



Benefits Briefing on Puerto Rico Plans

***Puerto Rico Qualified Retirement Plans
Significantly Impacted by Puerto Rico
Internal Revenue Code of 2011, as
Amended***

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Speaker



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Agenda

- Introduction
- New Qualification Requirements
- Limitations on Pre-Tax Contributions
- Taxation of Plan Distributions
- Deductibility of Contributions
- Other Provisions
- Qs & As

Introduction

- §§1023(n) and 1165 of the Puerto Rico Internal Revenue Code of 1994 (“1994 PR Code”)
- §§1033.09 and 1081.01 of the Puerto Rico Internal Revenue Code of 2011 (“2011 PR Code”, also known as the Internal Revenue Code for a New Puerto Rico), Act No. 1 of January 31, 2011 (Generally, effective 1/1/2011 – Some provisions effective 1/1/2012)
- PR Treasury Regulations under §§1023(n) and 1165 of the 1994 PR Code (“1994 PR Code Regs.”)

Introduction *(cont'd.)*

- PR Treasury Administrative Determination 11-02
- House Bill No. 3410 – 2011 PR Code Technical Amendments Bill
- Proposed PR Treasury Circular Letter

New Qualification Requirements

- Trust Situs Requirement (§1081.01(a)) (Effective 1/1/2011)
 - To be exempt from Puerto Rico income taxes, a trust funding a Puerto Rico qualified retirement plan must be either:
 - a trust established under the laws of the Commonwealth of Puerto Rico, or
 - a domestic trust as defined in the US Code

New Qualification Requirements *(cont'd.)*

- Coverage Testing (§1081.01(a)(3)) (Effective 1/1/2011)
 - 2011 PR Code incorporates special rules for meeting the Average Benefit Percentage Test in the case of mergers and acquisitions
 - Special rules similar to those in US Code §410(b)(6)(C)

New Qualification Requirements *(cont'd.)*

- Coverage Testing (§1081.01(a)(3)(D)) (Effective 1/1/2011) *(cont'd.)*
 - The rule provides that if an entity becomes or ceases to be a member of a controlled group, the minimum coverage rules will be deemed met during the “transition period” (which begins on the date of the change and ends on the last day of the first plan year beginning after the date of the change) in connection with any plan covering employees of the entities that are part of the controlled group if:
 - immediately before the acquisition or disposition the minimum coverage requirements were met; and
 - the plan’s coverage does not significantly change during the transition period, or
 - the plan meets the requirements set forth by the PR Treasury

New Qualification Requirements *(cont'd.)*

- Aggregation Requirements (§1081.01(a)(14)(A)) (Effective 1/1/2012)
 - For purposes of the qualification requirements of §1081.01(a) and the cash or deferred provisions of §1081.01(d) (non-discrimination and coverage testing), the employees of all corporations, partnerships or other entities that are members of a Controlled Group (as defined in §1010.04) or of an Affiliated Service Group (as defined in §1081.01(a)(14)(B)) shall be deemed employees of the same employer
 - Applicable only with respect to employers with employees in Puerto Rico

New Qualification Requirements *(cont'd.)*

- Definition of Highly Compensated Employee (§1081.01(d)(3)(E)(iii)) (Effective 1/1/2011)
 - officer of a participating employer, as defined by the PR Treasury,
 - 5% owner, or
 - an employee who for the preceding year received more compensation from the employer than the amount determined in US Code §414(q)(1)(B), as adjusted by IRS (\$110,000 for 2011, and \$115,000 for 2012)
 - Each year, the PR Secretary of Treasury must issue a notice with respect to the applicable dollar threshold for the following year's HCEs once guidance is issued by IRS

New Qualification Requirements *(cont'd.)*

- Benefits and Contributions Limitations (§1081.01(a)(11))
(Effective 1/1/2012)
 - Defined Benefit Plans – The annual benefit accrued cannot exceed the lesser of the amount determined in US Code §415(b), as adjusted by IRS (\$200,000 for 2012) (calculated as a straight life annuity without ancillary benefits under a non contributory plan) or 100% of the participant's average compensation for the participant's three highest years of service.
 - Annual benefit accrued as of 12/31/2011 cannot be reduced for plans subject to ERISA.

