# Staving off Anxiety Amidst Enforcement of Acts 20/22/60

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**Porzio Client Alert**

"*Puerto Rico, cuando mis labios pronuncian tu nombre, mi corazon se acelara…*" When renowned salsero Frankie Ruiz first sang these words, "Puerto Rico, when my lips pronounce your name, my heart races," he was crooning a love song to our beautiful island. However, in the wake of recent increased governmental scrutiny of individuals who have derived benefits from Acts 20/22/60, these lyrics – and those heart palpitations – have taken on a whole new meaning.

On January 29, 2021, the Internal Revenue Service ("IRS") added Puerto Rico Act 22 to its list of compliance campaigns. The impetus for this campaign is likely the analysis conducted by the IRS, which was commissioned by the House Appropriations Committee and revealed in the fall of 2020. In short, the IRS concluded that the hundreds of Americans who moved to Puerto Rico to take advantage of these tax incentives have stopped paying millions of dollars to the U.S. Treasury. Accordingly, the IRS has now decided to audit Act 22 decree holders, in particular, to verify whether they are in compliance with its requirements.

By way of background, Act 20, the Export Services Act, and Act 22, the Individual Investors Act, were enacted in 2012. Act 20 offered tax incentives for Puerto Rican companies to export services to other jurisdictions, while Act 22 offered tax incentives to individuals who relocate to Puerto Rico. In 2019, Acts 20 and 22, together with dozens of tax decrees, incentives, subsidies, and tax benefits, were combined to form the all-encompassing Act 60. Acts 20 and 22 both required that the individual benefitting from the incentives be physically present on the island for at least 183 days of a tax year. Act 60 requires the payment of an annual fee of $5,000 and annual contributions to nonprofits of $10,000. Between 2012 and 2019, the Puerto Rico government granted Act 20 benefits to 1,924 entities and Act 22 benefits to 2,331 individuals.

The new IRS campaign is ostensibly targeting two groups. The first group is taxpayers who have claimed benefits through Act 22 without meeting the requirements of IRC Section 937, Residence and Source Rules Involving Possessions. These are individuals the IRS suspects may be excluding income subject to U.S. tax on a filed U.S. income tax return (i.e., underreporting income), or failing to file and report income subject to U.S. tax. The second group is individuals who have met the requirements of IRC Section 937, but who may be erroneously reporting U.S. source income as Puerto Rico source income in order to avoid U.S. taxation. The stated objective of the IRS's campaign is to address noncompliance in this area through a variety of treatment streams, including examinations, outreach, and soft letters. However, criminal prosecutions are certainly not off the table.

On October 14, 2020, a federal grand jury in the District of Puerto Rico returned an indictment against the partner of a national accounting firm located in Puerto Rico, charging him with ten counts of wire fraud. The indictment alleges that the CPA devised a scheme to defraud the IRS through allegedly submitting false information to the government of Puerto Rico in an attempt to fraudulently provide a company (apparently owned by an undercover IRS agent) with federal tax relief via

the provisions of Act 20. This case is significant for two reasons: 1) the IRS utilized an undercover IRS agent to affirmatively contact and investigate the CPA; and 2) the IRS did not charge a conspiracy to commit tax evasion or traditional tax preparer violations, but rather, charged the defendant with wire fraud which is exponentially more serious. This means that the IRS is showing it is serious by employing aggressive investigative techniques, and charging defendants with non-tax criminal charges that carry very high penalties.

While the IRS has avowed to "vigorously pursue any individuals and professionals that fraudulently enrich themselves by abusing government tax incentive programs," it acknowledges that "[f]ederal and Puerto Rican tax laws have been put in place to invigorate the economy and provide financial relief to Puerto Rico." Many Act 20/22/60 decree holders have done just that. Between 2015 and 2019, Act 22 decree holders invested roughly $1.3 billion in purchased real estate. Act 20 has led to $1.2 billion in total investments and 36,222 total new jobs. In 2020, the Act 20/22 Society announced a record distribution of $1,085,000 to more than 30 non-profit organizations in Puerto Rico.

Act 20/22/60 decree holders have undoubtedly made significant contributions to Puerto Rico's economy. Nonetheless, increased government scrutiny remains a cause for concern for many law-abiding, tax-paying individuals who fear getting caught in crosshairs of these impending investigations. Strictly following the advice of lawyers and tax professionals may lessen or avoid the risk of adverse action by the IRS, but the threat of being put under a microscope by the IRS is real, especially in light of the fact that the IRS announced its intent to increase its scrutiny of decree holders.

All Act 20/22/60 decree holders should immediately take steps to ensure that they are in full compliance with the requirements of both the IRS and Puerto Rico, and that that they can prove compliance through objective (documentary) evidence. This is the best and strongest defense against any questions relating to compliance.

Separately, decree holders should keep in mind that under federal law there is no client-accountant privilege (save for a very limited exception that does not apply to decree holders' accountants who did their filings). Therefore, and not surprisingly, the IRS is expected to target decree holders' accountants for information, including documents and communications. That said, the attorney-client privilege does protect communications between a client and an accountant where the communication is made to the accountant in confidence for the purpose of obtaining legal advice from the lawyer. An accountant retained for this purpose is also known as a *Kovel* accountant. The term "*Kovel* accountant" comes from the landmark case *United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961).

Decree holders should verify they are documenting their compliance and safekeeping their proof. Moreover, if a decree holder has any questions about past or current compliance, it is important to keep in mind that the IRS will get their hands on communications between targets and their accountants. Therefore, decree holders with any pressing concerns about compliance should speak to their attorney, and if necessary, retain a *Kovel* accountant. Even if one perceives the chances of an IRS examination, civil action, or criminal charges to be small, the impact, should one take place, can be substantial, especially if the target is unprepared. And as anyone in Puerto Rico knows, even when there is only a 5% chance of rain, when it rains, it pours.