GOBIERNO DE PUERTO RICO
Departamento de Hacienda

OFFICIAL ENGLISH TRANSLATION

September 27, 2022

INTERNAL REVENUE CIRCULAR LETTER NO. 22-13 ("IR CL 22-13")

ATENTION: ALL EMPLOYERS, TRUSTEE, ADMINISTRATORS, PARTICIPANTS, AND BENEFICIARIES OF QUALIFIED RETIREMENT PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS

SUBJECT: RULES APPLICABLE TO DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS DUE TO THE PASSAGE OF HURRICANE FIONA IN PUERTO RICO

I. Statement of Motives

On September 17, 2022, the Governor of Puerto Rico ("Governor") issued Executive Order No. EO-2022-045, in which he declared Puerto Rico in a state of emergency due to the imminent passage of Tropical Storm Fiona by Puerto Rico and the impact that this could cause. Said tropical storm finally became a hurricane on Sunday, September 18, 2022 before reaching Puerto Rico.

In response, on September 27, 2022, the Department of the Treasury ("Department") issued Administrative Determination No. 22-08 ("AD 22-08") in order to establish several tax administration measures for the benefit of taxpayers and authorized representatives affected by the state of emergency generated by the passage of hurricane Fiona through Puerto Rico. Among these measures, AD 22-08 activated the Distributions Due to a Disaster Declared by the Governor under the provisions of Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(I) of the Puerto Rico Internal Revenue Code of 2011, as amended ("Code").

Said sections provide for, in the event of a disaster declared by the Governor, distributions from a qualified pension plan under Code Section 1081.01 ("Retirement Plan") or from an individual retirement account established under Code Section 1081.02 ("IRA Account") to cover expenses that the individual needs to incur to cover losses or damages suffered by the disaster and extraordinary and unforeseen expenses to cover basic needs of the individual and his family ("Special Disaster Distributions"), will be subject to a special tax, as provided by the Secretary of the Treasury ("Secretary") via a general communication. Likewise, Code Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(J) establish that Special Distributions due to Disaster will be taxed as follows:

- The first $10,000 distributed within the term established by the Secretary, and after a Declaration of a Disaster by the Governor of Puerto Rico, will be excluded from the definition of gross income, pursuant to Code Section 1031.01(b)(18), and will not be subject to any type of withholding at source (“Excluded Amount”);

- Any distribution in excess of the first $10,000 will be subject to a special 10% tax, in lieu of any other tax imposed by the Code, including the Alternate Basic Tax, as long as the total distributions made during the term established by the Secretary does not exceed $100,000; and

- In aggregate, the total distributions from a Retirement Plan or an IRA Account will not exceed the limit of $100,000 during the period established by the Secretary through a general communication.

The Secretary is authorized to establish the period of time during which these Special Disaster Distributions will be allowed and the documents that the participant or beneficiary of the Retirement Plan or the IRA Account must present to the employer or administrator of the Retirement Plan or IRA account for the Special Disaster Distribution.

In accordance with the foregoing, the Department issues this Circular Letter in order to establish: (i) the period of time during which Special Disaster Distributions may be made, both from Retirement Plans and IRA Accounts as a result of the passage of hurricane Fiona by Puerto Rico; and (ii) the responsibilities imposed on the trustees, administrators and service providers of the Retirement Plans and IRA Accounts regarding the fulfillment of their responsibilities as withholding agent in said Special Disaster Distributions.

II. Determination

In keeping with the statement of motives, the Department allows Special Disaster Distributions to be made from Retirement Plans and IRA Accounts, subject to compliance with the taxation and withholding at source rules of Code Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(J), respectively, and the administrative procedures established in this Circular Letter.

It should be noted that the provisions related to Special Disaster Distributions established by the Code apply to all those pension plans qualified under Code Section 1081.01 and those IRA Accounts established under Code Section 1081.02. Therefore, they do not apply in the case of non-deductible IRA Accounts established under Code Section 1081.03.

A. Special Disaster Distributions

Payments or distributions in cash that are made from a Retirement Plan or an IRA Account during the period between *October 6, 2022* and *December 31, 2022* (“Eligible Period”) and that have been requested by an Eligible Individual to cover Eligible Expenses, as such terms are defined in this Circular Letter, will qualify as Special Disaster Distributions. In the case of

Retirement Plans, the Special Disaster Distributions can be completed through the provisions of Code Section 1081.01(b)(1)(D). However, distributions in the form of annuities or periodic payments, as defined in Code Section 1031.02(a)(13)(D), are not considered Special Disaster Distributions since, as a general rule, the latter cannot be requested and fully disbursed within the Eligible Period.