New Qualification Requirements *(cont'd.)*

- Benefits and Contributions Limitations (§1081.01(a)(11))
(Effective 1/1/2012) *(cont'd.)*
 - Defined Contribution Plans – Annual additions to a participant's account in a defined contribution plan (excluding rollovers) cannot exceed the lesser of the amount determined in US Code §415(c), as adjusted by IRS (\$50,000 for 2012) or 100% of the participant's compensation for the limitation year
 - Each year, the PR Secretary of Treasury must issue a notice with respect to applicable benefits and contributions limits for following year once guidance is issued by IRS

New Qualification Requirements *(cont'd.)*

- Annual Compensation Limit (§1081.01(a)(12))
(Effective 1/1/2012)
 - Annual compensation limit equal to the amount determined in US Code §401(a)(17), as adjusted by IRS (\$250,000 for 2012) is imposed
 - Annual compensation limit for plans subject to ERISA not effective for years prior to 2012
 - Each year, the PR Secretary of Treasury must issue a notice with respect to applicable annual compensation limit for following year once guidance is issued by IRS

New Qualification Requirements *(cont'd.)*

- Limit on After-Tax Contributions (§1081.01(a)(15))
(Effective 1/1/2011)
 - 10% of the employee's aggregate compensation during the time the employee is a participant in the plan

New Qualification Requirements *(cont'd.)*

- Deadline to File Favorable Determination Letter Requests with the PR Treasury (§1081.01(a)(13)) (Effective 1/1/2012)
 - 2011 PR Code now expressly provides that for taxable years beginning on or after 1/1/2012, retirement plans intended to be qualified under the 2011 PR Code must request and obtain a favorable determination letter as to the Puerto Rico tax qualified status of plan (qualification requirement previously stated only in 1994 PR Code Regs.)
 - Request must be filed no later than the plan sponsor's deadline (including any extension) to file its Puerto Rico income tax return for the first year in which the plan began to cover Puerto Rico residents (15th day of 4th month following close of taxable year; 3 mos. automatic extension is available, if timely requested / i.e., 4/15, or 7/15 with extension, for a calendar year taxpayer)

New Qualification Requirements *(cont'd.)*

- Deadline to File Favorable Determination Letter Requests with the PR Treasury (§1081.01(a)(13)) (Effective 1/1/2012) *(cont'd.)*
 - Plans that as of 12/31/2011 have obtained, or have filed for, a determination letter from the PR Treasury under 1994 PR Code will be deemed to be in compliance with the requirement to obtain a qualification under the 2011 PR Code
 - Plans that currently have a PR Treasury qualification letter should be amended in compliance with the 2011 PR Code. However, since the qualification requirement is effective for plan years beginning on or after 1/1/2012, the deadline to be submitted for qualification will be in 2013. (e.g., 4/15/2013, or 7/15/2013 with extension, for a calendar year taxpayer)

New Qualification Requirements *(cont'd.)*

- Deadline to File Favorable Determination Letter Requests with the PR Treasury (§1081.01(a)(13)) (Effective 1/1/2012) *(cont'd.)*
 - PR Secretary of Treasury has discretion to issue guidance with respect to period of effectiveness of determination letters (e.g., qualification cycles, requirement to file only certain amendments)

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter
 - PR Treasury intends to issue it in early December 2011, and it is expected to provide as follows:
 - Plans must be amended to comply with the qualification provisions of the 2011 PR Code, including those which became effective 1/1/2011, on or before the end of the plan year beginning on or after 1/1/2012 (i.e., **on or before 12/31/2012**, for a plan with a calendar plan year)
 - Include list of qualification provisions that must be included in plan document (or appendix/supplement to the plan) in order to obtain a qualification letter under the 2011 PR Code

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - Plan must be operated in compliance with all 2011 PR Code provisions even though plan is not amended until 2012
 - A plan that is timely amended in compliance with 2011 PR Code must be filed for updated qualification letter on or before due date, including any extension, of participating employer's 2012 Puerto Rico income tax return (i.e., the 15th day of the 4th month after the close of the taxable year; the 15th day of the 7th month, if an automatic extension is timely requested; **4/15/2013, or 7/15/2013**, with extension, for a calendar year taxpayer)

