A REPORT FROM SOVEREIGNMAN.COM

THE ULTIMATE GUIDE TO PUERTO RICO'S TAX INCENTIVES

A BLACK PAPER

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SOVEREIGN MAN

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PUERTO RICO'S FANTASTIC TAX INCENTIVES: THE DETAILS, THE CHANGES, AND THE FACT THAT WE READ ALL 391 PAGES OF LEGISLATION… SO YOU DON'T HAVE TO

Sometimes, a country just has to take the bull by the horns and wrestle the beast to the ground.

And when that beast is three headed - debt, unemployment and brain drain - they've got to get creative.

That is where Puerto Rico found itself a few years back… at the very dark end of a long tunnel, heading towards a bleak future.

By 2012, Puerto Rico had suffered more than a decade of severe economic depression.

The unemployment rate had been hovering above 10% since the 1990s, but the Global Financial Crisis of 2008 pushed the unemployment rate to almost 20%.

In 2012, the government of Puerto Rico decided to change things up to make their territory more attractive for doing business and investing. They enacted two of their most important

tax incentives – Act 20, and Act 22- hoping that these incentives would create jobs and prosperity.

(Act 20 reduced corporate taxation to just 4% for certain businesses, and Act 22 *eliminated* capital gains and certain dividends for individual investors.)

Still, for years, these incentives remained largely undiscovered by Americans.

Then, in September 2017, the deadly Category 5 Hurricane Maria caused an estimated $100 billion of damages – comparable to Puerto Rico's entire economy. The island was nearly devastated.

And Puerto Rico doubled down on its efforts to make the territory attractive, relaxing some of the conditions of Acts 20 and 22.

Thanks to those revised, highly attractive conditions, more and more US taxpayers started moving to Puerto Rico, including Sovereign Man's founder, Simon Black. He's personally benefiting from the territory's many tax incentives. And he is seeing the positive changes that the incentives have brought the island, firsthand.

For example, the unemployment rate is coming down - to under 8%, a ten-year low -, and economic growth is finally picking up steam. People on the streets are hopeful.

(Just like almost anywhere in the world, in 2020, this growth was hampered by the pandemic and the lockdown measures implemented by the Puerto Rican government -- some of the most draconian in the nation.)

However, in late June of 2019, Puerto Rico completed **a massive overhaul** of their tax incentives, and enacted the **Incentives Code (Act 60).**

There was a lot of confusion, worry, and uncertainty. The proposed legislation became a law in a very short time, and most people - attorneys and applicants alike - were caught off guard.

We studied every page of the new law right away, and came to a positive conclusion: The government's main motive behind the overhaul was to systematize dozens of incentive acts -- Acts 20 and 22 are just the most famous ones -- that Puerto Rico has enacted over the years... **not** to eliminate them.

We will get to the Puerto Rican tax incentives including the recent changes in a moment, but first:

San Juan

A BRIEF WORD ABOUT US FEDERAL TAX

If a Canadian citizen decides to move out of Canada, he or she (after following certain procedures) can completely disconnect from the Canadian tax system.

The same applies to Australians moving out of Australia, Brits moving out of the UK, and so on.

But Americans can't do that. The United States government taxes its citizens on worldwide income, no matter where on Earth they live.

There are only two ways out of the Uncle Sam's tax net:

a) renouncing US citizenship, or

b) moving to one of the US territories, such as Puerto Rico.

And while renouncing might be too drastic of a measure for most, moving to a tropical paradise may work for many.

And according to US tax rules, US citizens who live in Puerto Rico and derive their income

from Puerto Rico are no longer subject to US federal income tax.

In other words, you no longer have to pay the IRS. Instead, you become subject to Puerto Rican taxes.

In years past, Puerto Rican taxes were even higher than the IRS charged. So it wasn't really a benefit.

But, again, in 2012, the Puerto Rican government passed some major tax incentives: Act 20 and Act 22.

So people who apply for the tax exemptions under these incentive acts are able to achieve tax rates of 4% on their corporate tax, and 0% on most of their investment income.

This is a great deal you should consider. **Saving money on taxes is your best risk-adjusted return**. If you save, say, 30% on taxes next year, that's 30% more money in your pocket, risk-free.

ACT 60 (THE INCENTIVES CODE) - THE LATEST DEVELOPMENT IN PUERTO RICO'S TAX INCENTIVES

In late June of 2019, Puerto Rico completed a massive overhaul of their tax incentives, and enacted the Act 60 -- The **Incentives Code**. Here is the entire text in both Spanish and English.

It systematized dozens of incentives acts that were enacted in a protracted, haphazard manner over the years. (Acts 20 and 22 are just the most famous ones, but there are many more.)

Now, instead of dozens of separate legislative acts, Puerto Rico has a single Incentives Code.

The Acts themselves are not even called Acts anymore: For example, Act 20 became Chapter 3 of the Incentives Code – Exportation of Goods and Services. And Act 22 is now part of Chapter 2 – Individuals.

(But for ease of understanding, we will keep calling them Act 20 and Act 22 in this report.)

Another goal of the new code was to make the incentives more transparent. The government is now collecting more data to measure the impact of the incentives on the economy.

They also perform audits to make sure companies are actually conducting business activity that is eligible. Unfortunately, besides attracting doers and real investors, the incentives also attracted some dishonest individuals who were abusing Puerto Rican hospitality and

tricking the system any way they could.

Now there is more oversight to prevent such abuse.

One of the more interesting new developments is the "My Future" account, where the government establishes an account with $1,000 in it for each student in the public school system, and will encourage parents to contribute to it. The money can only be spent for educational purposes, or for starting a new business when the kid grows up.

The entire Incentives Code consists of almost 400 pages, but after combing it though entirely, we outline the most important developments further.

And we can assure you - Puerto Rico remains the best way for US taxpayers (who do not plan to renounce their US citizenship) to save on taxes.

And you better jump on that bandwagon soon. Despite the obvious benefit to Puerto Rico, the Bolsheviks in control of the Senate hate when successful people benefit too, and could try to shut Puerto Rican incentives down one way or another. More on that further in the report.

But it hasn't happened yet, and in the meanwhile, you can save *a lot of* money in taxes while enjoying the amazing tropical paradise.

Old San Juan

THE EXPORT SERVICES INCENTIVES -- FORMER ACT 20

(Act 20 was absorbed into the new Act 60's ***Chapter 3 - Exportation of Goods and Services.****)*

In 2012, Puerto Rico enacted a piece of legislation aimed to attract Americans (and foreigners) to its shores called Act 20.

Act 20 applies to businesses based in Puerto Rico which provide services to clients outside of Puerto Rico (including in the US). As long as your clients are not based in Puerto Rico, you can qualify.

Services is the key word here: If you're a financial professional, a digital entrepreneur, or an attorney... or if you qualify under a laundry list of other occupations - that we cover further in this report - then you can save a fortune on taxes with Act 20.

Your company will only pay a flat 4% corporate tax (and a small municipal tax) to the Puerto Rican government. And it will pay nothing to the US federal government.

And if Puerto Rico considers your business activity to be "strategically important" for the island, under the new law your corporate income tax can go down all the way to 1% (but we have yet to meet anyone who could qualify for this).

Just to be clear – to qualify as an Act 20 company, most of your business activities must be performed in Puerto Rico. However, you can still travel to the US periodically to meet your clients, attend conferences, etc.

Cayo Santiago, the Monkey Island

ACT 20 - FOR COMPANIES

Tax breaks for companies exporting services from Puerto Rico to other jurisdictions (including the US)

- 4% corporate tax rate
- 0% tax on dividends that your Act 20 company pays you
- You – the company owner – still need to draw a "reasonable" salary if you work full-time, and pay Puerto Rican rates on it (comparable to the US)
- Your clients can't be located in Puerto Rico
- You will need to employ at least one full-time employee if your company's annual revenue exceeds $3,000,000. (That employee can be you.)
- This incentive is available to citizens of any country, not just Americans. And unlike Americans, foreign nationals do not need to move to Puerto Rico to take advantage of the incentives.

Now that we've given you an overview of Acts 20, it's time to get down to the nitty gritty.

DETAILS OF THE EXPORT SERVICES INCENTIVES (ACT 20)

The economy of Puerto Rico has been benefiting from manufacturing for decades; the island is home to many pharmaceutical companies. But after witnessing the great success of Singapore and Hong Kong - primarily service-based economies - Puerto Rico is shifting its focus to services, too.

Puerto Rico's main tax incentives come from a piece of legislation that was called the Act 20 of 2012, known as the Export Services Act.

Act 20 is interesting, because of its broad legislation. Here's the idea behind it…

You incorporate a business in Puerto Rico that's providing **a service** to clients **outside of Puerto Rico**.

