



# MANUAL TRANSMITTAL

Department of the Treasury  
Internal Revenue Service

4.71.21

FEBRUARY 16, 2024

## EFFECTIVE DATE

(02-16-2024)

## PURPOSE

- (1) This transmits revised IRM 4.71.21, Employee Plans Examination of Returns, Examination Procedures for Plans in U.S. Territories.

## MATERIAL CHANGES

- (1) Modified IRM 4.71.21.1.3 (3) to update the Taxpayer Bill of Rights (TBOR) content based on guidance from the Division Counsel/Associate Chief Counsel (National Taxpayer Advocate Program) and Branch 3 of the Associate Chief Counsel. (Procedure and Administration).
- (2) Added IRM 4.71.21.1.5, Related Resources, to provided resources related to U.S. Territory Plans.
- (3) Added IRM 4.71.21.2, Taxpayer Digital Communications Secure Messaging (TDC SM), to offer Taxpayer Digital Communications Secure messaging as a communications option per IGM TEGE-04-0622-0018.
- (4) Updated IRM 4.71.21.3 (5) for definition of a Domestic Corporation and a Foreign Corporation.
- (5) Added IRM 4.71.21.5, Procedure When Initially Contacting Taxpayer for Examination or Compliance Check, to include the procedures for Discussion and Documentation of Publication 1, Notice 609, Publication 5146 and the Examination Process in accordance with IGM TEGE-04-0222-0008.
- (6) Updated IRM 4.71.21.6(2)(b) to provide instructions for the forwarding of ERISA section 1022(i)(2) elections received by EP Examinations to the Director, EP Rulings and Agreements or their designee for storage.
- (7) Updated IRM 4.71.21.7.1(1) to state that the income tax provisions of the IRC, the Treasury Regulations promulgated thereunder, and Revenue Rulings and Revenue Procedures issued by the IRS are generally applicable in the Virgin Islands with some limitations.
- (8) Updated IRM 4.71.21.7.1(13) to eliminate the references to Rev. Rul 92-103 and obsolete Rev. Rul. 73-315.
- (9) Updated IRM 4.71.21.8 to reflect updated case closing procedures and to eliminate the requirement for completing the Checksheet for Employee Plans Compliance Activities (CECA) in accordance with IGM TEGE-04-0622-0016.
- (10) Updated IRM 4.71.21.8(8) to reflect the location of IRM Exhibits for EP Examinations as outlined in IGM TEGE-04-0123-0004, Location of IRM Exhibits for EP Examinations Employees.
- (11) Updated IRM 4.71.21.8(10) to reflect the appropriate reference to Document 6476 for EP Information Systems Codes.
- (12) Made editorial changes, including changes for Plain Language (the Plain Writing Act of 2010), throughout the document.

## EFFECT ON OTHER DOCUMENTS

This supersedes IRM 4.71.21 dated July 15, 2019 and incorporates the applicable provisions of TEGE 04-0123-0004, TE/GE 04-0222-0008, TEGE 04-0622-0016 and TEGE 04-062-0018.

**AUDIENCE**

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4.71.21

Examination Procedures for Plans in U.S. Territories

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4.71.21.1  
(07-15-2019)  
**Program, Scope, and Objectives**

- (1) **Purpose:** IRM 4.71.21, Employee Plans Examination of Returns, Examination Procedures for Plans in U.S. Territories, gives the basic examination procedures to help Employee Plans (EP) examiners and their managers to apply uniform techniques and procedures when examining plans in U.S. Territories.
  - (2) **Audience:** This IRM provides procedures for examiners, managers, and support staff in EP Examinations.
  - (3) **Program Owner:** Director, EP Examinations sets the program for the EP Examinations program.
  - (4) **Program Authority:** EP Examinations' authority to conduct examinations, resolve issues and determine tax liability is derived from Title 26, Internal Revenue Code, Subtitle F – Procedure and Administration, which includes but is not limited to:
    - a. IRC section 7602 - Examination of books and witnesses, which falls under Chapter 78 - Discovery of Liability and Enforcement of Title.

**Note:** IRC 7602 provides examiners with the authority to:

      - Audit any books, papers, records or other data necessary to complete an audit
      - Take testimony under oath to secure additional information needed
      - Issue summons for information necessary to complete an audit
      - Ask about any offense connected to the administering or enforcing of the Internal Revenue laws
    - b. IRC section 6201- Assessment authority, which falls under Chapter 63 - Assessment.
- Note:** EP Examinations' authority to resolve issues is derived from its authority to make determinations of tax liability under IRC 6201.

4.71.21.1.1  
(07-15-2019)  
**Background**

- (1) EP Examinations is the function designated to determine if a retirement plan is qualified under IRC 401 and the underlying regulations, and therefore, exempt from tax under IRC 501.
- (2) The Employee Plans examination program's primary objective is regulatory, emphasizing continued qualification of employee benefit plans (Policy Statement 4-119 and IRM 1.2.1.5, Servicewide Policies and Authorities, Policy Statements for the Examining Process.) EP selects and examines returns to:
  - a. Promote the highest degree of voluntary compliance with the tax laws on plan qualification.
  - b. Determine qualified plans' extent of compliance and the causes of non-compliance with the tax laws.
  - c. Determine whether such plans meet the applicable qualification requirements in operation.
- (3) Under Policy Statement 4-117, EP examiners and managers are given broad authority to:
  - a. Consider and weigh conflicting information, data, and opinions.
  - b. Use professional judgement according to auditing standards to make findings of fact and apply the IRS's position on issues of law to determine the correct tax liability.

## 4.71 Employee Plans Examination of Returns

- c. Exercise this authority to obtain the greatest number of tax determination agreements without sacrificing the quality or integrity of those determinations and to dispose of tax differences at the lowest level. See IRM 1.2.1.5, Servicewide Policies and Authorities, Policy Statements for the Examining Process.

- (4) All examinations are conducted according to Policy Statement 1-236, Fairness and Integrity in Enforcement Selection. See IRM 1.2.1.2.36, Policy Statement 1-236.

