Act 60 Tax Alert: Tax Court Rules Against “Good Faith” Puerto Rico Residency Claim

April 6, 2026

If you have any questions regarding the matters discussed in this article, please contact us.

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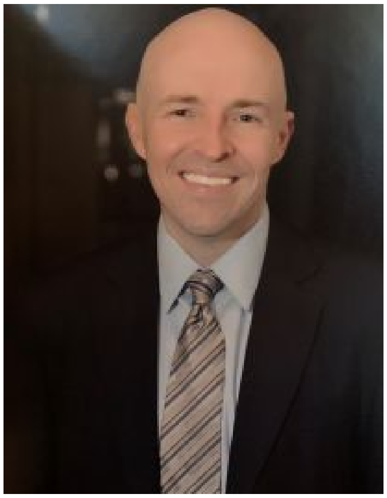

Tax Court Rules Against Puerto Rico Act 60 Resident: The Three-Year Trap That Can Cost You Everything

Overview

In March 2026, a U.S. Tax Court judge issued a bench ruling against an Act 60 investor who moved to Puerto Rico in mid-2021, recognized significant capital gains, and then relocated to Japan in late 2022 due to a family medical emergency. The Court denied the taxpayer’s Section 933 exclusion for his 2021 Puerto Rico-source income. As a result, he owed full U.S. federal income tax on gains he believed were tax-free.

While this is a bench ruling, and cannot be cited as precedent, this case carries important lessons for every current and prospective Puerto Rico Act 60 resident.

Facts of the Case

The Taxpayer’s Situation

Scott Ayers moved from Gilbert, Arizona to Puerto Rico on approximately June 1, 2021. During 2021, he realized short-term capital gains of $933,782 and excluded them from his U.S. federal income tax return under Section 933, believing he qualified as a bona fide resident of Puerto Rico (BFRPR).

In the fall of 2022, Mr. Ayers moved to Japan to support his family in the wake of his father-in-law’s heart attack. He did not return to Puerto Rico in 2022, 2023 or 2024. He continued living in Japan through the time he filed his petition with the Tax Court and at the time of the trial in March 2026.

The IRS’s Challenge

The IRS issued a Notice of Deficiency asserting that Mr. Ayers was not a BFRPR for 2021 and therefore could not exclude his Puerto Rico-source income. The deficiency totaled $332,594, plus a failure-to-file penalty of $33,260. (The IRS conceded an accuracy-related penalty of $66,519.)

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The Court's Ruling

Judge Emin Toro ruled in favor of the IRS on the tax deficiency and the late-filing penalty, but for the taxpayer on the accuracy-related penalty. Mr. Ayers owed the full tax plus the filing penalty.

The Rules You Need to Understand

Rule 1: You Must Be a BFRPR for the "Entire Taxable Year"

Section 933(1) is unambiguous: to exclude Puerto Rico-source income from your U.S. gross income, you must be a bona fide resident of Puerto Rico "during the entire taxable year." Because Mr. Ayers moved to Puerto Rico in June 2021, not January 1, he did not satisfy this requirement under the plain statutory text.

This rule is well-established and consistently enforced. Courts have uniformly held that a taxpayer who moves to Puerto Rico partway through a year cannot claim the Section 933 exclusion for that year.

Rule 2: The Year-of-Move Exception - and Its Hidden Catch

Treasury Regulation §1.937-1(f) provides a taxpayer-favorable exception for the year of the move. Under this exception, a taxpayer who moves to Puerto Rico mid-year can still qualify as a BFRPR for that year, but only if three conditions are all satisfied:

Condition 1: For the 3 years before the move, you were not a BFRPR.

Condition 2: For the last 183 days of the year of the move, you had no tax home outside Puerto Rico and no closer connection to any other place.

Condition 3: For each of the 3 taxable years following the year of the move, you were a BFRPR.

This third condition is the one that destroyed Mr. Ayers's case. By moving to Japan in late 2022 and remaining there through 2023 and 2024, he could not qualify as a BFRPR for those three subsequent years. Without satisfying Condition 3, the year-of-move exception was unavailable, thereby retroactively eliminating his 2021 exclusion.

KEY TAKEAWAY: If you moved to Puerto Rico partway through a year, your right to the Section 933 exclusion for that year depends on you remaining a BFRPR for the three years that follow. Leaving Puerto Rico, even for compelling personal reasons, can retroactively cost you the exclusion for the year you moved. See our year-of-move article for more information.

