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Puerto Rico's Act 60: When Are Pre-Move Bitcoin Gains Taxed?

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Bona fide residents of Puerto Rico may generally exclude Puerto Rican-source income from their US taxable income. [IRC §933](#). And residents of Puerto Rico covered by [Act 60](#) as individual resident investors are generally exempt from Puerto Rican income tax on capital gains and investment income, making these benefits particularly relevant to taxpayers holding appreciated Bitcoin. Whether gain from Bitcoin qualifies for this treatment, however, depends on the sourcing of the income and, in some cases, the application of the special rules for property acquired before the taxpayer became a bona fide resident of Puerto Rico. (Future applicants to the individual resident investor program who submit decree applications on or after Jan. 1, 2027, will be subject to a 4% income tax rate on capital gains and investment income. [Act 38-2026](#).)

The source of the income is the touchstone for determining whether income can be excluded. Income from the sale of personal property is generally sourced on the basis of the residence of the seller. [IRC §865\(a\)\(1\)](#). Under this general rule, income from the sale of personal property by a bona fide resident of Puerto Rico, a “BFRPR,” would generally be Puerto Rican-sourced income.

However, special rules apply to gains from dispositions of certain investment-type property owned prior to becoming a BFRPR, so-called “Tainted Property.” [Treas. Reg. §1.937-2\(f\)\(1\)](#). Under these special rules, gains from dispositions of Tainted Property within 10 years after becoming a BFRPR are treated as non-Puerto Rican-source income. [Treas. Reg. §1.937-2\(f\)\(1\)\(iii\)\(B\)](#). The purpose of these Tainted Property rules is to prevent avoidance of US tax on appreciated property by acquiring residence in Puerto Rico prior to its disposition. H.R. Rep. No. 108-755, at 795 (2004).

Whether Bitcoin acquired prior to moving to Puerto Rico should be considered Tainted Property is an often-asked question. The article first discusses Bitcoin held directly by an individual and then considers Bitcoin held through a partnership.

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Bitcoin

Bitcoin is a digital representation of value recorded on a cryptographically secured distributed ledger that the IRS generally treats as property for federal income tax purposes. [Notice 2014-21](#). Thus, gain or loss is recognized on a disposition of Bitcoin. IRC §1001.

Example 1: In 2018, Individual A purchased 1,000 Bitcoin (\$7,000 per coin) for \$7,000,000. His Bitcoin are now worth an estimated \$90 million (\$90,000 per coin).

On Sept. 1, 2025, he moves to Puerto Rico and becomes a BFRPR. On Jan. 21, 2026, he sells the 1,000 Bitcoin for \$90 million, realizing a gain of \$83 million, and wants to know whether he can exclude the gain from his US taxable income.

Split-Sourcing Election

An individual who becomes a BFRPR while owning Tainted Property may elect to split the source of the gain. If no such election is made, none of the gain on the disposition of the Tainted Property is considered Puerto Rican-source income, so it cannot be excluded from US taxable income. Treas. Reg. §1.937-2(f)(1)(i).

The allocation rule differs depending on the type of property:

- For marketable securities, a snapshot of the value of the asset is taken on the date the individual becomes a BFRPR. Treas. Reg. §1.937-2(f)(1)(vii)(A). Only appreciation after the individual becomes a BFRPR is Puerto Rican-source income. Treas. Reg. §1.937-2(f)(1)(vi)(A).
- For assets that are not marketable securities, income is allocated to Puerto Rico based on the number of days the individual has been a BFRPR as a proportion to the total days the individual owned the property. Treas. Reg. §1.937-2(f)(1)(vi)(B).

Tainted Property

The Tainted Property rules in Treas. Reg. §1.937-2(f)(1) provide that, if no split-sourcing election is made, then income from sources within Puerto Rico will not include gains from the disposition of property described in (f)(1)(ii) by an individual described in (f)(1)(iii). Treas. Reg. §1.937-2(f)(1)(i). The House Committee Report that accompanied the enactment of IRC §937 explained that Treasury and the IRS should exercise their regulatory authority to “prevent abuse, for example, to prevent US persons from avoiding US tax on appreciated property by acquiring residence in a possession prior to its disposition.” H.R. Rep. No. 108-755, at 795 (2004).

