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Puerto Rico Treasury Department Finally Grants Relief to Participants Affected by Hurricane Maria

After a long and tumultuous process, and 56 days after Hurricane Maria hit Puerto Rico, the Puerto Rico Treasury Department ("PR Treasury") issued Administrative Determination No. 17-29 ("AD 17-29") to grant relief on eligible distributions (including, hardship withdrawals) and plan loans by participants in Puerto Rico tax qualified retirement plans who were affected by Hurricane Maria. The PR Treasury had previously issued Administrative Determination No. 17-21 ("AD 17-21") concerning certain disaster assistance payments and interest-free loans to employees affected by the hurricane.

Eligible Distributions / Hardship Withdrawals

On November 15, 2017, the PR Treasury issued AD 17-29 (available here in Spanish) to provide that certain distributions from a qualified retirement plan ("Qualified Plans") under Section 1081.01 of the Puerto Rico Internal Revenue Code of 2011, as amended ("PR Code"), made by an "Eligible Individual" from September 20, 2017 to June 30, 2018 ("Eligibility Period"), requested to cover losses or expenses incurred by a Qualified Plan participant or beneficiary because of Hurricane Maria ("Eligible Expenses") would qualify as a distributable event under the PR Code ("Eligible Distributions").[1]

Eligible Distributions may be made either in the form of a lump-sum distribution, as defined in Article 1081.01(b)-2 of the PR Code Regs., or as a hardship withdrawal, as defined in Article 1081.01(b)-4 of the PR Code Regs. ("Eligible Hardship Withdrawal"). Distributions in the form of an annuity or periodic payments do not qualify as an Eligible Distribution.

Pursuant to AD 17-29, an Eligible Individual is an individual who is a tax resident of Puerto Rico during taxable years 2017 and 2018, as defined in PR Code Section 1010.01(a)(30).

Eligible Hardship Withdrawals are not subject to the 12-month suspension period on contributions generally applicable after a hardship withdrawal.

Eligible Expenses

Eligible Expenses are defined in AD 17-29 as all those expenses incurred by an individual or his/her spouse, descendants (e.g., children) or ascendants (e.g., parents), to cover the losses or damages caused by Hurricane Maria in Puerto Rico, and extraordinary and unforeseeable expenses to cover basic needs after Hurricane Maria. Eligible Expenses include, but are not limited to, expenses incurred during the recovery period after Hurricane Maria for the repair of damages to a residence or motor vehicle, medical expenses, replacement or repair of personal property, purchase of food and fuel, purchase and/or repair of power generators,

[1] AD No. 17-29 also provides relief for distributions from Puerto Rico individual retirement accounts ("PR-IRAs").

or lodging and food expenses resulting from the total or partial destruction of the principal residence caused by Hurricane Maria. The participant or beneficiary is not required to provide a detailed list of the expenses or losses incurred because of Hurricane Maria.

The Eligible Distribution must be made during the Eligibility Period. Consequently, the participant must make sure to timely file the request in order for the distribution to be made during the Eligibility Period. Notwithstanding, Eligible Expenses may be incurred after said date.

Tax Treatment

- The first $10,000 distributed as an Eligible Distribution during the Eligibility Period will be exempt from income taxes and the alternate minimum tax ("AMT") under the PR Code. Consequently, the first $10,000 distributed as an Eligible Distribution will not be subject to Puerto Rico income tax withholding.
- Eligible Distributions in excess of the first $10,000 will be subject to a flat 10% income tax rate in lieu of any other tax imposed under the PR Code, including the AMT. The 10% special rate is only available if the tax is withheld at the time of the distribution.
- An Eligible Individual may make several Eligible Distributions during the Eligibility Period, but such distributions may not exceed $100,000 (only the first $10,000 are tax exempt).
- Eligible Distributions requested under a Qualified Plan or PR-IRA automatically reduce the $10,000 and $100,000 limits with respect to any subsequent request for an Eligible Distribution regardless of the actual date of disbursement of the previous Eligible Distribution.
- Eligible Distributions are deemed to come first out of amounts not previously subject to tax (e.g., pre-tax and employer contributions and any related earnings) and then from amounts which had previously been subject to tax (e.g., after-tax contributions and amounts for which the tax was prepaid).
- The 10% special rate is only available if the tax is withheld at the time of the distribution. If the 10% tax is not withheld, the distribution will be taxed at the ordinary tax rates, including the AMT. The person/entity handling the distribution (e.g., the trustee) is required to withhold the 10% tax, and will be subject to applicable penalties for failure to do so, including the payment of the tax that should have been withheld.
- Eligible Distributions, and any tax withheld thereon, must be reported in PR Treasury Form 480.7C, Informative Return – Retirement Plans and Annuities.
- All other distributions/withdrawals which do not constitute Eligible Distributions, including, but not limited to, annuities, periodic payments, and other hardship withdrawals, are subject to the applicable tax, withholding tax and reporting rules, and will not enjoy the special tax treatment described in AD 17-29.

