of these incentives will be taxed like any other Puerto Rico resident.

Puerto Rico Tax Incentives for Businesses and Business Owners

In addition to the individual tax benefits described above, certain business entities, and their owners, are eligible to receive certain tax incentives as well.

- **Tax Incentives.**
    - "Exempt Businesses" are granted three (3) primary tax incentives and the owners of the "exempt business" are granted a significant tax incentive as well.
    - The primary incentive for "exempt businesses" is a flat 4%[5] income tax rate on the net income of the business. In addition, the real and personal property of "exempt businesses" enjoys a 75%[5] exemption from municipal and state property taxes. Finally, an "exempt business" also benefits from a 50%[5] exemption from the municipal licenses and taxes applicable to the business.
    - In addition to the business benefits, the shareholders, partners, or members of the "exempt business" will receive a 100% tax exemption from income tax on distributions from the business entity. Notwithstanding the above, individuals must pay themselves a reasonable salary based on the functions they perform for the company. This salary would be subject to Puerto Rico income tax and employment taxes.

Becoming an "Exempt Business"

In order to receive the tax benefits described above, the business must meet certain requirements to qualify as an "exempt business." The requirements include the following:

1. The entity must request and obtain a grant of exemption, including initial and annual filing fees ranging from $750 to $5,000, as well as annual contributions of $10,000 to nonprofit entities operating in Puerto Rico, which are not controlled by the business's owners or their descendants or ascendants.
2. The entity must have a bona fide office located in Puerto Rico;
3. The entity must be engaged in an "eligible service." "Eligible services" include the following:
    - Research and development
    - Publicity and public relations
    - Economic, environmental, technological, scientific, management, marketing, human resources, IT, and auditing consulting
    - Advice on matters related to any industry or business
    - Creative industries
    - Production of construction plans, engineering and architecture services, and project management
    - Professional services, such as legal, tax, and accounting services
    - Centralized management services
    - Electronic information processing center

[5] Certain small and medium-sized businesses will be eligible for a 2% flat income tax rate for a term of five (5) years, in addition to greater exemptions for property taxes and municipal taxes for the same five (5) year period.

- Development of computer programs
- Voice, video, audio, and data telecommunication to people located outside of Puerto Rico
- Call centers
- The distribution of physical form, in the cyber network, by cloud computing, or as part of a blockchain network and the income from licensing, program subscriptions, or service charges
- Shared services center
- Educational and training services
- Hospital and laboratory services, including medical tourism services and telemedicine facilities
- Investment banking and other financial services
- Marketing centers

4. The entity performs these "eligible services" for non-residents of Puerto Rico and/or foreign entities without any nexus to Puerto Rico.
5. The "eligible service" provided by the entity cannot be related to the conduct of a trade, business or other activity in Puerto Rico.
6. If the entity's actual or projected volume of business exceeds $3,000,000, the entity must maintain at least one (1) full-time direct employee and potentially up to three (3) full-time direct employees depending on the entity's industry.

These incentives will initially apply for a 15-year period and may be renewed for additional 15-year periods. To be clear, a U.S. entity just relocating to Puerto Rico and exporting services outside of Puerto Rico does not automatically qualify the entity for the incentives described above. The entity must also comply with the requirements highlighted above.

Easy to Say, Not So Easy to Do

There is no doubt that Puerto Rico offers significant tax incentives for individuals and entities to relocate to their island paradise as described in detail above. What is not as certain, however, is how much true tax benefit these individuals and entities will actually achieve.

Not only must these individuals meet and pass the stringent residency tests and face increasing IRS scrutiny in that regard, but they must also pay substantial fees and make substantial donations just to be eligible to receive these incentives. Once these hurdles are cleared, a detailed analysis of the type, source, and timing of an individual's expected income must be undertaken to fully quantify any tax benefit. When the dust settles and all the details are examined, it may only be the sun, the warmth, and the sand that ends up incentivizing certain individuals to relocate to the island.

Appendix

In all subsequent examples the presumption is that Joe became a bona fide resident of Puerto Rico upon relocation.