4.71.21.1.2  
(02-16-2024)

### Overview

- (1) There are five major U.S. territories:
  - American Samoa
  - Guam
  - Commonwealth of the Northern Mariana Islands (CNMI)
  - Puerto Rico
  - U.S. Virgin Islands (USVI)
- (2) U.S. statutory laws generally apply to the U.S. territories. Generally, U.S. territory residents are full U.S. citizens. However, for tax purposes, the IRC, in certain situations, treats the U.S. territories as foreign countries.
  - a. When the IRC uses the term in a geographical sense, the “United States” (U.S.) includes only the 50 states and the District of Columbia.
  - b. Income derived from the U.S. territories is ordinarily treated as foreign source income and entities organized in the territories are generally treated as foreign persons.
- (3) This IRM is a general overview of how to conduct an audit of qualified retirement plans in Puerto Rico and the USVI.
  - a. The audit techniques and audit scope depend on the type of plan and the jurisdiction of the plan.
  - b. The examiner and manager determine the examination’s location for each case.
- (4) Unless noted otherwise, apply the general examination procedures in IRM 4.70, TE/GE Examinations, to the examination of plans in U.S. Territories.

4.71.21.1.3  
(07-15-2019)

### Program Controls

- (1) Two review groups make sure examiners conduct examinations per technical, procedural, and administrative requirements:
  - a. Mandatory Review, see IRM 4.70.14, Resolving the Examination.
  - b. Special Review, see IRM 4.70.7, Special Review (SR) and Tax Exempt Quality Measurement System (TEQMS) Procedures.
- (2) Tax Exempt Quality Measurement System (TEQMS) is the quality control system TE/GE uses to oversee the entire examination program. For more information on TEQMS, see IRM 4.70.7, Special Review (SR) and Tax Exempt Quality Measurement System (TEQMS) Procedures.
- (3) The Taxpayer Bill of Rights (TBOR) lists rights that already existed in the tax code, putting them in simple language and grouping them into 10 fundamental rights. Employees are responsible for being familiar with and acting in accord

with taxpayer rights. See IRC 7803(a)(3), Execution of Duties in Accord with Taxpayer Rights. For additional information about the TBOR, see <https://www.irs.gov/taxpayer-bill-of-rights>.

- (4) The IRS is fully committed to protecting the privacy rights of taxpayers and employees.
  - a. Privacy laws are included in the IRC, the Privacy Act of 1974, the Freedom of Information Act, and IRS policies and practices.
  - b. For more information about these laws, visit the **IRS Electronic Freedom of Information Act Reading Room**.
  - c. For questions concerning privacy, email *\*Privacy*. For question on disclosure, email *\*Disclosure*.

4.71.21.1.4  
(07-15-2019)

**Acronyms,  
Abbreviations, Forms  
and Pubs**

- (1) This manual uses the following acronyms and references the following forms.

***Acronyms and Abbreviations***

Acronym	Definition
AIMS	Audit Information Management System
BIR	United States Virgin Islands Bureau of Internal Revenue
CCR	Case Chronology Record
CNMI	Commonwealth of the Northern Mariana Islands
EP	Employee Plans
ERISA	Employee Retirement Income Security Act of 1974
FDAP	Fixed or Determinable Annual or Periodic Income
HCE	Highly Compensated Employee
IDRS	Integrated Data Retrieval System
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
LB&I	Large Business and International
MOU	Memorandum of Understanding
POA	Power of Attorney
PRC	Puerto Rico Code
R&A	Rulings and Agreements
RCCMS	Reporting Compliance Case Management System
TDC SM	Taxpayer Digital Communication Secure Messaging

## 4.71 Employee Plans Examination of Returns

Acronym	Definition
TE/GE	Tax Exempt & Government Entities
U.S.	United States
USVI	U.S. Virgin Islands

### Forms and Pubs

Form	Name
Puerto Rico Form 499R-2/W-2PR	Comprobante De Retencion-Withholding Statement
<u>Form 1040</u>	U.S. Individual Income Tax Return
<u>Form 1042-S</u>	Foreign Person's U.S. Source Income Subject to Withholding
<u>Form 1120-F</u>	U.S. Income Tax Return of a Foreign Corporation
<u>Form 5330</u>	Return of Excise Taxes Related to Employee Benefit Plans
<u>Form 5500</u>	Annual Return/Report of Employee Benefit Plan
<u>Form 8689</u>	Allocation of Individual Income Tax to the U.S. Virgin Islands
<u>Form 8898</u>	Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession
<u>Form W-2</u>	Wage and Tax Statement

4.71.21.1.5  
(02-16-2024)

#### Related Resources

- (1) The following are resources related to U.S. Territory Plans:
  - International Issues Affecting Retirement Plans
  - Rev. Proc. 2004-37
  - Rev. Rul. 2004-75
- (2) The following are resources related to Puerto Rican Retirement Plans:
  - *EP Examination Process Guide – Puerto Rico Facts*
  - CFR 1.401(a)-50
  - Rev. Rul. 2008-40
  - Rev. Rul. 2011-1
  - Notice 2012-6
  - Rev. Rul. 2014-24
- (3) The following are resources related to U.S. Virgin Island (USVI) Plans :
  - *EP Examination Process Guide – Puerto Rico Facts*
  - CFR 1.401(a)-50
  - Rev. Rul. 2008-40
  - Rev. Rul. 2011-1
  - Notice 2012-6
  - Rev. Rul. 2014-24



4.71.21.2

(02-16-2024)