Property described in (f)(1)(ii) is considered “Tainted Property,” when:

(A) The property is of a kind described in IRC §731(c)(3)(C)(i) or [IRC §954\(c\)\(1\)\(B\)](#), “Investment-Type Property;” and

(B) The property was owned by the individual before the individual became a BFRPR.

Section 731(c)(3)(C)(i) Property

IRC §731(c)(3)(C)(i) lists the following eight kinds of Investment-Type Property:

- I. money;
- II. stock in a corporation;
- III. notes, bonds, debentures, or other evidences of indebtedness;
- IV. interest rate, currency, or equity notional principal contracts;
- V. foreign currencies;
- VI. interests in or derivative financial instruments (including options, forward or futures contracts, short positions, and similar financial instruments) in any asset described in any other subclause of this clause or in any commodity traded on or subject to the rules of a board of trade or commodity exchange;
- VII. other assets specified in regulations prescribed by the Secretary; or
- VIII. any combination of the foregoing.

The only potential category that Bitcoin may fall into is the sixth one as it does not fall into the other seven above-mentioned categories of property described in IRC §731(c)(3)(C)(i):

- I. Bitcoin is not money because it is not US coin or paper money;
- II. Bitcoin is not stock because it does not represent ownership in a corporation;
- III. Bitcoin is not a note, etc. because there is no requirement for one person to pay another person;
- IV. Bitcoin is not a notional principal contract because it is not a contract that provides for the payment of amounts by one party to another. [Treas. Reg. §1.988-1\(a\)\(2\)\(iii\)\(B\)\(2\)](#); [Treas. Reg. §1.446-3\(c\)\(1\)](#);
- V. Bitcoin is not foreign currency as per IRS guidance. [Notice 2014-21](#), Q&A-2; [Notice 2023-34](#);
- VI. Bitcoin as a commodity, or a derivative of a commodity, is discussed further below;
- VII. Bitcoin is not “other assets” because no regulations have been issued under IRC §731(c)(3)(C)(i); and
- VIII. Bitcoin is not any combination of the above because the only potential category for it to fall into is category VI.

Category VI: Commodities

The kind of property described in category VI (IRC §731(c)(3)(C)(i)(VI)) includes: “interests in...any commodity traded on or subject to the rules of a board of trade or commodity exchange....”

It is likely that Bitcoin should generally be treated as a commodity for US federal income tax purposes. Calvin, 190 T.M., *Taxation of Cryptocurrencies*, II.B. (“The CFTC has concluded that bitcoin is a commodity, the SEC has not disagreed with that conclusion, and bitcoin does not appear to be a security for federal income tax purposes; therefore, bitcoin seems likely, in general, to be classified as a commodity for federal income tax purposes.”).

Bitcoin may fall within this provision because Bitcoin futures contracts are actively traded on the Chicago Mercantile Exchange, which is a domestic board of trade designated as a contract market by the Commodity Futures Trading Commission. The statutory language does not require that the commodity itself be traded in spot form on the exchange; it may be sufficient that the commodity is the subject of trading on a qualified board of trade. Because Bitcoin is the underlying asset for CME-traded futures contracts, an ownership position in Bitcoin may constitute an “interest in” that commodity within the meaning of the statute.

For these reasons, Bitcoin may be treated as a kind of property described in IRC §731(c)(3)(C)(i)(VI) and may constitute “investment-type property” within the meaning of Treas. Reg. §1.937-2(f)(1)(ii)(A). It should be acknowledged, however, that this argument is uncertain. Reasonable arguments exist that spot ownership of Bitcoin may not constitute an “interest in” a commodity within the meaning of the statute, or that the CME futures rationale is broader than Congress intended. The IRS, however, need not rely on this argument alone. A more compelling basis exists under IRC §954(c)(1)(B).

Section 954(c)(1)(B) Property

Investment-Type Property, as described in IRC §954(c)(1)(B), is comprised of the following:

- (i) [property] which gives rise to dividends, interest, royalties, rents, and annuities...,
- (ii) [property] which is an interest in a trust, partnership, or REMIC, or
- (iii) [property] which does not give rise to any income.

