

(Substitute to
H. B. 2864)

(No. 250)

(Approved November 29, 2006)

AN ACT

To add Section 1012D to Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” in order to provide a special five (5)-percent rate applicable to distributions from deferred compensation plans and government plans effectuated during the period beginning on November 15, and ending on December 31, 2006, and to provide a special five (5)-percent rate applicable to the undistributed balance accrued over which the participant or beneficiary of said plans chooses to pay said tax in advance within the same period.

STATEMENT OF MOTIVES

Act No. 87 of May 13, 2006 (“Act No. 87”) amended Section 1165 of Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994” (“Code”) to grant, during the period beginning on May 16, and ending on November 15, 2006, a special rate of five (5)-percent applicable to distributions due to severance of the employee from the service on employee trusts exempted under said section. “Act No. 87” also provided, during the same period, for advance payments of said special tax on undistributed amounts accrued in such trusts.

The provisions of “Act No. 87” are limited to trusts that are a part of an employer stock bonus, pension, or profit sharing plan for the exclusive benefit of its employees or the beneficiaries thereof that comply with the provisions of Section 1165 of the Code and have obtained a favorable decision from the Department of the Treasury (Department) with respect to their exemption (generally known as qualified plans).

Notwithstanding the above, there are other trusts and deferred compensation agreements established by employers that provide retirement benefits to employees who were not granted the special five (5)-percent rate provided in “Act No. 87.” Unlike employee trusts exempted under Section 1165 of the Code, other trusts and agreements, generally known as unqualified plans, provide benefits for a certain group of key employees, or an individual person. These do not require the establishment of a trust for the deposit of funds and, as a general rule, the assets are available to the employer’s creditors in the case of insolvency (“unfunded”). The employee only has the promise of future payment by his employer, in accordance with the terms established in the deferred compensation agreement. Deferral of compensation for services is allowed under the doctrines of constructive receipt and economic benefit. Therefore, the control exerted by the employee in order to receive said compensation must be subject to substantial limitations or restrictions for the deferral to be valid.

On the other hand, the special rate benefit provided under “Act No. 87” was not extended to plans in which public employees participate either. Those include the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, the Teachers’ Retirement System, the University of Puerto Rico Retirement System, and the Electric Power Authority Employees Retirement System.

By means of the amendment provided herein, the same benefits granted by “Act No. 87” to participants and beneficiaries of employee trusts exempted under Section 1165 of the Code are hereby granted to the participants or beneficiaries of deferred compensation agreements, generally known as unqualified plans, and to the participants and beneficiaries of government plans.

BE IT ENACTED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.- Section 1012D is hereby added to Act No. 120 of October 31, 1994, as amended, to read as follows:

“Section 1012D.- Temporary Special Tax for Deferred Compensation Plans and Government Plans.

(a) Distribution.— Any amount of a deferred compensation plan or a government plan distributed during the temporary period which constitutes a total distribution within the same taxable year of the participant or beneficiary due to severance of the participant from the service shall be subject to a special tax rate of five (5)-percent, in lieu of any other tax imposed by this Subtitle.

(1) Application.— The special five (5)-percent tax shall apply to the amount distributed in excess of the total amount paid by the participant on which the latter has already paid taxes.

(2) Obligation to deduct and withhold.— All persons, acting in any capacity, who effectuate total distributions payable with respect to any participant or beneficiary within the same taxable year of the participant or beneficiary due to severance from the service during the temporary period, shall deduct and withhold from said distribution an amount equal to five (5)-percent of the amount thereof in excess of the total amounts paid by the participant on which the latter has already paid taxes.

(3) Obligation to pay or deposit deducted and withheld taxes.— All persons who are bound to deduct and withhold the tax under the provisions in clause (2) shall pay or deposit the tax amount deducted and withheld at the Collection Offices. The tax amount shall be deposited no later than the fifteenth (15th) day of the

following month as of the date on which the distribution was effectuated.

