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CPAs and Strategic Advisors

JANUARY 2023

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Comparison: Living in PR v. US mainland

Because of the Act 60 program and tax incentives, Puerto Rico is rapidly becoming home-away-from-home for U.S. citizens. Relocating to the island has magnificent benefits for your business and your lifestyle. On top of these incentives, there are other benefits to relocating. Consider a lower cost of living and easy travel between the island and the mainland with the Act 60 tax incentives, Puerto Rico is a very desirable place to live.

Lower Average Living Costs

According to multiple surveys, Puerto Rico has a much more budget-friendly economic climate than the mainland. Things like housing, groceries, entertainment, and transportation are about 25% lower than the U.S. Comparing more developed cities, San Juan prices are about 40% less than New York City and 20% lower than Los Angeles.

A Plethora of Housing Options

With a currently flourishing tourism industry and a booming real estate industry, there are endless opportunities for housing.

Renting: Short-term and long-term rentals can be found best through management channels like Airbnb. Long-term rentals may more easily found through ads for room rentals or even 2–3-bedroom apartment rentals. Rent is typically cheaper due to the lower cost-of-living. For a one-bedroom rental on the island you may see prices range on average between $750-800. On the mainland the average one-bedroom apartment rental would cost about $1400 monthly. Nonetheless, renting on the island could cut your housing expense in half.

Buying Property: A surge in the Puerto Rican real estate market has been seen in the past few years due to the island's tax benefits offers. Homeownership has been on the up and up!

While mandated by Act 60 to receive some tax incentives, homeowners and investors are quickly buying up real estate due to cost and exceptional lifestyle advantages. Note: An Act 60 decree holder must establish and maintain residency on the island to prove their commitment to Puerto Rico.

Cheaper Groceries and Takeout

The cuisine on the paradise island is quite the vibrant scene that always has people talking and wanting more. Scattered across

"Let the numbers speak for themselves: our skills, years of experience, and desire to serve will help you and your business thrive on the island!"

Juan Robles

Puerto Rico - Partner
Etrends Group

the island you will find roadside sellers, exclusive food trucks, and restaurants bursting at the seams with flavor. Should you prefer delivery, Uber Eats and a local delivery service called Uva make it easy for a quick drop-off right at your door.

On average, restaurant prices are 15-20% cheaper than the mainland. However, higher-end restaurants fall right in comparison with U.S. prices for higher-end restaurants because imported goods are more expensive in Puerto Rico.

Supermarkets, while very accessible, have most products imported. Meaning their prices are higher, but they offer a diverse range of produce, products, and goods for all types of diets and tastebuds. In contrast, local grocery products are about 8% lower in cost than the United States. So, if you want reasonably priced fresh fruits and veggies hit up the local Mercado.

