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GUIDE

INVESTORS - PUERTO RICO INVESTORS SOURCE OF INCOME TAXATION

PUERTO RICO TAX COMPLIANCE GUIDE

By Torres CPA Group
CifrasPR

Understanding the Puerto Rico tax system and its interrelation with United States is crucial for individuals and entities doing business in Puerto Rico. Puerto Rico is not a state; its's a territory, with its own Business and Payroll laws and regulations.

The following White Paper is designed to give an insight Tax Issues in Puerto Rico. It provides relevant background information, which will be of assistance to organizations considering establishing business in the Island. Nonetheless, it is highly recommended to seek advice and counsel from qualified professional sources before undertaking any business.

Certain exclusions and exemptions may apply and when specific problems occur in practice, it will often be necessary to refer to the laws and regulations of Puerto Rico, and to obtain appropriate accounting and legal advice.

It is understood that the following overview does not constitute any formal rendering of either legal, accounting, tax or professional services. If legal advice or other assistance is required, an attorney, CPA or tax adviser should be consulted.

Torres CPA Group is an Advice Certified Public Accounting Firm offering Audit, Tax, Consulting and Financial Outsourcing services for over 30 years. If you require any further information or help, please do not hesitate to contact us.

CPA William Torres Torres
CPA Saudhi Soto Pagán

info@torrescpa.com

PD: You can call me at my mobile 787-508-4545

Moving to Puerto Rico is Lowering Taxes Without Leaving the USA

Americans are in the uniquely unfavorable position of living under the world's most comprehensive tax regime and suffering from a government that can effectively enforce that regime anywhere in the world.

For many, U.S. tax rules are a tight and choking leash. It's no wonder that record numbers of Americans are giving up their citizenship to seek freedom elsewhere. Even if Americans move to a zero-tax jurisdiction they still must pay a full U.S. Tax bill.

There is a current misconception that the USA extraterritorial strategy consists of evading taxes and hiding money from the Government.

PUERTO RICO INCENTIVES

There are 100% legitimate ways to structure your taxes in Puerto Rico and obtain significant benefits from asset protection and taxes.

The Puerto Rican Government has adopted ultra-low tax rates for newly arriving investors and companies that perform services locally for customers located outside of Puerto Rico, exercising the 936 section benefits. The passage of Acts 22, 20, and 60 reduced taxes for incoming investors and businesses.

Puerto Rico is part of the U.S. Take any domestic flight; just a boarding pass and driver's license (or other accepted I.D.) will get you there. You also can buy real estate, register to vote, or get a driver's license.

Under the U.S. Internal Revenue Code, an American who becomes a resident of Puerto Rico begins a new tax life: all the income the person earns from Puerto Rican sources is subject to Puerto Rican income tax only, not to U.S. income tax, you cannot find similar benefits anywhere else in the world.

A Puerto Rico corporation or LLC is in fact a resident and citizen of Puerto Rico, not a U.S. resident or citizen.

Under the U.S. Internal Revenue Code Section 933 and Section 861, if the person performing the service (whether an individual or a corporation) is a Puerto Rico resident working in Puerto Rico, the income is exempt from U.S. tax. Section 933, a tool no other jurisdiction can match, which enables the Government of Puerto Rico to offer any benefit on locally generated income.

PUERTO RICO RESIDENT ELEGIBILITY

Individuals who become Puerto Rico residents are considered eligible under Act 22/60 unless the individual was a resident of Puerto Rico at any time, beginning on January 16, 1997, and ending on January 16, 2012.

An eligible individual must obtain a Tax Exemption Decree from the P.R. Government that will endure for a term of 15 years. The Tax Exemption Decree constitutes a contract between the service provider and the Government of Puerto Rico and will be unaffected by any future legislation.

Requirements:

An individual that becomes domiciled in Puerto Rico is considered a Puerto Rico resident.

- First, an individual's 183-day physical presence in Puerto Rico establishes a presumption of residency under the Puerto Rico Tax Code.
- Second, the individual must not have a tax home outside of Puerto Rico during the year. A tax home is determined where the person earns income and is usually located near a person's principal business place.
- Third, the individual must have a closer connection to Puerto Rico than to the U.S. or another country. This is determined by various factors, including but not limited to the location of the individual's home, family, personal belongings, and voting district. In summary needs to have his loved ones and loves things in P.R.