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - Plan that is not amended in compliance with 2011 PR Code, or which is not timely filed for qualification letter, will be treated as non-qualified funded plan for Puerto Rico income tax purposes
 - Guidance with respect to requests for updated qualification letters after a plan has obtained a qualification letter under the 2011 PR Code
 - That is, not all amendments will be required to be filed with the PR Treasury, as currently required in the qualification letters

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - Plan must be filed for updated qualification on or before the due date, including any extension, of the participating employer's Puerto Rico income tax return for the year in which amendment is adopted (i.e., the 15th day of the 4th month after the close of the taxable year; the 15th day of the 7th month, if an automatic extension is timely requested; **4/15, or 7/15**, with extension, for a calendar year taxpayer)
 - Plan that is not timely filed for updated qualification under the guidelines in the Circular Letter will be treated as non-qualified plans for Puerto Rico income tax purposes

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - Plan that is not submitted for an updated qualification letter under the 2011 PR Code or for **retroactive qualification under the 1994 PR Code**, or a plan that is not timely submitted for updated qualification letter after obtaining a qualification letter under the 2011 PR Code, on or before the participating employer's 2012 Puerto Rico income tax return (i.e., the 15th day of the 4th month after the close of the taxable year; the 15th day of the 7th month, if an automatic extension is timely requested; 4/15/2013, or 7/15/2013, with extension, for a calendar year taxpayer), will be able to obtain qualification only through a **voluntary correction program** that will require entering into a **closing agreement** with the PR Treasury, **in addition to filing for qualification through the regular qualification process**

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - This means that a plan that has never been received, or has been filed for, a qualification letter from the PR Treasury:
 - Must be amended to comply with the qualification provisions of the 2011 PR Code, including those which became effective 1/1/2011, on or before the end of the plan year beginning on or after 1/1/2012 (i.e., on or before **12/31/2012**, for a plan with a calendar plan year)

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - This means that a plan that has never been received, or has been filed for, a qualification letter from the PR Treasury *(cont'd.)*:
 - **May obtain retroactive qualification (including qualification under the 1994 PR Code)** through the regular qualification process (and without the need to enter into a closing agreement), if the plan is filed **on or before the participating employer's 2012 Puerto Rico income tax return (i.e., the 15th day of the 4th month after the close of the taxable year; the 15th day of the 7th month, if an automatic extension is timely requested; 4/15/2013, or 7/15/2013, with extension, for a calendar year taxpayer)**

New Qualification Requirements *(cont'd.)*

- Proposed Circular Letter *(cont'd.)*
 - This means that a plan that has never been received, or has been filed for, a qualification letter from the PR Treasury *(cont'd.)*:
 - Plan must be operated in compliance with all 2011 PR Code provisions even though plan is not amended until 2012

New Qualification Requirements *(cont'd.)*

- Some US Code Provisions Not Incorporated Into 2011 PR Code
 - Average contribution percentage (ACP) test
 - Top-heavy rules
 - Required minimum distributions (RMDs)
 - Safe-harbor plans
 - Safe harbor automatic enrollment plans
 - Reimbursement of contributions by participants who opt-out from participating in auto enrollment plan
 - Hardship withdrawals to repair principal residence

Limitations on Pre-Tax Contributions

Pre-Tax Contributions (§1081.01(d)(7)(A))

	1994 Code	2011 Code	US Code
2011	\$ 10,000	\$ 10,000	\$16,500
2012	\$ 10,000	\$ 13,000	\$17,000
2013 →	\$ 12,000	\$ 15,000	?