**Taxpayer Digital  
Communications Secure  
Messaging (TDC SM)**

- (1) The IRS is implementing Taxpayer Digital Communications Secure Messaging (TDC SM) as a more efficient way for taxpayers and their authorized representatives, if applicable, to exchange information and documents with the IRS. Taxpayers/representatives will use the TDC SM platform by invitation only. The procedures apply to all compliance activity types (cases) that include taxpayer contact with a start date on or after June 22, 2022.
- (2) You must offer TDC SM to all taxpayers and their representatives with the initial contact letter. TE/GE has revised many initial contact letters to include language that advises taxpayers and their representatives of the availability of TDC SM to communicate securely with you. The revised letters use selectable paragraphs that you must choose. Use the TDC SM paragraph with the initial contact letter and suggest that [irs.gov/TEGEConnect](https://irs.gov/TEGEConnect) be visited to enroll and get started.
- (3) For cases with start dates before June 22, 2022, where employees have already issued the opening letter initiating contact to the taxpayer/representative, those employees will consult with their manager to determine whether offering TDC SM is appropriate for facilitating efficient and effective issue resolution and/or timely case closure. If you and your manager think TDC SM would be beneficial, invite the taxpayer and their representative to use TDC SM to bring your case to conclusion. Include the following language with the request for information (e.g., Information Document Request):

While you can always reach me via the telephone number, fax number, and mailing address shown above, the IRS now has an easier method of communicating with taxpayers: IRS Secure Messaging. With this service, you (and your authorized representative, if applicable) will be able to quickly and easily communicate with me about your case. Please visit [irs.gov/TEGEConnect](https://irs.gov/TEGEConnect) for more information about secure messaging.

- (4) If contacting the taxpayer/representative by telephone, you should discuss the availability of TDC SM. You can review the Publication 5295 with the taxpayer/representative, or send by fax or mail if necessary. You can also send the publication by secure email, an option currently available through October 31, 2023, per interim guidance NHQ-01-1121-0004.
- (5) Taxpayers/representatives participating in the TDC SM must consent to receive and send information and documents via the TDC SM platform. Secure from the taxpayer and their representatives electing to participate with the TDC SM platform a signed Form 15314, TE/GE Secure Messaging Taxpayer Agreement Authorization of Disclosure to Designated Users. When returned, submit the signed form to the BSP shared mailbox (\*TEGE TDC TP Provisioning) for taxpayer and representative account creation. Once established, the system will notify the taxpayer and their representative through email with instructions on how to access their TDC SM account. You will send a welcome message to the taxpayer and their representative.
- (6) Document your invitation to the taxpayer and their representative to use TDC SM and their response in your CCR.
- (7) Upon closure of your case, send a message to the taxpayer that you are closing your case and future communications within TDC SM will not be possible for this case and follow procedures to close the case within TDC SM.

4.71.21.3  
(02-16-2024)

**Key Definitions, Terms  
and References**

- (1) **Bona Fide Resident:** a person who satisfies both of the following requirements under IRC 937(a):
- Is present for at least 183 days during the taxable year in Guam, American Samoa, the Northern Mariana Islands, Puerto Rico, or the U.S. Virgin Islands, and,
  - Doesn't have a tax home (determined under the principles of IRC 911(d)(3) without regard to the second sentence thereof) outside the specified possession during the taxable year and doesn't have a closer connection (determined per IRC 7701(b)(3)(B)(ii)) to the U.S. or foreign country than to such specified possession.

**Note:** Use 26 CFR 1.937-1(c)(3) rules to determine whether a person is present for any day.

- (2) **Competent Authority:** a tax treaty requires the designation of a Competent Authority for each country that is a party to the treaty.
- The respective Competent Authorities administer the provisions of the treaty.
  - The Commissioner, LB&I, acts as the U.S. Competent Authority to interpret and administer the operating provisions of tax treaties.
  - In interpreting treaties, the Commissioner, LB&I, acts only with the concurrence of the Associate Chief Counsel (International). See Delegation Order 4-12 (IRM 1.2.2.5.11).
- (3) **Control Test:** one or more U.S. persons must have the authority to control all substantial trust decisions. U.S. persons include:
- A citizen or resident of the U.S.
  - A domestic partnership
  - A domestic corporation
  - Any estate (other than a foreign estate)
  - A domestic trust
- (4) **Court Test:** a U.S. court must be able to exercise primary supervision over the trust's administration. Only a court within the geographical U.S. is considered a court within the U.S.
- (5) **Domestic Corporation:** a domestic corporation is a corporation that conducts its affairs in its home country. It may carry out activities in other states or regions of the country where it incorporates.
- A company that conducts business in a different country from the one in which it was created is called a **Foreign Corporation**.

**Example:** A company founded in Florida and operating out of Florida and Puerto Rico is considered a U.S. domestic corporation.

**Example:** A company founded in Canada is considered a foreign company in the U.S. However, a subsidiary, incorporated in the U.S., of a foreign company is classified as a domestic corporation.

- (6) **Dual Qualified Plan:** a U.S. sponsor's plan with a trust in the U.S., may operate in Puerto Rico and cover Puerto Rico employees. The Dual Qualified Plan must satisfy both the requirements of IRC 401(a) and Puerto Rico Code

(PRC) section 1165(a). The sponsor of a dual qualified plan may request under the IRS' determination letter program a plan document review for compliance with applicable rules under IRC 401(a).

- (7) **Employee Retirement Income Security Act (ERISA):** a federal law that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for individuals in these plans.
- (8) **ERISA Section 1022(i)(1):** a qualified trust is located in Puerto Rico and all of the participants are Bona Fide Residents of Puerto Rico. ERISA Section 1022(i)(1) qualified trusts are treated as exempt under IRC 501(a) as if they're part of a qualified plan under IRC 401(a). The effect is to exclude the U.S. trust income that the Puerto Rico trust earned from U.S. taxation, even though the plan doesn't satisfy IRC 401(a).
- (9) **ERISA Section 1022(i)(2):** provides that Puerto Rico plan trusts are treated as exempt under IRC 501(a) if their sponsors make a prospective and irrevocable election for the plan to comply with all of the IRC 401(a) qualification provisions, except for the Trust Situs requirement. The plan sponsor can either:
  - a. Register the election with the "Director's Representative of the IRS in Puerto Rico" (per 26 CFR 1.401(a)-50).