Bitcoin does not fall into either of the first two categories, though it would fall in the third category of property because it does not give rise to any income. IRC §954(c)(1)(C) contains rules for transactions in commodities. Although Bitcoin is generally treated as a commodity for US federal income tax purposes, for purposes of IRC §954(c)(1)(C) the term commodity only includes tangible personal property. Treas. Reg. §1.954-2(f)(2)(i). Because Bitcoin is intangible property, it would not be described in IRC §954(c)(1)(C).

Cryptocurrencies, like Bitcoin, may generate income from certain transactions, such as airdrops, hard forks, and staking. Nonetheless, airdrops and hard forks are one-off transactions, and Bitcoin does not generate staking income because it uses proof-of-work, not proof-of-stake. See [Rev. Rul. 2023-14](#) for a discussion of staking rules. As a result, Bitcoin does not generate any type of income and is treated as Investment-Type Property as described in Treas. Reg. §1.937-2(f)(1)(ii)(A).

In Example 1, the Bitcoin owned by Individual A is Tainted Property. Individual A owned Bitcoin prior to becoming a BFRPR, and Bitcoin is considered Investment-Type Property as described in both IRC §731(c)(3)(C)(i) and IRC §954(c)(1)(B). Because he was a BFRPR for less than 10 years when he sold the Bitcoin in 2026, the Tainted Property rules apply to his \$83 million gain on the sale. If he does not make a split-sourcing election, the full amount of the gain will not be Puerto Rican-source income, and none of the gain can be excluded from his US taxable income.

Bitcoin Held Via Partnership

The rules are more complicated when Bitcoin is held through a partnership.

Example 2: Individual B is a 20% partner in a US partnership, PRS. In 2018, PRS purchased 1,000 Bitcoin (\$7,000 per coin) for \$7,000,000. PRS's 1,000 Bitcoin are now worth roughly \$90 million (\$90,000 per coin).

On Sept. 1, 2025, she moves to Puerto Rico and becomes a BFRPR. On Jan. 21, 2026, PRS sells the 1,000 Bitcoin for \$90 million, realizing a gain of \$83 million. Twenty percent of the gain (\$16.6 million) is allocated to her.

She wants to know whether she can exclude the \$16.6 million gain from her US taxable income.

As described above, to determine whether a BFRPR can exclude income or gains from US taxable income, it is necessary to determine the source of the income. Although the Bitcoin are sold by PRS, the source of the gain is determined at the partner level. IRC §865(i)(5). Because Individual B was a BFRPR at the time of the sale, the \$16.6 million gain allocable to her would be Puerto Rican-source income unless the Tainted Property Rules apply.

For the Tainted Property rules to apply, the Bitcoin must be Investment-Type Property and Individual B must have owned the Bitcoin prior to becoming a BFRPR. Treas. Reg. §1.937-2(f)(1)(ii). As discussed above, Bitcoin should be treated as Investment-Type Property. The only outstanding question, then, is whether Individual B is treated as owning the Bitcoin prior to becoming a BFRPR.

Entity vs. Aggregate Treatment

Under Subchapter K, a partnership is governed by two competing theories: the entity theory, which recognizes the partnership as a separate entity distinct from its partners, and the aggregate theory, which treats the partnership as a mere collection of partners where the entity serves only as a transparent conduit. *See, e.g.*, IRC §741 and §751, respectively.

This distinction is particularly significant in the sourcing context, where the applicable rules may yield different outcomes depending on whether the partnership is viewed as a separate taxpayer or as a collection of its partners.

If PRS is treated as an entity, then Individual B should not be treated as owning the Bitcoin that PRS owns. On the other hand, if PRS is treated as an aggregate, then she should be treated as owning her share of the Bitcoin that PRS owns. Under an aggregate approach, the Bitcoin in Example 2 would be treated as Tainted Property.

In *Holiday Village Shopping Center v. U.S.*, [773 F.2d 276](#) (Fed. Cir. 1985), the Federal Circuit Court of Appeals stated:

"[C]ourts have disregarded the partnership entity and treated the partnership as a collection of individuals where each partner owns a proportionate share of the assets.... The legislative history...shows that Congress did not intend a partnership to be treated in all situations as an entity for tax purposes.... The proper inquiry...is whether...it 'is more appropriate' to treat the partnership as an aggregate or 'collection of individuals' than as 'a separate entity.'"