The tax exemption period begins on the date an individual becomes a resident of Puerto Rico and the application is filed.

PUERTO RICO TAX INCENTIVES ACT 22

Act 22/60 completely exempts new residents from Puerto Rican taxation on dividends and interest, and capital gains after becoming a Puerto Rico resident. Given that Puerto Rican residents are also exempt from U.S. income tax on Puerto Rico sourced income, Act 22/60 means tax freedom for American individuals who can arrange for their investment income.

0% Taxes on Dividends and Interest: A qualified individual's income from P.R. source dividends and interest are exempt from Puerto Rico income taxes during the exemption period. US sourced dividend and interest would still be subject to federal taxation.

0% -15% Taxes on Capital Gains: A qualified person's income from long-term capital gains is exempt from Puerto Rico income taxes during the tax exemption period after the individual becomes a Puerto Rico resident. A qualified individual's long-term capital gains (capital asset appreciations) before becoming a resident of Puerto Rico are subject to a 15% tax rate if realized within ten years of residency; or 5% if realized after ten years of residency. It does not include gains on Real Estate, which are taxed in the country of location. Puerto Rico will apply as credit any capital gains tax in US on any PR taxable capital gain.

0% Federal Taxes on Puerto Rico sourced Income: Under the U.S. Internal Revenue Code, income derived from Puerto Rico sources by individuals, or an Entity qualified as bona fide residents are exempt from federal income taxation.

INCOME TAXATION SOURCING RULES

The source is the determining factor of taxation on the income.

The source rule applies irrespective of the payer's residence, the place in which the service contract is agreed, or the location or payment time.

The place where the deposit of money is made has no bearing on the Source of Income determination. Tax liability is driven by the source of income rules, not the place where cash is deposited.

The three main issues used to determine the source of income are: the character of the activity, the location of performance, and identification of all statutory and regulatory exceptions.

Taxation and sourcing of income rules

A U.S. citizen is subject to worldwide taxation on income from all sources. However, Puerto Rico residents are subject to U.S. tax only on their income from sources within the U.S. or foreign (other foreign countries), with minor exceptions.

When the Internal Revenue Code (IRC) speaks of income sourcing, it refers to the origin of the income as being earned in the U.S., foreign, or in Puerto Rico. The taxpayer must first determine whether the gross income in each category is from U.S. sources, foreign, or Puerto Rico sources. The taxpayer can figure the taxable income in each category source.

The source rules are designed to determine whether the U.S., foreign, or Puerto Rico has a closer connection or "nexus" to the income. If income is Puerto Rico's sourced income, Puerto Rico has the primary right to tax the income. Puerto Rico also has the primary right to tax eligible activities at 4%, ACT 20/60 or 100% exempt, Act 22/60.

Summary of the Rules

- Where the services are performed determines the source of income from salaries and other compensation.
- The residence of the payer determines the source of interest income.
- For pension distributions attributable to contributions, the place where the services were performed that earned the pension determines the source of pension distributions.
- For investment earnings on pension contributions, the location of the pension trust determines the source of investment earnings on pension contributions.
- The location of the payer determines the source of dividend income.
- The seller's tax home determines the source of income from selling personal property.
- The place where title passes determines the source of income from selling inventory.
- Income from selling inventory produced is allocated between U.S. and non-U.S. sources.
- The location of the property determines the income source from rent, natural resource royalties and sale of real estate.
- The location where the property is used determines the income source from royalties for patents or similar properties.

SOURCING OF SERVICES COMPENSATION INCOME

Personal Services

The general rule for sourcing wages and personal services income is controlled by where the service is performed. The residence of the service recipient, the place of contracting, and the time and place of payment are irrelevant.

Salaries, wages, and other compensation for labor or personal services are taxable where labor or services performed, if in P.R. then are subject to P.R. taxes.

Income earned by providing services in the United States or foreign is U.S. sourced taxable income.

Services performed inside and outside P.R.

For compensation for labor or personal services performed both inside and outside P.R., special rules apply in determining the source of income. Compensation source of income can be established either on a time basis or based on the cost and value of services.

If services are performed both within and without, the compensation for the services is allocated on the basis that most correctly reflects the proper source of income under the facts and circumstances. In many cases, an apportionment on a time basis may be acceptable.