**Note:** Since the position of Director's Representative of the IRS in Puerto Rico no longer exists, the plan sponsor/administrator may send the election to EP Examinations.

  - b. File an election as part of an application for a favorable determination letter. See #2 in the table in IRM 4.71.21.6 (2), Examination of Puerto Rico Plans.
- (10) **Fixed or Determinable Annual or Periodic Income (FDAP):** U.S. Source Income that isn't effectively connected (per IRC 864(c)) with a U.S. trade or business. Pension distributions nonresident aliens receive are generally FDAP income under IRC 871(a) and IRC 861(a)(3).

**Note:** See IRC 871(f) for exclusions of certain annuities from income.

- (11) **Foreign Person:** includes:
  - Nonresident aliens
  - Foreign corporations
  - Foreign partnerships
  - Foreign trusts
  - Foreign estates
  - Any person that is not a U.S. person

**Note:** U.S. person is defined in IRC 7701(a)(30).

- (12) **Form 499R-2/W-2PR:** a Puerto Rican form used to report Puerto Rico employment tax.
- (13) **Form 1042-S:** information report sent by the withholding agent to the payee (a Foreign Person that received income subject to withholding under IRC 1441).

- (14) **The Hacienda:** the Puerto Rico Department of Treasury which oversees Puerto Rico's administration of the tax laws and its determination letter program.
- (15) **Mirror Code System of Taxation:** The territory adopts the IRC as if it were the territory's code, except that the name of the territory is substituted for the U.S. and vice versa. The territories that use a Mirror Code System of Taxation are the USVI, Guam and CNMI.
- (16) **Plan Sponsor:** A designated party, usually a company or employer, that establishes a retirement plan, such as an IRC 401(k) plan established for the benefit of the organization's employees.
- (17) **Residual Tax Liability:** generally, Bona Fide Residents of the USVI don't have to file with the U.S. for any tax year in which they are a Bona Fide Resident during the entire tax year, if they:
- Report and pay tax on their income from all sources to the USVI.
  - Identify the source(s) of the income on the return.
- (18) **26 U.S. Code Section 933:** most residents of Puerto Rico are U.S. citizens, but aren't subject to U.S. federal income tax, except on income from non-Puerto Rico sources.

**Note:** They may exclude salary earned from non-Puerto Rico sources deferred under a 401(k)-type plan, subject to limitations, as long as the plan is qualified by the Puerto Rico tax authorities (the Hacienda).

- (19) **Tax Coordination Agreement:** Tax treaties or agreements allowing the Competent Authorities of the U.S. and the tax department of the relevant territory to:
- Exchange information
  - Provide mutual assistance to prevent the evasion of tax and avoidance of tax
  - Provide mutual assistance and training
  - Improve tax administration procedures
- (20) **Trust Situs:** The location where the trustee performs his or her duties of managing the trust.
- (21) **U.S. Citizen:** The term United States Citizen means:
- An individual born in the United States
  - An individual whose parent is a U.S. citizen
  - An individual who has been naturalized as a U.S. citizen
  - An individual born in Puerto Rico
  - An individual born in Guam, or
  - An individual born in the U.S. Virgin Islands
- (22) **U.S. Source Income:** U.S. Source Income generally includes income effectively connected with either:
- A trade or business in the U.S
  - Passive U.S. Source Income

- (23) **United States Virgin Islands Bureau of Internal Revenue (BIR):** BIR is the Virgin Islands Department of Treasury which oversees the administration of the tax laws in the U.S. Virgin Islands.
- (24) **Worldwide Source Income:** U.S. Citizens and resident aliens must report income from all sources within and outside of the U.S.
  - a. For a U.S. Citizen or resident alien, the rules for filing income, estate and gift tax returns and for paying estimated tax are generally the same whether they are living in the U.S. or abroad.
  - b. The Puerto Rican government taxes Puerto Rico residents on their worldwide income. Puerto Rico is part of the U.S. and most U.S. laws apply in Puerto Rico.
  - c. However, for Puerto Rico residents:
    - Puerto Rico source income is generally exempt from U.S. individual income tax
    - Income from sources outside Puerto Rico is subject to U.S. taxation

4.71.21.4  
(07-15-2019)  
**Introduction to  
Retirement Plans  
Maintained in U.S.  
Territories**

- (1) **Treatment of U.S. Territories under Title I of ERISA.** For purposes of ERISA Title I, the term United States includes the U.S. territories.

**Note:** This means the plans maintained in the territories are subject to DOL jurisdiction.

- (2) **Territory Tax System and Relationship to the U.S. Tax Code.** The U.S. territories of American Samoa, Guam, the CNMI, Puerto Rico, and the USVI are generally treated as foreign for U.S. tax purposes, unless otherwise specified in the Code or related statutes.
  - a. Each U.S. territory has a semi-autonomous territorial income tax system it administers.
  - b. Each of the territories' tax systems imposes income tax upon individuals (including U.S. citizens and residents) who are Bona Fide Residents of the territory or who have income from sources within the territory.
  - c. Various Code sections generally allow Bona Fide Residents to exclude territory source income from federal gross income. These Bona Fide Residents generally file income tax returns with their U.S. territory taxing authority and, depending on the specific territory or source of income, may be exempted from having to file a federal income tax return with the IRS.
  - d. The territories of Guam, CNMI and the USVI have a Mirror Code Section of Taxation to the U.S. By contrast, the U.S. territories of Puerto Rico and American Samoa have income tax laws that are similar to U.S. income tax laws, but that aren't necessarily mirrored or directly linked to the Code.
- (3) **Tax Coordination Agreements and Mutual Agreement Procedures.** The IRS has entered Tax Coordination Agreements with each of the five major U.S. territories allowing the IRS and the five territorial tax departments to do the activities in IRM 4.71.21.4 (3).