1. Joe Smith, a U.S. citizen, decided to relocate to Puerto Rico on January 1, 2023. At the time of his move, he owned publicly traded stock with a fair market value of $1,000 and an adjusted income tax basis of $10 that he acquired on January 1, 2014. On January 1, 2024, Joe sold his publicly traded stock for $1,000. Because (i) Joe owned the publicly traded stock before moving to Puerto Rico, (ii) $990 of gain existed on the stock prior to moving to Puerto Rico, and (iii) Joe was not a bona fide resident of Puerto Rico for 10 years or more, the $990 of gain will generally be considered U.S. source income and will be subject to U.S. income taxes. Joe does, however, have the option to elect to source a portion of the gain to Puerto Rico. This election would not, however, result in any of the gain being allocated to Puerto Rico because it is publicly traded stock and no appreciation occurred in Puerto Rico. The gain will also be subject to Puerto Rico income tax, with some relief from double taxation provided by tax credits.
2. Assume the same facts as in example #1, except the stock was private non-marketable stock, instead of publicly traded stock. Because (i) Joe owned the private stock before moving to Puerto Rico, (ii) $990 of gain existed on the private stock prior to moving to Puerto Rico, and (iii) Joe was not a bona fide resident of Puerto Rico for 10 years or more, the $990 of existing gain will generally be considered U.S. source income and subject to U.S. income taxes. Joe does, however, have the option to elect to source a portion of the gain to Puerto Rico. If Joe makes this election, because the private stock is not a publicly traded marketable security, the appreciation is spread ratably over the taxpayer's entire holding period, regardless of where the taxpayer resided when the appreciation in value occurred. If the election is made, $99 of gain is sourced to Puerto Rico and $891 of gain is sourced to the U.S. This is calculated as follows: $990 (total gain) x (365 days in Puerto Rico/3,650 total days he held the private stock) = $99 to Puerto Rico. $990 (total gain) x (3,285 days in the U.S. /3,650 total days he held the private stock) = $891 to the U.S. As a result of this allocation, $891 of gain will be subject to U.S. income taxes. The entire gain will also be subject to Puerto Rico income tax, with some relief from double taxation provided by tax credits.
3. Joe Smith, a U.S. citizen, decided to relocate to Puerto Rico on January 1, 2023. At the time of his move, he owned publicly traded stock with a fair market value of $1,000 and an adjusted income tax basis of $10. On January 2, 2033, Joe sold the publicly traded stock for $10,000. Because (i) Joe owned the publicly traded stock before moving to Puerto Rico and (2) was a bona fide resident of Puerto Rico for 10 years or more, all $9,990 of gain will be considered Puerto Rico source income and will not be subject to U.S. income taxes. If Joe was a “resident individual investor” at the time of the sale, Joe would pay a 5% tax on $990 of the gain (the gain that existed before he moved to Puerto Rico) to Puerto Rico, but the additional $9,000 of gain would not be subject to tax by Puerto Rico (or the U.S.).
4. Assume the same facts as in example #3, except the stock was private non-marketable stock, instead of publicly traded stock. Because (i) Joe owned the private stock before moving to Puerto Rico and (2) was a bona fide resident of Puerto Rico for 10 years or more, all $9,990 of gain will be considered Puerto Rico source income and will not be subject to U.S. income taxes. If Joe was a “resident individual investor” at the time of the sale, Joe would pay a 5% tax on $990 of the gain (the gain that existed before he moved to Puerto Rico) to Puerto Rico, but the additional $9,000 of gain would not be subject to tax by Puerto Rico (or the U.S.).
5. Assume the same facts as in example #3, except Joe sold the publicly traded stock on January 2, 2036, instead of January 2, 2033. Because the tax incentives for “resident individual investors” will expire on December 31, 2025, Joe will pay the standard Puerto Rico long-term capital gains rate of 15% on the entire $9,990 gain. He will not, however, pay any U.S. income tax on any of the gain because he was a bona fide resident of Puerto Rico for 10 years or more.

Appendix (continued)

