

BUSINESS INSIGHT



RELIEF OVER DISTRIBUTIONS FROM QUALIFYING RETIREMENT PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS DISTRIBUTIONS

In the aftermath of the earthquakes experienced since December 2019, many Puerto Rico residents have been forced to incur unexpected expenses, causing financial hardship among Puerto Rican families. Pursuant to such hardship, on February 19, 2020, the Puerto Rico Department of Treasury ("PRTD") issued Circular Letter No. 20-09 ("CL 20-09") to provide guidance regarding relief over distributions from Puerto Rico Qualified Retirement Plans ("Retirement Plans") and Individual Retirement Accounts ("IRA"). The spread of COVID-19 has brought forth a similar situation.

Consequently, on March 29, 2020, the PRTD issued Circular Letter No. 20-23 ("CL 20-23") to amend CL 20-09 and include within the definition of Eligible Expenses certain expenses incurred due to the state of emergency declared as a result of COVID-19.

The PR Internal Revenue Code ("Code") allows the early distribution of accumulated amounts to participants or other beneficiaries when it is determined that there is a case of extreme economic emergency ("hardship"). As provided in CL 20-23, distributions from Retirement Plans or IRA accounts made to cover additional expenses due to COVID-19 emergency will also be considered hardship or disaster distributions ("Eligible Distributions").

CIRCULAR LETTER NO. 20-09 ("CL 20-09")

I. Eligible Distributions

Distributions made to satisfy the hardship and that are made from a Retirement Plan or an IRA Account during the period between **February 20, 2020 and June 30, 2020** ("Eligible Period") will be deemed as **Eligible Distributions** if the following is met:

- Distributions must be made by an individual who is considered a bona fide resident of Puerto Rico for the entire 2020 ("Eligible Individual")
- Distributions must be used to cover losses or damages suffered due the disaster or emergency officially declared as such by the Puerto Rico Governor and be extraordinary and unforeseen expenses to cover basic needs ("Eligible Expenses"); and
- Distributions must be made during the **Eligible Period**.

For purposes of the limits established under Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(I) of the Code, the earthquakes and the emergency due to COVID-19 will be considered as only one (1) event. As a result, the Distributions made during the Eligible Period will be subject to the limits established under CL 20-09 no matter if the same were used to cover either Eligible Expenses due to the earthquakes, or due to COVID-19, or both.

Tax Treatment

Eligible Distributions made in accordance with the abovementioned will be subject to the following:

- First **\$10,000** will be exempt from income tax. Also, such amount will not be subject to any type of income tax withholding at source.
- Distributions **in excess of the \$10,000** will be subject to a preferential income tax rate of 10%, instead of any other tax, including the alternate basic tax, as long as the total amount of the distributions do not exceed \$100,000.

- Total Eligible Distributions from a Retirement Plan or IRA account may not exceed \$100,000 during the period established by the PRTD Secretary.

Any person disbursing Eligible Distributions must deduct and withhold the 10% from the excess of \$10,000 mentioned above. If the required withholding is not made at the time of disbursement, the amount distributed will not be eligible for the preferential tax treatment.

Reporting

The distributions should be reported to the Eligible Individual and the PRTD, as follows:

- **Form 480.7C, Informative Statement – Retirement Plans and Annuities:** for distributed amounts of a Retirement Plan and the tax withholding made.
- **Form 480.7, Informative Statement – Individual Retirement Account:** for distributions of an IRA Account and the tax withheld.

Application Process

In order to receive the Eligible Distribution, the Eligible Individual must submit personally, by mail or email, to the employer who maintains the Retirement Plan or to the plan's administrator, or, in case of an IRA Account, to the financial institution or insurer that maintains the account, the applicable distribution request form, along with the following information:

- Name and mailing address of the Eligible Individual;
- Physical address of the principal residence of the Eligible Individual as of the date of the application for the Eligible Distribution;
- Certification that the individual is resident of Puerto Rico and will continue to be one for the year 2020;
- Certification that the amount requested as an Eligible Distribution does not exceed the established limit of \$100,000;
- Certification that amount requested as an Eligible Distribution will be used to cover expenses related to:
 - » any losses suffered as a result of the emergency
 - » extraordinary expenses incurred to cover basic needs as a result of the emergency; or
 - » to compensate for unearned income due to the emergency.
- Certification that the Eligible Individual has not previously received Eligible Distributions from other Retirement Plans or IRA accounts, or Eligible Distributions. If so, he/she must include date of distribution, amount distributed, and tax withheld, if any.
- Certification that the Eligible Individual has not received previous Eligible Distributions from other Retirement Plans or IRA accounts, or Eligible Distributions exempt from the income tax withholding. If received, the individual must include date of distribution and the amount distributed.
- Certification that the Eligible Individual will be responsible for the payment of applicable tax payments on the distributions requested if either:
 - » at the end of the tax year, he/she is not considered to be a Puerto Rico resident due to noncompliance with the residency rules under the Code and as established by CL 20-09;
 - » the amounts received as Eligible Distributions were not used to cover Eligible Expenses; or
 - » distributions exceeded the \$100,000 limit.

II. Responsibilities of Withholding Agent

The employer, administrator or service provider that makes the payment of Eligible Distributions will be a withholding agent and, as such, it will be responsible for making the applicable tax withholding and for remitting it to the PRTD no later than the 15th day of the month following the date on which the distribution was made. Failure to comply will result in penalties.

III. Retirement Plans

Retirement Plans are not required to introduce amendments allowing for these Eligible Distributions, but, should the administrator elect to introduce them or did not adopt amendments pursuant to Administrative Determination No. 17-29 related to Hurricane Maria, the amendments must be adopted into the plan no later than December 31, 2020. Eligible Distributions can be made on or before June 30, 2020 even if the retirement plan is in process of adopting the amendments, which must be completed by December 31, 2020 .

IV. Notarization requirement

CL 20-09 required that the application for the Eligible Distribution be notarized, but Circular Letter No. 20-24 eliminated said requirement and allowed for the electronic submission of the application without the intervention of a notary public.

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