Eligible Individuals may choose to receive Special Disaster Distributions regardless of other forms of payment available to them under the Retirement Plan or IRA Account. In addition, such Eligible Individuals who receive a Special Disaster Distribution do not have to be subject to a restriction period to continue with their contributions to the Retirement Plan or the IRA Account after the distribution is completed. For example, a retirement plan participant will be allowed to receive Special Disaster Distributions from a Retirement Plan during the month of October 2022 and continue to benefit without any limitation or reduction be applicable to that same taxable year contributions. In the case of Special Disaster Distributions from IRA Accounts, the penalty provided in Code Section 1081.02(g) will not apply. However, the individual could be subject to the penalties imposed by the financial institution or insurer according to the contract or document of the IRA Account.

On the other hand, distributions made during the Eligible Period to be used as contributions to a Retirement Plan or IRA Account, including contributions to the same Retirement Plan or IRA Account or to another Retirement Plan, or IRA Account, and vice versa, will not be considered Special Disaster Distributions and, therefore, will not be subject to the provisions of Code Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(J) and this Circular Letter. Therefore, such distributions will be considered fully taxable distributions subject to the withholding at source rules established in Code Section 1081.01(b) in the case of Retirement Plans and Code Section 1081.02(d) in the case of IRA Accounts and, for income tax purposes, are considered as taxable income subject to the tax rates established in Subtitle A of the Code. In addition, in these cases, the penalties for early withdrawal provided by Subtitle A of the Code will apply.

B. Eligible Individuals

For purposes of Code Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(J) and of this Circular Letter, the term "Eligible Individual" refers to an individual who throughout calendar year 2022 is considered a bona fide resident of Puerto Rico. Therefore, in those cases in which distributions from Retirement Plans or IRA Accounts are received during the Eligible Period by persons who are not considered residents of Puerto Rico for the entire calendar year 2022, the distributions will not be considered Special Disaster Distributions and therefore will not be entitled to the tax treatment provided in this Circular Letter. Said distributions will be subject to the withholding rules at source established in Code Sections 1081.01(b) and 1081.02(d), as applicable, and for income tax purposes, they are considered taxable income subject to the rates of contribution established by Subtitle A of the Code.

C. Eligible Expenses

For purposes of this Circular Letter and in accordance with the provisions of Code Section 1081.01(b)(1)(D)(vi)(II), "Eligible Expenses" are considered to be all those expenses that an individual incurs to correct losses or damages suffered by a Disaster Declared by the Governor of Puerto Rico and extraordinary and unforeseen expenses to cover basic needs as a result of said disaster. Eligible Expenses include, but are not limited to, expenses for the repair of damage to a residence, business establishment or motor vehicle, expenses for the acquisition of a new primary residence or business establishment when the primary residence or business establishment has been destroyed by hurricane Fiona, payment of medical expenses, replacement or repair of real estate, purchase of food and fuel, payments for purchase or repair of electricity generators or lodging and food expenses due to total or partial destruction of the main residence incurred during the recovery period after the passage of said hurricane. However, it will not be necessary that, as part of the application, the Eligible Individual submit a detail of the expenses incurred or losses suffered due to the passage of hurricane Fiona.

The fact that the expenses have been paid by the participant or beneficiary's spouse, descendants or ascendants, will not invalidate their eligibility. In addition, related expenses may have been incurred by the Eligible Individual, their spouse, descendants or ascendants. For example, an Eligible Individual may obtain a distribution to cover part of the cost of repairing the residence of his or her parents or children. For the distribution to be considered a Special Disaster Distribution, it must be made during the Eligible Period. The Eligible Individual must ensure that the application is completed with sufficient time for the Special Disaster Distribution to be received within the Eligible Period. However, it will not be necessary for the expenses related to said distributions to be incurred within the Eligible Period. Therefore, an Eligible Individual may receive a Special Disaster Distribution during the Eligible Period to cover Eligible Expenses to be incurred at a later date.

D. Tax Treatment

Special Disaster Distributions from Retirement Plans or IRA Accounts received by an Eligible Individual during the Eligible Period, as a consequence of the passage of hurricane Fiona, will be taxed in accordance with the provisions of Code Sections 1081.01(b)(1)(D) and 1081.02(d)(1)(J). To qualify for this benefit, it is an essential requirement that every person, regardless of the capacity in which they act, who makes Special Disaster Distributions, deduct and withhold from said distributions, in the manner in which they exceed $10,000, an amount equal to ten percent (10%). If the required withholding at source is not made at the time of payment, the amount distributed will not be eligible for the tax treatment described herein. Therefore, said distribution will be considered as taxable income for the Eligible Individual and will be subject to the regular income tax rates established by the Code.