However, compensation for services performed by a Puerto Rico resident in the U.S. is a Puerto Rico sourced income if all the following are met: The services are performed temporarily in the U.S., presence in the U.S. during the taxable year does not exceed 90 days, and compensation for services does not exceed \$3,000.

Time Basis

Using a time basis to figure your P.R. sourced compensation.

This is done by multiplying your total compensation by the following fraction:

- Number of days or hours you performed services in P.R. during the year.
- Total number of days or hours you performed services during the year in P.R. and outside of P.R.

You can use a unit of time of less than a day, if appropriate. The period for which the compensation is made does not have to be a full year.

For example,

- a U.S. firm engaged taxpayer A, a citizen, and resident of Puerto Rico, to develop a new product for worldwide sales.
- In developing this product, taxpayer A was present in the U.S. for 56 days (8 weeks) to work out actual production problems.
- The entire project took twenty weeks, for which he was paid \$60,000. Taxpayer A performed the service temporarily in the U.S. for 56 days.
- He was paid more than \$3,000. Therefore, the income cannot be solely Puerto Rico sourced and needs to be allocated as follows: 8 weeks in U.S. / 20 weeks' total project x \$60,000 paid = \$24,000 sourced U.S.

Self-employed Individuals

If you are self-employed, you determine the source of compensation for labor or personal services subject to self-employment on the basis that most correctly reflects the proper source of that income.

Negotiation, commissions, and US 1099

Negotiation commissions are determined to be those performing services and source of fees that follow the analogy of services performed, the source of rendering the service.

Compensation for labor or personal services, US 1099, including fees, commissions, fringe benefits, and similar items performed wholly within P.R., income sources are within P.R.

Agents, brokers & custodian

For trading in stocks and securities and certain commodities through a resident broker, commission agent, custodian, independent agent, trading stocks and securities, and certain commodities, special rules apply.

Not to compete compensation

Determines the place/location in which you agree not to perform. Services that should be considered to have been performed in P.R. may not always be apparent, especially given the rise of electronic transactions. Generally, an enterprise is not considered to have performed services in the U.S. without some physical presence of a permanent establishment in the U.S.

Scholarships, grants, prizes and awards

The source of scholarships, fellowship grants, grants, prizes, and awards are established by the payer's residence regardless of who distributes the funds.

Payments for research or study in the U.S. made by the US, a U.S. resident, or a U.S. domestic corporation are U.S. sources. Similar payments from a Puerto Rico government agency or a Puerto Rico company, or a non-US resident are Puerto Rico source payments even though the funds are disbursed through a U.S. agent.

Payments made to a PR resident by an entity named as a public international organization under the International Organizations Immunities Act are Puerto Rico sourced.

Activities performed outside PR: Scholarships, fellowship grants, targeted grants, and achievement awards received by a nonresident for activities performed, or to be performed, outside PR are not PR sourced income.

Pensions and annuities

The income source is determined by where the services were provided to earn Pension and Annuities' rights.

If you receive a pension from a domestic trust for services performed both in and outside the U.S., part of the pension payment comes from U.S. sources. That part is the amount attributable to earnings of the pension plan and the employer contributions made for services performed in the U.S. These apply whether the distribution was made under a qualified or nonqualified stock bonus, pension, profit-sharing, or annuity plan (whether or not funded).

Suppose you performed services as an employee of the U.S. Government. In that case, you might receive a distribution from the U.S. Government under a plan, such as the Civil Service Retirement System, that is treated as a qualified pension plan. Your source of income is U.S. taxable, as well as the amount of the distribution that is attributable to your total U.S. Government basic pay and in addition to any tax-exempt or payments for services performed outside the U.S.

Retirement plan

Withdrawals from an IRA, 401(k), or other U.S. tax deferred retirement account would not be covered by Act 22. So, moving to the island won't lessen the tax on withdrawals. The situation is the same with Social Security and other pension income.

Puerto Rico has its own IRA system, with both traditional and Roth plans, but it is distinct from the US IRA system. Income from employment in Puerto Rico cannot contribute to a US IRA and vice versa.

For a Puerto Rico resident, a US Roth IRA distribution would be taxable by the Puerto Rican Government; unless the US Roth IRA liquidates and the proceeds are used to contribute to a Puerto Rican Roth IRA (subject to contribution limits similar to the U.S.). The opposite is true as well.