If you follow these simple conditions, then your business becomes eligible for a special corporate tax rate of just 4%. (Compare this to the US mainland's current rate of 21%.)

And there is no second layer of taxation. Any dividends your Act 20 company pays you are tax-free.

THERE IS ALSO A SMALL MUNICIPAL TAX

One thing to note, besides the 4% corporate tax, there is also a small local tax that the municipality where your Act 20 company is located, imposes.

Currently, the rate is 0.5% in most municipalities, but it can dip as low as 0.2% in others. (For example, 0.2% would be your municipal tax rate in the San Juan area if your income is less than $1,000,000.)

However, Act 20 companies get a 50% discount on those rates, so expect to pay 0.1% - 0.25% to your municipality, in addition to your 4% corporate tax rate to Puerto Rico.

The definition of "service", as it comes to qualifying for the rates, is very broad. Here are a few examples of eligible activities:

- Research and development
- Advertising and public relations
- Any kind of consulting (economic, scientific, environmental, technological, managerial, marketing, human resources, computer, auditing...)
- Creative industries (design, art, architecture, creative education, etc.)
- Commercial art and graphics services
- Architectural and engineering services, project management
- Professional services (legal, tax, accounting…)
- Data processing centers
- Computer programming
- Blockchain-related businesses
- Call centers
- Remote medical services (telemedicine)

- Educational and training services
- Shared service centers
- Investment banking and financial services (asset management, financial management, management of pools of capital, escrow account management services, etc.)
- Commercial distribution of products manufactured in Puerto Rico for jurisdictions outside Puerto Rico (including the US)
- Centralized managerial services (strategic direction, planning, budgeting... provided to companies located elsewhere)
- Assembly, bottling, packaging operations of products for export
- Trading companies
- Any other service that Puerto Rican government will deem eligible and important for Puerto Rico

And even this long list is not exhaustive. If your business fits the general criteria of "servicing clients located outside Puerto Rico", then you likely qualify.

PUERTO RICO IS CRYPTO-FRIENDLY

Act 60 explicitly listed blockchain-related businesses as eligible service activity.

Previously, blockchain-related businesses were a gray area in the code. Since 2019, Puerto Rico explicitly mentions business activities based on this new technology as eligible to qualify under Act 20.

Again, the key to obtaining this 4% corporate tax rate is that you're providing a service (or services) exported outside of Puerto Rico.

An architectural firm providing services to Puerto Rican residents wouldn't qualify. But if you're working with clients in the mainland US, Europe, or Asia, then your business meets the "qualifying activity" criteria.

Moreover, when an Act 20 company distributes profits to you – i.e. through dividends – such distributions are taxed at 0%.

What a "refreshing" idea -- Puerto Rico let's you take the money ***that you earned*** and put it in your pocket, tax-free. (Again, you need to be a bona fide resident of Puerto Rico for this to work.)

Important to mention - the business owner and employees must receive a "reasonable" salary based on the services provided. This salary is taxed at ordinary Puerto Rico income tax rates (outlined below).

Again, the salary must be "reasonable". In other words, don't think that you can pay yourself $1 per year.

That said, you don't have to pay yourself mainland US wages, either. You'll find that wages in Puerto Rico are generally lower than that. (Consult with your accountant about what the appropriate salary should be. If you need a referral in Puerto Rico, we will be happy to direct you to professionals we trust. Write us at clients@sovereignman.com.)

And the applicable Puerto Rican tax rates are somewhat lower than in the US:

Net taxable income (USD)	Puerto Rican Tax Rate
Less than $9,000	0%
$9,000 to $25,000	7%
$25,000 to $41,500	14%
$41,500 to $61,500	25%
Over $61,500	33%

So, an annual salary of $50,000 means a tax payment of around $5,500 to Puerto Rico.

Even with having to pay themselves a reasonable salary, business owners who move, say, from California to Puerto Rico are saving tens and sometimes hundreds of thousands of dollars a year in taxes.

But there might still be some additional expenses besides paying income tax on your salary:

Note that the new Act 60 introduced an employment requirement to Act 20.

If your Act 20 company churns $3,000,000 (or more) of revenue a year, you will need to employ a full-time employee – a resident of Puerto Rico – working a normal 8-hour day. (That's 2,080-hour of work per year, including vacations.)

If your company earns less than that, there is no official employment requirement at all, as before.

However, our lawyers on the ground strongly recommend to *always* have at least one employee working for your Act 20 company -- after all, someone has to actively "export" those services.

This requirement should not affect you much if you plan to live in Puerto Rico and actively work on your business: That's because that single employee can be you, the business owner.

If you don't plan to work on your business full-time, then you will need to hire at least one employee (but only when your annual revenue is $3,000,000 or more).

You can also employ part-time employees if you want, as long as their cumulative amount of hours worked reach 2,080 (or more) a year. For example, you can hire two employees working for 1,040 hours each, or three employees working 694 hours, and so on.

In case the employee quits - or gets fired - then the government gives you 90 days to find a new one. If you meet this deadline, the lost time will still be counted towards the required 2,080 hours.

Beach resort near San Juan

A DECREE IS A CONTRACT BETWEEN YOU AND PUERTO RICO

We want you to understand an important thing - any decree that you obtain in Puerto Rico is essentially a legal contract between you (or your company) and the government of Puerto Rico.

For Act 20, the term is 15 years, which can be extended for 15 additional years (assuming the incentives will still be around).

And as of today, the Act 22 benefits expire on December 31, 2035.

Puerto Rico can't just change its mind on the conditions of the contract.

And even if the government of Puerto Rico changes its mind tomorrow, the courts will enforce the contract and make the government honor the low tax rate written in the decree.

Simon himself has been skeptical of Puerto Rican incentives for years. Primarily because he knows that whatever benefits the government giveth, they can also taketh away.

But now there is a sufficient body of case law that has developed to demonstrate that the contracts hold up in court.

A few years ago, for example, Walmart won a major victory against the Puerto Rican government.

Walmart had its own tax deal with the government of Puerto Rico to pay just 2%. But given its current fiscal desperation, the government wanted to change Walmart's tax rate.

The dispute went to court. And Walmart won. A deal's a deal.

So, the government can't just change the conditions of the contact it signed. But you can…

The Act 60 explicitly states that if Puerto Rico changes incentives for the better in the future, then you have a right to negotiate with the government and ask to change the terms of your already-signed contract to match the changes.

So, for example, if the corporate tax rate goes down to 2% for Act 20 companies from the current 4% (we don't actually expect that to happen), then you should also be able to lower your tax burned to 2%.

Cueva Ventana natural cave

Now, let's look at various real-life situations and how exactly you can take advantage of Act 20.

Moving your entire company to Puerto Rico

There's good news if your entire business in the US (or elsewhere) falls under the category of "providing services": If you can move it entirely to Puerto Rico, then you can take full advantage of Act 20's incentives.

Lawyers, programmers, or contractors working remotely, for example, can slash their tax rates to just 4%.

(Of course you still need to convince your employees - if you have any - to move to the island as well.)

Here is the approximate sequence of steps you will take:

a) Start a new company in Puerto Rico and apply for the Act 20 decree

b) When approved, start operating through your Act 20 company

c) Wind down your US operations completely

By doing that, you will eventually be able to take the fullest advantage of the Act 20.

Below we try to compare apples-to-apples: taxation of a C corporation in the US and an Act 20 company.

(In a C corporation, the company is taxed first – at a corporate tax rate – and when the company pays a dividend to its owners, the owners are taxed second – at dividend tax rates. In reality, your taxation in the US will depend on many factors we cannot account for here: your choice of legal entity, income, marital status and much more. Your effective tax rate in the US might be lower, or much higher.)

BEFORE moving to Puerto Rico	AFTER moving to Puerto Rico
US company (C corp)	**Act 20 company**
Generates 100% of revenue. Pays US taxes:	**Generates 100% of revenue. Pays PR taxes:**
• 21% corporate tax rate + applicable state taxes • Up to 23.8% tax on dividend distribution	• 4% corporate tax rate • You draw a reasonable salary and pay normal Puerto Rican income tax on it • 0% tax on any dividend distributions to you

And if the corporate and dividend tax rates go up in the US -- which they probably will, and soon -- that will make Puerto Rican incentives much more attractive.

CAN W-2 EMPLOYEES BENEFIT FROM ACT 20 LEGISLATION?

The Act 20 legislation is very broad. However, even if you are a very highly paid W-2 employee, you won't be able to qualify for Act 20 benefits. Remember, you should have a **company in Puerto Rico exporting services**.

However, if you can convince your employer that:

a) you can work remotely (from Puerto Rico); and

b) you can switch to providing services as an independent contractor,

...then yes, your potential Act 20 company can help you reduce your tax obligation to just 4%.

