

The Act 60 Enforcement Wave Has Arrived: Is Your Compliance File Ready?

By Matt Eddleman

IRS scrutiny of Puerto Rico Act 60 decree holders has moved from routine data collection to criminal investigations, grand jury subpoenas of law firms, and multimillion-dollar civil fraud penalties.

For most of the past decade, Puerto Rico's Act 60 tax incentives, the 4% export-services rate and the individual resident investor exemptions on post-move capital gains, dividends, and interest, have been marketed as a settled, low-risk planning tool. That era is over. Over the past several months, three independent threads of federal scrutiny have converged: a scathing December 2025 GAO audit, an active DOJ criminal investigation with grand jury subpoenas reaching into law firms' privileged files, and a coordinated IRS enforcement campaign that has already produced a felony guilty plea and multiple civil fraud assessments. Decree holders who have treated their Act 60 structure as "filed and forgotten" now have a narrowing window to get their documentation in order before the IRS gets there first.

What Changed, and Why Now

- **The GAO report (December 12, 2025).** The Government Accountability Office found that the IRS went nearly four years without updated data on who actually holds Act 60 decrees, and sat on referrals involving taxpayers who never substantiated the 183-day physical presence requirement. That data gap is now closed. The GAO also quantified the stakes: the average Act 60 claimant's federal taxable income dropped 39% after relocating, and average federal tax paid dropped 46%, a revenue loss the report puts in the hundreds of millions annually. California is a particular focus: 381 individuals who claimed the resident-investor incentive in 2021 relocated from California, the largest state cohort in the data and a likely joint target of the IRS and the California Franchise Tax Board.



- **The IRS enforcement campaign.** The IRS Large Business and International Division has run a dedicated Act 60 compliance campaign since January 2021, concentrating on hedge fund managers and cryptocurrency investors who may have recharacterized U.S.-source income as Puerto Rico-source. By 2023 the IRS had identified roughly 100 high-wealth individuals for investigation, with a meaningful share expected to proceed to criminal referral. The Service is now cross-referencing Form 8898 filings against Puerto Rico's own decree-holder lists, a data-matching capability the GAO report specifically pushed it to formalize. Puerto Rico's Hacienda has independently audited an estimated 1,800 Act 20/22 decree holders and tightened its own reporting and background-check requirements.
- **The DOJ criminal investigation.** The Department of Justice is pursuing a parallel criminal track, and it has escalated to a step most Act 60 holders never anticipated: subpoenaing law firms directly for client files, including residency analyses, sourcing positions, and legal opinions given to Act 60 clients. A federal subpoena to an attorney requires internal DOJ authorization and a showing that the requested material isn't protected by a valid privilege claim, but that requirement has a well-known exception. Under the crime-fraud exception, communications made in furtherance of a client's alleged tax evasion lose their privilege protection even if the attorney acted in complete good faith and had no idea the advice would be misused. The client, not the firm, holds the privilege, and the client must justify withholding each document individually. Blanket privilege assertions are not permitted. If DOJ can persuade a court that a client used counsel to further a fraud, the firm's file becomes discoverable. This is not hypothetical: public reporting

indicates at least one major law firm has already been drawn into the investigation.

The Fact Patterns Drawing Scrutiny

The enforcement actions to date share a common profile, and it is worth measuring your own structure against it:

- **Pre-move appreciation on capital assets, especially cryptocurrency.** The IRS treats digital assets as property, and it does not accept that relocating to Puerto Rico and promptly selling long-held crypto converts years of U.S.-source appreciation into Puerto Rico-source gain. The split-sourcing and 10-year lookback rules under Treas. Reg. §1.937-2 exist precisely to prevent this, and they are the central issue in nearly every enforcement action referenced above.
- **Residency that doesn't hold up to a closer-connection analysis.** Satisfying the 183-day presence test is necessary but not sufficient. Tax home and closer-connection factors (family location, banking relationships, driver's license, voter registration, business activity) all matter, and the IRS is now examining them with real data rather than assumptions.
- **Services income sourced to Puerto Rico without matching activity.** If a portfolio manager or consultant is billing Puerto Rico-source management or consulting fees but spending substantial time in New York, Miami, or elsewhere, the sourcing position needs contemporaneous support (travel logs, calendars, and work-location records) not just a decree.
- **Use of pass-through entities to recharacterize gain.** IRS guidance, including Chief Counsel Advice addressing

this pattern directly, makes clear that S corporations and partnerships are not a safe harbor around the lookback rules.

- **Reporting gaps independent of the underlying tax position.** Missing or incorrect Forms 8898, 5471, 3520/3520-A, 8938, or FBAR filings carry their own penalty exposure, and a missing Form 8898 can leave the statute of limitations open indefinitely on the residency question itself.

The consequences when these issues surface on audit are not limited to back taxes and interest. Reported matters include a guilty plea over roughly \$30 million in improperly shielded capital gains, and a Tax Court case in which the IRS rejected a taxpayer's bona fide residency claim outright and asserted a 75% civil fraud penalty on a nearly \$5 million deficiency.

What This Means If You Hold an Act 60 Decree

The options available to a taxpayer with a compliance gap are dramatically better before the IRS makes contact than after. Once an examination or investigation opens, amended returns, delinquent international information return relief, and the Streamlined Filing Compliance Procedures are generally off the table, and the remaining paths, including examination, Appeals, Tax Court, or a refund suit, are slower, costlier, and far less forgiving. Practically, that means now is the time to:

1. Pull the file and stress-test it. Does the residency analysis hold up on all three tests (presence, tax home, and closer connection) with contemporaneous documentation, not reconstructed memory?

2. Revisit every pre-move asset. Crypto, carried interest, and appreciated securities held before the move to Puerto Rico all need a defensible split-sourcing analysis, not an assumption that the gain is exempt.
3. Confirm every required federal filing is actually on file. Form 8898, and, where applicable, Forms 5471, 926, 8858, 3520/3520-A, 8938, and FBAR.
4. Evaluate remediation before a letter arrives. Depending on the facts, that may mean a qualified amended return, delinquent international information return relief with a reasonable-cause statement, the Streamlined Procedures, or, where exposure is more serious, the IRS Criminal Investigation Voluntary Disclosure Practice. Proposed reforms to VDP terms are pending; the sooner a gap is identified, the more options remain open regardless of how that guidance finalizes.

How Frost Law Can Help

Frost Law's tax controversy team advises both sides of the Act 60 life cycle: taxpayers structuring a new relocation correctly from day one, and existing decree holders who need their compliance posture reviewed, quietly, and before the IRS asks. Our work includes bona fide residency and sourcing analysis, coordination of the full U.S. and Puerto Rico reporting picture, voluntary disclosure and Streamlined Procedures filings, and audit and criminal tax defense when contact has already been made.

If you or a client hold an Act 60 decree, the right time to have that file reviewed is before an examination letter arrives, not after. Contact Frost Law's tax controversy team at [\(410\) 497-5947](tel:410-497-5947) or [schedule a confidential compliance review](#).