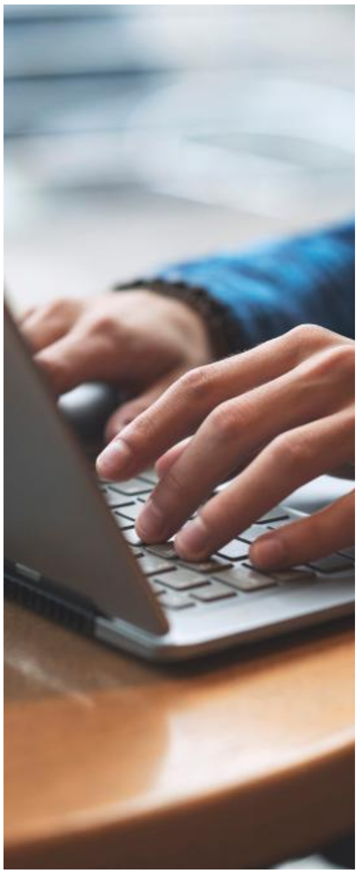
Internet Connectivity Reliability

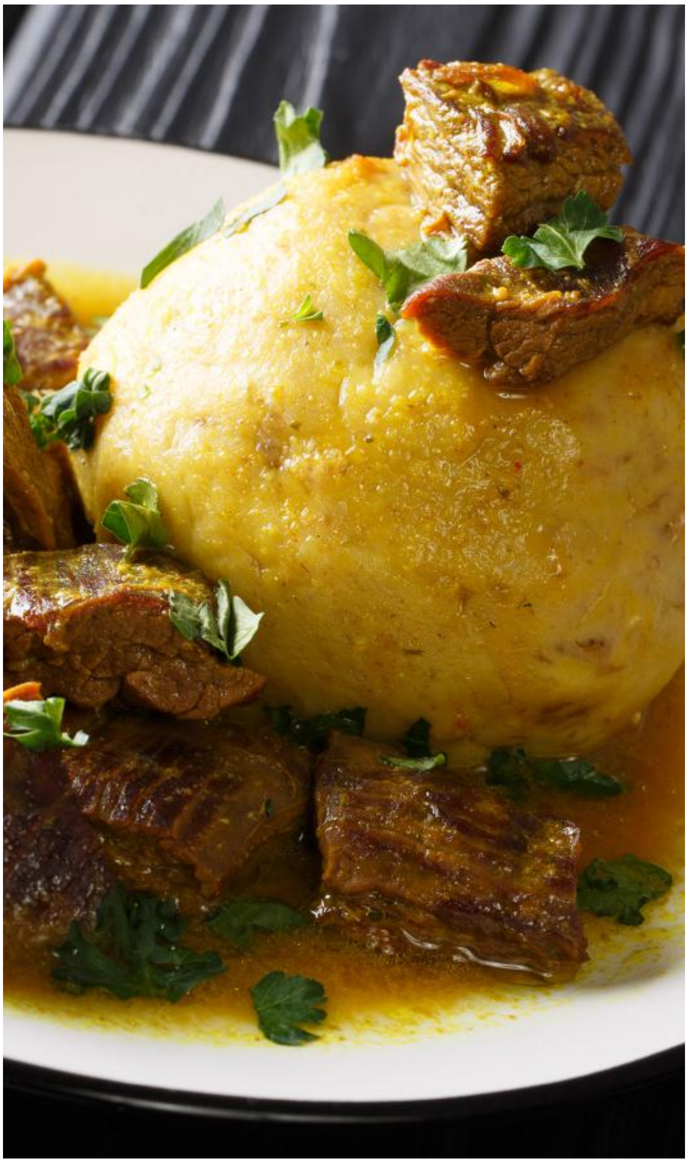
Even with all the natural disasters to hit the island lately, the island's internet infrastructure has been improved, reinforced, and is still seeing more updates. To guarantee internet services, there are over 30 internet providers on the island and 3 major 5G networks.

Cell service is also improving on the island as companies upgrade their infrastructure. For highly reliable cell service, major companies like T-Mobile and Claro help provide the island with the best coverage.

Higher Electricity Bills

Unfortunately, because of the string of natural disasters, the power grid has experienced major damages. And the island is struggling to keep up with the needs of its residents. At least once or twice a week power outages and blackouts are expected but they only last 1-2 hours.
However, in good news, the power grid is being upgraded, renovated, and the situation is improving. Residential and tourist spots have installed back-up fuel powered generators and solar panels to help offset and provide stable power supply!





Travel Made Easy

With two main airports—San Juan International Airport and Rafael Hernandez Airport—flying to and from the island is very easy.
Travelling around the island is best done with car, so owning or renting one is your best bet. Renting is typically cheaper if you are on the island only for a short period. Should you purchase one from a dealership on the island, you may pay $2000-5000 more than the mainland prices.

Other ways to travel around Puerto Rico are available, too. The busing system is reasonable at $0.75 for a ride. Taxi services or Uber are more expensive on the island than they would be in the U.S. due to a tariff that begins at $5.

Accessible Healthcare

With well-managed and extensive healthcare infrastructure around the island, Puerto Rico has accessible health institutions. However, the public healthcare system is underfunded, and with the shortage of doctors and nursing staff, your best bet is to use a private sector for your healthcare needs.

Pharmacies are also scattered across the island so getting your prescriptions filled is super easy!

Health insurance on the island is also cheaper and is advised to have. There are great options such as Triple-S or First Medical that will cover you on just the island. If interested, you can buy insurance coverage that is good for the island and the U.S. mainland such as HealthShare Plan from Liberty. Private insurance is less expensive on the island than it would be on the mainland, and you would have access to care that is great quality.

A Big Deal: Banking

Banking in Puerto Rico is not as easy as it may be on the U.S. mainland. Sometimes things that would take a day in the U.S. could take a week in Puerto Rico. If your current bank has a branch on the island, you are in luck! However, that isn't always the case, and you should research which banks are there that would best fit your needs. Additionally, opening a bank account on the island shows a Closer Connection and helps establish and pass requirements for the Act 60 tests.