A distribution from a traditional U.S. IRA to a Puerto Rico resident would be taxable by both the U.S. and the Puerto Rico Government unless liquidated. The proceeds are used to contribute (subject to contribution limits) to a Puerto Rican traditional IRA, in which case the distribution would only be taxable by the Puerto Rico Government. Again, the opposite scenario is true as well. For taxable distributions, the availability of credit from either Government for tax paid to the other prevents double taxation, and you end up effectively only paying the higher rate.

There are two components for sourcing pension income: contributions to the pension plan and the earnings accrued from investing those contributions.

- a) The contribution portion is sourced according to where services that earned the pension are performed.
- b) The investment earnings portion is sourced according to the location of the pension trust. U.S. social security benefits are considered to be from U.S. sources.

Example: A U.S. citizen worked in Puerto Rico for a U.S. company. All services were performed in Puerto Rico. Upon retirement, the taxpayer remained in Puerto Rico and began receiving a pension from the U.S. pension trust of their employer. Distributions from the U.S. pension trust must be allocated between (1) contributions, which are Puerto Rico sourced income, and (2) investment earnings, which are U.S. sourced income.

INVESTMENT INCOME

INTEREST INCOME

The residence of the payer determines the interest income source.

Interest income includes earnings from bank accounts, bonds, and notes. The interest that arises from sources within the 50 states and the District of Columbia is income from sources within the U.S.

However, interest on deposit with a Puerto Rico domestic corporation or partnership is Puerto Rico sourced income if the deposits are made on a Puerto Rico branch of the corporation or partnership and the Puerto Rico branch is engaged in the commercial banking business.

Interest paid by a U.S. trade or business (U.S. branch) corporation is deemed paid by a U.S. domestic corporation and, therefore, from sources within the U.S.

Example 1: Taxpayer A, a U.S. taxpayer, receives interest income from a personal loan made to taxpayer B, a U.S. citizen but resident of Puerto Rico, since taxpayer B is a Puerto Rico resident, although a U.S. citizen, the income is Puerto Rico sourced income.

Example 2: Taxpayer C, a Puerto Rico corporation doing business in PR., receives interest income from taxpayer D, a U.S. citizen and resident, the income is U.S. sourced because the payer is a resident of the U.S.

Example 3: Using the same facts as Example 2, except that taxpayer D makes the payment from a Swiss bank account to taxpayer C's bank in the Cayman Islands. The income is U.S. sourced because the payer is a resident of the U.S.

DIVIDEND INCOME

The payer's country of incorporation determines dividend income. Dividends from U.S. domestic corporations are U.S. sourced income. Dividends from Puerto Rico corporations are Puerto Rico sourced.

The source of interest and dividends is the tax residence of the payer. So, the way to benefit from Act 22 concerning interest or dividends is that the payer's tax residence is a Puerto Rico sourced (at least 80%) entity, which would make the income's source Puerto Rico.

If you hold U.S. bank C.D. as part of your portfolio, you could replace them with a C.D. of Puerto Rican banks (whose deposits are covered by FDIC insurance) to produce income that is entirely tax free.

Dividend of PR entities with US effectively connected income (ECI)

ECI are sales made within a country even if the entity was not doing trade or business in that country.

The services source of income of ECI is always where the services are provided.

Sales of inventory is sourced where the transfer of title is done. However, in many e-commerce transactions there is no clear determination of where the transfer of title occurs. For the IRS if sold within US, it would be US ECI

Dividends are Puerto Rican sourced if the Puerto Rican corporation meets the “80-50 test” for a three-year period, 80% of gross income is Puerto Rican sourced income as a trade or business activity and 50% of gross income is Puerto Rican ECI, items sold in P.R. However, a Puerto Rico corporation's dividend may be U.S. sourced income if at least 50 percent of its gross income for the preceding three years was (ECI), where sales is derived from US sourced.

PR ECI Dividends are Puerto Rican sourced based on the “possession source ratio,” the numerator of which is the gross income of the Puerto Rican corporation from sources within Puerto Rico and the denominator of which its total gross income of within and without ECI income.

A dividend may also be U.S. sourced income if that dividend was from a Puerto Rico corporation that distributed it from earnings and profits that the corporation inherited from a US domestic corporation, but only to extend the dividend that qualifies for a dividend received deduction.