If you are able to work from anywhere – i.e. if you work in copywriting, digital marketing, telemedicine, investment management, consulting, design, coding, para-legal work, medical transcription, accounting, recruiting, etc. – then you owe it to yourself to check out Puerto Rico's Act 20 (or to be more precise, Incentives Code's Chapter 3 - Exportation of Goods and Services).

Moving part of your company to Puerto Rico

Even if your primary business doesn't fall under the "services" umbrella, there's still a way to qualify for the 4% corporate tax rate.

In this case, however, you won't be able to slash your **entire** business's taxation to just 4%. But a significant portion of your business would be enjoying that tax rate by relocating to Puerto Rico.

That portion will entirely depend on the nature of your business, and what exact services you will be able to provide from Puerto Rico.

For example, we know people in Puerto Rico who sell products online using the Fulfillment by Amazon (FBA) - Amazon's packing and shipping service.

The company buys products manufactured in China and sells them in the US, using the services of Amazon - an American company.

What can be done from Puerto Rico, you may ask?

Here is how it works for them.

A big part of any serious business is marketing. Customers need to know you exist. And since marketing is a service, it can be provided ("exported") from Puerto Rico.

As a result, the marketing company in Puerto Rico pays a 4% corporate tax rate, and the FBA business writes off these marketing expenses.

> One thing to understand - moving a **portion** of your business will involve an additional step. You will need to hire a specialist to prepare what's called a **transfer pricing study**, which will reveal how much your marketing company in Puerto Rico can charge for its services.
>
> That company won't be able to charge too much, or shift an oversized amount of revenue to Puerto Rico to save on taxes. The rates should be according to the current market conditions.
>
> In other words, your Act 20 marketing company and the rest of your business should interact as if they were unrelated to each other (with an arm's length relationship).
>
> Any serious accounting firm in Puerto Rico or in the US can perform a transfer price study for you.
>
> (If you need a reference, let us know by writing to clients@sovereignman.com.)

Other people we know have a manufacturing business based in Asia, and they also use an Act 20 company to reduce their taxes.

No, they did not relocate the manufacturing itself to Puerto Rico to qualify for a 4% tax rate. (Though they could have done it -- there is a separate incentive aimed at attracting manufacturing to the island. Still, it was more practical for them to keep manufacturing in Asia.)

Instead, they use an Act 20 company to provide every possible "management service" to their manufacturing business overseas, such as governance, administration, payroll, accounting, marketing, etc..

The Puerto Rican Act 20 management company pays a 4% corporate tax, and the manufacturing business writes off the management expenses.

If you think you can relocate a portion of your business to Puerto Rico, then the following list can serve as an approximate sequence of steps one would take:

1. Start a new company in Puerto Rico and apply for Act 20 decree.
2. Set up transfer pricing and service agreements between your US and Puerto Rican company.
3. Move your "services" part of the business to Puerto Rico.
4. Your Puerto Rican company will charge a "management fee" to your US company. The exact percentage of the revenue you will be able to "shift" to Puerto Rico will depend on the transfer pricing analysis.

In the example below we assume your Act 20 company charges a management fee in the amount of 50% of the company's revenue. (Again, in reality, the exact amount will depend on the nature of your business, transfer pricing study, etc.)

BEFORE moving to Puerto Rico

US company (C corp)

Generates 100% of revenue. Pays US taxes:

- 21% corporate tax rate + applicable state taxes
- Up to 23.8% tax on dividend distribution

AFTER moving to Puerto Rico

US company (C corp)

Pays management fees to your Act 20 company and pays US taxes on 50% of the revenue:

- 21% corporate tax rate + applicable state taxes
- Up to 23.8% tax on dividend distribution

50% of the company's revenue shifts to Puerto Rico in the form of a management fee

Act 20 management company

Charges management fees to your US company and pays PR taxes on 50% of the revenue:

- 4% corporate tax rate
- You draw a reasonable salary and pay normal Puerto Rican income tax on it
- 0% tax on any dividend distributions to you

Colonial architecture in Old San Juan

So, the effective tax rate of your US-Puerto Rico structure will be an average of the US (high) and Puerto Rican (low) tax rates.

Non-Americans can benefit from Act 20, too

If you are not a US citizen, you have many options beyond Puerto Rico. Pretty much the entire world is open to you.

But instead of setting up shop in one of the traditional tax havens - such as BVI or Nevis - you might still consider Puerto Rico instead.

The low 4% tax rate and no tax on dividend distributions will apply to you too, no matter where you are located.

That's what concerns the Puerto Rican side of the story.

Of course you still may have to pay tax to the country where you currently live (read - where you are a tax resident.)

If you live in Monaco or the UAE, that's where your taxation potentially stops, because these countries impose no tax on their residents at all.

Even if you live in a much more tax-heavy jurisdiction, such as Austria, incorporating in Puerto Rico will help you save on taxes. Austria does not tax corporate income of your foreign company if you are running an active business abroad. But Austria will tax any dividends distributions coming from abroad.

So, before going all-in in Puerto Rico, talk to an experienced attorney where you live to see how your country treats income from a foreign country.

DO YOU NEED TO MOVE TO PUERTO RICO TO TAKE ADVANTAGE OF ACT 20?

If you are an American paying taxes to Uncle Sam and you open an Act 20 company, then you need to become a bona fide resident of Puerto Rico to take advantage of tax incentives there. We cover what exactly this entails further in the report.

Otherwise, you become liable for the GILTI tax on earnings from your Puerto Rican companies.

Yes, the GILTI tax.

The Global Intangible Low-Taxed Income (GILTI) tax was created by President Trump's tax reform and is the tax that the US government now imposes on foreign corporations owned by Americans. (The IRS considers Puerto Rico a "foreign country" for GILTI tax purposes.)

Because most foreigners, however, are not US citizens and not paying US taxes, they can set up a Puerto Rican company, keep living in their home countries, and still benefit from Puerto Rico's low taxation.

However, in some cases, foreign countries don't like their residents moving their companies offshore, so those home governments impose restrictions. These restrictions are called Controlled Foreign Corporation (CFC) rules. You will need to discuss CFC rules of your country with your local tax advisor.

FORM AN ACT 20 COMPANY TODAY TO USE IT LATER?

Even if you're not ready to move to Puerto Rico yet, but would like to lock down the incentives **as they are currently**, you can still form an Act 20 company.

This information may come in handy in the future, if the government changes its mind and decides to alter the law to make it less attractive.

In this case, forming an Act 20 company quickly may serve you well.

By locking in conditions as you like them, future changes should not affect you. You would have the program's **current** conditions baked into your decree for years to come.

However, during that time your company needs to stay active and maintain at least some basic commercial activity each year. Consider moving part of your real business - no matter how small - to Puerto Rico, even if it will mean paying GILTI tax.

Also, your Act 20 company also needs to have an office in Puerto Rico. A virtual office is fine.

And you would still need to do all compliance reporting associated with your Act 20 company, such as submitting annual tax returns, an annual Act 20 report and your state department filing. So, there would be costs associated with maintaining your company.

However, when you are ready to ramp up your operations, make the plunge, and move to Puerto Rico, your company will be there, ready to go under the most beneficial conditions.

As you can see, there are nuances and costs associated with this strategy. You definitely need to talk to an experienced lawyer if you plan to pursue it. Send us a message at clients@sovereignman.com if you need a reference.

HOW TO APPLY FOR ACT 20 DECREE

It's not enough to just start a company in Puerto Rico to get the tax benefits we discussed. You still must apply for a decree.

You do it by submitting an application at the Single Business Portal of the Office of Industrial Tax Exemption (OITE) of Puerto Rico to obtain a tax exemption decree, which will provide full details of tax rates and conditions.

Again, this decree is a contract between the government of Puerto Rico and you.

Once you obtain the Act 20 decree, the benefits granted in it will be secured during the term of the decree – 15 years – even if Puerto Rico changes the law later or even repeals it completely.

(Again, you can request to improve the terms of your contract, if the conditions of any future law are better than what you have in your contract.)

We know people who applied for Act 20 without professional help, but for the smoothest sailing, consider working with a seasoned professional.

> We can refer you to an experienced attorney if your case is complicated (involving transfer study, etc).
>
> And if your case is simple, the program's official promoters can even **help you for free**. (They later take a small cut from the 4% corporate tax rate that you pay to the government.)
>
> Let us know if you need a reference to an official promoter or an attorney by writing to clients@sovereignman.com.

However, if you are a committed DIY person, you can apply yourself by using the official government's website. (Register as a new user first.)

To help you, the Department of Economic Development and Commerce of Puerto Rico (DDEC) created this application help file and also the registration FAQ section.

The current processing time is around three months.

And here's a quick breakdown of what it costs to apply (DIY):

Act 20 cost to apply - $2,020:

- Government application fee: $1,000

- Entity incorporation (LLC) : $250
- Permitting fees: $600
- Affidavits: $100
- Notary: $70

Annual maintenance cost of Act 20 - $500

- Annual filing: $500 (you submit it with a mandatory annual report).