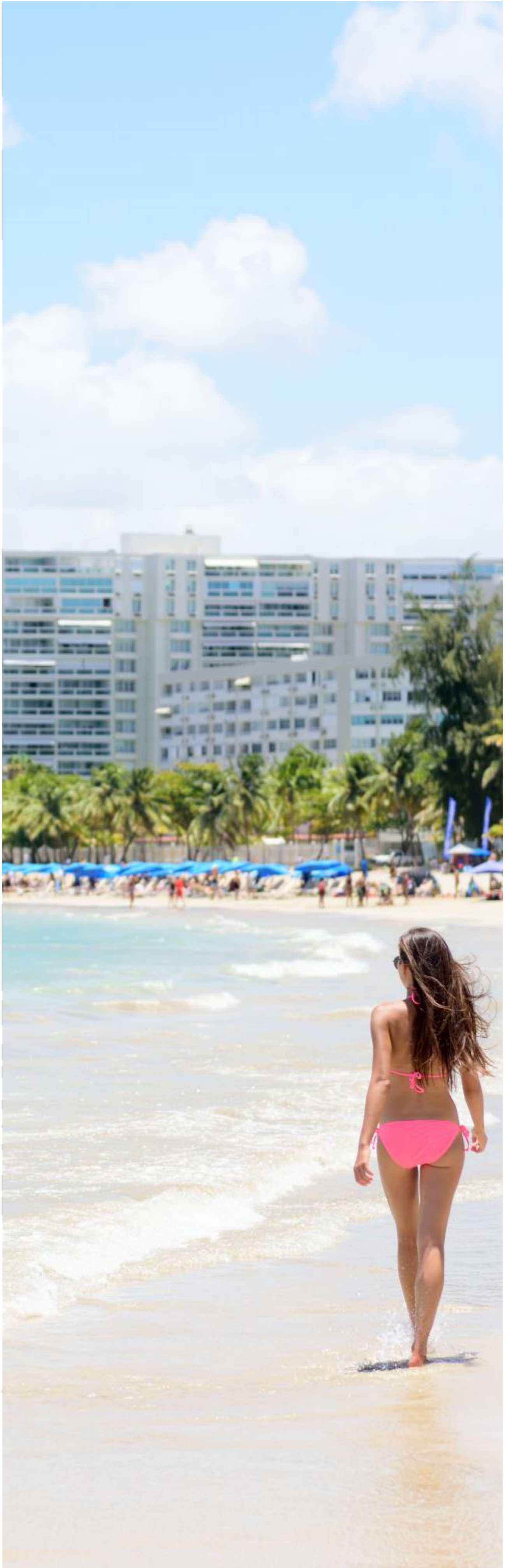
Opening a personal account is simple: just need your I.D., proof of address, and a deposit. Note: Different banks may vary with how much you need to deposit and may have other forms or requirements you need to meet.

For business accounts the process is very different than personal ones. You will need a Certificate of Incorporation, Merchant's Registry issued by the Department of Treasury, Articles of Incorporation or By-Laws, identifications of all, and Taxpay ID evidence.

As a very cash-orientated place, Puerto Rico has ATMs all over the island—most belonging to two of the biggest banks on the island: Banco Popular and First Bank. Luckily, all major credit cards are accepted throughout the island. While you may use your U.S. debit card linked to any mainland account, you will be charged a fee if withdrawing from an ATM in Puerto Rico.

The Bottom Line

Heedless of the higher electricity bills and more expensive imported goods, overall, the island life has many financial advantages that the U.S. does not have. Cheaper housing. Affordable healthcare. Lucrative tax incentives. The 200 days a year of sunshine and beautiful landscape are just a bonus!



When Cancellation of Debt (COD) Income Can Be Tax-Free

Sometimes debts can pile up beyond a borrower's ability to repay, especially if we are heading into a recession.

But lenders are sometimes willing to cancel (forgive) debts that are owed by financially challenged borrowers.

While a debt cancellation can help a beleaguered borrower survive, it can also trigger negative tax consequences. Or it can be a tax-free event.

General Rule: COD Income Is Taxable

When a lender forgives part or all your debt, it results in so-called cancellation of debt (COD) income. The general federal income tax rule is that COD income counts as gross income that you must report on your federal income tax return for the year the debt cancellation occurs.

Fortunately, there are several exceptions to the general rule that COD income is taxable. You can find the exceptions in Section 108 of our beloved Internal Revenue Code, and they are generally mandatory rather than elective. The two common exceptions are:

- Bankruptcy
- Insolvency

The cost of being allowed to exclude COD income from taxation under the bankruptcy or insolvency exception is a reduction of the borrower's so-called tax attributes.

