



Tax



Taxpayer



Incentives

Physical Presence Test to bona fide residents in Puerto Rico during the COVID-19 Pandemic

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The physical presence test for bona fide residents of Puerto Rico for 2020 will prove to be a different one due to COVID-19 travel and related disruptions.

Each year, taxpayers looking to claim Puerto Rico bona fide residence under Section 933 and the Section 937 Regulations issued under the United States Internal Revenue Code (“Regulations”) have to determine whether they satisfy the three tests of the Regulations: physical presence, tax home and closer connection. In this publication, we highlight how the physical presence test may look like for certain taxpayers for 2020 due to the COVID-19 pandemic and provide tips on how to tackle this test accounting systems may be set up to generate reports that comply with tax reporting and facilitate the reconciliations needed for income tax returns;

Constant changes to the tax laws provide new challenges and opportunities that could potentially affect your tax bill. We strive to keep our clients informed and are available to assist with any tax issue during the tax year.



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Collaborated in the preparation of this tax article.

Introduction

The physical presence test is satisfied for the tax year if the taxpayer meets one of the following conditions:

1. was present in the relevant territory for at least 183 days during the tax year;
2. was present in the relevant territory for at least 549 days during the 3-year period that includes the current tax year and the 2 immediately preceding tax years. During each year of the 3-year period, the taxpayer must be present in the relevant territory for at least 60 days;

3. was present in the United States for no more than 90 days during the tax year;
4. had earned income in the United States of no more than a total of \$3,000 and was present for more days in the relevant territory than in the United States during the tax year; or
5. had no significant connection to the United States during the tax year.

For purposes of this publication, we will focus on condition number 1, which requires physical presence of at least 183 days within the possession during the tax year in question. Generally, an individual is treated as being present in a relevant possession on any day that he or she is physically present in that location at any time during the day.

IRS Publication No. 570 provides certain exceptions to the “physically present” requirement in cases where the individual is outside of the relevant possession:

1. on business or personal travel for up to 30 days;
2. to receive, or to accompany a qualified family member to receive, qualifying medical treatment;
3. or has left or is unable to return to the relevant possession during 14-day period within which a major disaster occurs in the relevant possession for which a Federal Emergency Management Agency’s (“FEMA”) notice of a federal declaration of a major disaster is issued in the Federal Register, or any period for which a mandatory evacuation order is in effect for the geographic area in the relevant possession in which your main home is located (“Major Disaster”).

On March 27, 2020, FEMA published Notice DR-4493-PR in the Disaster Federal Register establishing a major disaster for Puerto Rico. As a result of the foregoing declaration of a Major Disaster, the 14-day period during which any individual is outside of Puerto Rico during the pandemic beginning on January 20, 2020 will be counted as days within Puerto Rico for purposes of the physical presence test.

As opposed to IRS Notice No. 2017-56, which provided relief for the physical presence test for a 117-day period beginning on September 6, 2017, and ending on December 31, 2017 for Hurricanes Irma and María, the IRS has not provided any additional relief for complying with the physical presence test during the global pandemic.



Practical scenarios

Based on the foregoing, we present the following scenarios assuming there was one Major Disaster during the taxable year and the year of move rules are not applicable:

- the first column in purple sets forth scenarios for a Taxpayer that should not face great challenges in complying with the physical presence test for 2020 as a result of the COVID-19 pandemic
- the second column in teal sets forth scenarios for a Taxpayer that require closer evaluation and assessment of the taxpayer’s residence for 2020 in light of the physical presence test

<p>Taxpayer quarantined in Puerto Rico during 2020 and was physically present in Puerto Rico for at least 183 days</p>	<p>Taxpayer travelled outside Puerto Rico and the United States during 2020 and was not physically present in Puerto Rico for at least 183 days</p> <p>KGT Tip 1: Taxpayer should evaluate whether he or she complies with the rest of the physical presence test alternatives provided in the Regulations (for example, the Taxpayer was outside of Puerto Rico and the United States for 30 days; the 14-day rule for Major Disasters; the Qualifying Medical Treatment exception)</p>
<p>Taxpayer travelled outside of Puerto Rico and the United States for a period longer than 14 days but otherwise was physically present in Puerto Rico for at least 183 days</p>	<p>Taxpayer was outside Puerto Rico during 2020, was not physically present in Puerto Rico for at least 183 days within the rules set forth in the Regulations, and does not satisfy other physical presence test alternatives</p> <p>KGT Tip 2: Taxpayer should plan for a 2020 taxable year without the Puerto Rico bona fide residency exception for federal income tax purposes. Taxpayer should also plan for tax implications in Puerto Rico and any relevant country, if outside the United States. Additional tax implications will depend on the tax rules where the taxpayer was located. If the taxpayer has an Act 22 tax exemption grant, he or she should understand the implications of the change in tax residence and required compliance obligations under said grant.</p>

In all scenarios, the taxpayer should maintain proper documentation to support his/her status. The foregoing discussion includes general considerations for Puerto Rico and United States federal tax purposes in connection to the physical presence test. We do not intend to discuss tax implications at State or local level, or implications in other countries. Also, taxpayers should consider compliance with the tax home and closer connection tests for every taxable year as well.

We are committed to keeping you up to date with all tax-related developments. Please contact our Tax Department should additional information be required regarding this or any other tax issue. We will be glad to assist you.



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