- (4) Responsibility for the Tax.— All persons bound to deduct and withhold the tax under the provisions of clause (2) shall be responsible before the Secretary for the payment of said tax and shall not be responsible before any other person for the amount of any payment thereof.
- (5) Tax Return.— All persons bound to deduct and withhold the tax under the provisions of clause (2) shall file a tax return with respect thereof on or before February 28 of the following year.
- (6) Failure to Withhold.— Should the withholding agent, in violation of the provisions in clause (2), fail to deduct and withhold the tax under said clause, the amount that should have been deducted and withheld (unless the recipient of the distribution pays the tax to the Secretary) shall be collected from the withholding agent following the same procedure that would be used in the case of a tax owed by the withholding agent.
- (7) Penalty.— Should any person fail to pay or deposit the taxes deducted and withheld under clause (2) within the term established in clause (3), a penalty of two (2)-percent of the amount of the insufficiency shall be imposed to said person if the omission is for thirty (30) days or less and an additional (2)-percent for every thirty (30) day period or fraction thereof while the omission subsists, up to a maximum of twenty-four (24)-percent. For purposes of this clause, the term “insufficiency” shall mean the excess of the tax amount that should have been

paid or deposited over the amount thereof, if any, which was paid or deposited on or before the date established therefor.

- (8) **Estimated Tax.**— The participant or beneficiary that receives one or more distributions in accordance with subsection (a) upon which the withholding provided in clause (2) of this subsection has been effectuated shall not consider the amounts distributed or withheld for the purpose of the calculating the estimated tax provided in Section 1059.
- (b) **Advance Payment.**— Any undistributed balance accrued under a deferred compensation plan or government plan over which, during the temporary period, the participant or beneficiary pays the tax in advance shall be subject to a special tax rate of five (5)-percent in lieu of any other tax imposed by this Subtitle.
 - (1) **Total or partial advance payment.**— The participant or beneficiary may pay in advance the special tax on the total or part of the undistributed balance accrued that is in excess of the total amount paid by the participant on which the latter has already paid taxes.
 - (2) **Choice to pay the special tax on undistributed amounts accrued in advance.**— The choice to pay in advance shall be made within the temporary period by filling out the form provided by the Secretary for such a purpose. The tax shall be paid at the Collection Offices.
 - (3) **Distributions for advance payment.**— All participants or beneficiaries subject to the provisions in the document of the plan may request from the administrator of the trust of the plan or the employer the distribution of the amount equal to five (5)-percent that corresponds to the special tax on the portion of the

undistributed balance accrued on which the same shall pay the tax in advance. The amount thus distributed shall reduce the interest of the participant or beneficiary in the established trust or account. The administrator or employer shall report the amount distributed to cover the advance payment in the form provided by the Secretary for such a purpose. The participant or beneficiary shall include the distributed amount in his/her income tax return for the 2006 taxable year as an exempted distribution.

- (4) Amendments to allow the special tax distribution.— All employers subject to the rules and limitations that may apply to deferred compensation plans or government plans, including, but not limited to, the provisions of the United States Internal Revenue Code of 1986, as amended, and the Employee Retirement Income Security Act (ERISA), as amended, may amend the document of the plan to allow a distribution for the sole purpose of satisfying the portion equal to the special tax corresponding to the part of the undistributed balance accrued for which the participant or beneficiary shall pay said tax in advance. Said amendment must include a language indicating that the agent-payor shall issue the instrument of payment (certified check, cashier's check, or money order) payable to the Secretary of the Treasury. If the participant or beneficiary utilizes the amount so distributed for other purposes, including the payment of another tax owed to the Secretary, the amount distributed for the payment of the special five (5)-percent tax rate shall be paid in accordance with the tax rates in effect at the time of the distribution.

