

August 11, 2014 www.mcvpr.com**EMPLOYEE BENEFITS ALERT*****Puerto Rico Treasury Provides Guidance Regarding
Tax Prepayment on Accrued Value of Retirement Plan Benefits***

Article 14 of Act Number 77-2014 added Section 1023.21 to the Puerto Rico Internal Revenue Code of 2011, as amended ("PR Code"). Section 1023.21 allows the beneficiaries of Puerto Rico retirement plans (whether or not qualified under the PR Code) to elect to prepay the income tax applicable on the accrued value of their benefits in such plans at a reduced tax rate. This election must be made on or before October 31, 2014.

On August 6, 2014 the Puerto Rico Treasury Department ("Treasury") issued Administrative Determination Number 14-16 ("AD 14-16") to provide guidance as to the manner of making such election and its income tax consequences.

AD 14-16

Participants or beneficiaries of retirement or deferred compensation plans (whether or not qualified under Section 1081.01 (a) of the PR Code) can prepay the applicable income tax on all or part of the value of the benefits accrued under such plans at the reduced tax rates provided under Section 1023.21 (b). This election must be made between July 1, 2014 and October 31, 2014.

The election is voluntary and can be made by: (i) the plan participant; (ii) the beneficiary of a deceased participant; or, (iii) an alternate payee or beneficiary designated by a qualified domestic relations order (jointly referred to as the "Participant"), with respect to their individual account benefits, or the benefits assigned to them under the plan. This election can be made in connection with the Participant's account balance in a defined contribution plan (such as a profit-sharing plan) or the present value of his accrued benefits in a defined benefit plan (such as a regular pension plan).

If the individual participates in two or more plans, his tax prepayment election will apply separately to each plan in which he is a participant. That is, the Participant can make a tax prepayment election as to all or some of the retirement plans in which he is participating.

PREPAYMENT TAX RATE

If the prepayment election is made in connection with a retirement plan qualified under Section 1081.01 (a) of the PR Code, the applicable prepayment tax rate will be 8 %.

If the election is made in connection with a plan not qualified under Section 1081.01 (a) (such as a non-qualified deferred compensation plan), the applicable prepayment tax rate will be 15 %.

A retirement plan will be considered qualified if, at the time the Participant completes the prepayment election process, the plan has received a favorable determination letter under Section 1081.01 (a). For these purposes, a retirement plan will be considered qualified if, at the time the Participant completes the tax prepayment process, *the plan has already filed* a timely request for such qualification but has not yet received a letter of qualification from Treasury.

Retirement plans qualified under the provisions of the Puerto Rico Internal Revenue Code of 1994, as amended, that have not filed for qualification under Section 1081.01 (a) of the PR Code at the time the Participant completes the prepayment process will also be treated as non-qualified plans. In these cases, the applicable prepayment tax rate will be 15 %.

FORM OF PREPAYMENT

The tax prepayment under Section 1023.21 can be made in connection with all or only part of the value of the benefits accrued by the Participant in a retirement plan. Also, the prepayment can be made with funds belonging to the Participant or accumulated under the plan.

Section 1023.21, however, does not allow the prepayment of an amount that exceeds the value of the Participant's account balance in the retirement plan at the time he elects to prepay the tax. Thus, the election cannot be made on amounts to be contributed to plan, or investment income to be earned, after the prepayment date.

The tax prepayment may, but need not to, be accompanied by the immediate distribution of the Participant's plan benefits. If the Participant meets the requirements under the plan to receive a distribution of benefits (i.e., termination of employment, retirement or plan termination), he can make the tax prepayment on the accrued benefits and, either receive an immediate distribution of such benefits, or defer the distribution of the amounts upon which the prepayment is made.

TAX PREPAYMENT PROCEDURE

The tax prepayment can be made directly by the Participant or, at his request, by: (i) the plan trustee; (ii) the paying agent of the plan; or (iii) in the case of some non-qualified retirement plans, the sponsoring employer (the "Service Providers").

If the tax prepayment is made in connection with benefits in a plan qualified under Section 1081.01 (a) of the PR Code, the Participant must fill and file with Treasury Form SC 2911 - "Election for the prepayment of the special tax on benefits accumulated in an Employees Trusts-Qualified Plans". If the tax prepayment is made in connection with benefits accumulated under a plan not qualified under Section 1081.01 (a) of the PR Code ("non-qualified deferred compensation plans"), the Participant must fill and file with Treasury Form SC 2912 - "Election for the prepayment of the special tax on benefits accrued in Deferred Compensation Plans-Non-Qualified Plans".

The procedure to prepay the tax is as follows:

- 1. Prepayment made by the Participant**

If the payment is made directly by the Participant, he will have to fill and file with Treasury the applicable tax prepayment election form (Form SC 2911 or Form SC 2912, jointly referred to as the "Prepayment Forms"). The Participant must complete one Prepayment Form for each plan in which he has benefits and for which he wants to prepay the applicable tax.

The Participant will have to include with the Prepayment Form a recent copy of his plan account statement, benefits calculation, certification issued by the Service Provider or other document issued by the plan showing the value of the benefits accrued in the retirement plan and dated within 30 days from the date of the tax prepayment (jointly, "Account Statement").