THE INDIVIDUAL INVESTOR INCENTIVES -- FORMER ACT 22

*(Act 22 has been absorbed into the Act 60's **Chapter 2 - Individuals**)*

If you are relocating to Puerto Rico for Act 20 benefits (which we covered above), you might also want to consider Act 22.

The Puerto Rican government makes applying for and maintaining Act 22 significantly more expensive than Act 20, Still, depending on your situation, potential tax savings can far outweigh the costs.

Act 22 benefits individual traders and investors.

This act **cuts most capital gains taxes to *zero*** for qualifying investors and traders. It also eliminates taxes on certain **dividends, interest and royalties**.

Again, Act 22 can only slash your taxation on ***income originating in Puerto Rico***, not elsewhere.

Luckily, the IRS explains that capital gains you earn from the sale of stocks, bonds, and crypto (but not real estate) will be taxed depending on where *you* are located. So, if you live in Puerto Rico, then your capital gain on, for example, the sale of Apple stock, will be considered Puerto Rico-sourced.

Important: Full capital gains tax elimination only applies to capital gains accrued on your assets **after** you moved to Puerto Rico. This means that if you invested in Apple stock 20 years ago, and are sitting on serious capital gains before moving to Puerto Rico, you won't be able to avoid paying tax on it.

Navio beach

But you can still get a serious break. If you stay a Puerto Rican resident for at least ten years, you can reduce your tax rate on that portion of capital gains to just 5%.

The same goes for crypto. The crypto crowd who invested in bitcoin several years ago cannot move to Puerto Rico and cash out their millions tax-free, but they can reduce their tax rate to just 5% if they commit 10 years to Puerto Rico.

To take advantage of tax benefits under Act 22, **you need to become a bona fide resident of Puerto Rico**, which means you will need to relocate to the island and live there pretty much full-time. We explain what it takes to become a bona fide resident further in the report.

Unlike Act 20, Act 22 is not that attractive to non-Americans.

First, the US does not even tax capital gains on US-based stocks and bonds if you are not a US citizen, so there are no additional tax advantages by going the PR route. And secondly, in order to move to Puerto Rico, foreigners have to go through the arduous US immigration procedures.

ACT 22 – FOR INDIVIDUALS

Tax breaks for individual investors who become bona fide residents of Puerto Rico

- 0% **capital gains** tax on stocks, bonds, crypto, etc. on appreciation accrued *after* they move to Puerto Rico.
- (5% capital gains tax on the appreciation accrued *prior* to moving to Puerto Rico, if they stay in Puerto Rico for at least ten years.)
- 0% tax rate on **interest, dividends and royalties** from Puerto Rican sources.
- There is a $5,000 acceptance fee, and an obligatory $10,000 annual donation to an approved charity in Puerto Rico. There is also an annual filing fee of $5,000.
- Within two years of obtaining your Act 22 decree, you will need to buy property in Puerto Rico and use it as your primary residence (no minimum price requirement).

DETAILS OF ACT 22

On January 17, 2012, Puerto Rico enacted Act 22 of 2012, known as the "Individual Investors Act." It aims to encourage individual investors, high-net-worth individuals and retirees to move to Puerto Rico.

The incentive comes in the form of a **0% rate on passive income** derived from Puerto Rican sources.

Act 22 completely exempts Puerto Rican **bona fide residents** from taxation on dividends, interest, capital gains, and royalty income coming from **Puerto Rican sources** that they accrue **after moving to Puerto Rico**.

But don't forget that even if Puerto Rico doesn't want to tax you, Uncle Sam still might..

Fortunately, the IRS exempts Puerto Rican residents from paying US taxes on their **Puerto Rican-sourced income**.

Rio Camuy Cave Park

So, if your investment income stems from Puerto Rican sources (while you are a bona fide resident of the territory) then you will **pay tax to no one**.

However, this doesn't mean that the only way to save on taxes on your investment income is to buy a dividend-producing stock of a company based in Puerto Rico. While that qualifies under Act 22, many other situations work, too.

For example, any capital appreciation on stocks, purchased anywhere in the world, qualifies for tax elimination. That's because the IRS considers **your location** to be the source of the capital appreciation when you sell the appreciated asset, and not the location of the company you invested in.

The same goes for bonds and cryptos.

This is the reason why Puerto Rico is becoming the center of gravity of the Western Hemisphere for all things crypto.

In short, it's essential to understand what the IRS considers the source of income you may earn.

Capital appreciation of stocks, bonds, and crypto qualifies for the tax exemption, and below is a table that summarizes the situation for other types of passive income.

Type of Income	Source of income depends on…	Will Act 22 eliminate taxes?
Capital gain from the sale of personal property (e.g. stocks, bonds, crypto, art, precious metals…)	The residence of seller	**Yes.** Eliminating worldwide capital gains taxation on stocks, crypto, precious metals… is the main benefit or Act 22.
Interest	The residence of payer	**Maybe.** Act 22 will help **only** if interest comes from a Puerto Rico-based business or an individual.
Dividends	The location of the dividend-paying company	**Maybe**. Act 22 will help **only** if a company paying dividend is incorporated in Puerto Rico.
Capital gain from the sale of real estate	The location of the property	**No.** Act 22 does not apply to real estate, even Puerto Rican.
Rental income	The location of the property	**No**. Rental income is not covered by Act 22.
Royalties	For natural resources royalties – source depends on location of property. For music, patents, copyrights royalties – source depends on where the property is used.	**Maybe.** Act 22 will help **only** if the royalty payments originate in Puerto Rico (i.e. in case of music royalties, Puerto Rico-based ACEMLA payments would qualify)
Pension distributions	Where you performed the services that earned the pension.	**No.** Act 22 will not help reduce taxation on your pension distributions.

Again, for Act 22 benefits to kick in, you must successfully obtain your tax decree and satisfy bona-fide residency requirements of the report) for that calendar year. **If you do not accomplish these steps in full, all income will be taxed by the IRS.**

ACT 22 HAS BECOME MORE COSTLY OVER THE YEARS

With Act 22, the government does not receive any tax revenue. Instead, they chose to benefit from it in other ways.

Over time, Act 22 has become more costly to qualify for and maintain (but definitely still worth it if you have substantial capital gains to shelter from taxation).

First, there is a $5,000 acceptance fee.

Then, the changes made to the incentives in 2019 (Act 60 systematization) increased the annual mandatory charity donation from $5,000 to $10,000.

The donation is split into two parts: The first $5,000 goes to one of the charities specifically approved by the government, and the second $5,000 will still go to the Puerto Rican charity of your choice.

Among the latest developments, in April of 2020, the Puerto Rican government announced that the annual filing fee was increasing effective immediately from $300 to $5,000 -- another annual expense you will have to assume as a beneficiary of Act 22.

Act 60 also specified that **within two years** of obtaining your Act 22 (but not Act 20) decree, you will need to buy a property in Puerto Rico and use it as your primary residence (you can't rent it out). You will need to keep it throughout the validity of your Act 22 decree.

And while there is no minimum purchase price requirement, you will likely struggle to find anything reasonably priced on the island.

The famous incentives attracted thousands of successful people to the territory, including our own founder. And every one of them needs a place to live there.

As a result, rent and purchase prices have skyrocketed, especially in and around San Juan -- the capital city.

Reportedly, you can still find good value if you are willing to go further out. Our own team member living in Fajardo reported that the real estate market there is much "calmer" than in San Juan.

And one of our own readers found an ultimate solution -- Laura lives on her own boat while enjoying the Act 20 benefits. This makes rent and purchase prices irrelevant.

Below is an example of how Act 22 works with stock purchases:

	2019	2020 you move to Puerto Rico	2022
Stock price	While in the US, you purchase stock for $20	**The day of your move** to Puerto Rico, stock costs $30 ($10 gain until now)	As a bona fide resident of Puerto Rico, you sell your stock for $50 ($30 of total gain)
Tax situation	-	- The gain of $10 ($30 - $20) will be subject to US taxes once you sell it. - Any further gain starting from the day of your move will be tax-free (subject to Puerto Rican tax)	Your total gain of $30 splits in two: 1) **$10 gain – to US** (up to 23.8% tax) 2) **$20 gain – to PR** (0% tax)

So, when you finally do pay the tax while living in Puerto Rico, you pay the following:

- The gains accrued **before** your move to Puerto Rico (in our example, $10)

You will pay US tax on qualified dividends on that portion of the gain, with the current rate of up to 23.8%, depending on your tax bracket.

- The gains accrued **after** your move to Puerto Rico.

This calculation is easy - You pay nothing, to no one.

However, it pays to keep living in Puerto Rico… for at least ten years, to be exact.