## 4.71 Employee Plans Examination of Returns

- a. Tax Coordination Agreements allow the U.S. Competent Authorities and the relevant territory to resolve, by mutual agreement, inconsistent tax treatment between the two jurisdictions.
- b. Mutual Agreement Procedures exist to settle issues where there is inconsistent tax treatment between the IRS and the U.S. territories' taxing authorities. These issues usually involve allocations of income, deductions, credits, or allowances between related persons, determinations of residency, and determinations of the source of income and related expenses.

4.71.21.5  
(02-16-2024)

### Procedure When Initially Contacting Taxpayer for an Examination or Compliance Check

- (1) Include and mail the following documents to the taxpayer with your initial contact letter:

- a. Publication 1, Your Rights as a Taxpayer.
- b. Notice 609, Privacy Act Notice.
- c. Publication 5146, Employment Tax Returns: Examinations and Appeal Rights (for employment tax examinations only).
- d. The initial Form 4564, Information Document Request.

**Note:** Do not send a copy of the publications or notice to any representatives.

- (2) Take the following actions during an examination initial telephonic contact or interview:

- a. Verify the taxpayer's receipt of Publication 1 and Notice 609. If conducting an employment tax examination, verify the taxpayer's receipt of Publication 5146.
- b. Briefly describe the rights discussed in Publication 1 and Notice 609 and respond to any questions.
- c. Briefly describe the examination process and inform the taxpayer and/or representative of the resolution options available for unagreed cases (e.g., managerial conference, Fast Track Settlement, formal appeal, right to petition the United States Tax Court, etc.).
- d. Document the confirmation of receipt of Publication 1, Notice 609, and Publication 5146 if applicable, and the discussion held with the taxpayer and/or representative on your case chronology record.
- e. Discuss the items that will be examined, the types of documents to be received, how the taxpayer is to provide the documents; confirm any appointment scheduling.

**Note:** You may also document the confirmation and discussion in any initial interview workpapers.

4.71.21.6  
(02-16-2024)

### Examination of Puerto Rico Plans

- (1) Retirement plans adopted by employers in Puerto Rico are generally similar to qualified plans adopted by employers in the U.S. (e.g., defined benefit, stock bonus, and profit-sharing plans).
- (2) There are three types of retirement plans covering residents of Puerto Rico that provide tax-favored benefits under U.S. law:

Plan Type	Plan Characteristics
a) Puerto Rico plans qualified in Puerto Rico only (ERISA section 1022(i)(1))	<p>a. If a Puerto Rico pension plan with a <b>trust sited</b> in Puerto Rico (or the U.S.) is exempt under PRC section 1081.01, and all the participants are <b>residents</b> of Puerto Rico, the trust is treated as exempt under <u>IRC 501(a)</u> as though it were part of a qualified plan under <u>IRC 401(a)</u>. The effect of ERISA section 1022(i)(1) is to exclude a Puerto Rico trust's income earned in the U.S., from U.S. taxation even though the plan is not qualified under <u>IRC 401(a)</u>.</p> <p>b. Participants in, and employers maintaining, an ERISA section 1022(i)(1) plan aren't generally eligible for favorable tax treatment under <u>IRC 402</u> (re: the taxability of a beneficiary of an employees' trust) or <u>IRC 404</u> (re: deductions for contributions of an employer to an employees' trust).</p> <p>c. Although these plans aren't subject to <u>IRC 401(a)</u>, they are subject to ERISA Title I. Compliance with Title I of ERISA is a qualification requirement under PRC section 1081.01(a)(9).</p> <p>d. Although these plans aren't subject to the funding standards in <u>IRC 412</u>, <u>IRC 430</u>, and <u>IRC 431</u>, funding standards are imposed on these plans under similar provisions in ERISA Title 1.</p> <p>e. These plans would normally not be subject to IRS examination. However, sometimes a plan may have intended to be an ERISA section 1022(i)(1) plan, but due to a plan sponsor or administrator's action, the plan would have to qualify under IRC 401.</p>



Plan Type	Plan Characteristics
<p>b) Puerto Rico Plans electing to comply with all of the IRC 401(a) qualification provisions, except for the Trust Situs requirement (ERISA section 1022(i)(2))</p> <p>A plan administrator can make the election by:</p> <ol style="list-style-type: none"> <li>Filing the election with EP Examinations, or</li> <li>Filing the election as part of an application for a favorable determination letter with EP Determinations.</li> </ol> <p><b>Note:</b> If the election is filed with EP Examinations, the group manager should send Letter 5890 to the plan administrator acknowledging receipt and forward a copy of the election and a copy of the issued Letter 5890 to the Manager, EP Rulings and Agreements, Quality Assurance.</p> <p><b>Note:</b> See the instructions for Form 5300 to apply for a favorable determination letter.</p>	<p>Under ERISA section 1022(i)(2), a Puerto Rico plan sponsor may make a prospective and irrevocable election for the plan to comply with all of the IRC qualification provisions, except for the Trust Situs requirement. The election:</p> <ol style="list-style-type: none"> <li>Enables the plan to cover both U.S. and Puerto Rican employees.</li> <li>Once made, is irrevocable and can't be changed. Therefore, the plan must continue to qualify until it's terminated, and all assets have been distributed.</li> <li>Requires the plan to meet all IRC 401(a) requirements (other than the requirement that the trust be sited in the United States) at all times.</li> <li>The sponsoring employer can claim a deduction under the rules of IRC 404(a)(4). <b>Note:</b> If a trust would otherwise be exempt under IRC 501(a) except for the fact that it is created or organized outside the U.S., contributions to that trust by an employer that is a resident, corporation, or other entity of the U.S., are deductible per IRC 404(a) if otherwise deductible.</li> <li>Makes the plan subject to audit by the IRS just like any other plan in the U.S. following the same procedures, including focused examinations.</li> </ol>