Example 1: Taxpayer A, a U.S. person, received dividends from a Puerto Rico corporation with no U.S. ECI. The dividend is Puerto Rico's source income.

Example 2: Taxpayer B, residing in the U.S., receives dividends from Puerto Rico with no U.S. Effectively Connected Income and deposits them in her U.S. bank account. The dividend is Puerto Rico's source income.

Example 3: Taxpayer C, residing in Puerto Rico, receives \$800 in dividend from a Puerto Rico corporation, which is 60% US ECI, then 40% of the dividend is PR source and 60% is US source.

Substitute dividend

A substitute dividend payment made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction is considered the source of income in the same manner as a distribution on the transferred security.

Dividend equivalent payments: U.S. sourced dividends also include all dividends equivalent to payments. Currently, dividend equivalent payments have (1) substitute dividends and (2) payments made under a specified contract that, directly or indirectly, are contingent on or determined by reference to the payment of a dividend from U.S. sources.

Guarantee of indebtedness

Amounts received, directly or indirectly, for the provision of a guarantee of indebtedness are considered U.S. source income if they are paid by:

- A US non-corporate resident or a U.S. corporation, or
- By any Puerto Rico person if the amounts are effectively connected to a U.S. trade or business conduct.

Sourcing of Rent and Royalty Income

Gross income from sources within the U.S. includes rents or royalties from property located in the U.S. or from any interest in such property, including rents or royalties for the use, or the privilege of using, in the U.S., such as patents, copyrights, secret processes, and formulas, goodwill, trademarks, trade brands, franchises and other such property.

The income arising from the rental of property, whether tangible or intangible, located within the U.S., or from the use of property, whether tangible or intangible, within the U.S., is from sources within the U.S.

Rental income or compensation for the use of the tangible property is sourced to the place where the rental property is located.

Rents and royalties received from a controlled foreign corporation (CFC) by its U.S. shareholders are treated as income in a separate limitation basket (category) to the extent that they are derived from the CFC's income in the same basket. This look-through rule characterizes a U.S. shareholder's income received from a CFC as having the same character as that of the CFC's income.

Personal income tax rates in effect:

Net taxable income (USD)

Not over 9,000, 0%

over \$9,000, but not over \$25,000, 7% of the excess over \$9,000

over \$25,000, but not over \$41,500, \$1,120 plus 14% of the excess over \$25,000

over \$41,500, but not over \$61,500, \$3,430 plus 25% of the excess over \$41,500

over \$61,500, \$8,430 plus 33% of the excess over \$61,500

If the individual's net taxable income exceeds \$500,000, they will have to pay an additional tax (i.e., progressive adjustment tax). This tax is 5% of the excess of the total net taxable income over \$500,000, limited to 33% of their personal and dependents' exemption plus USD \$8,895.

In addition to the regular income tax, individuals must compute an ABT assessed by a previously established table. The ABT taxable income is calculated by adding back specific income items exempt from regular income tax. All individuals with an ABT net taxable income of USD \$25,000 or more will need to calculate the ABT.

Capital Gains

Capital gains are the primary benefit of Act 22/60.

The source for capital gains on the sale of securities and other personal property is your place of residence, so gains on stocks, bonds, or other personal property, such as precious metals or crypto, that you recognize while being a resident of Puerto Rico are treated as Puerto Rican sourced income and thus eligible for exemption under Act 22/60.

Even if you keep your U.S. brokerage account, while you are a bona fide Puerto Rican resident, capital gains earned in those accounts count as Puerto Rico--sourced income and can qualify for Act 22 treatment.

Sourcing of Capital assets and sales of property

The source for personal, tangible property capital asset sales are:

Sale of real property = Where the property is located

Sale of non-inventory personal property = Resident of seller

Sale of inventory purchased = Where transfer title/sold was made

Sale of inventory produced = Where the inventory is produced

Non-Inventory Personal Property

Income from the disposal of the non-inventory personal property, including personal property capital assets are sourced to the seller's residence unless depreciation was claimed on the personal property; in which case the depreciation recapture comes from the country where the depreciation took place, and any excess in gain is sourced to the country of seller. These include Stocks, Securities, Crypto, and others.

Sale of Inventory

Income earned on the sale of self-manufactured inventory is sourced where it is manufactured unless sales are U.S. effectively connected. Then, 50% is sourced where it was manufactured and 50% U.S. sourced.