Rule 3: Intent and Circumstances Do Not Matter

Mr. Ayers argued that he intended to return to Puerto Rico and that his departure was involuntary, driven by his father-in-law's medical crisis and subsequent financial reversals. The court rejected these arguments entirely.

The bona fide residence tests under Sections 933 and 937 are objective, mechanical tests. They do not ask why you left or what you planned to do. The court was clear: the statute does not consider intent. Unfortunate circumstances, no matter how sympathetic, do not provide relief.

Rule 4: The Loper Bright Challenge Backfired

Mr. Ayers also attempted to challenge the validity of the Treasury regulations themselves, citing *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244 (2024), the 2024 Supreme Court case that eliminated the "Chevron deference" to agency interpretations. The court was unimpressed.

Judge Toro noted that Mr. Ayers's argument was internally self-defeating: his only path to winning lay in the regulations, which provided the year-of-move exception that Congress never enacted. Arguing that the regulations were invalid eliminated his only potential relief. Under the statute alone, his position was hopeless regardless of the regulations' validity.

The Late Filing Penalty

Mr. Ayers's 2021 return was due October 15, 2022, after an extension. He filed it on November 28, 2022, which was 44 days late. The court upheld a $33,260 failure-to-file penalty under Section 6651(a)(1).

Mr. Ayers pointed to his father-in-law's health emergency as the cause of the late filing, but the court found he had not adequately connected those events to the failure to file his 2021 return on time. This is a separate and independent lesson: the reasonable cause exception for late filing requires a direct causal link between the emergency and the failure to file; vague references to difficult circumstances are not enough.

What This Means for You

The Tax Court put it plainly: a taxpayer claiming the year-of-move exception faces "an all-or-nothing deal; he must take the bitter (residency for three years after the move) with the sweet (exemption for the year of the move). He cannot pick and choose by claiming refuge in the statute."

If You Moved to Puerto Rico Partway Through a Year

Your Section 933 exclusion for that year is contingent on you maintaining BFRPR status for the three following years. Consult your advisor immediately if you have left Puerto Rico or are considering leaving within the three-year window. Document your ties to Puerto Rico carefully during the three-year period. Your physical presence, tax home, and absence of closer connections to other jurisdictions all matter.

If You Are Considering Leaving Puerto Rico

Before you relocate, even temporarily, evaluate the impact on your BFRPR status for prior years and the current year. Leaving Puerto Rico carries tax consequences that can reach backwards in time.

A temporary absence from Puerto Rico for a medical emergency or other compelling reason does not automatically destroy BFRPR status, but permanently relocating elsewhere, even under duress, does.

The "closer connection" test and the "tax home" test are applied throughout the year, not just at year-end. Your ongoing conduct and ties matter.

File on Time - Every Year

The failure-to-file penalty is 5% of unpaid tax per month, up to 25%. In Ayers, a 44-day late filing cost the taxpayer $33,260, on top of the underlying tax bill. The court required a direct, documented causal link between the emergency and the missed deadline; a general reference to difficult circumstances was not enough. File extensions early and use them. If something threatens your ability to file on time, document it specifically and contemporaneously.

A Note on This Case

The Ayers decision is a bench opinion issued under Tax Court Rule 152. It is not precedential, meaning it cannot be cited as authority in other cases. However, it reflects the Tax Court's clear and consistent application of the Section 933 and 937 rules, and it illustrates exactly how these rules operate in practice. Practitioners and taxpayers should treat it as a serious warning.

The facts in Ayers are sympathetic. Mr. Ayers did not leave Puerto Rico to evade taxes. He left because of a genuine family emergency. The court acknowledged this but applied the law as written. The outcome underscores that Act 60 compliance is not merely a matter of good intent; it requires rigorous, sustained adherence to objective legal tests.

About Tom Duffy, C.P.A., P.A. & P.C.

Tom Duffy C.P.A., P.A. & P.C. is a Greater Chicago-based firm specializing in international taxation, with a particular focus on Puerto Rico. The firm maintains a highly specialized practice focused on representing Puerto Rico residents who benefit from the island's tax incentive programs, including Act 60 (formerly Acts 20 and 22), positioning it among the most specialized practices of its kind in the United States. Clients rely on the firm's deep expertise to navigate and comply with complex U.S. tax obligations, particularly as they relate to Puerto Rico's unique tax framework. With over twenty years of experience, Tom Duffy provides strategic international tax planning and comprehensive U.S. tax return preparation. The firm serves clients throughout the United States, its territories, and internationally. Tom Duffy is a member in good standing of the American Institute of CPAs and is licensed to practice in both Florida and Illinois.

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