Furthermore, according to the provisions of Code Section 1081.01(b)(1)(D)(iv), the Special Disaster Distributions shall be understood to be distributed first from the participant or beneficiary's contributions and accumulation of value that have not been previously taxed and, if not sufficient, then it is distributed from the nontaxable basis, such as voluntary contributions (“after-tax contributions”) and amounts on which the participant paid contributions in advance. The Department reserves the right to request additional documents or information from the Eligible Individual that validates that he or she, the spouse, descendants or ascendants who benefited from the money received from the Special Disaster Distributions were residents of Puerto Rico during the entire calendar year 2022, and that the amount received was used to satisfy Eligible Expenses. Said request will be considered as a supplement to the Individual Income Tax Return as provided in Code Section 6010.02(g)(3)(A).

On the other hand, the amount distributed from a Retirement Plan and the withholding at source made must be reported to the Eligible Individual and to the Department in Form 480.7C "Informative Return - Retirement Plans and Annuities" corresponding to taxable year 2022. In the case of Special Disaster Distributions from an IRA Account, the amount of the distribution and the tax withheld at source must be reported to the Eligible Individual and to the Department on Form 480.7 “Informative Return – Individual Retirement Account” corresponding to the taxable year 2022.

Said forms must be filed electronically with the Department *no later than February 28, 2023* and must also include any other distribution that has been made during the year 2022 that is not considered a Special Disaster Distribution. That is, total distributions and other payments completed before October 6, 2022, Special Disaster Distributions made during the Eligible Period in excess of the $100,000 limit, as well as annuities and periodic payments, as defined in Code Section 1031.02(a)(13)(D). Said distributions are not subject to or eligible for the 10% special tax rate, and therefore continue to be subject to the ordinary rules established in the Code and the Regulations.

For example, Eligible Individual “A” makes two Special Disaster Distributions during the Eligible Period to cover Eligible Expenses. The first distribution was from a Retirement Plan in the amount of $60,000 and the second was from an IRA in the amount of $60,000, for a total of $120,000 in Special Disaster Distributions. In this case, the first $10,000 corresponding to the Excluded Amount are not subject to income tax, the following $90,000 will be subject to the special rate of 10%, to the extent that the corresponding withholding has been made at source, and the remaining $20,000, as it is a distribution in excess of the $100,000 limit, will be subject to the ordinary tax rules and the penalties provided in Code Section 1081.02.

E. Special Disaster Distribution Application Process

To receive a Special Disaster Distribution, as part of the application process, the Eligible Individual must submit, personally or electronically or by mail, to the employer that maintains the Retirement Plan or the provider of administration services for the plan, or, in the case of an IRA, to the financial institution or insurer that maintains the account, a certification signed under penalty of perjury (“Application”) that includes the following:

1. Name and postal address of the Eligible Individual.

2. Physical address of the Eligible Individual principal residence as of Special Disaster Distribution application date.
3. Certification that the individual is a resident of Puerto Rico at the time of the distribution and will continue to be a resident of Puerto Rico throughout the calendar year 2022.
4. Certification that the amount requested does not exceed the limit provided in this Circular Letter.
5. That the requested distribution amount will be used to cover expenses related to:
   - (a) Losses suffered as a result of the impact of hurricane Fiona;
   - (b) Extraordinary expenses incurred to cover basic needs after the passage of hurricane Fiona;
   - (c) To compensate for lost income after the passage of hurricane Fiona, or
   - (d) Any other expense that is considered an Eligible Expense.

A suggested model of the Application that the individual must sign in accordance with the provisions of this Part II-E is included as an annex to this Circular Letter, for example purposes. The use of this model is not mandatory and the administrators of Retirement Plans and IRA Accounts can use the model or format of their choice, as long as the one finally used contains the information required in this Part II-E and the applicant's signature including a language stating that the Application is signed under penalty of perjury.

The administrator of the Retirement Plan or fiduciary of the IRA Account that receives the Application from the requesting Eligible Individual, will *not* be required to validate or verify that the need for the money resulting from said distribution will be used to cover or reimburse all or part of the unexpected expenses incurred, or the cost of repairing damages suffered, due to the passage of hurricane Fiona, and the amount of such costs or damages. However, said administrator or trustee must verify whether or not the individual is a resident of Puerto Rico based on the information provided in the Application. In addition, in cases where the Eligible Individual requests more than one Special Disaster Distribution, the administrator or trustee must reduce the amount of Special Disaster Distributions still available to said individual by the amount of Special Disaster Distributions previously requested.

