

Source Of Income

The source of income is important in determining if the income may be excluded under section 933 of the Internal Revenue Code. The table below describes the general rules for determining the source of your income:

Example Of Source Of Income Rules

| Item of Income | Factor Determining Source |
|---|---|
| Salaries and other compensation | Where the service is performed |
| Social Security Benefits | *U.S. Source income by definition (IRC Sec. 861) |
| Pensions: | |
| Contributions | Where services were performed that earned the pension |
| Investment earnings | Where pension trust is located |
| Interest | Residence of the payer |
| Dividends | Location of payer |
| Rents | Location of property |
| Royalties: | |
| Natural resources | Location of property |
| Patents, copyrights, etc. | Where the property is used |
| Sale of real property | Location of property |
| Sale of personal property | **Seller's tax home (<i>but see Special Rules for Gains From Dispositions of Certain Property for exceptions</i>) |

* Special Rules

Caution: *Bona Fide Residents of Puerto Rico should use Publication 915 to determine how much of their Social Security Benefits may be taxable.

Caution: **There are special rules for gains from dispositions of certain investment property (for example, stocks, bonds, debt instruments, diamonds, and gold) owned by a U.S. citizen or resident alien prior to becoming a bona fide resident of a possession. For additional details see Publication 570.

Deductions

It is important to remember that deductions which apply to your exempt Puerto Rican income are not deductible on your Federal income tax return. For example, **self employment tax deduction:** If you are a bona fide resident of Puerto Rico and you exclude all of your self-employment income from gross income, you cannot take the deduction for part of *your self-employment tax* on Schedule 1 (Form 1040), line 27, because the deduction is related to excluded income. You must pay self-employment tax on net self-employment earnings of \$400 or more. For more information see Publication 570 "Self Employment Tax Deduction" in chapter 4.

The personal exemption amount is \$0 for tax years beginning 2018 through tax year 2025.

Deductions that do not specifically apply to a particular income item must be allocated between your gross income subject to U.S. tax and your total gross income from all other sources. Examples of deductions that do not definitely apply to a particular type of income are alimony payments and certain itemized deductions (such as medical expenses, charitable contributions, and real estate taxes and mortgage interest on your personal residence). To find the part of the deduction that is allowable, you must apportion those items that do not apply to any specific type of income based on the ratio that your gross income subject to Federal tax bears to gross income from all sources.

EXAMPLE: You and your spouse, both under 65, are U.S. citizens and bona fide residents of Puerto Rico for the entire year. You file a joint return. This year you earned \$22,500 from Puerto Rican sources and your spouse earned \$67,500 from the U.S. Government. You have \$27,000 of itemized deductions that do not apply to any specific type of income. These are medical expenses (doctor's fees) \$4,000, real estate taxes \$5,000, home mortgage interest of \$12,000, and charitable deductions of \$6,000 (cash contributions). You apportion deductions for your Federal tax return as follows: multiply the deduction to be allocated by a fraction. The numerator of the fraction is your gross income subject to Federal tax and the denominator is your total gross income from all sources (including exempt Puerto Rican income).

$$\text{Formula: } \frac{\text{gross income subject to Federal tax}}{\text{gross income from all sources}} \times \text{deduction} = \text{allowable portion of deduction}$$