You generally reduce these tax attributes (future tax benefits) by one dollar for each dollar of excluded COD income. But you reduce tax credits by one dollar for every three dollars of excluded COD income. You reduce these attributes only after calculating your taxable income for the year the debt cancellation occurs, and you reduce them in the following order:

1. Net operating losses
2. General business credits
3. Minimum tax credits
4. Capital loss carryovers
5. Tax basis of property
6. Passive activity losses and credits
7. Foreign tax credits

As mentioned above, any tax attribute reductions are deemed to occur after calculating the borrower's federal taxable income and federal income tax liability for the year of the debt cancellation.

This taxpayer-friendly rule allows the borrower to take full advantage of any tax attributes available for the year of the debt cancellation before those attributes are reduced.

Principal Residence Mortgage Debt Exception

A temporary exception created years ago and then repeatedly extended by Congress applies to COD income from qualifying cancellations of home mortgage debts that occur through 2025.

Under the current rules for this exception, the borrower can have up to $750,000 of federal-income-tax-free COD income—or $375,000 if the borrower uses married-filing-separately status—from the cancellation of qualified principal residence indebtedness. That means debt that was used to acquire, build, or improve the borrower's principal residence and that is secured by that residence.

Is Airbnb Rental Income Subject to Self-Employment Tax?

That's a good question.

In Chief Counsel Advice (CCA) 202151005, the IRS opined on this issue.

But before we get to what the IRS said, understand that the CCA's conclusions cannot be cited as precedent or authority by others, such as you or your tax professional.

Even so, we always consider what the CCA says as semi-useful information, so here's some analysis that goes beyond what the IRS came up with.

The Exact Question

To be specific, the CCA asks whether net income from renting out living quarters is excluded from self-employment income under Section 1402(a)(1) when you're not classified as a real estate dealer.

If excluded under IRC Section 1402(a)(1), you don't owe self-employment tax on your net rental income. That's the outcome you want to see, and I'm here to help.

The taxpayer addressed in this CCA was an individual who owned and rented out a furnished beachfront vacation property via an online rental marketplace (such as Airbnb or VRBO).

The taxpayer provided kitchen items, linens, daily maid service, Wi-Fi, access to the beach, recreational equipment, and prepaid vouchers for rideshare services between the rental property and a nearby business district.

The CCA's Conclusions

According to the CCA, when you're not a real estate dealer, net rental income from renting out living quarters is considered rental from real estate and is therefore excluded from self-employment income—if you don't provide services to rental occupants.

The self-employment income exclusion for net rental income collected by a non-dealer is a statutory provision. The statute itself doesn't say anything about providing services.

But IRS regulations state that providing services to renters can potentially cause you to lose the exclusion from self-employment income.

According to the CCA, you must include the net rental income in calculating your net self-employment income—which could cause you to owe the dreaded self-employment tax (ugh!)—if you provide services to renters and the services

- are not clearly required to maintain the living quarters in a condition for occupancy and
- are so substantial that compensation for the services constitutes a material portion of the rent.