As an example, if on October 15, 2022 an Eligible Individual requests a Special Disaster Distribution of $25,000 from his IRA Account, and on November 1, 2022 requests a Special Disaster Distribution of $30,000 to his Retirement Plan, the first $10,000 of the IRA Account corresponding to the Excluded Amount are not subject to income tax or withholding tax, and the remaining $15,000 of the IRA Account as well as the $30,000 of the Retirement Plan are subject to income tax and withholding at source special fixed rate of 10%. If the Eligible Individual does not make certain that special tax rate of 10% is withheld at source from the $15,000 withdrawal from the IRA Account and the $30,000 distribution from the Retirement

Plan, they will not be able to benefit themselves of the special rate of 10% in said distributions, at the time of filing the income tax return for taxable year 2022.

It should be noted that any Eligible Individual who, during the Eligible Period, receives more than $10,000 in distributions from Retirement Plans and IRA Accounts without withholding at the source of the tax, as provided in the Code and this Circular Letter, will not be able to opt for the special taxation provided here. Therefore, any distribution in excess of $10,000 that has not been subject to withholding at source will be subject to income tax and penalties for early withdrawal as provided in the Code.

F. Withholding Agent Responsibilities

Trust or annuity contract employer, administrator or service provider that process the Special Disaster Distribution will act as Department's withholding agent and will be responsible for making the withholding provided in Part II-D of this Circular Letter. Similarly, it will be responsible for remitting the payment of said tax withheld to the Department no later than the fifteenth (15) day of the month following the date on which the distribution was made.

The ten percent (10%) preferential tax rate will be applicable only to the taxable portion of a Special Disaster Distribution. Therefore, the withholding agent will only be required to withhold at source said tax on the part of the Special Disaster Distribution, net of the Excluded Amount, which has not been previously subject to tax or which is not exempt from income tax, if any.

In those cases, when the withholding agent fails to comply with its responsibility to withhold at source the taxes as required in this Circular Letter, the Department will proceed to collect from said withholding agent the total amount of the tax not withheld following the same procedure as would be used if it were a tax owed by said withholding agent. In addition, the withholding agent will be subject to the penalties imposed by Subtitle F of the Code to withholding agents who fail to comply with their responsibilities, including the one imposed in Code Section 6080.02 to any principal officer or person with a principal function who, knowingly, has decided not to withhold at source and deposit the income tax imposed by the Code.

G. Retirement Plan Terms

In the case of Retirement Plans, the provisions of this Circular Letter are optional. Employers that maintain Retirement Plans in Puerto Rico may, but are not required to adopt all or part of them. For example, an employer may decide to amend its retirement plan to facilitate Special Disaster Distributions as provided in Code Section 1081.01(b)(1)(D), but limit such distributions to a maximum amount less than $100,000 established in said section or require that they be related to certain particular events. In addition, the Administrator of a qualified Retirement Plan both in Puerto Rico and in the United States, may limit changes to the rules for handling distributions to participants in Puerto Rico to those that are consistent with the relevant provisions of the United States Internal Revenue Code ("Federal Code") or with the changes authorized by the Federal Internal Revenue Service (“IRS”) for participants in retirement plans affected by hurricane Fiona.

Those Retirement Plans that adopt the provisions of Code Section 1081.01(b)(1)(D) must be formally amended to that effect no later than December 31, 2022. However, the approval and disbursement of distributions under this Circular Letter are allowed prior to the date of adoption of such amendments. Therefore, Special Disaster Distributions can be completed no later than December 31, 2022, even if the corresponding amendment has not been adopted by that date.

In the case of Retirement Plans that have adopted the provisions of Administrative Determination No. 17-29 ("AD 17-29") issued on November 15, 2017 or Internal Revenue Circular Letter No. 20-06 issued on February 19, 2020 to allow distributions due to the passage of hurricane Maria or the earthquakes that occurred since January 6, 2020, respectively, it will be understood that they have already been amended and in compliance with the provisions of Code Section 1081.01(b)(1)(D). Therefore, they may disburse distributions in accordance with this Circular Letter without the need to amend the Retirement Plan.

H. Amendments to Retirement Plans to adopt the provision for Special Disaster Distributions

Amendments to Retirement Plans that merely adopt the provisions of Code Section 1081.01(b)(1)(D) and this Circular Letter are not considered a "qualifying amendment" for purposes of Tax Policy Circular Letter No. 16-08. Therefore, it is not necessary to file them with the Department.

III. Effectiveness

The provisions of this Circular Letter are effective immediately.

For additional information related to the provisions of this Circular Letter, you can send a message through your SURI account.

Cordially,

[Signed in Spanish version]

Francisco Parés Alicea
Secretary