That's because, if you stay a bona fide resident of Puerto Rico for ten years or more, your tax obligation on the portion of capital gain you accrued while **still living in the US** will also go down... to 5%.

After living in Puerto Rico for at least ten years, it becomes the responsibility of Puerto Rico to tax the entire capital gain. The IRS taxes nothing at all.

And Puerto Rico chooses to tax it at 5%. That's a lot lower than the maximum 23.8% you would be paying on it otherwise.

	2019	2020 you move to Puerto Rico	2031 (ten years later)
Stock price	While in the US, you purchase stock for $20	**The day of your move** to Puerto Rico, stock costs $30 ($10 gain until now)	After being a bona fide resident of Puerto Rico, you sell your stock for $50 ($30 of total gain)
Tax situation	-	- The gain of $10 ($30 - $20) will be subject to US taxes once you sell it. - Any further gain starting from the day of your move will be tax-free (subject to Puerto Rican tax)	Your total gain of $30 splits in two: 1) **$10 gain – to PR** (at 5%) 2) **$20 gain – to PR** (no tax)

The difference between a 23.8% and a 5% tax rate can play a huge role if you, say, picked up Amazon shares back in 1997 when it just went public.

If you invested just $1,000 in Amazon back in 1997 (when it traded for $2), following this strategy could save you an additional $178,000 in taxes.

In this case, it may be worth waiting for ten years. When you finally sell your Amazon stock, instead of paying up to 23.8% in taxes (on the capital appreciation before your move to Puerto Rico), you will pay only 5%.

Dorado beach

A SPECIAL CASE OF NON-MARKETABLE SECURITIES

You will need to know the price of an asset on the day of your move to Puerto Rico to be able to split the total gain in two: before and after your move.

In the case of, say, Amazon stock, you can easily find out the price of it on any given day in the past by just Googling it.

It's much harder to determine the fair market price of less liquid investments on a given day, such as privately held businesses.

Let's imagine that you bought a share in a pool-cleaning business in 2019 for $50,000. In 2020, you become a bona fide resident of Puerto Rico. And in 2022, you sell your share for $120,000, for a total gain of $70,000.

It's impossible to determine the exact value of the business on the day of your move. Then, how do you know what share of the appreciation you should be paying to the US (at 23.8%), and Puerto Rico (at 0%)?

The IRS says you need to use a "time-based allocation" method in this case. That's just a fancy way to say that you'll need to calculate the number of days you held an asset in the US versus in Puerto Rico.

Let's say you bought one share in the business on January 1, 2019. You move to Puerto Rico on February 1, 2020. And you sell your business on November 31, 2022.

You owned your share of the busine ss:

- In the United States – for 396 days
- In Puerto Rico – for 668 days.

Total days owned – 396+ 668 = 1,064 days

Now you can calculate the gain allocation:

- To the US (tax rate of up to 23.8%): 396/1,064 * $70,000 = $26,053
- To Puerto Rico (tax rate of 0%): 668/1,064 * $70,000 = $43,947

Total gain: $26,053 (US) + $43,947 (PR) = $70,000

Ritz Carlton Beach Resort in Dorado

Important to mention - The IRS gives you a break in case your investment goes south **after** your move to Puerto Rico.

Let's assume you invested $1,000 in a stock. The stock market has been doing well, and on the day you move to Puerto Rico, your investment is worth $2,000.

But right after your move, the market corrects, and your $2,000 investment becomes $1,200.

At this point, you sell it.

What happens in this case? Would you still be "locked in" for the US-side portion of the gain of $1,000 at the rate of 23.8%? (This $1,000 gain we calculated as the $2,000 value of the investment on the day of your move to PR minus $1,000 of your initial investment).

The IRS has clarified that this is not the case.

If you sell your investment for $1,200 while living in Puerto Rico, then you will owe the IRS taxes only on the $200 appreciation, not the entire $1,000.

HOW TO APPLY FOR ACT 22 DECREE

Your mere relocation to Puerto Rico will not make you eligible for the tax benefits under Act 22.

To get them, you need to submit an application to the Office of Industrial Tax Exemption (OITE) of Puerto Rico.

This decree is a contract between the government of Puerto Rico and you, the individual investor, so the benefits granted in it will stay unchanged for the term of the decree even if Puerto Rico tax laws change for the worse, or if this tax incentive is cancelled altogether.

(You can request to improve the terms of your contract, if the conditions of the new law become better than what you have in your contract.)

As of today, the law states that the benefits of Act 22 will be active until December 31, 2035 only. But our guess is that this deadline will be extended in the future. And even if it's not, there are more than 15 years of tax-free capital appreciation in front of you.

Applying for Act 22 is not difficult, and you can do it yourself by using the official government's website. (You first need to create an account.)

To help you, the Department of Economic Development and Commerce of Puerto Rico (DDEC) created this application help file and also the registration FAQ section.
Still, you may choose to hire a professional to help you. Write us at clients@sovereignman.com if you need a referral.

The current processing time is six to eight months, but the benefits will apply retroactively to the date you become a bona fide resident of Puerto Rico (usually, the date of your move to the island).

You can even submit your Act 22 application before your move. Once the decree is granted, the government gives you a full year to actually move to Puerto Rico.

And here's a quick breakdown of what it costs to apply (DIY):

Initial cost to apply for Act 22 - $15,170:

- Government application fee: $5,000

- Affidavits: $100
- Notary: $70
- Mandatory donation to a charity in Puerto Rico: $10,000 (required for the very first year too)

Annual maintenance cost of Act 22 - $15,000:

- Annual mandatory donation to a charity in Puerto Rico: $10,000.
- Annual filing: $5,000 (you submit this with a mandatory annual report)

Property purchase

And within two years, you need to purchase a property and use it as your primary residence.

As you can see, **it is not free to obtain and to maintain an Act 22 decree**, so you should be saving much more than $15,000 a year in capital gains (and other applicable income) for it to make sense.

Flamenco beach

JOIN THE 20/22 ACT SOCIETY TO STAY INFORMED AND MEET LIKE-MINDED PEOPLE IN PUERTO RICO

People behind The 20/22 Act Society are good friends of Sovereign Man and were instrumental in creating this report.

The Society is like a Rotary Club for ex-mainlanders. They provide support for people who are making the move to Puerto Rico or are considering doing so.

They are also a powerful lobbying group and have been actively fighting through some controversial changes in the latest laws (and have succeeded).

The Society is based in Dorado – a town popular with expats about 45 mins away from San Juan, Puerto Rico's capital. It regularly holds member events in Dorado and the San Juan area. You will also find informal Act 20/22 meetups in most popular expat communities across the island.

In other words, if you are serious about Puerto Rico, you may want to consider becoming a member yourself. This way, you will be aware of every smallest change out there and will meet like-minded people.

The 20/22 Act Society is also an official Puerto Rican charity, and accepts donations which are mandatory under Act 22 conditions.

Among other things, they help poor students attend universities, help the homeless and the elderly of Puerto Rico, purchase computers for schools, and finance animal rescue operations.

OTHER CHANGES TO PUERTO RICAN INCENTIVES YOU NEED TO KNOW ABOUT

And here are the changes that that Act 60 brought in 2019, that are not specific to Act 20 or Act 22:

- **The term of all decrees is standardized across the board**

The tax decree that you obtain in Puerto Rico is essentially a contract between you and the government of Puerto Rico.

Under the new law, the initial term of that contract is 15 years, extendable for another 15 years. (Previously, the initial term was 20 years and the extension - 10 years.)

> Act 22 is an exception here. Regardless of when exactly you recieve your Act 22 decree, it will be valid until December 31, 2035. This deadline does not change under the new law.

- **Special tax breaks for in-demand professionals**

(Important: This is not about exporting services, which is eligible activity under Act 20. It's about real jobs, on the ground, in Puerto Rico.)

If you are a professional practicing **medicine, pediatrics, or dentistry,** consider moving to Puerto Rico. Your tax rate will go down to just 4%.

Some strings are attached, however, as you will be required to perform community service for at least 180 hours a year.

Talk to the lawyers on the ground for more details. (Write us at clients@sovereignman.com if you need a reference.)

Scientists and research scientists can also have a happy, tax-free life in Puerto Rico. Grants of up to $190,000 and salaries up to $250,000 will be tax-free. In return, 60 hours of free community service will be required.

- **Tax breaks for young people**

If you are 35 and younger, Puerto Rico will eliminate any tax on your newly established company for the first $500,000 of your cumulative worldwide income. Any kind of business qualifies. Income beyond the first $500,000 will be subject to regular PR income tax rates (comparable to the US).

- **Annual incentives report by Puerto Rico's Department of Economic Development and Commerce (DDEC)**

The DDEC publishes a yearly report (available to the public) on all incentives decrees requested and granted. That covers every incentive type, including Act 20 and Act 22.