Plan Type	Plan Characteristics
3.) Dual Qualified Plans (Puerto Rico Plans Required to Satisfy both Puerto Rican and U.S. Law)	<p>a. U.S. based employer with the trust situs in the U.S. covering Puerto Rican employees.</p> <p>b. Must satisfy both the requirements of <u>IRC 401(a)</u> and PRC section 1081.01(a).</p> <p>c. Sponsor may have its plan document reviewed for compliance with IRC 401(a) under the IRS's determination letter program. The standard of review is the same as for any other plan submitted with the intent to be determined to be qualified under <u>IRC 401(a)</u>.</p> <p><b>Note:</b> An EP Determination specialist may make a referral to EP Examinations for operational defects found during the determination letter process.</p> <p>d. Because the trust of Dual Qualified Plan is sited in the U.S., it's exempt from taxation under IRC 501(a) as long as the related plan satisfies the qualification requirements of IRC 401(a), similar to any other qualified plan/trust. However, if the plan is required to satisfy any PRC requirements that contradict the requirements of IRC 401(a), its qualified status under the Code might be jeopardized.</p> <p><b>Note:</b> This is most likely to happen with an <u>IRC 401(k)</u> plan, due to different definitions of a highly compensated employee (HCE under IRC 414(g)), different methods for determining excluded employees under coverage testing, different dollar amounts that can be deferred, and different correction methods for failing the actual deferral percentage (ADP under <u>IRC 401(k)(3)(A)</u>) test.</p> <p>e. Employers sponsoring these plans may claim deductions for plan contributions to the extent allowed under <u>IRC 404</u>.</p> <p>f. Subject to examination by EP Examinations.</p>

(3) A Puerto Rico trust is considered a foreign trust under IRC 7701(a)(31)(B) and the corresponding regulations.

- a. However, a Puerto Rico trust that meets the requirements of either ERISA section 1022(i)(1) or (2) is treated as exempt under IRC 501(a) as though it were a U.S. trust. The trust isn't subject to the tax withholding requirements under IRC 1441 unless distributions are made to participants.

**Note:** IRC 1441 and IRC 1442 impose withholding requirements on income that nonresident aliens and foreign corporations receive from sources within the

## 4.71 Employee Plans Examination of Returns

U.S. A withholding agent must withhold 30 percent of any payment of an amount subject to withholding made to a payee that is a Foreign Person (26 CFR 1.1441-1(b)).

- b. Because of ERISA section 1022(i), the trust of a Puerto Rico plan may be exempt from taxation on its U.S. investments regardless of whether the plan is treated as qualified under U.S. law.
- (4) If a Puerto Rico trust doesn't meet the requirements of either ERISA section 1022(i)(1) or (i)(2), it's taxable in the U.S. on certain U.S. source income and subject to withholding under IRC 1441.
- (5) A Puerto Rico retirement plan must qualify under IRC 401(a) for the trust to be tax-exempt if any of the following apply:
  - a. It has a trust in the U.S. since it would be considered a dual qualified plan.
  - b. It has employees who live in the U.S. since they are not residents of Puerto Rico.
  - c. It made an ERISA section 1022(i)(2) irrevocable and prospective election for the plan to comply with all of the IRC qualification provisions (except that the trust is located in Puerto Rico).
- (6) Unlike U.S. plans, all plans intending to qualify under PRC section 1081.01(a) must apply for a determination letter under the program administered by the Hacienda.
- (7) Excise taxes that apply to plans qualified under IRC 401(a) (for example, excise tax under IRC 4971, IRC 4975, etc.) also apply to Dual Qualified Plans and ERISA section 1022(i)(2) plans.

**Note:** These taxes do not apply to ERISA section 1022(i)(1) plans.

- (8) IRC 402(d) allows participants in ERISA section 1022(i)(2) plans (but not section 1022(i)(1) plans) to enjoy the favorable tax treatment permitted under IRC 402 for qualified plan participants.

**Note:** A trust that would be exempt under IRC 501(a) except for the fact that it is created or organized outside the U.S. is treated as if it were exempt under section 501(a) (IRC 402(d)).

- (9) An individual who is a Bona Fide Resident of Puerto Rico for the entire taxable year, generally, may exclude Puerto Rico source income from gross income (IRC 933(1)).
  - a. Individuals can exclude any distributions from a retirement plan from income for U.S. tax purposes if the income is derived from Puerto Rican sources.
  - b. Individuals receiving plan distributions from both U.S. and Puerto Rican sources must determine the source of the income to calculate how to tax the distribution.
  - c. The exclusion is available regardless of whether:

- The plan is qualified under IRC 401(a) or the PR Code
- The sponsor has made an ERISA section 1022(i)(2) election

4.71.21.6.1  
(07-15-2019)  
**Puerto Rico Plans -  
Planning the  
Examination**

- (1) Your examination's scope and depth, for a Puerto Rico plan, depends on the type of plan you are examining. Discuss with your group manager the scope of the examination and whether the examination should be conducted at the employer's location.
- (2) Use Letter 6031 as your initial appointment letter.
- (3) Perform a pre-audit analysis as you would for any other Form 5500 exam. See IRM 4.70.12, Planning the Examination.
- (4) Review the Form 5500 to determine whether the plan is required to be qualified under IRC 401(a).

**Note:** If the plan isn't subject to IRC 401(a) requirements, (in other words, the plan is an ERISA section 1022(i)(1) plan), don't examine it. Survey the case per IRM 4.70.12.3.11, Decision to Survey a Return.

- a. If Form 5500, line 8b lists code 3C, the plan sponsor is stating that their plan is an ERISA section 1022(i)(1) plan (the plan isn't intended to be qualified under IRC 401, IRC 403, or IRC 408).

**Note:** Often plan sponsors/administrators erroneously leave this line item blank.

- b. If Form 5500, line 8b lists code 3J, the plan sponsor is stating that their plan is a U.S.-based plan that covers Puerto Rico residents and is qualified under both IRC 401(a) and PRC section 1165.

**Note:** Plan sponsors should use Code 3J when they made an ERISA section 1022(i)(2) election, or their plan is a dual qualified plan. Often plan sponsors/administrators read the instructions on feature codes quickly or incompletely (example, they stopped reading as soon as they see "a plan that covers residents of Puerto Rico," and mistakenly use this code for plans intended to be ERISA section 1022(i)(1) plans only).

