March 2020

PENSION ANALYST

Important information – Plan administration and operation

Prudential
Bring Your Challenges

Puerto Rico Treasury issues relief for earthquake victims

Who's affected

This information applies to sponsors of defined contribution retirement plans covering Puerto Rico employees including those qualified under the Puerto Rico Internal Revenue Code (Puerto Rico-only plans) and plans qualified under both the United States Internal Revenue Code and the Puerto Rico Internal Revenue Code (dual-qualified plans).

Background and summary

Under the Internal Revenue Code of Puerto Rico (PR IRC), special tax rules apply to distributions from qualified retirement plans following the Declaration of a Disaster by the Governor of Puerto Rico (known as "special disaster distributions"). The earthquakes that have occurred in southern areas of Puerto Rico since January 6, 2020, have significantly affected individuals and businesses. Recognizing this impact, the Governor of Puerto Rico declared Puerto Rico in a state of emergency and the Puerto Rico Treasury Department (Hacienda) recently issued guidance establishing terms for special disaster distributions made to alleviate hardships caused by the earthquakes. This relief is similar to relief provided to Hurricane Maria Victims in 2017 and provides special rules for plan sponsors that want to offer distributions to affected employees who reside in Puerto Rico. It also lessens the tax burdens related to these special distributions.

Action and next steps

Plan sponsors should review the information in this publication to determine potential impacts to their plans. If you need more information regarding these special distribution opportunities, please contact your Prudential Retirement representative.

In this issue

Special rules for distributions

Hacienda has provided special rules, allowing Puerto Rico-only or dual-qualified retirement plans to make distributions available on a broader basis to "eligible individuals." An eligible individual is an individual who is considered a resident of Puerto Rico for the whole 2020 calendar year.

Plan sponsors may permit such distributions immediately, as long as they amend their plans to provide for them by December 31, 2020, or had adopted an amendment for the special Hurricane Maria distribution relief issued by the Hacienda in November 2017, as described in the Plan Amendment section below.

Special disaster distributions

"Special disaster distributions" can be made in the form of a total distribution or partial hardship distribution, but must be made for "eligible expenses" as defined by Hacienda. Special disaster distributions may be made for any disaster-related expenses, not just those hardship reasons listed in existing regulations (i.e., casualty losses, funeral expenses). Disaster-related expenses include expenses incurred to cover losses or damages related to the earthquakes such as expenses for the repair or replacement of a residence, motor vehicle, or generator, purchase of food or fuel, or lodging expenses due to total or partial destruction of a primary residence of the eligible individual, his or her spouse, descendants, or ascendants.

Special disaster distributions must be made between February 20, 2020 and June 30, 2020 (the "eligible period"), but it is not necessary for the expenses to be incurred within the eligible period.

Plan administrators are not required to verify that a distribution will be used for eligible expenses, but must verify that the individual is a resident of Puerto Rico based on information provided in an affidavit.

The standard 12-month suspension of contributions following hardship distributions does not apply in these situations.

Special tax rules for special disaster distributions

The following special tax rules apply to special disaster distributions:

- The first $10,000 distributed during the eligible period is exempt from income tax and the alternate basic tax (ABT) under the PR IRC. Therefore, this amount would not be subject to Puerto Rico income tax withholding.
- Distributions in excess of the first $10,000 are subject to a flat 10% income tax rate with **mandatory** 10% withholding. If the 10% income tax is not withheld at the time of the distribution, the amount distributed is subject to the ordinary income tax rates, including the ABT, established by the PR IRC.

Special disaster distributions are deemed to come first from amounts that had not previously been taxed (e.g., pre-tax, employer contributions, and related earnings) and then from amounts that had previously been subject to tax (e.g., after-tax contributions).

An individual may make several special disaster distributions within the eligible period, but total eligible distributions, taken from all eligible plans, cannot exceed $100,000. Distributions previously requested, including annuity payments or periodic payments, reduce the $100,000 and $10,000 limits. Annuity payments, periodic payments, and any amount distributed in excess of these limits are not subject to or eligible for the special tax rules described above.

Process for requesting a special disaster distribution

To receive a special disaster distribution, an affidavit with the following information must be submitted with the request:

- Name and mailing address of the eligible individual;
- Physical address of the primary residence of the eligible individual as of the date of the request; and

- Certification that:
  - The individual is a resident of Puerto Rico and will continue to be a resident of Puerto Rico throughout the calendar year 2020;
  - The amount requested does not exceed the limit for special disaster distributions;
  - The amount requested will be used:
    - For expenses related to losses sustained due to the impact of the earthquake;
    - For extraordinary expenses incurred to cover basic needs after the earthquake; or
    - To compensate for income that ceased to accrue after the earthquake.
  - The individual has not received special disaster distributions from other qualified plans or IRAs or, if applicable, the distribution dates, amounts received, and amounts withheld, if any;
  - The individual has not received special disaster distributions exempt from withholding or, if applicable, the distribution dates and amounts requested or received; and
  - The individual assumes responsibility for the payment of taxes on requested distributions, if the individual:
    - Does not comply with the residency requirement;
    - Does not use the distribution amount for eligible expenses; or
    - Receives distributions in excess of the limits.

Plan amendments

Employers may, but are not required to, adopt any or all of these provisions. In addition, employers may elect to limit special disaster distributions to an amount lesser than $100,000 or require that they be related to certain events in particular (e.g., only for the earthquakes but not for other Declared Disasters) or limit the definition of eligible expenses. Sponsors of dual qualified plans may also limit the provisions so they are consistent with relief and guidance issued for plans qualified under the US IRC.

Plan sponsors may permit special disaster distributions before plan documents are formally amended to permit them. However, the necessary amendments must be adopted no later than December 31, 2020 with a retroactive effective date. Adoption of these provisions are not considered a "qualification amendment." Therefore, it is not necessary to file them with Hacienda. For sponsors that use Prudential Retirement's document services, we will notify you when applicable amendments are available.

Plans that adopted the special disaster distributions provisions of the PR IRC following the Hurricane Maria Hacienda relief issued in November 2017 are not required to adopt an additional amendment to offer these special disaster distributions.

Plan sponsor next steps

Plan sponsors with Puerto Rico-only or dual-qualified retirement plans should review the impacts of this guidance with the plan's legal counsel. If you would like to make these special disaster distributions available from your plan, please contact your Prudential Retirement representative, so that we can ensure these transactions are handled appropriately. Questions regarding this relief may also be directed to your Prudential Retirement representative.

Pension Analyst by Prudential Retirement
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