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Tax Insights: Estate taxes - the final difference for PR US citizens

A US citizen who is born or naturalized in Puerto Rico and is resident of Puerto Rico ("PR persons") at the time of death is considered a non-resident alien for US estate tax purposes. Non-resident aliens are taxed in property considered located in the US.

Prior to enactment of Sections 2208 and 2209 of the US Internal Revenue Code ("US IRC"), as amended, in September 2, 1958, the US estate tax was applicable to residents and citizens of the US. Nevertheless, the language was not sufficient to impose any federal estate taxes on PR residents. A US citizen could prevent the application of the estate tax by simply establishing his/her domicile in Puerto Rico, or any other possession.

After the enactment of Sections 2208 and 2209 any US citizen resident of Puerto Rico at the time of death that acquired his/her US citizenship solely by being a citizen or Puerto Rico, being born in Puerto Rico or being naturalized in Puerto Rico will be treated as a non-resident alien for estate tax purposes.

Given the current political situation, Puerto Rico has authority over its internal affairs unless any US law has occupied the field. Under the status quo, there are some remarkable differences when the situation of Puerto Rico US citizens is compared with that of the US citizens residing in one of 50 states.

Some of these differences have been extensively discussed nowadays due to the fiscal crisis and the efforts of local government officials to obtain some relief and assistance from the federal government:

- no right to vote for representation in US Congress, and
- the ineligibility of Puerto Ricans to vote in presidential elections.

There are also other differences, tax differences that are never referred to. US estate taxes are not the exception, a PR person is treated differently for US estate tax purposes, as mentioned before. This requires a detailed planning in order to minimize the impact of US estate taxes upon the estate of these citizens.

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If any PR person is subject to US estate tax because he or she has property located in the US and is considered a non-resident alien, the only exclusion allowed for federal estate tax purposes is $60,000 versus $5,430,000 if he or she were treated as others US citizens born or naturalized in the US.

The table below shows an example of the effect of the above mentioned differences in treatment.

It is true that the easiest way to eliminate the impact of this rule is to move to the US, it is also true that with careful planning and assistance from an estate tax consultant you can minimize it and still stay in our beloved island.

Even when this difference in treatment for PR persons could be challenged and in certain way argued as discrimination, as of today we do not have any Tax Court case or ruling that addresses this discrepancy in treatment for PR persons.

At **Kevane Grant Thornton** we can help you understand the complex estate tax rules and to determine the course of action. We provide sound and practical solutions to minimize the effect of taxes evaluating alternatives on your estate assets.

	PR RESIDENT BORN OR NATURALIZED IN PR		OTHER US CITIZENS	
	PR	US	PR	US
PR assets	$ 3,500,000		$ 3,500,000	$ 3,500,000
US assets	$ 2,500,000	$ 2,500,000	$ -	$ 2,500,000
	$ 6,000,000	$ 2,500,000	$ 3,500,000	$ 6,000,000
Exclusion	$ (1,000,000)	$ (60,000)		$ (5,450,000)
PLPR deduction	$ (2,916,667)	n/a		$ -
Taxable	$ 2,083,333	$ 2,440,000		$ 550,000
Estate tax	$ 208,333	$ 921,800	$ 102,842	$ 176,300
FTC	$ (208,333)			$ (102,842)
Net estate tax	$ -	$ 921,800	$ 102,842	$ 73,458