Making the most of the company stock in your Puerto Rico 1081.01(d) plan account

Are there tax planning opportunities when Employer Stock is distributed as part of a qualifying lump-sum distribution?
If you receive a qualifying lump-sum distribution from a Puerto Rico–only qualified Cash or Deferred Arrangement (CODA) or 1081.01(d) plan and the distribution includes stock of your employer ("Employer Stock"), you are subject to a special tax treatment in connection with the increase in value of the Employer Stock at the time of distribution and any increase in value that may subsequently occur until you decide to sell the Employer Stock. A distribution is considered a qualifying lump-sum distribution if all of the benefits under the Puerto Rico-only qualified plan are paid to the employee within a taxable year and is on account of the employee's separation from service or plan termination.

First, you are not taxed on the distribution of Employer Stock you receive (as opposed to sale and liquidation of such stock and a distribution in cash). Each share of Employer Stock you receive includes appreciation and will also include any "after tax" amounts that you contributed to the plan for the acquisition of that stock (if any). For example, say you contributed an "after tax" amount of $10 to buy a share of Employer Stock through your employer's Puerto Rico-only qualified retirement plan. If the share is worth $25 at the time of the qualifying lump-sum distribution, the appreciation is $15 per share ($25 value minus $10 cost). If you decide not to sell the share of Employer Stock at the time of the distribution, you would not be subject to Puerto Rico income tax on this part of the distribution.

Second, you will be taxed when you sell the stock and you may take advantage of long-term capital gains tax treatment if you have possessed the stock for more than one year.

Am I allowed to rollover the Employer Stock to a Puerto Rico IRA (PR IRA)?
A rollover of a qualifying lump-sum distribution to a PR IRA must be in the form of cash and invested by the PR IRA in accordance with certain investment requirements. Generally, under these rules, Employer Stock received as part of a qualifying lump-sum distribution may not be rolled over into a PR IRA.

On the other hand, if you decide to receive an in-kind distribution of Employer Stock through a qualified lump-sum distribution, you can have the potentially significant benefit of shifting what would otherwise be ordinary income or income subject to possible 20% lump-sum taxation to a long-term capital gain at the time of sale. Furthermore, if the Employer Stock is not immediately liquidated, any additional appreciation after the stock is distributed would be taxed at capital gains rates (short-term rate if held one year or less, or long-term rate if held longer).

Who should consider taking an in-kind distribution of Employer Stock and not rolling it over into a PR IRA?
- Have highly appreciated Employer Stock[1]
- Expect to be or are in a high tax bracket
- Have a diversified portfolio

Why consider taking an in-kind distribution of Employer Stock
- *Long-Term Capital Gains Rates*—potential tax savings attributable to the long-term capital gains tax rate[2]

Due to the highly complex nature of retirement plan distributions, we should discuss your options and you should talk to your legal and/or tax advisor before making any final decision.

Example

$100,000 in Employer Stock held in Puerto Rico-only Qualified CODA account

	Standard CODA distribution		Employer stock
Take distribution	**Standard CODA distribution** Cash out $100,000		**Employer stock** Distribute in-kind and sell shares
Minus taxes*	**$100,000 x 0.20 = $20,000**	**20% Lump-Sum tax rate 15% Long-Term Capital Gains tax rate**	**$100,000 x 0.15 = $15,000**
Final balance	**$80,000**		**$85,000**

Total tax savings = $5,000

*Assumes a 20% lump-sum tax rate and 15% long-term capital gains tax rate. Tax rates reflect income tax rates in effect as of January 2024 which rates may change. There may be additional tax considerations, such as the AMT.

[1] Lump sum distributions are generally subject to a 20% taxation. However, lump sum distributions of substantially large amounts may be subject to Puerto Rico Alternative Minimum Tax (AMT). AMT is imposed gradually and may reach up to 24% if net income subject to AMT surpasses $250,000 as of the date of this notice (January 2024). As such, the amount of the distributions should be considered to avoid AMT.

[2] Taking into account potentially beneficial long-term capital gain tax rates and an exposure to AMT, the timing and amount of the distribution should be considered. If carefully structured, you may avoid the 20% lump-sum distribution rate and instead pay a usually lower long-term capital gain tax rate (15%) while, at the same time, avoiding the 24% AMT by not reaching the net income threshold subject to AMT.

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