The Prepayment Form must be filed in triplicate with the Tax Collector's Office of Treasury and the payment of the special tax can be made in cash, certified check, money order or credit or debit card. Upon its filing, the officer of the Tax Collector's Office will stamp-received the Prepayment Form and will return to the Participant two of the copies of the form. Within 30 days after the prepayment, the Participant must deliver to the Service Provider one of these copies as evidence of the prepayment. The Participant must keep the third copy.

The Participant can make the tax prepayment using his own funds or can request the administrator of the retirement plan to issue a certified check or manager's check from the Participant's accrued funds in the plan. The check must be filed with the Prepayment Form.

As long as the Participant does not receive a distribution of his retirement plan benefits, the Service Provider will not be required to file with Treasury Form 480.07C, Informative Return-Retirement Plans and Annuities, reporting such distribution and the applicable tax prepayment. If the Participant receives a distribution of his benefits in the retirement plan, the Service Provider will be required to file Form 480.07C and report the distribution and the applicable tax prepayment.

The prepayment of the applicable tax directly by the Participant must be completed no later than October 31, 2014 in order to be entitled to the reduced special tax rate.

2. **Prepayment made by the Service Provider**

The Participant can request the Service Provider to make the prepayment. In these cases, the Participant must fill the Prepayment Form and have it filed with the Service Provider (in quadruplicate) no later than October 31, 2014. The Service Provider will return one copy of the form to the Participant, showing the date of filing under the seal or signature of one of its officers.

The Service Provider will be responsible, in these cases, of attaching to the Prepayment Form the Account Statement showing the value of the Participant's accrued benefits in the retirement plan and of ensuring that no taxes are prepaid over amounts in excess of the Participant's accrued benefits as of the prepayment date.

No later than the 15th day of the month following the date of the Participant's request to prepay the tax, the Service Provider must remit to Treasury the applicable tax prepayment using: (i) Form 480.9D, Payment Voucher for the Special Tax on distributions from Employees Trusts (Qualified Plans); or (ii) Form 480.9E, Payment Voucher for the Special Tax on Distributions from Deferred Compensation Plans (Non-Qualified Plans). The Service Provider will have to file with Treasury (in triplicate) the Prepayment Forms provided by the Participant and the Account Statements together with the payment vouchers.

Treasury will stamp received and return to the Service Provider two copies of the Prepayment Form. Within the next 30 days, the Service Provider will deliver to the Participant one of these two copies of the Prepayment Form and will keep the other for its records. The Service Provider may complete the deposit of the tax prepayment with Treasury using only one payment voucher for all the tax prepayment requests received during the prior month.

PREPAYMENT PERIOD

If the prepayment is made directly by the Participant, the payment must be deposited with the Tax Collector's Office no later than October 31, 2014. If the prepayment is made by the Service Provider, the Participants must file the Prepayment Forms with the Service Provider no later than October 31, 2014 and the Service Provider must deposit with the Tax Collector's Office the applicable tax prepayments and file the Prepayment Forms received from the Participants no later than the 15th day of the month following the request of prepayment.

Treasury will not accept Prepayment Forms filed by mail or through any postal carrier.

AMENDMENT TO RETIREMENT PLANS

The determination as to whether the plan should be amended to allow Participants to use funds accrued thereunder to prepay the applicable tax should be made by the employer sponsoring the plan. Treasury will not rule on these amendments either by way of an interpretation of general application or through the issuance of an administrative determination.

If a retirement plan qualified under Section 1081.01 (a) of the PR Code is amended solely to enable the tax prepayment election, such amendment will not be considered a "qualification amendment" required to be submitted for qualification with Treasury. Likewise, the amendment of a qualified retirement plan allowing Participants to use accrued benefits to prepay the applicable tax will not result in the disqualification of the plan under Section 1081.01 (a).

Retirement plans (whether or not qualified) are not required to allow the tax prepayment. This decision will rest solely with the plan sponsor.

TAX TREATMENT OF THE PREPAYMENT

The value of the accrued benefits in a retirement plan with respect to which the special tax is prepaid will be considered as part of the Participant's basis in his retirement plan account. Consequently, any distributions attributable to the benefits for which such taxes were pre-paid, will not be included in net income for purposes of the alternate basic tax nor will they be subject to the alternate basic tax. However, the investment income and the appreciation in value accrued on the benefits with respect to which the special tax was prepaid will be taxed as provided by the tax rules in effect at the time of their distribution.

In those cases where the Participant directed the Service Provider to prepay the tax with funds arising from his benefits in the retirement plan, the amounts used to pay the applicable tax will not be considered as an increase in the Participant's basis in the plan.

The funds accrued under a plan and used by a Participant to prepay the special tax will not be treated as been distributed for income tax purposes.

REFUND OF TAX PREPAYMENT

All tax prepayments under Section 1023.21 of the PR Code are final and irrevocable and, as such, cannot be refunded to the Participant, even if the value of the benefits accrued under the plan over which the prepayment was made decline thereafter.

We have included links to [AD 14-16](#) and Forms [SC 2911](#) and [SC 2912](#).

If you have any questions or comments regarding the above, or would like to receive specific advice on this matter, you may contact any of the attorneys of our Employee Benefits Practice Group listed below:

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