6. Assume the same facts as in example #4, except Joe sold the private stock on January 2, 2036, instead of January 2, 2033. Because the tax incentives for "resident individual investors" will expire on December 31, 2025, Joe will pay the standard Puerto Rico long-term capital gains rate of 15% on the entire $9,990 gain. He will not, however, pay any U.S. income tax on any of the gain because he was a bona fide resident of Puerto Rico for 10 years or more.
7. Joe Smith, a U.S. citizen, decided to relocate to Puerto Rico on January 1, 2023. At the time of his move, he owned publicly traded stock with a fair market value of $1,000 and an adjusted income tax basis of $1,000 that he acquired on January 1, 2014. On January 1, 2024, Joe sold his publicly traded stock for $10,000. Because (i) Joe owned the publicly traded stock before moving to Puerto Rico and (ii) Joe was not a bona fide resident of Puerto Rico for 10 years or more, the $9,000 of appreciation will generally be considered U.S. source income and subject to U.S. income tax. Joe does, however, have the option to elect to source a portion of the gain to Puerto Rico. If Joe makes this election, because the stock is a publicly traded marketable security, the allocation of the appreciation is made by reference to the market value of the security at the close of the market on the first day the taxpayer becomes a bona fide resident of Puerto Rico. If the election is made, all $9,000 of gain will be sourced to Puerto Rico since all the appreciation occurred after Joe became a bona fide resident of Puerto Rico and will not be subject to U.S. income tax as a result. Further, if Joe was a "resident individual investor" at the time of the sale, he will receive a 100% exemption from Puerto Rico taxes on the gain since all the appreciation occurred after he was a bona fide resident of Puerto Rico.
8. Assume the same facts as in example #7, except the stock was private non-marketable stock, instead of publicly traded stock. Because (i) Joe owned the private stock before moving to Puerto Rico and (ii) Joe was not a bona fide resident of Puerto Rico for 10 years or more, the $9,000 of appreciation will generally be considered U.S. source income and subject to U.S. income taxes. Joe does, however, have the option to elect to source a portion of the gain to Puerto Rico. If Joe makes this election, because the private stock is not a publicly traded marketable security, the appreciation is spread ratably over the taxpayer's entire holding period, regardless of where the taxpayer resided when the appreciation in value occurred. If the election is made, $900 of gain is sourced to Puerto Rico and $8,100 of gain is sourced to the U.S. This is calculated as follows: $9,000 (total gain) x (365 days in Puerto Rico/3,650 total days he held the private stock) = $900 to Puerto Rico. $9,000 (total gain) x (3,285 days in the U.S./3,650 total days he held the private stock) = $8,100 to the U.S. Joe will have to pay U.S. income tax on the $8,100 of gain sourced to the U.S. If Joe was a "resident individual investor" at the time of the sale, Joe will receive a 100% exemption from Puerto Rico income taxes on all $9,000 of gain, as all the appreciation occurred while he was a bona fide resident of Puerto Rico.
9. Joe Smith, a U.S. citizen, decided to relocate to Puerto Rico on January 1, 2023. At the time of his move, he owned publicly traded stock with a fair market value of $1,000 and an adjusted income tax basis of $1,000. On January 2, 2033, Joe sold his publicly traded stock for $10,000. Because (i) Joe owned the publicly traded stock before moving to Puerto Rico and (2) was a bona fide resident of Puerto Rico for 10 years or more, all $9,000 of gain will be considered Puerto Rico source income and will not be subject to U.S. income tax as a result. Further, if Joe was a "resident individual investor" at the time of the sale, he will receive a 100% exemption from Puerto Rico taxes on the gain since all the appreciation occurred after he was a bona fide resident of Puerto Rico.
10. Assume the same facts as in example #9, except the stock was private non-marketable stock, instead of publicly traded stock. Because (i) Joe owned the private stock before moving to Puerto Rico and (2) was a bona fide resident of Puerto Rico for 10 years or more, all $9,000 of gain will be considered Puerto Rico source income and will not be subject to U.S. income taxes. In addition, if Joe was a "resident individual investor" at the time of the sale, Joe will receive a 100% exemption from Puerto Rico taxes on the gain since all the appreciation occurred after he was a bona fide resident of Puerto Rico.

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Appendix (continued)

11. Assume the same facts as in example #9, except Joe sold the publicly traded stock on January 2, 2036, instead of January 2, 2033. Because the tax incentives for "resident individual investors" will expire on December 31, 2025, Joe will pay the standard Puerto Rico long-term capital gains rate of 15% on the entire $9,000 gain. He will not, however, pay any U.S. income tax on any of the gain because he was a bona fide resident of Puerto Rico for 10 years or more.
12. Assume the same facts as in example #10, except Joe sold the private stock on January 2, 2036, instead of January 2, 2033. Because the tax incentives for "resident individual investors" will expire on December 31, 2025, Joe will pay the standard Puerto Rico long-term capital gains rate of 15% on the entire $9,000 gain. He will not, however, pay any U.S. income tax on any of the gain because he was a bona fide resident of Puerto Rico for 10 years or more.

Disclosure