See also [Rev. Rul. 89-85](#) ("[t]he treatment of partnerships in each context must be determined on the basis of countervailing factors applicable to such context."); *Casel v. Commr.*, [79 T.C. 424](#) (1982) ("When the 1954 Code was adopted by Congress, the conference report...clearly stated that whether an aggregate or entity theory of partnerships should be applied to a particular Code section depends upon which theory is more appropriate to such section.").

Gains on sales of non-inventory personal property are generally sourced to the residence of the seller. IRC §865(a). In Example 2, the PRS partnership sold the Bitcoin. If PRS were treated as an entity for sourcing purposes, the gain would be sourced based on PRS's residency. However, gains on sales of non-inventory personal property are not sourced at the partnership level; rather, such gains are sourced at the partner level. IRC §865(i)(5).

Sourcing partnership gain at the partner level is an application of the aggregate approach to partnerships. Because an aggregate approach is used to source Bitcoin owned by a partnership prior to a partner becoming a

BFRPR, it makes sense to also apply an aggregate approach to determine whether the partner is treated as owning the Bitcoin prior to becoming a BFRPR. In Example 2, PRS owned the Bitcoin prior to Individual B becoming a BFRPR. Consequently, under the aggregate approach, Individual B should be treated as owning her share of the PRS Bitcoin prior to becoming a BFRPR.

In a recent Chief Counsel Advice, [CCA 202538025](#), the IRS applied the Tainted Property rules to gains from sales of personal property by a partnership. In doing so, the IRS appears to have applied an aggregate approach, treating assets owned by a partnership as if the assets were owned by a partner prior to the partner becoming a BFRPR.

Treas. Reg. §1.937-2(j) and Aggregate Approach?

Some practitioners point out that Treas. Reg. §1.937-2(j) presents an argument for treating partnerships as entities rather than as aggregates for purpose of the Tainted Property Rules. The Tainted Property rules incorporate the IRC §318(a) attribution rules for shares of stock. Treas. Reg. §1.937-2(j). Under these attribution rules, shares of stock held by a corporation or partnership are considered as owned by the shareholders or partners. The fact that the Treasury Department in drafting the regulations invoked these attribution rules could suggest that the drafters considered partnerships to be treated as entities (as opposed to aggregates) in this context. On the other hand, the [IRC §318\(a\)](#) rules do not just apply to partnerships; they also apply to corporations. Therefore, the drafters of the regulations may have been more focused on applying the attribution rules to corporations than to partnerships.

In the context of the Tainted Property rules, the regulations can reasonably coexist with an aggregate approach. Treating partners as owning their proportionate share of partnership-held investment property aligns with the Tainted Property rules' policy goals specified in [H.R. Rep. No. 108-755](#), at 795 (2004): to prevent taxpayers from avoiding US tax on appreciated property by establishing Puerto Rican residency shortly before a disposition. While the regulations do not explicitly require aggregate treatment, they do not preclude it, and an aggregate interpretation is consistent with both the structure and policy of the rules.

Example 2 Summary

In Example 2, (i) Bitcoin is Investment-Type Property, (ii) Individual B should be treated as owning her share of the Bitcoin prior to becoming a BFRPR, and (iii) she was a BFRPR for less than 10 years when the Bitcoin was sold. Consequently, the Tainted Property rules should apply to Individual B's portion of the gain (\$16.6 million) flowing from the PRS partnership. If she does not make a split-sourcing election, the full amount of the gain will not be Puerto Rican-source income, and none of the gain can be excluded from her US taxable income.

Notably, if she files her original return without making the split-sourcing election, she cannot later amend to make the election. *Hodel v. Commissioner*, [T.C. Memo. 1996-348](#) (“once the taxpayer makes an elective choice, he is stuck with it.”).

What About Other Cryptocurrencies?

Although this article focused on Bitcoin, practitioners advising Act 60 residents frequently encounter a broader question: Whether the Tainted Property rules apply to the full range of cryptocurrencies their clients hold. It is worth observing that the IRS’s ability to characterize a cryptocurrency as Investment-Type Property may heavily depend on which cryptocurrency is at issue. Bitcoin’s unique position as the underlying asset for the CME-traded futures contracts affords the IRS a potential argument under IRC §731(c)(3)(C)(i) that simply does not exist for most other cryptocurrencies. The vast majority of cryptocurrencies, those with no futures contracts trading on a regulated board of trade, clearly do not fall under IRC §731(c)(3)(C)(i).

