

October 1, 2014 www.mcvpr.com

EMPLOYEE BENEFITS ALERT

PR Treasury Provides Additional Guidelines Regarding Tax Prepayment on Retirement Plans Accrued Balances

As mentioned in our August 11th [Employee Benefits Alert](#), on July 1, 2014, 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 at a reduced tax rate the income tax on the accumulated value of their benefits in such plans ("Prepayment"). This election must be made on or before October 31, 2014.

Subsequently, 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.

On September 29, 2014, Treasury issued Circular Letter of Tax Policy No.14-02 ("CL TP 14-02") to provide additional guidelines regarding the Prepayment, as follows:

- Employers are not required to amend their plans to allow participants to make the Prepayment by using funds accumulated thereunder.
- If the Participant makes the Prepayment at a Treasury Collection Office ("Collection Office"), the employer or service provider has to take the necessary measures to account as part of the participant's basis in the plan the amount upon which the Prepayment was made in order to avoid further taxation on its subsequent distribution.
- In the case of plans that allow partial or in-service withdrawals to active participants, the employers must allow the participant to make the Prepayment using plan funds if an in-service distribution is duly requested, and subject to compliance with the requirements provided under the plan to receive such distribution. Nonetheless, plans are not required to make the Prepayment to Treasury on behalf of the participant. The employer may provide to the participant a check payable to Treasury and, after the participant makes the Prepayment at the Collection Office, he will then provide to the employer a stamped copy of Model SC 2911 - "Election for Prepayment of Special Tax on Accumulated Amounts in Employee's Trusts (Qualified Plans)" ("Form SC 2911"). If at the time of the preparation and filing of Form 480.7C Informative Declaration – Retirement Plans and Annuities ("Form 480.7C") for the 2014 taxable year, the participant has already delivered a stamped original of Form SC 2911 to the employer, the amount of in-service distribution used to make the Prepayment will be reported in Form 480.7C as a non-taxable amount.
- If the employer does not allow the use of in-service withdrawals to make the Prepayment when it is otherwise permissible under the terms of the plan, the participant may claim the benefit using the procedures provided (i) in the summary plan description, (ii) by the U.S. Department of Labor, or (iii) by the Employee Benefits Security Administration.

- The employer is not legally required to inform participants about their right to make a prepayment or about the rules and applicable procedures that must be followed for such purposes.
- Distributions from retirement plans made during the Prepayment period are subject to an 8% withholding tax (for qualified plans) and a 15% withholding tax (for nonqualified plans). In these cases, however, a Form SC 2911 must be completed and the tax due on the amounts distributed must be paid in accordance with the provisions of AD 14-16. The employer can withhold the tax due on the distribution and follow the prepayment process on behalf of the participant to remit the amount withheld to Treasury, or can instead issue two checks: one payable to Treasury in the amount of the tax due on the distribution, and the other payable to the participant for the remaining amount.
- If the participant receives a plan distribution during the Prepayment period, but the employer or service provider withholds from the distribution an amount greater than 8% (15% in non-qualified plans), the participant can request to Treasury a reimbursement of the excess amount withheld in his Puerto Rico income tax return for the 2014 taxable year.
- No personal or business checks can be used to make the Prepayment unless made by a financial institution, investment company or insurance company.
- In the case of plans which accounts are not valued within the 30-day period immediately preceding the Prepayment (i.e. a pension plan with annual valuation), the participant can use the most recent account statement even if issued prior to said 30-day period. The amount of the Prepayment cannot be greater than the total amount of the participant account, or the value of the accumulated benefits, disclosed in the statement.
- The actuarial assumptions that must be used to determine the present value of benefits accrued under a defined benefit plan will be those provided under Section 417(e)(3) of the U.S. Internal Revenue Code of 1986, as amended.
- CL TP 14-02 clarifies that if Section 1023.21 of the PR Code is amended to extend the Prepayment period, the provisions of CL TP 14-02 and AD 14-16 will remain in effect during the extended period.

A copy of CL TP 14-02 is available [here](#).

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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