This is a serious push towards more transparency by the government.

The report will include the name of the business and principal shareholders, the date the decree was granted, the municipality where the business operates, number of jobs created, etc.

BECOMING A BONA FIDE RESIDENT OF PUERTO RICO

To qualify for the Puerto Rican incentives that we discuss in this report, as a US citizen, you must make the island your primary home and **become a bona fide resident there**. **There is no other way around it.**

This means that you, your business, your family, and your possessions must relocate to Puerto Rico. Of course, if you decide that Puerto Rico is not for you, you can always move back (and lose the tax benefits).

> Rules for **foreigners** (not US citizens) planning to move to Puerto Rico will differ from the ones we discuss in this section.
>
> Instead, foreigners need to meet the substantial presence test (but not closer connection test) discussed in chapter 1 of Publication 519.
>
> And as a foreigner willing to move to Puerto Rico, you will have to experience all the unpleasantries of the very tough US immigration system.
>
> And remember - you can still reap the benefits of Act 20, without ever being on the ground. More on that in the Act 20 section of the report.

However, **the IRS will not let you go easily. You must pass three tests** to satisfy the requirements to become a Puerto Rican resident for tax purposes.

The very detailed IRS Publication 570 explains that every year during which you want to be considered a bona fide resident of Puerto Rico, you must satisfy **each** of the following three tests**:**

	Test 1 Personal Presence	Test 2 Tax Home	Test 3 Closer Connection
Primary way to satisfy	Spend 183 days a year in Puerto Rico	Move your office to Puerto Rico	Move your family, buy a property or rent long-term in Puerto Rico… (see much more below)

You must satisfy **all three** of the above tests in each calendar year. Let's look more closely at each of these conditions.

Test #1 - Personal Presence

To satisfy the first test, you must meet **any one** of the following five conditions:

1) Be present in Puerto Rico for at least 183 days during the tax year.

These 183 days don't need to be consecutive, you can make multiple trips to the US or elsewhere during the year.

This is the most straightforward method for people relocating their business to Puerto Rico, so we recommend that you focus on it, especially in the first couple of years. (To be on the safe side, we recommend you spend at least a few days more than 183.)

2) Be present in Puerto Rico for at least 549 days (aggregate) during a 3-year period. And during each year of the 3-years, you need to be present in Puerto Rico for at least 60 days.

For the math to work, you will still need to spend at least 183 days during your first two years in Puerto Rico. However, this method allows you to spend as little as 60 days in Puerto Rico in the 3rd year **but only** if you have been spending a lot of time in Puerto Rico during the previous two years.

Example: if you spent 245 days in both 2021 and 2022, in 2023 you can spend only 60 days for a total of 550 days (245 + 245 + 60 = 550, which is more than the required 549 days).

3) Be present in the United States for 90 days or less during the tax year.

At first, this condition seems easy to meet, but remember that you still must meet two other tests - tax home and closer connection (we explain both further down).

4) Earn less than $3,000 in wages, salaries, or professional fees in the United States, AND spend more time in Puerto Rico than on the mainland during the tax year.

Even if you spend more time in Puerto Rico than in the US during the year, this option may not work for you if you are relocating to Puerto Rico for Act 20 benefits. Chances are you will still be travelling to the United States to meet clients, perform some work… meaning that you will have US-based wages or professional fees.

5) Have **no** significant connection to the United States during the tax year.

The IRS considers that you have a significant connection to the United States if you:

- Have a permanent home in the US (rental property is OK), or
- Are registered to vote in the US, or
- Have a spouse or a child under the age of 18 whose main home is in the US (unless the child is in school in the US or has legally divorced parents).

Luxury mansions in Guayanabo

Tracking your days spent in Puerto Rico

Unless you plan to spend the **entire** year - or close to it - in Puerto Rico, you will need to track the exact number of days you spend on the ground. We recommend that you start an excel spreadsheet where you will be tracking every day you spend in Puerto Rico, in the US, and in other countries.

Here is what the IRS considers a day spent in Puerto Rico:

- Any presence on the ground in Puerto Rico counts as a day

Even if you spend just 30 mins in the San Juan airport during your layover from Miami to the US Virgin Islands, it counts as a day spent in Puerto Rico.

- You get a 14-day relief in case of natural disasters

If a hurricane – or other major disaster – hits the island while you live in Puerto Rico, the IRS allows you to relocate outside of Puerto Rico for 14 days and still consider these days as spent in Puerto Rico.

To take advantage of this relief, you must have been a bona fide resident of Puerto Rico *before* the hurricane happened.

Cruise port in Ponce

(In 2017, in the aftermath of the catastrophic hurricanes Irma and Maria, the IRS extended the 14-day rule to 268 days. So, in 2017/2018, you could have been outside of Puerto Rico for almost nine months, and these days would still have counted towards your physical presence test.)

- You get a 30-day relief if you travel internationally (but not to the US)

You can spend up to 30 days internationally and still consider those as days spent in Puerto Rico. You can travel for business or pleasure, but you can't travel to the United States.

There are two caveats with this relief:

a) By the end of the year, you will still need to spend more days in Puerto Rico than in the US; and,

b) You cannot use these 30 days towards the "60 days of presence" for the 549-day test that we discussed above.

- Relief in case of medical emergency

Any day you must spend outside of Puerto Rico in order to receive medical help still counts as a day spent in Puerto Rico. The same applies if you have to accompany your parent, spouse or child to receive medical treatment outside of Puerto Rico.

...

After clearing the first hurdle (the physical presence test), you will still need to pass the next two tests: the Tax Home and the Closer Connection ones.

Test #2: Tax Home

To satisfy the second requirement, you must have a "tax home" in Puerto Rico during the tax year.

Consider it your "office test."

Puerto Rico must become your primary place of business or employment.

Only if the nature of your business does not require you to have a "normal place of business", then your tax home is where you regularly live.

Club Nautico on Rincon beach

In other words, you pass this test by living in Puerto Rico and doing most of your work there.

It doesn't mean, however, that you can't do any work outside of Puerto Rico at all. You can still travel to the United States, or elsewhere, to attend conferences, meet your clients, etc. As long as your main business (or consulting) activity happens in Puerto Rico, then you should be fine.

(Make sure you confirm your compliance with a professional who is familiar with your business activity.)

Test #3: Closer Connection

And finally, you will need to prove to the IRS (if audited) that you have a closer connection to Puerto Rico than to the US or any foreign country during any part of the tax year.

Here are the considerations and the best practices you can employ to convince the IRS that Puerto Rico is indeed your primary home.

Factor	Best practice
Real estate - Critical factor in determining your closer connection. Make sure to get it right	- In the US, sell or rent out (long-term) all your properties at fair market value (renting to a family member at lower rates is a red flag). If you keep your property, spend as little time there as possible. - In Puerto Rico, buy a property or rent long-term. Switch from short-term to long-term rent as soon as possible. (Under the new Incentive Code rules, Act 22 applicants will have to purchase a property within the first two years of obtaining a decree.)
Family - Critical factor in determining your closer connection. Make sure to get it right	- Relocate your family, including your underaged children, to Puerto Rico. - Enroll your kids in the Puerto Rican school system - this includes private schools; homeschooling also works. (Exceptions apply if your child is enrolled in school or college in the US, or if you are officially divorced.)
Personal belongings (automobiles, furniture, clothing, and jewelry…)	- Sell your vehicle in the US and buy a new one in Puerto Rico. Alternatively, import your US vehicle to Puerto Rico. (We recommend the first path, as it will save you time, headache and money.) - Move all other belongings to Puerto Rico. Do not rent a storage unit in the US.
Social, political, cultural, professional, charitable organizations	- Give up all nonessential memberships in the US. - Join as many organizations in Puerto Rico as possible. For example, get a gym membership, join a country club, a church, a social group, a school board, etc. - Consider donating to charities in Puerto Rico. (If you are applying for an Act 22 decree, you will be doing this already.)

Factor	Best practice
Banking activities (personal and business)	- Open a checking account in Puerto Rico to pay day-to-day personal and business expenses. - Get a credit card in Puerto Rico. (**Important**: Even though the FDIC protection of up to $250,000 does apply to Puerto Rican banks**,** we still do **not** recommend you move your **entire** life savings there: Mainstream Puerto Rican banks are in worse shape than their US counterparts.)
Driver's license	- Get a driver's license in Puerto Rico.
Voter's registration	- Do not vote in the US, including in the presidential election. - Register to vote in Puerto Rico. (You don't actually have to vote if you don't want to.)
Other considerations	- Use your Puerto Rican address on all forms and documents. - Obtain health insurance in Puerto Rico. (Good news - it's cheaper than in the US.) - On the date of your departure, send an email to your friends and family saying that you are relocating.