This does not leave the IRS without recourse, however. IRC §954(c)(1)(B)(iii), which captures property that does not give rise to any income, requires no commodity classification and no regulated futures market. Most cryptocurrencies, in their natural state, are speculative digital assets that sit in a digital wallet and appreciate or depreciate in value without generating any income to their holders, fitting squarely within IRC §954(c)(1)(B)(iii).

Gives Rise to Income

Whether a particular cryptocurrency “gives rise to” income within the meaning of IRC §954(c)(1)(B)(iii) is not always self-evident. Unlike dividends, interest, or rents, which flow automatically from the property itself, staking rewards require an affirmative act by the holder. But that does not mean the property does not give rise to income. Some proof-of-stake cryptocurrencies are designed with staking as a core feature, making the potential to generate staking rewards an inherent characteristic of the asset. For a taxpayer who has been regularly staking throughout the holding period, staking may very well satisfy the “gives rise to income” requirement, thereby removing the cryptocurrency from Investment-Type Property status under IRC §954(c)(1)(B)(iii). Treas. Reg. §1.937-2(f)(1)(ii)(A). Such a finding could mean that the gain on disposition qualifies as Puerto Rican-source income eligible for exclusion from US taxable income, a significant benefit for Act 60 residents with substantial pre-move appreciation.

Under “change in use” rules, Treas. Reg. §1.954-2(a)(3) provides that the “use or purpose for which property is held is for more than one-half” of the taxpayer’s holding period, but it also contains an anti-abuse rule stating that the change in use will not be respected if a principal purpose of the change was to avoid the rules.

Accordingly, if a taxpayer regularly earns staking income for more than half of their holding period and there was no change in use intended to manipulate the rules, that cryptocurrency is likely treated as property that gives rise to income and would likely fall outside IRC §954(c)(1)(B)(iii). In practice, the analysis requires a review of the relevant facts.

The same regulation contains an anti-abuse rule: If a principal purpose of a change in use or purpose of property was to avoid including gain or loss in the computation of foreign personal holding company income, all the gain or loss from the disposition of the property is treated as foreign personal holding company income.

Thus, a taxpayer who was not staking a particular cryptocurrency before moving to Puerto Rico but commenced staking after the move, in an attempt to cause the coin to give rise to income and thereby escape the IRC §954(c)(1)(B)(iii) characterization, should not succeed under this anti-abuse rule.

Practitioners should approach this area with caution. At present, there is simply no direct authority addressing how digital assets fit within IRC §954(c)(1)(B)(iii), and the IRS has given no indication of how it views the staking question in this context. The analysis above is drawn from statutory and regulatory text that was never written with cryptocurrencies in mind, and practitioners who advise clients in this space should proceed accordingly.

Takeaways

If an individual directly owns Bitcoin before moving to Puerto Rico, unless a split-sourcing election is made, none of the gain in the first 10 years of becoming a BFRPR is Puerto Rican-source income, and none of the gain can be excluded from the individual's US taxable income.

If an individual becomes a BFRPR while owning a partnership interest that in turn owns Bitcoin, under the aggregate rules of partnerships, the individual should be treated as owning a proportionate share of the Bitcoin prior to becoming a BFRPR. Aggregate principles are used to determine the source of the gain on the partnership sale of the Bitcoin. Consequently, it makes sense to also apply aggregate principles for purposes of the Tainted Property rules. After all, the Tainted Property rules are intended to prevent avoidance of US tax on appreciated property by acquiring residence in Puerto Rico. Applying entity principles in this context would defeat congressional intent.

These conclusions likely extend beyond Bitcoin. Most cryptocurrencies that do not generate recurring income may be treated as Investment-Type Property under §954(c)(1)(B)(iii), even where they lack a commodity-based argument under [IRC §731\(c\)\(3\)\(C\)\(i\)](#). However, the analysis may differ for proof-of-stake assets that generate staking income, depending on the facts.

Despite the significance of these issues, the IRS has not yet issued published guidance on the application of the Tainted Property rules to cryptocurrency. With the Act 60 program now extended through 2055, the number of high-net-worth individuals moving to Puerto Rico with appreciated cryptocurrencies is likely to increase substantially in the years ahead. The IRS should prioritize issuing guidance in this area.

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