

Act 65-2025 Amends Tax Rules that Impact Certain Distributions from Retirement Plans Qualified under the PR Code

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PRACTICE AREAS

- Employee Benefits

An McV Employee Benefits Alert

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On July 17, 2025, Governor Jenniffer González Colón signed into law Act 65-2025 amending, among others, Section 1021.02 of the Puerto Rico Internal Revenue Code of 2011, as amended (the “PR Code”), to exempt from the Alternative Basic Tax (“ABT”) lump sum distributions from Puerto Rico qualified retirement plans that are subject to the preferential tax rate of 10% under Section 1081.01(b) of the PR Code.

Under PR Code Section 1081.01(b), if total benefits under a benefit trust with respect to a participant are paid or made available to the participant or his/her beneficiary within a single taxable year of the latter due to the participant's separation from service for any reason, or plan termination (“total distribution” or “lump sum distribution”), the amount of such distribution, in the amount which exceeds the sum contributed by the participant, which has been taxed to him, shall be considered ordinary income subject to the ordinary income tax rates of the PR Code, except:

- In case of total distributions with respect to which the applicable obligations of withholding at source and of deposit of the PR Code have been met, the applicable tax rate shall be twenty percent (20%), instead of the ordinary income tax rates of the PR Code, or
- Total distributions made by an employees' trust forming part of a pension, profit sharing, stock bonus or stock option plan that qualify for a preferential tax rate of ten percent (10%), if: (i) the trust is organized under the laws of Puerto Rico or has a Puerto Rico resident trustee and uses such trustee as paying agent; and (ii) at least ten percent (10%) of all trust assets attributable to Puerto Rico resident participants, are invested in “property located in Puerto Rico” as defined under the PR Code.

Although the original intention was to cap taxation of lump sum distributions at either the 20% or 10% tax rate as the case may be, the PR Code included both lump distributions within the computation of the ABT, with the result that taxpayers within certain tax brackets had to compute their tax liability under the regular tax and the ABT and the higher tax, the net effect being that taxpayers in

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fact could be subject to a higher effective tax rate. Pursuant to Act 65-2025, for tax years commencing after December 31, 2024, lump sum distributions from retirement plans that qualify for the preferential tax rate of 10% are exempt from the ABT. Consequently, these types of lump sum distribution in fact will be subject to a 10% effective tax rate since they are no longer subject to ABT but lump sum distributions subject to a 20% tax rate will continue to be subject to the ABT which can result in a higher effective tax rate.

The provisions enacted by Act 65-2025 are in effect immediately. Act 65-2025 can be accessed in its entirety [here](#).

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