The country's income earned from the sale or purchase of inventory is established where the title transfer occurs.

Intangible assets

The sale of intangibles is treated similarly to an amortizable personal property so that any gains are the source of the country where prior amortization deductions were taken. Still, any remaining profit is the origin of the country where the property is used. However, the source of contingent payments is considered royalty income.

Previous to moving to PR appreciation Capital Gains

Moving to Puerto Rico does nothing to shelter previous appreciation capital gains.

Determining how to split a capital gain between appreciation that happened before you moved to Puerto Rico and appreciation that occurred while you were there depends on the property type.

For investments that include trading in a public market, such as listed stocks and precious metals, you start by establishing the investment's price on the day of your move to the Island.

All profits up to that price are considered to have been earned before your move, and are taxable by both Puerto Rico and the U.S. The rest of the profit is deemed to have been accrued while you were in Puerto Rico and is taxed by no one.

For example, a mainland U.S. investor purchased stock for \$100 on January 1, 2016. Then he moves to Puerto Rico on January 1, 2017, on which day the stock is worth \$200. On January 1, 2018, he sells the stock for \$400, for a capital gain of \$300 (\$100 of which was accrued before moving to Puerto Rico and \$200 of which was accumulated after moving).

Puerto Rico will tax the \$100 accrued before moving at 15% and by the U.S. at 20%. The PR Government will credit the U.S. tax; the effective total tax rate is still 20%, just if you had stayed on the mainland. The \$200 accrued after moving will be exempt from U.S. tax since you are a Puerto Rican resident for all of that period; it will also be exempt from Puerto Rican taxes under Act 22/60.

For non--marketable stocks and other interests in private companies, there is no clear and a straightforward way to establish the value as of the day you become a Puerto Rican resident. The rules pretend that appreciation in private security you took with you to Puerto Rico happened evenly day by day from the time you bought it while living on the mainland to the time you sold it while living in Puerto Rico.

If you bought stock in a corporation for \$100, 100 days before you moved and sold it for \$300, 200 days after you arrived in Puerto Rico, one third (\$100) of the gain would be treated as having been accrued while you were still on the mainland (fully taxable), and two thirds (\$200) would be treated as having been accumulated while you were a Puerto Rican resident (tax-free).

Flow Through Information from Schedule K-1s

The source and character in the hands of a partner or S corporation shareholder of any item of income, expense, and so on shall be determined as if such item was realized directly from the source recognized by the partnership or S corporation.

The flow through entity generally provides information concerning the source of distributive amounts. One exception is that gain from the sale by a partnership of personal property is sourced based on the partner's residence (with exceptions).

However, partnership income generally retains its character where it flows through to the individual.

Example: A partnership has 60 percent U.S. sourced ordinary income and 40% PR sourced income. Therefore, 60 percent of the distribution would be U.S. taxable and 40% PR taxable income.

Example: A partnership is formed in the U.S. with two equal partners who are both U.S. citizens and earn \$20,000 from personal property sale that is not inventory. Partner A's tax home is in the U.S. and partner B's tax home is in Puerto Rico. Partner A would have \$10,000 U.S. sourced income, and partner B would have \$10,000 Puerto Rico sourced income, and exempt under Act 22.

Community Income

If married, your subject to the community property laws of Puerto Rico, or a U.S. state, or a U.S. possession, generally must follow those rules to determine your or your spouse's income for tax purposes. However, you must disregard specific community property laws if:

- Both you and your spouse are nonresident aliens, or
- One is a nonresident alien, and the other is a U.S. citizen or resident, and both do not choose to be treated as U.S. residents.

Earned income

Earned income of a spouse, other than a trade or business income, and a partner's distributive share of partnership income are treated as the spouse's income whose services produced the income. That spouse must report all of his earnings on its return.

Trade or business income: Trade or business income, other than a partner's distributive share of partnership income, is treated as the spouse's income that carries the trade or business. That spouse must report all of his earnings on a its return.

Partnership income (or loss)

A partner's distributive share of partnership income (or loss) is treated as the partner's income (or loss). The partner must report this on its return.

Separate property

Prenuptial agreement is part of the community property law.

Separate property income:

Income derived from one spouse's particular property (and which is not earned income, trade or business income, or partnership distributive share income) is treated as the spouse's income. That spouse must report all of his earnings on its return.