You don't have to do **everything** we outline in the table above, but you should do **as much as you reasonably can**. If the IRS runs an audit on you, they need to leave convinced that you treat Puerto Rico as your primary home.

As you can see, in order to meet all three tests, you will need to live pretty much full-time in Puerto Rico, which may mean a big change in lifestyle for you.

In October of 2018, we released a report on what it's like to live in Puerto Rico, opportunities Simon sees in Puerto Rico, real estate prices on the island and much more. Make sure you check it out if you are considering Puerto Rico as a place to live. In the SMC library, we also have a case study about a Californian couple happily living in Puerto Rico.

PICKING THE RIGHT TIME OF THE YEAR TO MOVE TO PUERTO RICO

For most, it might be best to make a move to Puerto Rico in November or December.

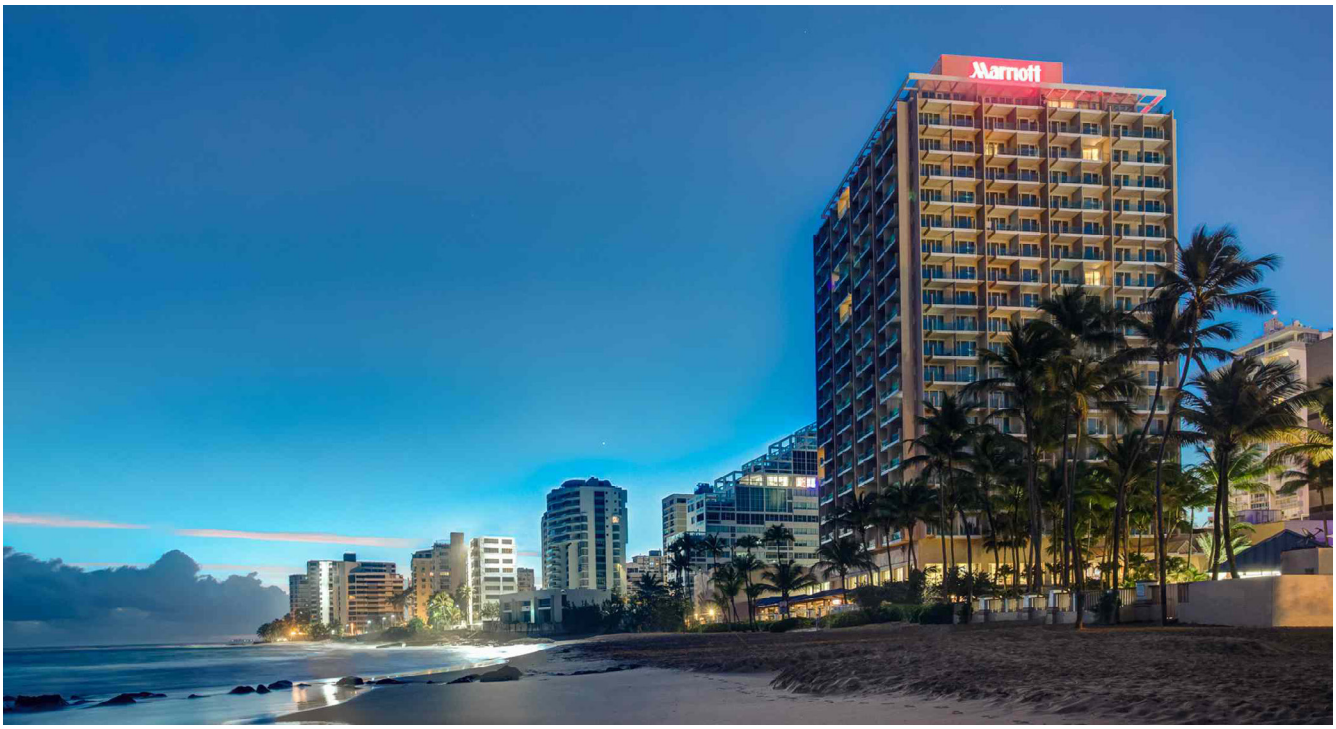
This way you will have the entire upcoming year to establish the necessary ties to Puerto Rico and meet all three tests. So, to become a bona fide resident of Puerto Rico in 2022, you might want to consider moving to Puerto Rico in December 2021.

However, if you want to move to Puerto Rico mid-year, you can do that, too of course.

And you can even become a bona fide resident **in the same year if you move within the first six months of the year** (no later than the end of June).

In order to become a bona fide resident of Puerto Rico in the year you physically move, you still need to meet the test #1 (physical presence), but the IRS agreed to provide relief in regard to test #2 (tax home) and test #3 (closer connection).

For that, you need to meet all of the following conditions. (Let's assume that you move to Puerto Rico on June 30, 2021):



Hotels in Condado neighborhood, San Juan

1) You weren't a bona fide resident of Puerto Rico during the previous three years (in 2018, 2019, and 2020).
2) You establish a tax home (test #2) in Puerto Rico and a closer connection (test #3) to Puerto Rico for the final six months of 2021.
3) You plan to be a bona fide resident of Puerto Rico for the next two full years after your move (in 2022, and 2023).

If you meet all three above-mentioned conditions, the IRS will consider you a bona fide resident of Puerto Rico for the entire year 2021.

However, if you think you might want to move back to the US within the next two years (in our example, earlier than the end of 2023), then you'd be better off just relocating at the end of 2021 and becoming a bona fide resident of Puerto Rico in 2022. That way, the IRS shouldn't be chasing you down because you left Puerto Rico earlier than they expected you to.

(A similar provision exists if you want to leave Puerto Rico to go back to the US mid-year, and still claim your bona fide residency in Puerto Rico for the year of the move. Please refer to page 7 of the Publication 570 for more details.)

REPORTING REQUIREMENTS AS A PUERTO RICAN RESIDENT

We are not tax/legal advisors, therefore make sure you consult with a tax attorney familiar with local tax laws and with your individual situation. The following section was written after consulting a tax attorney and reviewed the said professional, however it does not constitute tax guidance.

As a Puerto Rican resident, your tax reporting requirements will change.

First, if you're a bona fide resident of Puerto Rico during the entire tax year and if all your income stems *entirely* from Puerto Rican sources, you *will not* need to file a US federal income tax return.

Instead, bona fide Puerto Rico residents need to file Form 482, Puerto Rican Individual Income Tax Return, by April 15 of each year.

However, **if any of your income comes from outside Puerto Rico, you will also need to file your US tax return.**

(Rules are different if you are a **US government employee** living in Puerto Rico – you will always need to file a US income tax return in such a case.)

Once again, it is very important that you talk to a tax advisor to make sure you get the reporting part right.

US citizens generally need to report their foreign-held assets, including foreign financial accounts. And in some cases, Puerto Rico is indeed considered "foreign" for reporting purposes.

Do your Puerto Rican bank account and the Act 20 company need to be reported to the IRS somehow?

Generally, reporting of foreign financial accounts and assets generally happens in two different forms:

a) FBAR, a.k.a. FinCEN Form 114, and

b) Form 8938.

Reporting of your Puerto Rican bank account on each form will be different.

Let's start with the FBAR.

American taxpayers who own foreign financial accounts with an aggregate value exceeding $10,000 at any point in the year, must report all their foreign financial accounts on the FBAR form.

However, for FBAR reporting purposes, US territories are not considered "foreign". **There is no need to report your financial accounts located in Puerto Rico.**

The story changes when we look at Form 8938, however.

In this case, US territories, such as Puerto Rico, or US Virgin Islands *are* considered foreign, and generally need to be reported on Form 8938.

But there is an important exception -- **if you become a bona fide resident of Puerto Rico, you will not need to report your financial accounts located on the island, regardless of their size.**

In all other cases, there will be reporting to do, subject to reporting thresholds which will depend on whether you are married or single, and whether you live in the US or overseas:

Do you need to report your PUERTO RICAN bank account?		
	On FBAR	**On Form 8938**
When residing **in the US**	No reporting required	Single and filing separately: Need to report if the total value of assets was more than $50,000 on the last day of the tax year, or more than $75,000 at any time during the year. Filing jointly: Need to report if the total value of assets was more than $100,000 on the last day of the tax year, or more than $150,000 at any time during the year.
When residing **overseas**	No reporting required	Single and filing separately: Need to report if the total value of assets was over $200,000 on the last day of the tax year, or over $300,000 at any time during the year. Filing jointly: Need to report if the total value of assets was over $400,000 on the last day of the tax year, or over $600,000 at any time during the year.
When residing **in Puerto Rico**	No reporting required	No reporting required

As you can see, the *only* time you do *not* need to report your Puerto Rican bank account on either form is when you are a bona fide resident of Puerto Rico.

In a similar way, your Puerto Rican corporation (for Act 20 purposes, for example), generally needs to be reported on Form 5471 and Form 8938.