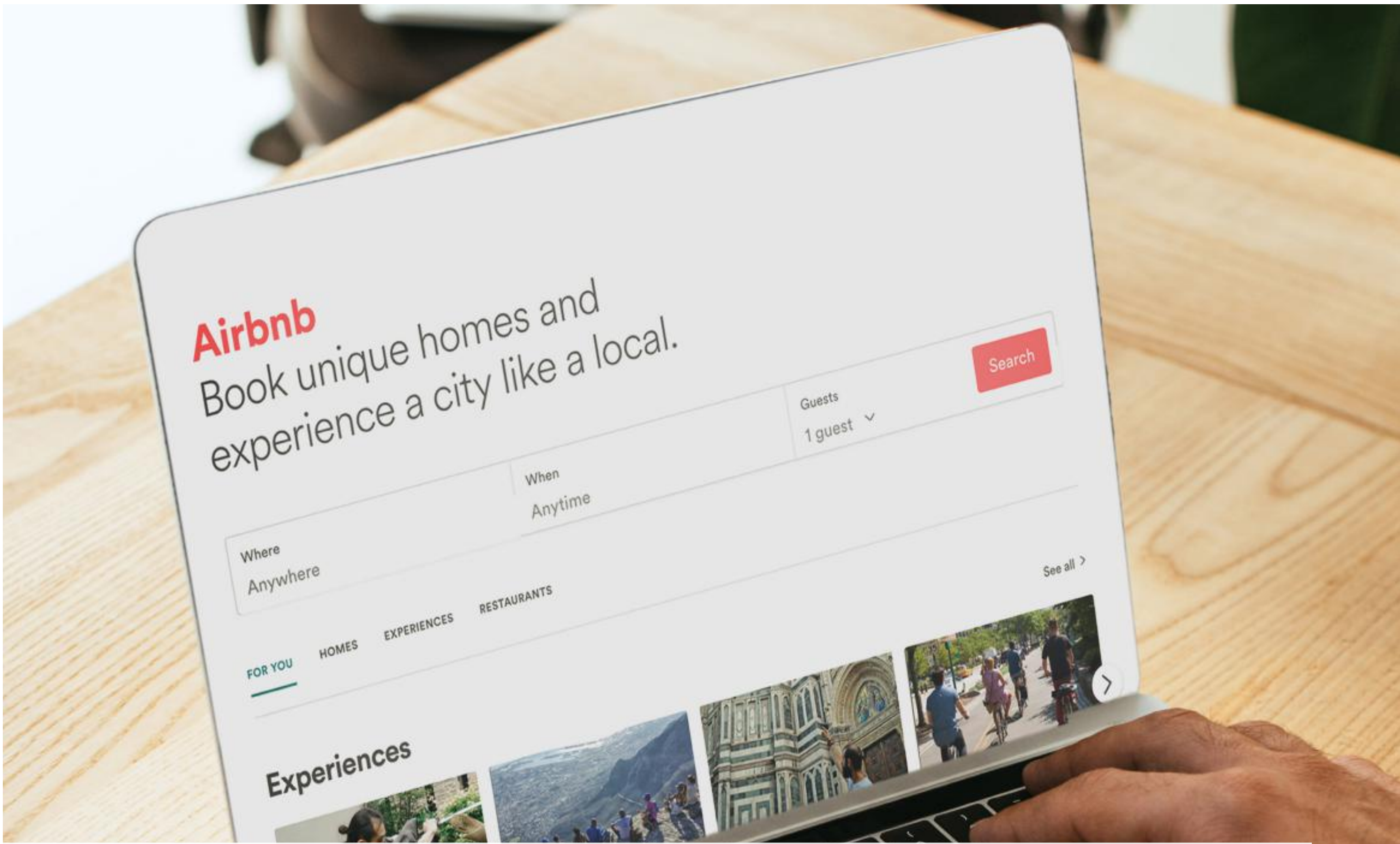
So, according to the CCA, determining whether providing services to renters will trigger exposure to the self-employment tax is the big issue for folks who rent out living quarters.

The CCA's anti-taxpayer conclusion rests on the giant assumption that the services provided by the taxpayer were above and beyond what was required. But were they? Probably not!

The Customarily Issue

According to IRS regulations, services are generally considered above and beyond the norm only if they exceed the services that are customarily provided to renters of living quarters.

Therefore, services that simply maintain a vacation rental property in a condition that is customary for rental occupancy should not be considered above and beyond and therefore should not trigger exposure to the self-employment tax.



In assessing whether services provided to renters are above and beyond what's customary, circumstances obviously matter.

In the real world of vacation rentals in expensive resort areas, renters customarily expect and receive lots of services that might be considered above and beyond in other circumstances.

For instance, in resort areas, renters customarily expect and receive cable service; Wi-Fi access; periodic housekeeping services, including changing bedding and towels; repair of failed appliances; replacement of burned-out lightbulbs; replacement of dead smoke alarm batteries; access to recreational equipment such as bicycles, kayaks, beach chairs, umbrellas, and coolers; and so forth and so on. That's a lot of services!

Why are lots of services provided in expensive resort areas? Because rental charges in expensive resort areas are—wait for it—expensive! The cost may be $2,000 or more per week or $5,000 or more per month, or even higher during peak periods—maybe much higher! So, rental amounts that could be attributed to the provision of all the services would almost always be a small fraction of the overall rental charges.

In the context of expensive resort area vacation rentals, it's hard to imagine what services would be so above and beyond the norm that the property owner's net rental income would be exposed to the self-employment tax.

It shouldn't matter if the services are provided directly by the owner of the property (unlikely) or indirectly by a rental management agency and included as part of the fee paid by the owner of the property (likely).

The Substantiality Issue

In assessing whether services provided to renters are above and beyond the norm, substantiality also matters.

