

PR TREASURY ISSUES RELIEF RULES ON DISTRIBUTIONS FROM A RETIREMENT PLAN AND/OR IRA TO COVER EARTQUAKE DAMAGES

On February 19, 2020, the Secretary of the Puerto Rico Treasury Department (the “Secretary”) issued the Circular Letter of Internal Revenue No. 20-09 (“CL IR 20-09”) to establish the rules and procedures applicable to early withdrawal or distributions by eligible individuals of (i) participant benefits under a Puerto Rico tax qualified retirement plan (“Retirement Plan”), and/or (ii) deductible individual retirement account (“IRA”) funds, to cover losses or damages suffered due to the recent earthquakes (“Earthquakes”) that hit the south area of Puerto Rico (collectively hereinafter referred to as “Special Disaster Distributions”).

The Secretary issues CL IR 20-09 based in his delegated powers under the PR Code in connection with the special tax provisions that are deemed applicable to Special Disaster Distributions after the occurrence of an event declared as a disaster by the Governor of Puerto Rico (a “Declared Disaster”) as the Earthquakes which were declared as such by the Governor of Puerto Rico under Executive Order No. OE 2020-01. The following summarizes the applicable rules related to CL IR 20-09:

General Provisions on Special Disaster Distributions

The Retirement Plan and IRA distributions that are deemed qualified as Special Disaster Distributions under CL IR 20-09, are those that shall be processed in compliance with the following general requirements:

- (i) Requested and paid during the period from **February 20, 2020 through June 30, 2020** (the “Eligible Period”);
- (ii) In case of Retirement Plans, may not be paid in form of annuities and installment payments.
- (iii) Paid to an individual considered a Puerto Rico bona fide resident for the entire calendar year 2020 under the PR Code (i.e. physical presence in the Island for at least 183 days during a calendar year) (the “Eligible Individual”). An Eligible Individual may request Special Disaster Distributions for the benefit of his/her spouse, ascendants or descendants, provided that such individuals be considered also bona fide residents of Puerto Rico during the year 2020;
- (iv) Eligible Individuals may opt to receive Special Disaster Distributions regardless if the Retirement Plan or IRA provides other forms of related payments (i.e. loans).
- (v) Are not subject to period restrictions in the continuation of their contributions to the Retirement Plan or the IRA after completing the distribution (i.e. 12-month suspension for Retirement Plans).
- (vi) Section 1081.02(g) penalty of 10% from IRA early withdrawals (before attaining 60 years of age) does not apply.
- (vii) Cannot be used to make contributions to a Retirement Plan or IRA.
- (viii) Must be used to cover or reimburse Eligible Expenditures (as defined below) incurred by such Eligible Individual (as well as by the spouse, ascendants or descendants of said Eligible Individual) or his/her beneficiary(ies) as a result of the occurrence of Earthquakes; and
- (ix) Comply with the distribution request process described below.

The Eligible Expenditures for purposes of CL IR 20-09 include, but are not limited to: (a) expenses for the repair of damages to a residence, commercial establishment or motor vehicle; (b) expenses to verify if a property meets established construction codes and the repairs needed to meet such codes; (c) expenses for the acquisition of a new principal residence or a commercial establishment as a result of the Earthquakes; (d) payment of medical expenses, replacement or repair of real property; (e) purchase of food and fuel; and (f) payments for purchase or repair of power generators or lodging and food expenses due to the total or partial destruction of the main residence during the recovery period after the Earthquakes occurred. Said Eligible Expenditures can be incurred after the Eligible Period, subject to that the Special Disaster Distribution is requested and completed during the Eligible Period.

Tax Treatment on Special Disaster Distributions

The tax rules and reliefs on Special Disaster Distributions under PR Code and CL IR 20-09 include the following:

1. The **first \$10,000** of the Special Disaster Distributions will be excluded from taxable gross income determination, and therefore shall be not subject to income tax, alternative basic tax (“ABT”), and tax withholding at source;
2. Special Disaster Distributions in **excess of \$10,000 up to a maximum of \$100,000** will be subject to a fixed preferential tax rate of 10% of the taxable amount instead of any other tax under the PR Code including the ABT. Such 10% fixed tax rate shall be withheld at source upon distribution.
3. Subject to applicable Retirement Plan imposed limits (if any), the Eligible Individual may be able to request various Special Disaster Distributions from one or more Retirement Plans or IRA accounts during the Eligible Period, but up to a combined maximum of \$100,000 per a Declared Disaster. Special Disaster Distributions that exceed \$100,000 during the Eligible Period will be subject to applicable regular tax provisions under the PR Code.
4. To determine the amount to be excluded or subject to the preferential tax rate of 10% as described above, all Special Disaster Distributions made during the Eligible Period per a Declared Disaster will be added even though were made from different Retirement Plans and/or IRAs; and
5. In the event the applicable withholding is not made upon distributions in excess of \$10,000, the Eligible Individual will be subject with respect to said distributions to regular income tax rates and applicable early withdrawal penalties under the PR Code.

