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TO OUR CLIENTS AND FRIENDS

August 27, 2014

Window for Prepayment of Tax on IRA Accounts

As indicated in our July 7, 2014 Memorandum to Clients and Friends, Act 77-2014 amended the Puerto Rico Internal Revenue Code of 2011, as amended (“2011 Code”), to among other matters, allow taxpayers to elect (the “Election”) to prepay the Puerto Rico income tax (the “Prepayment”), at a reduced rate (the “Special Tax”), with respect to certain items, including all or a portion of the balance accumulated by taxpayers in individual retirement accounts (“IRA Accounts”) that will be subject to Puerto Rico income tax upon distribution (the “Taxable Benefits”).

On August 25, 2014, the Puerto Rico Treasury Department (“Treasury”) issued Administrative Determination 14-18 (“AD 14-18”), to establish the rules and procedures for the Prepayment of the Special Tax, as follows:

- Applicable Special Tax rate: **8%** on all or a portion of the Taxable Benefits accumulated in the IRA Account as of the date of Prepayment.
- The Election may only be made by the beneficiary of the IRA Account (the “IRA Beneficiary”).
- The IRA Beneficiary must effect the Prepayment of the Special Tax between **July 1 and October 31, 2014** (“Prepayment Period”).
- An IRA Beneficiary holding more than one IRA Account may make an Election with respect to one or more of the IRA Accounts, whether the accounts are with a single trustee or more than one trustee. Accordingly, an IRA Beneficiary making an Election for one IRA Account is not required to make an Election for all of the IRA Accounts. An IRA Beneficiary who intends to make a Prepayment for more than one IRA Account may make a single Election to cover all IRA Accounts with a single trustee, but a separate Election will be required for each trustee with whom the IRA Beneficiary has IRA Account(s).
- A Prepayment is only allowed on the amount of Taxable Benefits actually accumulated in the IRA Beneficiary’s account as of the time of Prepayment, as evidenced by a statement corresponding to the most recent reporting quarter issued by the IRA Account’s trustee (“Account Statement”). However, the amount of Taxable Benefits with respect to which a Prepayment can be made may not include amounts contributed to an IRA that correspond to the 2014 taxable year or any subsequent taxable year.
- **Procedure for Prepayment**
 - The Prepayment must be made by the IRA Beneficiary with respect to all or a portion of the balance of the IRA Account’s Taxable Benefits accumulated as of the date the Prepayment is made.
 - The IRA Beneficiary must:
 - Complete a Form SC 2910, in triplicate, for the IRA Account(s) with respect to which the IRA Beneficiary will make a Prepayment. Multiple IRA Accounts held with one trustee may be included in a single Form SC 2910, but a separate Form SC 2910 must be filed with respect to each trustee.
 - File the Form SC 2910, together with an Account Statement for each IRA Account and the payment (cash, certified check, money order,

credit or debit card), **at a Collection Office** (“Colecturía”) on or before **October 31, 2014**.

- Although AD 14-18 does not expressly state so, it appears that filing by mail or other courier service is **not** allowed.
- Within 30 days from the filing date, the IRA Beneficiary must forward to the IRA Account trustee one of the date-stamped copies of the Form SC 2910 filed, and keep the other for his/her records.
- The IRA Beneficiary may make the Prepayment with his/her own funds or with funds distributed by the IRA Account. If a distribution from an IRA Account is to be used for these purposes, the trustee must receive from the IRA Beneficiary a written representation that the amount of the distribution will be used exclusively for the Prepayment. Furthermore, the trustee must issue a certified or manager’s check payable to the Secretary of the Treasury for the amount of the Prepayment.
- **Other Tax implications**
 - A distribution from an IRA Account to effect the prepayment will **not** be subject to the penalties of Section 1081.02(g) of the 2011 Code, but may be subject to any applicable penalties under the terms of the IRA Account.
 - A distribution from an IRA Account to effect the prepayment must be reported by the trustee in Form 480.7 by no later than **February 28, 2015**.
 - The amounts with respect to which the IRA Beneficiary has made a Prepayment will increase the IRA Beneficiary’s basis in his/her IRA Account and, accordingly, will not be subject to income tax (including the alternate basic tax) upon distribution. Any amount withdrawn from the IRA Account to make a Prepayment will reduce the IRA Beneficiary’s basis in his/her IRA.
 - Any amount distribution from the IRA Account to make a Prepayment will be attributed to the amounts with respect to which the IRA Beneficiary has made a Prepayment and, therefore, is not to be prorated amongst the other components of the IRA Account.
 - The penalty for early withdrawal of funds from an IRA Account is increased from 10% to 30% when the funds withdrawn relate to amounts with respect to which a Prepayment is made.
 - In the case of a rollover of an IRA Account with respect to which a Prepayment has been made, the trustee must provide to the IRA Beneficiary a detail of the amount in such account that is covered by any Prepayments. Should a rollover trustee fail to withhold the applicable early withdrawal penalty of 30% due to the former trustee’s failure to provide the IRA Beneficiary the detail regarding Prepayments, the former trustee shall be responsible for the applicable penalty.
 - An IRA Beneficiary may make a rollover of an IRA Account with respect to which a Prepayment has been made to a non-deductible IRA. The penalty for early withdrawal of funds from a non-deductible IRA Account will continue to be 30% when the funds withdrawn relate to amounts with respect to which a Prepayment is made.
- The taxes prepaid pursuant to AD 14-18 will not be refunded.



If you have any questions or comments, or would like additional information about this matter, please call any of our tax attorneys:

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