A Tax Court decision addressed a situation where the taxpayer rented out trailer park spaces and furnished laundry services to tenants. The laundry services were clearly provided for the convenience of the tenants and not to maintain the trailer park spaces in a condition for rental occupancy. Tenants were not separately billed for the laundry services, and they were not separately paid for.

The Tax Court concluded that any portion of the rental payments that was attributable to the laundry services was not substantial enough to trigger exposure to the self-employment tax. Accordingly, the Tax Court opined that all of the trailer park owner's net rental income was excluded from self-employment income.

As stated above, in the context of the rental of expensive vacation properties, any portion of rental charges that could be attributed to the provision of services would likely be insubstantial in relation to the overall rental charges. If so, according to the Tax Court, the provision of such services would not expose the property owner to the self-employment tax.

How to Section 1031 Exchange into a Delaware Statutory Trust

As you likely know, the Section 1031 tax-deferred like-kind exchange is one of the greatest wealth-building mechanisms for real estate investors.

With Section 1031, you can avoid taxes on all your property upgrades during your lifetime and then pass the property to your heirs when you die. The heirs receive the property with a step-up to fair market value, and they can likely sell the property and pay no taxes.

But what if you want to get off the landlord bandwagon? There are options. For example:

- You could use an UPREIT.
- You could invest in an opportunity zone fund.
- You could invest in a Delaware statutory trust as we explain here.

1031 Exchange Overview

The 1031 exchange, or like-kind exchange, has been around since the Revenue Act of 1921. Its purpose is simple: allowing you to swap a business asset without there being a taxable event, because your economic position hasn't really changed.

The basics of a 1031 exchange are straightforward:

- Before you sell the old asset, you must begin the exchange by contracting with a qualified intermediary.
- You may list up to three potential replacement assets within 45 days of the sale of your qualified asset.
- You must close on at least one of those three identified assets within 180 days of the sale.
- For the exchange to be fully tax-free, you must acquire a new asset of greater value than the one you're selling. If you don't trade up, you'll likely have some taxable gain.

IRC Section 1031(a) provides that no gain or loss is recognized on the exchange of real property held for productive use in a trade or business or for investment (relinquished real property) if the relinquished real property is exchanged solely for real property of a like kind that is to be held either for productive use in a trade or business or for investment (replacement real property).

Such Section 1031 assets include, among others:

- Residential or commercial real estate held for investment, rental, or business use
- Raw land held for investment
- Tenant-in-common-held real estate
- Delaware statutory trust interests

Assets that don't qualify for Section 1031 include:

- Securities, stocks, and bonds
- Partnership interests
- Assets held as inventory
- Personal-use real estate
- Foreign real estate

What Is a Delaware Statutory Trust?

The Delaware statutory trust property ownership structure allows you (as a smaller investor) to own a fractional interest in large, institutional-quality, and professionally managed commercial property along with other investors. Note that with the Delaware statutory trust, you are an owner.

And it's that ownership interest that makes an investment in a Delaware statutory trust a qualifying replacement asset for purposes of a 1031 exchange. Revenue Ruling 2004-86 confirms the Delaware statutory trust ownership and its qualification for a 1031 exchange.

Some Thoughts on Delaware Statutory Trust Investments

Liquidity
Delaware statutory trusts do not have a secondary market. This means your money is locked up in this investment, perhaps for up to 10 years.

Minimum investment
In general, most Delaware statutory trusts require that you be an accredited investor. Such trusts do their own due diligence on your status, but in general you meet the requirements for classification as an accredited investor when

- your income is $200,000 or more ($300,000 with your spouse) over the past two years, and you reasonably expect such income for the current year; or
- your net worth exceeds $1 million excluding the value of your primary residence.

Lack of control
Unlike with property you own yourself, you don't have control over the property in the Delaware statutory trust. Of course, you also don't have the day-to-day landlord headaches.

Leverage
You have heard the saying that you should use other people's money to increase your rate of return. In the real estate investment world, this is common—and it can work. But if you had no mortgage on your 1031 property, you should consider investing in a non-leveraged Delaware statutory trust to reduce the risk that you could lose your investment.

Backup for the 45-day rule
When you must identify up to three properties under the 45-day rule and then buy one of them within 180 days, you play with fire. Consider naming two properties and using the Delaware statutory trust as a backup. Should the other properties fail, you would use the Delaware statutory trust to preserve your tax-deferred status and live to play the Section 1031 card another day.

Park your investment
If you think the market for buying property will be better seven to 10 years down the road, you could do a Section 1031 exchange into a Delaware statutory trust to park your investment.