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Changes to Puerto Rico tax-qualified retirement plans

On page 13 of our most recent Newsletter (Business Law Developments—Number 78/February 2011), José E. Villamarzo, Esq., one of our tax partners, wrote an article about the possibility of new changes to Puerto Rico tax-qualified retirement plans. The article referred to two bills that were being considered in the Puerto Rico Legislature (House Bill Number 3070, and its equivalent, Senate Bill Number 1909). However, after the article was completed and just prior it was sent to our readers through our mailing lists, House Bill Number 3070 was approved by the Legislature, and signed by the Governor, to become what is now Act No. 1 of January 31, 2011, also known as the Puerto Rico Internal Revenue Code of 2011. Accordingly, said changes have been now enacted into law. We apologize for any inconvenience this change may have caused to our readers.



The new Puerto Rico Internal Revenue Code of 2011 (the “Code”) was approved on January 31, 2011 (“Act No. 1”), which intends to provide tax benefits to individuals and corporations, stimulate the economy and aid in the creation of jobs. Among the numerous changes introduced under the new tax code, we hereby list the most significant provisions to which special attention should be given by employers and plan sponsors regarding the establishment, qualification and administration of qualified retirement plans in Puerto Rico.

- Act No. 1 provides a new special rule for the purposes of coverage testing in the case of a corporate merger, acquisition or spin-off when an entity is no longer part of a controlled group. Although there are various aspects of this new requirement which are still unclear, plan sponsors and/or employers who are in the process of a corporate reorganization should take note of it.
- There is an “annual addition” limit similar to that under the U.S. Internal Revenue Code of 1986, as amended (the “IRC”). Effective for plan years commencing on or after January 1, 2012, there will be certain limits on the benefits that any participant can receive. These limits differ depending on whether the plan is a defined benefit plan or a defined contribution plan.

- Effective for plan years commencing on or after January 1, 2012, there will be a dollar limit on the amount of compensation that could be considered for purposes of determining the contributions or benefits under the plan and nondiscrimination testing. The Code specifies that in the case of dual qualified plans, the provisions of the IRC will apply in lieu of the Code. However, this limit and the annual additions are not indexed.
- All employees of all corporations, partnerships or any other person that is part of a controlled group of corporations, partnerships or a services affiliated group will be considered as employees of a single employer. We understand that this could create problems during nondiscrimination testing; hence, special attention by plan sponsors and employers should be granted as well.
- There is a new income tax withholding requirement of 10% imposed to in-service withdrawals and any other distribution which is not a lump sum distribution. Also, there is a new provision to determine compliance with the 10% investment requirement in order to benefit from the 10% preferential tax rate in the case of lump sum distributions. Now this 10% investment requirement needs to be determined based on the average daily balance of the trust investments instead of the close of the plan year.
- The definition of “highly compensated employee” has finally been changed to substantially match its counterpart under the IRC.
- There are new salary deferral limits which will not be reduced by contributions made to a Puerto Rico IRA. The limits will be: for January 1, 2011, \$10,000; January 1, 2012, \$13,000; and January 1, 2013, \$15,000. The catch-up limit will now be \$1,500. All of these amounts are not indexed.
- Finally, effective January 1, 2012, the Code will elevate to law the current regulatory requirement that all trust claiming exemptions will need to request a determination from the Puerto Rico Secretary of the Treasury. Therefore, you should contact your retirement plan service provider or legal counsel in order to assure compliance with this and every other requirement imposed under the Code in order not to jeopardize your plan’s current qualified status.