- (5) Research Integrated Data Retrieval System (IDRS) and/or Tax Exempt Determination System.

**Note:** IDRS command code EMFOLL gives the plan's effective date, the favorable determination letter issue date (if there is one), and the number of participants in the plan.

- (6) Request the following documents in your initial appointment letter:
  - The plan document
  - The trust document
  - All amendments that relate to the year under examination and any subsequent amendment to date
  - Forms W-2
  - Forms 499R-2/W-2PR
  - Payroll register
  - Personnel records

## 4.71 Employee Plans Examination of Returns

- Employee census data (including dates of hire, dates of birth, dates of rehire, dates of entry and dates of termination)
- Copy of Letter 5890 (if applicable) as prepared by the EP Examinations group manager (or designee) and mailed to the plan administrator to acknowledge receipt of the election to be treated as an IRC 401(a) plan. See the second Note in IRM 4.71.21.4 (2)
- The most recent IRS determination letter that applies to the year(s) under examination and any special demonstrations submitted with your determination letter application
- The most recent Hacienda favorable determination letter

**Note:** Determination letters from the IRS are optional. However, the plan sponsor must request a determination letter from the Hacienda, as they are mandatory for all Puerto Rico plans covering at least one Puerto Rico employee.

- (7) Ask the following questions in your initial interview to determine the type of plan:

- Is the plan trust located in the U.S.
- Does the plan cover employees who live in the U.S.
- Have you made an election to qualify the plan under U.S. law
- Does the plan have a determination letter issued by the IRS
- Does the plan have a determination letter issued by Hacienda

### 4.71.21.7 (07-15-2019) Examination of U.S. Virgin Island (USVI) Plans

- (1) EP began auditing U.S. Virgin Island (USVI) plans in fiscal year 2010, as part of a Memorandum of Understanding entered between the IRS, TEGE and the USVI Bureau of Internal Revenue (BIR).
- (2) Employers in the USVI generally adopt retirement plans similar to those adopted by U.S. employers (such as defined benefit, stock bonus, and profit-sharing plans). IRC 401(k) plans are the most common.
- (3) The IRS has concurrent jurisdiction with the BIR over USVI plans because of:
  - a. The potential for a USVI trust to earn FDAP income on U.S. investments.
  - b. Individuals potentially owing residual taxes to the U.S. if a USVI plan is no longer qualified under the USVI Code,

**Note:** See also the Memorandum of Understanding (MOU) between the IRS and the BIR in 2010 on USVI plans.

**Note:** Furthermore, because USVI plans are covered under ERISA Title I, they also fall within the audit jurisdiction of the U.S. Department of Labor.

- (4) USVI plan sponsors may submit requests for determination letters to IRS EP Rulings and Agreements (R&A) using the same procedures that apply to U.S. plan sponsors.
  - a. EP R&A issues determination letters on whether a plan is qualified under the U.S. IRC.
  - b. EP R&A doesn't rule on qualification under the USVI Mirror Code System of Taxation; however, the USVI BIR may recognize the determination letter for qualification under the USVI Mirror Code System of Taxation.

- (5) All USVI plans (whether or not they have a favorable determination letter) come under the IRS's jurisdiction, as well as that of the BIR.
- (6) BIR examiners conduct most of the audits of USVI plans.
  - a. The BIR refers issues they find on audits to IRS EP and vice versa.
- (7) Generally, any income tax adjustments and closing agreement sanctions are payable to the BIR, as opposed to the IRS.

**Note:** When IRS collects income taxes and/or closing agreement sanctions collected by IRS, whether conducted unilaterally or jointly with a BIR examiner, we turn them over to the BIR.

- (8) If you discover a funding deficiency, the plan sponsor must correct it. However, neither the IRS nor the BIR is entitled to collect excise taxes under IRC 4971. See IRM 4.71.21.7.1, Income and Excise Tax Related to USVI Plans, for an explanation.
- (9) Follow the procedures in 4.70.12, Planning the Examination, with one additional requirement. Your group manager contacts the BIR as a courtesy to allow them the opportunity to assign a trained examiner to conduct the audit jointly after the required waiting period.
- (10) Request the same records you'd request for the same type of plan maintained by a domestic plan sponsor.
- (11) Use the same interview questions as those for the same plan type maintained by a domestic plan sponsor.
- (12) Auditing techniques and audit scope depend on the type of audit. Approach both the same as you would for a plan maintained by a domestic plan sponsor.

4.71.21.7.1  
(02-16-2024)  
**Income and Excise Tax  
Related to USVI Plans**

- (1) Income from the USVI is subject to taxation under a Mirror Income Tax System of Taxation (Mirror Code). Under the Mirror Code, the USVI adopts the U.S. IRC as if it were the territory's code, except that the name of the territory is substituted for the U. S., and vice versa, wherever necessary to give the IRC the proper effect in the Virgin Islands and vice versa. Consequently, the income tax provisions of the IRC, the Treasury Regulations promulgated thereunder, and Revenue Rulings and Revenue Procedures issued by the IRS are generally applicable in the Virgin Islands with some limitations.

**Exception:** Other parts of the IRC, including the estate and gift tax rules and excise taxes, aren't mirrored.

- (2) In general, U.S. citizens and residents pay tax to the U.S. on their worldwide income, regardless of where they reside or where the income is sourced. However, a Bona Fide Resident of the USVI files their return and pays any tax due to the USVI.
- (3) U.S. citizens and U.S. residents who are Bona Fide Residents of the USVI don't owe income tax to the U.S. and aren't subject to IRS reporting requirements (except for any residual tax described below). So, it's important to determine whether an individual is a Bona Fide Resident to calculate tax liability.

## 4.71 Employee Plans Examination of Returns

- (4) A Bona Fide Resident of the USVI, under IRC 937(a), is generally a person who meets all of these criteria:
- Is present in the USVI for at least 183 days during the taxable year.
  - Doesn't have a tax home (determined under the principles of IRC 911(d)(3) without regard to the second sentence thereof) outside the USVI during the taxable year.
  - Doesn't have a closer connection (determined under the principles of IRC 7701(b)(3)(B)(ii)) to the United States or a foreign country than to the USVI.