Request for Eligible Distribution

Along with the request for an Eligible Distribution, the Participant must provide the employer or plan administrator a sworn statement (in person, by mail or e-mail) including the following:

- Name and mailing address of the Eligible Individual;

- Physical address of the principal residence of the Eligible Individual as of the date of the request for an Eligible Distribution; and
- A certification that the:
    - Eligible Individual is a resident of Puerto Rico and will continue to be a resident of Puerto Rico in 2017 and 2018;
    - Eligible Distribution being requested does not exceed the $100,000 limit and that the Eligible Distributions will be used to cover:
        - losses resulting from Hurricane Maria;
        - extraordinary expenses incurred to cover basic needs after Hurricane Maria; or
        - to compensate for unearned income after Hurricane Maria**;**
    - Eligible Individual has not received other Eligible Distributions (otherwise must include the date and amount of any Eligible Distributions previously received); and
    - Eligible Individual has not received Eligible Distributions not subject to withholding (otherwise must include the date and amount of any Eligible Distributions previously received which was not subject to withholding);
    - Eligible Individual assumes responsibility for the payment of any tax on the amounts requested if the Eligible Individual: (i) does not comply with the residency requirement; (ii) the amounts received are not use to cover Eligible Expenses, or (iii) received distributions from Qualified Plans or PR-IRAs in excess of the $100,000 limit.

The plan administrator or trustee is not required to confirm that the Eligible Individual will use the amount received to cover Eligible Expenses or validate the quantity or cost of the damages or expenses. Notwithstanding, the plan administrator or trustee must confirm, based on the information provided in the sworn statement, that the individual is a resident of Puerto Rico. In addition, the plan administrator or trustee must reduce the amounts available for Eligible Distributions by any amounts of any Eligible Distributions previously requested.

Terms of the Plan

The provisions of AD 17-29 are optional. That is, a plan is not required to provide for Eligible Distributions or may provide for lower limits or a limited definition of Eligible Expenses (generally to be consistent with US Code provisions and IRS relief in case of dual-qualified plans).

Plan amendments related to Eligible Distributions must be adopted on or before December 31, 2018 with a retroactive effective date. That is, Eligible Distributions may be allowed even when the terms of the plan do not currently allow them. AD 17-29 provides that plan amendments related to Eligible Distributions do not constitute a "Qualification Amendment", and therefore, are not required to be filed with the PR Treasury for updated qualification.

Qualified Plan Loans

During the Eligibility Period, a Qualified Plan is allowed to make loans to participants even though the terms of the plan do not currently provide for them, to the extent the plan is amended on or before December 31, 2018 to allow them.

The plan may modify the repayment terms of plan loans outstanding as of September 20, 2017, and loans disbursed during the Eligibility Period, to allow participants to stop making loan payments for up to one year, or re-amortize the loan for up to one additional year without stopping the repayment. Note that the plan loans must still comply with the plan loan provisions or policy and the plan requirements of ERISA and the US Code, if applicable.

AD 17-29 provides that plan amendments related to the Plan Loans relief do not constitute a "Qualification Amendment", and therefore, are not required to be filed with the PR Treasury for updated qualification.

Qualified Disaster Assistance Payments

On October 4, 2017, the PR Treasury issued AD 17-21 (available here in Spanish) which provides that "Qualified Disaster Assistance Payments" (as defined below, and hereinafter, "QDAPs"), received by an individual with the purpose of providing assistance to repair, mitigate or compensate for any loss or damage suffered by such individual caused by Hurricane Maria would be excluded from gross income (i.e., exempt from Puerto Rico income taxes – tax-free for the individual).

A QDAP is defined as any amount paid to, or for the benefit of, an individual:

- to provide or pay necessary and reasonable expenses to the individual, or his family members, for items such as food, medications, gasoline, lodging, medical expenses, care of children and/or dependents, the purchase of power generators, and funeral expenses, incurred because of Hurricane Maria, to the extent the payment is made directly to the item or service provider;

- to pay necessary and reasonable expenses incurred for the repair or rehabilitation of a principal residence, or the repair or replacement of its content, to the extent such repair, rehabilitation or replacement is attributable to damages caused by Hurricane Maria, and to the extent the payment is made directly to the item or service provider;

- payments directly made to an individual as monetary assistance to cover the expenses related to any damage or loss suffered by such individual as a result of Hurricane Maria; or

- payments made by federal, state or local governments, or their respective agencies or instrumentalities, as a result of Hurricane Maria, to promote general welfare, to the extent any expense compensated by such payment is not otherwise covered by insurance or in other manner.

QDAPs must also comply with the following requirements:

- payments must be delivered to the individuals between September 21 and December 31, 2017;

- QDAPs may not be granted under an arrangement that discriminates in favor of highly compensated employees, as defined in PR Code Section 1032.06(d)(2);

- QDAPs are limited to $1,000 per month, and cannot be attributed or related to the employee's position or salary.

On or before January 31, 2018, any employer that makes a QDAP must file with the Puerto Rico Treasury Department a sworn statement including the name and social security number of each employee to whom a QDAP is made, and the total amount paid between September 21 and December 31, 2017. At a later time, the PR Treasury will issue guidance on the electronic filing of this information. In addition, employers must include QDAPs paid in the employee's Withholding Statement, PR Treasury Form 499R-2/W-2PR for 2017. The employer may claim a deduction for any QDAPs made to employees.

Interest Free Loans to Employees

In addition, AD 17-21 provides that any employer who provides interest-free loans to employees from September 21 to June 30, 2018, to provide assistance to employees to cover necessary and reasonable expenses of the individual or his family members, and expenses for the construction or repair of the employee's principal residence, incurred because of Hurricane Maria, shall not recognize taxable income for such loan, to the extent the loan(s) total amount granted during said period does not exceed $20,000. Multiple loans are allowed to the extent the $20,000 maximum amount is not exceeded. Employers may provide these loans to employees in addition to the QDAPs.