

Bona Fide Resident of Puerto Rico - Closer Connection Test

Bona Fide Resident of Puerto Rico

In general, to be considered a bona fide resident of Puerto Rico, an individual must meet (i) a presence test, (ii) a tax home test, and (iii) a closer connection test.¹ In this article we will primarily focus on the closer connection test.

Let's start with an example of a US citizen named Joe. Joe lives in Connecticut and works for a hedge fund. Joe is married and has two children. Joe has heard about certain tax benefits of moving to Puerto Rico. Joe decides to move to Puerto Rico and become a bona fide resident of Puerto Rico so that he can take advantage of the special tax benefits there.

Joe meets the presence test because he spends more than 183 days in Puerto Rico each year.² In addition, Joe's principal place of business is in Puerto Rico. Therefore, Joe meets the tax home test.³

Closer Connection Test

To meet the closer connection test, Joe must have a closer connection to Puerto Rico than to the U.S. or to a foreign country.⁴ Since Joe only spends a week or two each year traveling outside the U.S. and Puerto Rico, Joe clearly does not have a closer connection to any foreign country. However, Joe spends several months a year in the U.S. and continues to have assets and other connections to the U.S. Therefore, it is necessary for Joe to determine whether he meets the closer connection test.

¹ Code §937(a) and Treas. Reg. §1.937-1. All section references are to the Internal Revenue Code of 1986, as amended (the "Code") and the regulations promulgated thereunder.

² Treas. Reg. §1.937-1(c).

³ Treas. Reg. §1.937-1(d).

⁴ Treas. Reg. §1.937-1(e).



The closer connection test applies the principles of the “closer connection exception” under Code §7701(b)(3)(B)(ii) and Treas. Reg. §301.7701(b)-2(d).⁵

[Form 8898](#), *Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession*, is required for certain individuals becoming residents of Puerto Rico (or other U.S. possessions). Part III of Form 8898 is titled “Closer Connection to the United States, Foreign Country, or Possession.” This part of the form lists a number of questions that are intended to “elicit information relevant to determining whether an individual has closer connections to the United States or a foreign country than to the relevant possession for purposes of the closer connection test of §937(a).”⁶

Treas. Reg. §301.7701(b)-2(d) is titled “Closer connection to a foreign country,” and provides:

(1) In general. For purposes of section 7701(b) and the regulations under that section, an alien individual will be considered to have a closer connection to a foreign country than the United States if the individual or the Commissioner establishes that the individual has maintained more significant contacts with the foreign country than with the United States. In determining whether an individual has maintained more significant contacts with a foreign country than the United States, the facts and circumstances to be considered include, but are not limited to, the following -

- (i) The location of the individual’s permanent home;
- (ii) The location of the individual’s family;
- (iii) The location of personal belongings, such as automobiles, furniture, clothing and jewelry owned by the individual and his or her family;
- (iv) The location of social, political, cultural or religious organizations with which the individual has a current relationship;
- (v) The location where the individual conducts his or her routine personal banking activities;
- (vi) The location where the individual conducts business activities (other than those that constitute the individual’s tax home);

⁵ Treas. Reg. §1.937-1(e).

⁶ Notice 2006-73. Note that Part IV of [Form 8840](#), *Closer Connection Exception Statement for Aliens*, has similar questions to those listed in Part III of Form 8898.



(vii) The location of the jurisdiction in which the individual holds a driver's license;

(viii) The location of the jurisdiction in which the individual votes;

(ix) The country of residence designated by the individual on forms and documents; and

(x) The types of official forms and documents filed by the individual, such as Form 1078 (Certificate of Alien Claiming Residence in the United States), Form W-8 (Certificate of Foreign Status) or Form W-9 (Payer's Request for Taxpayer Identification Number).

(2) Permanent home. For purposes of paragraph (d)(1)(i) of this section, it is immaterial whether a permanent home is a house, an apartment, or a furnished room. It is also immaterial whether the home is owned or rented by the alien individual. It is material, however, that the dwelling be available at all times, continuously, and not solely for stays of short duration.

As indicated in the quoted regulation above, the closer connection test is a "facts and circumstances" test. The IRS and a court would look at the facts and circumstances to determine whether Joe maintained more significant contacts with the U.S. than with Puerto Rico.

Joe's Time in the U.S.

Even though Joe may meet the presence test by spending more than 183 days in Puerto Rico, and even though none of the factors listed in the regulation specifically mention time spent by the taxpayer in the U.S., a highly critical factor in assessing Joe's contacts with the U.S. would be how much time he spends in the U.S. If Joe spends 185 days in Puerto Rico during the year and 180 days in the U.S., it would seem that Joe may be on the tipping point of not meeting the closer connection test.

Permanent Home

The location of an individual's permanent home is the first listed factor in the regulation and is perhaps the most important factor.

If Joe owns a home in Connecticut and does not sell it or does not rent it while he is in Puerto Rico, this could be a very significant connection to the U.S.