**Note:** Taxpayers who change their residency status to or from the USVI have reporting requirement with the IRS (IRC 937(c)). They use Form 8898 for this purpose.

- (5) A taxpayer is required to file identical income tax returns with both the U.S. and the USVI per IRC 932(b) if he/she is either a U.S. citizen or resident and not a Bona Fide Resident of the USVI and has:
- USVI source income.
  - Income effectively connected with the conduct of a trade or business in the USVI.
- (6) Taxpayers required to file in IRM 4.71.21.7.1 (5) above must:
- Submit Form 8689, along with the tax return when they file.
  - Pay any tax due to the USVI (only). However, that tax is allowed as a credit against the individual's U.S. tax liability.
- (7) The effect of IRC 932(c) is that Bona Fide Residents of the USVI report their worldwide income to the BIR and don't owe tax to the U.S. even on U.S. Source Income.
- However, filers who don't report all of their income and the income source to the BIR lose their status as Bona Fide Residents of the USVI under IRC 932(c) and must:
    - File with both the BIR and the IRS as IRC 932(a) filers
    - Submit a Form 8689 and Form 1040 to the IRS on their U.S. Source Income
  - A Bona Fide Resident of the USVI isn't subject to any U.S. filing requirement if he/she timely files an amended return with the USVI in order to correct a previously filed return with the USVI (as stated in final regulations under IRC 932(c) example).
- (8) Distributions from an employee's 401(a) trust are taxed at the time of distribution (IRC 402(a)). Participants in a plan that would be qualified but for the fact that the trust is sited in the USVI, are nonetheless eligible for the favorable tax treatment permitted under IRC 402 for qualified plan participants (IRC 402(d)).
- (9) A corporation created or organized in the USVI is considered a foreign corporation and is required to file Form 1120-F for FDAP income from sources within the U.S. and income that is effectively connected with the conduct of a trade or business in the U.S.

- a. A USVI corporation doing business in the U.S. must file a return with:
    - The IRS to report its income from U.S. sources
    - The USVI to report its worldwide income and is permitted a foreign tax credit for tax paid to the IRS
  - b. Likewise, a U.S. corporation doing business in the USVI must file a return with:
    - The BIR to pay tax on income from sources in the USVI
    - The IRS to pay tax on its worldwide income, and is permitted to take a foreign tax credit for the tax paid to the USVI
- (10) Contributions to trusts that would otherwise be exempt under IRC 501(a) except for the fact that they're created or organized outside the U.S. by an employer that is a U.S. resident, corporation, or other entity are deductible (IRC 404(a)(4)).
- (11) By virtue of having a foreign trust, a USVI plan isn't a qualified plan under IRC 401(a). Therefore,
- a. Excise taxes that apply to plans qualified under IRC 401(a) (i.e., excise tax under IRC 4971, IRC 4975, etc.) don't apply to USVI plans.
  - b. The IRS may not assess IRC 4971 or IRC 4975 excise tax (or other types of excise tax that apply to IRC 401(a) plans) for a USVI plan, because those excise taxes, by their terms, only apply to IRC 401(a) qualified plans.
  - c. Because the USVI Code doesn't mirror the IRC's excise tax provisions, the USVI can't levy those excise taxes on a USVI plan.
- (12) However, the MOU between the IRS and the BIR allows the IRS to share certain related information, such as facts about an exclusive benefit violation or a prohibited transaction with the BIR to help the BIR administer the USVI Code's mirror requirements (for example, correction of a prohibited transaction).
- (13) It appears that U.S. citizens residing in one of the 50 states or the District of Columbia who work for an employer who has a USVI qualified plan may be excluded as nonresident aliens for IRC 410(b) and IRC 401(k)(3) tests. The definition of Bona Fide Residence determined under the principles of 26 CFR 1.937-1(b) should be utilized to determine tax home for purposes of pension plan coverage exclusions.

4.71.21.8  
(02-16-2024)

**Closing Examinations of Retirement Plans Maintained in U.S. Territories**

- (1) Follow the procedures in IRM 4.70.14.2.1, Agreed Resolution , when you close an agreed case.
- (2) Before you close the examination, have a closing conference with the taxpayer or taxpayer's representative (POA) either in person or by telephone. In the closing conference, inform and discuss with the taxpayer and/or POA:
  - a. You've completed the audit.
  - b. You'll issue a closing letter.
  - c. The years and returns covered by the letter.
  - d. The issues you found during the exam.



- e. The actions taken to resolve the issues and prevent future occurrences.
- (3) Document the case chronology record (CCR) that you held the closing conference and what you discussed.
- (4) Complete any RCCMS field that appears in red when you “Validate for Close” in RCCMS.
- (5) Complete all of the appropriate RCCMS closing actions, making sure the “Update AIMS” box is checked.
- (6) For surveyed returns, follow the procedures in IRM 4.70.12.3.11, Decision to Survey a Return.
- (7) For unagreed Form 5500 examinations, follow the procedures in IRM 4.70.14.2.4.
- (8) Save all workpapers, forms and letters you generated in the RCCMS Office Documents folder using the TE/GE RCCMS Naming Convention. Examiners can now find and directly access all relevant Employee Plans Examination Exhibits (including the RCCMS Naming Convention) at the IRM/IGM page on the TE/GE Connect site.

**Note:** Documents scanned into RCCMS must be the final version of the document that includes the date and signature, if applicable. For example, the scanned exam closing letter posted in RCCMS must be the one dated and signed by the Director, EP Examinations.

- (9) Scan documents received from the taxpayer or POA into the RCCMS Office Document Case File Folder using the TE/GE RCCMS Naming Convention.
- (10) Refer to Document 6476, EP Information Systems Codes for the applicable disposal codes to be utilized at case closing for all types of closures.