GUIDE

INVESTORS - CAPITAL GAINS AND U.S. TAXABLE INCOME PREVIOUS TO MOVING TO PUERTO RICO

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PUERTO RICO TAX COMPLIANCE GUIDE

By Torres CPA Group
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Understanding the Puerto Rico tax system and its interrelation with United States is crucial for individuals and entities doing business in Puerto Rico. Puerto Rico is not a state; its's a territory, with its own Business and Payroll laws and regulations.

The following White Pater is designed to give an insight Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing business in the Island. Nonetheless, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Certain exclusions and exemptions may apply and when specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico, and to obtain appropriate accounting and legal advice.

It is understood that the following overview does not constitute any formal rendering of either legal, accounting, tax or professional services. If legal advice or other assistance is required, an attorney, CPA or tax adviser should be consulted.

Torres CPA Group is an Advice Certified Public Accounting Firm offering Audit, Tax, Consulting and Financial Outsourcing services for over 30 years. If you require any further information or help, please do not hesitate to contact us.

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Previous to Moving to Puerto Rico Appreciation Capital Gains And other US taxable Income

CAPITAL GAINS

Moving to Puerto Rico does nothing to shelter previous appreciation capital gains.

Determining how to split a capital gain between appreciation that happened before you moved to Puerto Rico and appreciation that occurred while you were there depends on the type of property.

Puerto Rico taxes pre-move realized capital gain at the effective capital gain tax rate at currently 15% during the first ten years of residency and at 5% after that.

The US will tax at a 20% rate on capital gains (28% for precious metals). PR would give you credit for the US tax paid, so the effective rate of tax would be the higher tax rate, if capital gains exceed $250,000 in a tax year, then capital gain rate is 24%.

For investments that are trading in a public market, such as listed stocks and precious metals

You start by establishing the investment's price on the day of your move to the island. All profit up to that price is considered to have been earned before your move (and is taxable by Puerto Rico and the US). The rest of the profit is deemed to have accrued while you were in Puerto Rico (and is taxed by no one).

For example, a mainland US investor purchased stock for $100 on January 1, 2017. Then he moves to Puerto Rico on January 1, 2018, on which day the stock is worth $200. On December 1, 2018, sells the stock for $400, for a capital gain of $300 ($100 of which accrued before moving to Puerto Rico and $200 of which accumulated after moving).

Puerto Rico will tax the $100 accrued before moving at 15% (24% if capital gains exceed $250,000 taxable year) and by the US at 20%. The PR will allow a credit for the US tax; the effective total tax rate is still 20%, just if you had stayed on the mainland, unless gains exceed $250,000, then would be an additional 4%. The $200 accrued after moving will be exempt from US tax since you are a Puerto Rican resident for all of that period, also will be exempt from Puerto Rican taxes under Investors Act.

For Crypto Previous moving to Puerto Rico appreciation Capital Gains

Determining how to split a capital gain between appreciation that happened before you moved to Puerto Rico and appreciation that occurred while you were there depends on the type of property.

For Crypto investments you start by establishing the investment's price on the day of your move to the island and or the first day of year you move into Puerto Rico if you did not have a tax home elsewere.

All profit up to that price is considered to have been earned before your move (and is taxable by Puerto Rico and the US). The rest of the profit is deemed to have accrued while you were in Puerto Rico (and is taxed by no one). Taxable when trade any form, holding on it would not trigger a tax event.

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Puerto Rico will tax the $100 accrued before moving at 15% (24% if capital gain exceed $250,000) and by the US 20%. The PR Hacienda will allow a credit for the US tax; the effective total tax rate is still 20%, just if you had stayed on the mainland. The $200 accrued after moving will be exempt from US tax since you are a Puerto Rican resident for all of that period, also will be exempt from Puerto Rican taxes under Act 22.

For non-marketable stocks and other interests in private companies

There is no clear and straightforward way to establish the value as of the day you become a Puerto Rican resident. The rules pretend that appreciation in private security you took with you to Puerto Rico happened evenly day by day from the time you bought it while living on the mainland to the time you sold it while living in Puerto Rico.

If you bought stock in a corporation for $100, 100 days before you moved and sold it for $400, 200 days after you arrived in Puerto Rico, one third ($100) of the gain would treat as having accrued while you were still on the mainland (fully taxable), and two--thirds ($200) would treat as having accumulated while you were a Puerto Rican resident (tax free).

Puerto Rico will tax the $100 accrued before moving at 15% and by the US (under current rules, at 20%). The US will allow a credit for the Puerto Rican tax; the effective total tax rate is still 20%, just had stayed on the mainland.

The $200 accrued after moving will be exempt from US tax since you are a Puerto Rican resident for all of that period, also will be exempt from Puerto Rican taxes under Act 22.

DIVIDENDS AND INTEREST

The source of interest and dividends is the tax residence of the payer. So, the only way US citizens can benefit from Act 22 concerning interest or dividends is if the payer's tax residence in Puerto Rico, which would make the income's source of Puerto Rico.

If you hold US bank CDs as part of your portfolio, you could replace them with CDs of Puerto Rican banks (whose deposits are covered by FDIC insurance) to produce income that is entirely free of tax.

RETIREMENT INCOME, SOCIAL SECURITY AND OTHER PENSIONS

Withdrawals from a US IRA, 401(k), or other US tax-deferred retirement account would not be covered by Act 22. The situation is the same as Social Security and another pension income.

Growing Together

Puerto Rico has its own IRA system, with both traditional and Roth plans, but it is distinct from the US IRA system. Income from employment in Puerto Rico cannot be contributed to a US IRA and vice versa.

For a resident of Puerto Rico, a distribution from a US Roth IRA would be taxable by the Puerto Rican government.

A distribution from a US traditional IRA to a Puerto Rico resident would be taxable by both the US and the Puerto Rican government

For taxable distributions, the availability of credit from either government for tax paid to the other prevents double taxation, and you end up effectively only paying the higher rate.

Puerto Rican IRAs allow very little investment freedom, they must invest at least 34% of contributions into obligations of the Commonwealth of Puerto Rico.

Business and Investment Income

Rents from personal property. If you rent out personal property, such as equipment or vehicles, how you report your income and expenses is generally determined by the net income, tax where the property is use.

Business, S Corps or Partnership Ordinary Income

The ordinary income, gains, losses, deductions, and credits are passed through to the owner based on each distributive share of these items. It will be taxable base on the location of the entity. Capital Gains will be tax were at owner residence.

Real Estate Property

Income is determined by the net income, tax where the property is located.

Royalties

Royalties from copyrights, patents, and oil, gas and mineral properties are taxable as ordinary income at the location of the property payor or where the property is use.

Business as a self-employed writer, inventor, artist, etc., report your income and expenses where the services was performed.

Double Taxation

As a Puerto Rico Resident all your worldwide income will be included in the Puerto Rico Tax Return. For taxable income subject to tax in other jurisdiction, the availability of credit from either government for tax paid to the other prevents double taxation, and you end up effectively only paying the higher rate.