- (5) Distribution of amounts for which the special tax was paid in advance.— The accrued amounts for which the special five (5)-percent tax was paid in advance may only be distributed in accordance with the terms specified in the deferred compensation plan or the government plan.
- (6) Effect of the advance payment.— The accrued amounts for which the special tax is paid in advance shall be considered as amounts contributed by the participant for which the same already paid the tax. If the participant or beneficiary receives an annuity, said amounts shall be considered as amounts contributed by the employee for purposes of subclause (B) of clause (2) of subsection (b) of Section 1022.
- (7) Amendments to deferred compensation plans.— Any amendment to the provisions on deferred compensation plan distributions during the temporary period or within the two (2) years following the culmination thereof must be submitted to the Secretary for evaluation. If the main purpose of the amendment is to accelerate the distribution of amounts that were paid in advance, the distribution of such amounts shall pay a tax in accordance with the tax rates in effect at the time of the distribution.
- (8) Tax applicable to amounts for which no advance payment was made.— At the time of their distribution, the amounts accrued after the advance payment, as well as any amount accrued prior to such payment and for which the advance tax payment was not made, shall pay a tax according to the a tax in accordance with the tax rates in effect at the time of the distribution.

- (9) Upon distribution, the participant or beneficiary shall not take into consideration the amounts for which he/she has paid the special tax rate of five (5)-percent in advance, nor the special tax paid upon the calculation of the estimated tax provided in Section 1059.
- (c) Definitions.— For purposes of this Section, the following terms shall have the following meaning:
- (1) Undistributed balance accrued.— Maximum amount for which the participant or beneficiary may pay the special tax rate of five (5)-percent in advance.
 - (2) Collection Offices.— Internal Revenue Collection Offices of the Department of the Treasury of Puerto Rico.
 - (3) Temporary period.— Period between November 15 and December 31, 2006.
 - (4) Deferred compensation plan.— Compensation plan established by an employer through which the participant defers part of his/her compensation, pursuant to the doctrines of constructive receipt and economic benefit, that is not under the provisions of subsection (e) of Section 1165 of the Code. The Plan shall be evinced by a written document. The establishment of a trust for the deferred funds to be deposited shall not be required.
 - (5) Government Plans.— This term includes the Employees Retirement System of the Government of the Commonwealth of Puerto Rico, the Teachers' Retirement System, the University of Puerto Rico Retirement System, and the Electric Power Authority Employees Retirement System.

(6) Severance from the service.— Permanent retirement, death, dismissal, or resignation of the participant.”

Section 2.- Regulations

The Secretary of the Treasury is hereby authorized to prepare all regulations and forms necessary to implement this Act. The regulations that are approved to implement this Act are hereby exempted from the provisions and requirements established in Act No. 170 of August 12, 1988, as amended, known as the “Uniform Administrative Procedures Act of the Commonwealth of Puerto Rico.”

Section 3.- Severability Clause

If any section or provision of this Act were declared null or unconstitutional by any competent court with jurisdiction, said ruling shall not affect or invalidate the remaining provisions of this Act, but rather its effect shall be limited to the clause, section, part, or provision declared null or unconstitutional.

Section 4.- Effectiveness

This Act shall take effect immediately after its approval.

CERTIFICATION

I hereby certify to the Secretary of State that the following Act No. 250 (Substitute to H.B. 2864) of the 4th Session of the 15th Legislature of Puerto Rico:

AN ACT to add Section 1012D to Act No. 120 of October 31, 1994, as amended, known as the “Puerto Rico Internal Revenue Code of 1994,” in order to provide a special five (5)-percent rate applicable to distributions from deferred compensation plans and government plans effectuated during the period beginning on November 15, and ending on December 31, 2006, and to provide a special five (5)-percent rate applicable to the undistributed balance accrued over which the participant or beneficiary of said plans chooses to pay said tax in advance within the same period,

has been translated from Spanish to English and that the English version is correct.

In San Juan, Puerto Rico, today 14th of December of 2007.

Francisco J. Domenech
Director