It was mentioned above that Joe spends several months a year in the U.S. A significant question would be: Where does he stay when he is present in the U.S.? Is he in a hotel on business without his family accompanying him? Or does he stay in his former principal residence in Connecticut with his family?

If the home that Joe stays in is available to him at all times, then this could be considered Joe's permanent home in the U.S.⁷ For example, if Joe's parents had an in-law suite that Joe and his family could use whenever they wanted, it would be considered a permanent home in the U.S.

Lacking a permanent home in the U.S. is not, in and of itself, a requirement of meeting the closer connection test. Joe may have two permanent homes: one in the U.S. and one in Puerto Rico. However, having a permanent home in the U.S. would be a very significant strike against Joe in analyzing whether he meets the closer connection test.

Location of Family

The location of an individual's family is the second listed factor in the regulation and is perhaps the second most important factor.

In our society, when an individual has a spouse and children, his or her closest family members are generally the spouse and children. It would be very important to analyze where Joe's wife and children are throughout the year. If Joe is spending several months a year in the U.S., where are his wife and children during this time? Do they spend nearly the entire year in Puerto Rico? Or are they coming to the U.S. as much as (or even more than) Joe? Where are Joe's children enrolled in school? Where do they go to camp? Are they regularly connecting with individuals in the U.S. or is Puerto Rico more like their home base?

The more time that Joe's spouse and children spend in the U.S., the more that Joe would be treated as having U.S. connections.

Every individual's circumstance is different. For example, if Joe were not married, did not have children, and his widowed mother lived with him in Puerto Rico, then the time that his mother spends in the U.S. would be an important factor to consider.

⁷ Treas. Reg. §301.7701(b)-2(d)(2).

Location of Personal Belongings

The location of personal belongings is the third listed factor in the regulation. If Joe and his wife did not move any of their furniture from their Connecticut home to Puerto Rico, but instead purchased new furniture for their Puerto Rican home, that would suggest continued connections with the U.S. The U.S. connections might be considered particularly strong if their Connecticut furniture included heirlooms or other furniture with significant sentimental attachments (furniture received as a wedding gift, etc.).

Other Factors Listed

The regulations quoted above list multiple other factors. These factors are important and should be considered when trying to meet the closer connection test. For example, Joe should get a Puerto Rican driver's license, designate Puerto Rico as his residence on official forms, and register to vote in Puerto Rico. However, one should understand that the IRS and a judge may not heavily weight factors that can be easily manipulated.

Years Spent in Puerto Rico

Although not explicitly listed as a factor, if Joe moves to Puerto Rico for just a few years and then moves back to the U.S., it may suggest that Joe's connections to Puerto Rico were not that significant. The IRS can generally audit individuals for up to three years after they have filed their tax returns.⁸ This "after-the-fact" review can provide the IRS with certain insights (one might say 20/20 hindsight) that are not apparent up front.

Further, if Joe moves back to the U.S. after a short number of years, an IRS auditor may feel that Joe was "taking advantage" of the tax breaks in Puerto Rico. Although the tax breaks are wholly legitimate for bona fide residents of Puerto Rico, the IRS auditor may be motivated to investigate Joe's contacts with the U.S., hoping to torpedo Joe's claim that he met the closer connection test. If Joe's facts are already close to the line, having a motivated IRS auditor may be a concern.

If after leaving Puerto Rico, Joe and his wife sell all of their Puerto Rican furniture, or donate it to a charity, this would perhaps suggest that they did not have much of a connection to those personal belongings (as compared to furniture they may continue to own in Connecticut).

⁸ Code §6501(a).



Creative Planning and Consulting for Tax
Minimization and Wealth Preservation.

Planning to Meet the Closer Connection Test

Clearly, it is advisable to only have one permanent home, and to have that home in Puerto Rico. In addition, it is important for close family members to be located in Puerto Rico during as much of the year as possible.

If an individual moves to Puerto Rico and wishes to claim bona fide residency in Puerto Rico, but the individual continues to have contacts with the U.S., it would be prudent for the individual to take stock of their daily activities in Puerto Rico. Recollections of genuine and meaningful interactions on a regular basis with people located in Puerto Rico may be the key to sway a judge (who is otherwise on the fence) of the strong connections the individual has with Puerto Rico.

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

Tom Duffy C.P.A., P.C. is a Greater Chicago-based firm that specializes in international taxation with a particular focus on U.S. possessions. In addition, the firm is one of the few CPA firms in the country that specializes in representing residents of Puerto Rico during IRS examinations, specifically those taxpayers granted tax incentives under Puerto Rico's Act 60 (formerly Act 20/22).

Our foreign clients rely on our knowledge and expertise in complying with their U.S. tax obligations. Tom Duffy has over fifteen years of experience in international tax planning and associated U.S. tax return preparation. The firm services clients in the United States, its possessions, and throughout the world.

For more information, please visit us at www.tomduffycpa.com.