But as a bona fide resident of Puerto Rico, this filing requirement falls away for you.

If you earn more than $75,000, you will need to file Form 8898 when you move to Puerto Rico

If your worldwide gross income exceeds $75,000 for the year of your move to Puerto Rico, you will need to file Form 8898, "Statement for Individuals Who Begin or End Bona Fide Residence in a US Possession," along with your tax return.

This form determines whether you meet all three tests we discussed above.

If you are married, the $75,000 filing threshold applies to each spouse separately.

So if in the year of your move to Puerto Rico you have income of $80,000 and your spouse has income of $70,000, then you should file Form 8898, while your spouse is not required to file it.

You should file the form (once) the year that you become a bona fide resident of Puerto Rico.

For example, if you moved to Puerto Rico in September 2021 and didn't become a bona fide resident for 2021, then your first tax year would be 2022, and you would need to file the form with your 2022 tax return (before April 15, 2023).

But if you moved in March 2021 and met all the requirements for bona fide residency, 2021 would be your first tax year, and you would need to file Form 8898 with your 2021 tax return.

(You will need to file the form again when you move back from Puerto Rico.)

If you need a reference of a trustworthy tax professional who can assist you with your tax filing requirements, don't hesitate to message us at clients@sovereignman.com.

PUERTO RICO'S OTHER INCENTIVES

In this report, we are focusing on Acts 20 and 22 (now Chapters 3 and 2 of the new Act 60, respectively), because they are straightforward and apply to many of our readers.

However, the chapters corresponding to Acts 20 and 22 form just a small portion of the new Incentives Code.

Aerial view of old San Juan

Puerto Rico has **a lot more** incentives for you to choose from...

There are tax incentives for young entrepreneurs (younger than 35), for companies working in the tourism space, for those in manufacturing, for those in finance, for investing in green energy, and much more.

Let's look at the structure of the new Incentives Code, chapter by chapter.

Chapter 2 - Individuals

This chapter covers incentives for individual investors (former Act 22), and incentives for people with in-demand professions, such as doctors and scientists.

Chapter 3 - Exportation of Goods and Services

The former Act 20 is a part of this chapter of the Incentives Code. But it is only responsible for the "services" part of the chapter's name. There is also a "goods" portion.

If you plan to start a trading company reselling goods, patents, copyrights and much more to clients located outside of Puerto Rico (these items can be produced anywhere, not just in Puerto Rico), then your tax rate can be lowered to just 4%.

Chapter 4 - Finance, Investments, and Insurance

This chapter can be hugely important if you would like to start a financial institution in Puerto Rico.

And you don't have to start a new Bank of America, or Deutsche Bank. Starting a much more modest financial institution will work as well. Our own Strategic Bank was formed using tax incentives from this section (formerly, Act 273).

But besides that, this chapter also includes incentives for promoting Puerto Rico as an international insurance center. Make note if you are in the insurance/reinsurance business.

Finally, the same chapter includes incentives aimed to attract private equity funds to the island.

Chapter 5 - Visitor Economy

If you think you might be interested in setting up a tourism-related company in Puerto Rico, then incentives in this chapter are for you.

A very wide range of activities is covered - from providing any kind of services to tourists visiting Puerto Rico, to promoting Puerto Rico abroad, to even much more brick-and-mortar activities, such as running a bed and breakfast or constructing a hotel.

Almost any activity aimed at promoting tourism on the island qualifies for a tax benefit.

Chapter 6 - Manufacturing (including research and development)

Puerto Rico's incentives became popular because of Act 20 (companies providing services).

But if you think you could manufacture (anything) on the island, then the generous incentives from this chapter are for you.

Also, pay attention to this chapter if you think you might want to set up a company in Puerto Rico dedicated to research and development of a new product, service, or a new industrial process.

Chapter 7 - Infrastructure and Green Energy

Aims to encourage the improvement, construction and general development of infrastructure in Puerto Rico, especially connected with the production of renewable energy.

Chapter 8 - Agriculture

Again, a wide range of activities can qualify for tax incentives from this chapter - any dairy-related activity, land cultivation, fruit and vegetable growing, animal breeding, and even breeding of fighting cocks are just some of the qualifying activities.

Chapter 9 - Creative Industries

Incentives from this chapter aim to establish Puerto Rico as an attractive place to hold music and film festivals, to produce films, television series, video games, all kinds of other video or audio media, and much more.

If you think you could benefit and would like to learn much more, let us know by writing to clients@sovereignman.com. **If there is substantial interest, we will dedicate a special report on one or more of these incentives.**

POTENTIAL RISKS TO PUERTO RICO'S TAX INCENTIVES

You may be wondering whether these incentives will stay in place in the longer term, or if they may go away…

No one has a crystal ball, but there is always a chance these tax incentives may go away.

The potential danger comes from two sides -- the US and Puerto Rico itself.

We think it's unlikely that the Puerto Rican government will cancel the incentives outright. As a result of the pandemic, the territory needs capital and immigration more than ever. If anything, they may just hike up the annual fees of the incentives in order to raise more revenue.

But as you may have heard, Puerto Rico wants to become a state. In November 2020, Puerto Rican voters approved the statehood ballot, with 52.3% of the vote.

Should Puerto Rico become a state, then its unique tax system -- and incentives that are derived from it -- will disappear.

However, it's not the first statehood referendum in Puerto Rico's history -- statehood has been on the ballot six times before. In 2017, voters requested statehood. But the initiative died out, and Puerto Rico remained a US commonwealth.

This time, with Democrats holding the majority in the US House of Representatives and Senate, there may be a higher chance of Puerto Rico becoming the 51st or 52nd state (Washington, D.C. is in the line, too).

According to Article IV, Section 3 of the US Constitution, new states may be admitted by Congress. Prominent politicians like the Senate Majority Leader Chuck Schumer have expressed interest in Puerto Rico's statehood, and again, his party has the majority in both chambers.

But the issue is not a slam dunk...

While admitting Puerto Rico would guarantee that Democrats will receive additional votes each election, the territory is a financial mess, and admitting it as a state is not a straightforward decision.

If only a few House majority members and/or only one Senate majority member voted against Puerto Rican statehood, then the initiative would fail. And this is a possibility — the moderate members of Congress may be opposed to admitting Puerto Rico.

El Yunque rain forest

Even if Puerto Rican statehood would one day be approved, the actual process could take years to finalize.

Even if you get three or four years' worth of tax savings before Puerto Rico becomes a state, that could still be a tremendous advantage… especially if you're a high earner and/or if you're moving from a high-tax state.

In our view, a bigger threat to Puerto Rican tax incentives might come from a potential change to the US tax code itself.

Right now, the US tax code allows for Americans to move to one of the US possessions (e.g. Puerto Rico), establish a bona fide residence there, and become subject to the possession's (often more beneficial) tax system. The federal tax rules largely stop applying to them then.

This could change: the US Congress could simply disqualify US taxpayers from being subject to Puerto Rican tax rules *only*, even if they move there full time.

Still, there could be a grandfather clause, which would allow those currently on the island to continue to enjoy the 4% corporate tax rate, 0% tax on eligible dividends and capital gains, etc.

Thus, if you think you can benefit from the incentives, you may want to consider the move before the potential changes take place.

There's little downside to moving to Puerto Rico right now. Even if the incentives last just a few years, it may still be totally worth it.

CONCLUSION

The United States government taxes its citizens on their worldwide income, no matter where on Earth they live. Uncle Sam will want you to pay into the country's coffers even if you leave the US today and don't set foot on American soil for the next 50 years.

Aside from the east African country of Eritrea, the US is the only other country on the planet that taxes its citizens on their worldwide income, even if they don't live in their homeland. (And Eritrea does not have the resources to enforce the rule.)

There is only so much the US citizens can do in order to reduce their taxes.

Renouncing US citizenship is one option. This way one disconnects entirely from Uncle

Mona Island

Sam's tax net, which is likely to become much more entangling during the current administration.

But this measure is obviously not for everyone.

There is another solution that will work for many more Americans -- Puerto Rican tax incentives. It is hands down the best opportunity we've ever seen for decreasing business and personal taxes for US citizens.

Our founder Simon Black himself relocated to Puerto Rico and now enjoys tropical weather and low taxes.

And you can do the same. But you shouldn't delay the decision for too much longer.

While we don't have a crystal ball, there is a chance the Puerto Rican tax incentives won't be around for too much longer.

Puerto Rico could become a state in the future, or the legislators could change the US tax code to make incentives inapplicable.

However, this won't happen overnight. And even if the incentives only last three or four more years, they may still be totally worth it for you.

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We are not investment or tax advisors, and this should not be considered advice. It is very important to do your own analysis before making any investment or employing any tax strategy.

You should consider your own personal circumstances and speak with professional advisors before making any investment.

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