

Technical Amendments Act – Puerto Rico Retirement Plans, IRAs, Individual Retirement Annuities and Educational Contribution Accounts

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An McV Tax Alert

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Following is a summary of by the recently enacted Act 40-2020 (“Act 40”) which incorporates technical amendments to the Puerto Rico Internal Revenue Code of 2011, as amended (“PR Code”).

This summary specifically addresses provisions under the PR Code related to Puerto Rico Retirement Plans, IRAs, individual retirement annuities and educational contribution accounts. **Unless otherwise stated, the amendments become effective as of April 17, 2020, when Act 40 was approved.**

I. Puerto Rico Retirement Plans

Act 40 contains the same retirement plan amendments to PR Code Section 1081.01 included in House Bill No. 2172 (“HB 2172”), which was vetoed by the Puerto Rico Governor earlier this year. We notified our clients and friends of HB 2172 in our McV Employee Benefits Alert of November 21, 2019 available at this **link**.

■ *Retirement Plan Distributions to Puerto Rico Non-Residents*

Act 40 introduces locally the State Taxation of Pension Act of 1995, Public Law No. 104-95, as amended, a federal law that provides that a State (including Puerto Rico) cannot impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State, as determined under the laws of such State. *See 4 U.S.C. §114(a)*. In general, with respect to plans qualified under the US Code, this federal law preempts the PR Code from the imposition of any income tax to distributions to individuals who are not residents of Puerto Rico (“Non-PR residents”) even if such individuals performed services covered by the retirement plan in Puerto Rico while they were Puerto Rico resident individuals.

PR Code Section 1081.01(b)(1)(E) partially codified the aforementioned rule and now provides that, for taxable years beginning in 2019 and thereafter, distributions of retirement income, as defined under 4 U.S.C. §114(a), made by

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plans qualified under the U.S. Internal Revenue Code of 1986, as amended (“US Code”), and funded through a U.S. trust, to Non-PR Residents will not be subject to Puerto Rico income tax. The local rule applies exclusively to plans qualified under both the U.S. Code and the PR Code (known as “dual-qualified plans”) funded through a trust situs in the U.S.

The Secretary of the Puerto Rico Treasury Department (“PR Treasury”) will issue guidance on the evidence that must be furnished by Non-PR Resident to confirm his/her Puerto Rico non-residency status to be exempt from Puerto Rico income tax, including income tax withholding, on the retirement plan distribution.

■ *Withholding Tax on Retirement Plan Distributions and Participant Loan Rules*

Act 40 reinstated certain withholding tax provisions on plan distributions and participant loan repayment rules inadvertently eliminated by Act 257-2018:

- Withholding tax rate of 10% on the taxable portion of annuity or periodical payments over the first \$31,000 received during the year (\$35,000, if the participant or beneficiary is age 60 or older).
- No taxes will be withheld from all or part of a total distribution resulting from separation of service or plan termination that is rolled-over to another Puerto Rico qualified retirement plan, individual retirement account or annuity, at the election of the participant or beneficiary.
- A participant loan will be deemed a taxable distribution, unless these conditions are met:
 - Loan repayment must be made through substantial equal payments at least on a quarterly basis; and
 - Loan repayment must be completed within 5 years or less, unless the loan is taken to finance the purchase of the participant’s principal residence, in which case a longer repayment period is permissible as provided by the retirement plan.

II. IRAs, Individual Retirement Annuities, and Educational Contribution Accounts

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Act 40 changes the filing deadline of informative returns regarding IRAs, individual retirement annuities, and educational contribution accounts. Fiduciaries and life insurance companies or cooperatives must file electronically the required informative returns (i.e., PR Treasury Forms 480.7, 480.7B and 480.7B.1):

- By February 28th following the year in which distributions were made from the IRA, individual retirement annuity or educational contribution account to the individual/taxpayer; and
- By November 30th following the year in which contributions made by the individual/taxpayer will be claimed in the Puerto Rico individual income tax return as a tax deduction.

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