Request Process for Special Disaster Distributions

In order to receive a Special Disaster Distribution, the Eligible Individual must submit to its employer, plan administrator or the financial or insurance institution holding the IRA, as applicable, by means of personal delivery, mail or electronically, a sworn statement (the “Sworn Statement”) detailing the following information along with the applicable institution’s distribution application form:

1. Name and mailing address of the Eligible Individual;
2. Physical address of the principal residence of the Eligible Individual as of the date the application for the Special Disaster Distributions is submitted;
3. A Certification that the individual is a bona fide resident of Puerto Rico and that will continue to do so for the entire year 2020;
4. A Certification that the amount requested as a Special Disaster Distributions does not exceed the limit of \$100,000 established in CL IR 20-09;
5. A Certification that the amount requested as an Special Disaster Distributions will be used to cover expenses related to (i) losses suffered from the impact of the Earthquakes; (ii) extraordinary expenses incurred to cover

basic necessities after the Earthquakes; (iii) expenses to verify if a property meets established construction codes and the repairs needed to meet such codes or (iv) to compensate for unearned income after the Earthquakes;

6. A Certification that the Eligible Individual has not received previous Special Disaster Distributions, or the amount and distribution date in the event such Special Disaster Distributions were already received;
7. A Certification that the Eligible Individual has not received previous Special Disaster Distributions exempt from withholding at source (\$10,000 or less), or the amount and distribution date in the event such Special Disaster Distributions were already received; and
8. A Certification that the Eligible Individual will be the responsible for the payment of applicable tax payments on the distributions requested in the event that either (i) at the end of the tax year is not considered a Puerto Rico bona fide resident by virtue of not meeting residency rules under the PR Code and the regulations thereunder; (ii) the amounts received as Special Disaster Distributions were not used to covered Eligible Expenditures; or (iii) distributions were in excess of \$100,000.

Employer, Plan Administrator and Financial or Insurance Institutions Responsibilities

The employer, plan administrator or the financial or insurance institution holding the IRA will be subject to the following responsibilities with respect to tax withholding and reporting with respect Special Disaster Distributions:

1. Withhold the preferential 10% tax rate on taxable Special Disaster Distributions in excess of \$10,000, or the applicable tax rates under the PR Code when distributions exceed the \$100,000 cap.
2. Report the Special Disaster Distributions in a Form 480.7C, Informative Return - Retirement Plans and Annuities, or Form 480.7, Informative Return – Individual Retirement Account, as applicable.
3. Submit the amounts withheld to PR Treasury no later than the fifteenth (15th) day of the following month of said withholding.
4. If the required withholding is not made or if made was not deposited with PR Treasury as required, the withholding agent will be responsible to pay the applicable taxes and penalties on such Special Disaster Distributions.
5. The Special Disaster Distributions will be deemed first from pre-tax contributions of the Eligible Individual until exhausted and then from after-tax contributions, if any.

Note that evidence of the Eligible Expenditures incurred is **not** required to be submitted under CL IR 20-09 as part of the request for Special Disaster Distributions and the Sworn Statement. However, plan administrators may do so as a matter of internal administration. However, the institution that receives the request must verify if the Eligible Individual certified that he/she is a bona fide resident of Puerto Rico and that will continue to do so for the entire year 2020 in order to process the Special Disaster Distribution, and must take in consideration if prior Special Distributions have been requested.

Notwithstanding the above, the Puerto Rico Treasury Department (“PR Treasury”) reserved its right under CL IR 20-09 to request additional documents or information from the Eligible Individual to validate that he, his spouse, descendants or ascendants who were benefited by the Special Disaster Distributions were residents of Puerto Rico during the entire calendar year 2020, and that the amount received was used to meet Eligible Expenditures. Such a requirement shall be considered as a supplement to the Eligible Individual’s income tax return.

Implications to Retirement Plans

The provisions of CL IR 20-09 with respect to PR Code qualified retirement plans are **optional**. Moreover, the employers that maintain PR Code qualified plans may, but are not required to, adopt all or some of the provisions under CL IR 20-09. Also, dual qualified plans are authorized under CL IR 20-09 to adopt distribution rules under the United States Internal

Revenue Code of 1986, as amended, or under the reliefs provided by the Internal Revenue Service (“IRS”) applicable to retirement plan provisions to those affected by the Earthquakes.

Retirement Plans that adopt amendments to provide for the provisions under CL IR 20-09 must do so no later than December 31, 2020. However, Special Disaster Distributions can be made even if the retirement plan has not been amended to adopt the applicable provisions; provided the Special Disaster Distributions are requested and completed during the Eligible Period. Notwithstanding, if the Retirement Plan adopted the provisions of the Administrative Determination No. 17-29 to allow for distributions as a result of the passage of Hurricane Maria, are deemed to be amended and in compliance with PR Code Section 1081.01(b)(1)(D), and not further amendments must be made, unless different provisions or parameters are been adopted for this Earthquakes relief distributions window.

Note however that even tough CL IR 20-09 may not require amendments to the Retirement Plan subject to the above described, affirmative adoption of this distribution amendments may be required by the plan administrator or the financial or insurance entity to process the Special Disaster Distributions, or to evidence the approval of such distributions.

Finally, amendments to adopt CL IR 20-09 provisions will not be considered as qualification amendments under Circular Letter of Tax Policy No. 16-08 and therefore, are not required to be submitted for a favorable determination from PR Treasury.

This document has been prepared for information purposes only and is not intended as, and should not be relied upon as legal advice. If you have any questions or comments about the matters discussed in this notice, wish to obtain more information related thereto, or about its possible effect(s) on policy or operational matters, please contact us.

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