Catch-up Contributions (§1081.01(d)(7)(C))

	1994 Code	2011 Code	US Code
2011	\$ 1,000	\$ 1,000	\$ 5,500
2012	\$ 1,000	\$ 1,500	\$ 5,500
2013 →	\$ 1,000	\$ 1,500	?

Limitations on Pre-Tax Contributions *(cont'd.)*

- Contributions to Puerto Rico deductible individual retirement accounts (“IRAs”) no longer reduce annual pre-tax contributions limitation (§1081.01(d)(7)(A)) (Effective 1/1/2011)
 - e.g., In 2011, participant may contribute up to \$10,000 to qualified retirement plan, \$5,000 to IRA, and \$5,000 to spouse’s IRA
- Applicable pre-tax and catch-up contributions limit for federal employees in Puerto Rico is the limitation established under US Code §402(g). (§1081.01(d)(7)(A)(ii))

Limitations on Pre-Tax Contributions *(cont'd.)*

- Applicable pre-tax contributions limit for Puerto Rico participants in dual qualified plans is the limitation established under US Code §402(g). (§1081.01(d)(7)(A)(ii)) (Effective 1/1/2011)
- However, contributions by Puerto Rico participants in dual qualified plans cannot exceed the sum of the 2011 PR Code annual pre-tax contribution limit and the 2011 PR Code annual limit on contributions to an IRA. (§1081.01(d)(7)(A)(iii)) (Effective 1/1/2011)
- Each year, the PR Secretary of Treasury must issue a notice with respect to applicable pre-tax and catch-up contributions limits applicable the following year for federal employees and participants in dual-qualified plans once guidance is issued by IRS.

Taxation of Plan Distributions

- Special 20% Tax Rate for Lump-Sum Distributions (§1081.01(b)(1)(A)) (Effective 1/1/2011)
 - **Special 20% tax withholding rate and maximum tax rate**, previously applicable only to lump-sum distributions on account of separation from service, are **now also applicable to lump-sum distributions due to plan termination** (even if there is no separation of service at the time the plan is terminated)

Taxation of Plan Distributions *(cont'd.)*

- Special 10% Tax Rate for Lump-Sum Distributions that Meet Puerto Rico Property Investment Requirement (§1081.01(b)(1)(B)) (Effective 1/1/2011)
 - In the case of distributions that are subject to a 10% tax withholding and tax rate because the plan (or account of the participant is invested at least 10% in Puerto Rico property, compliance with the investment requirement **to be calculated on the average balance**, and the look-back period to determine if the 3-year investment period is met will consider years in which the participant's assets were invested in a transferor plan

Taxation of Plan Distributions *(cont'd.)*

- Special 10% Tax Rate for Lump-Sum Distributions that Meet Puerto Rico Property Investment Requirement (§1081.01(b)(1)(B)) (Effective 1/1/2011)
 - Includes in definition of Puerto Rico located property:
 - Plan assets invested in fixed or variable annuities issued by domestic insurance companies or by a foreign insurance company of which at least 80% of its gross income during the three prior calendar years was from Puerto Rico sources, and
 - Deposits in interest bearing accounts in commercial banks, cooperatives, thrift associations authorized by the Puerto Rico or U.S. governments

Taxation of Plan Distributions *(cont'd.)*

- Annual Tax Exemption on Distributions From Retirement Plans (*i.e.*, tax free) (§1031.02(a)(13)) (Effective 1/1/2011)
 - \$11,000 (\$15,000 for persons age 60 or older as of 12/31)
 - 2011 PR Code provides that exemption is only applicable to distributions on account of separation from service in the form of an annuity or in installments
 - Distributions in installments means:
 - annual payments made during a fixed period of time of no less than 5 years in substantially equal amounts, or
 - Required minimum distributions under US Code §401(a)(9)
 - §1081.01(b)(3)(C) (Effective 1/1/2011)
 - Annual exemption is applicable only to distributions from qualified plans (PR Treasury interpretation is that exemption is per plan)

Taxation of Plan Distributions *(cont'd.)*

- 10% Withholding Applicable to Other Distributions (§1081.01(b)(3)(B)) (Effective 1/1/2011)
 - Taxable portion of distributions other than lump-sum distributions are subject to a 10% withholding
 - Applies to in-service distributions (e.g., hardship withdrawals, 59½), annuities and installments

Taxation of Plan Distributions *(cont'd.)*

- 10% Withholding Applicable to Other Distributions (§1081.01(b)(3)(B)) (Effective 1/1/2011) *(cont'd.)*
 - Administrative Determination 11-02 clarifies that with respect to distributions in year 2011 in the form of an annuity or in installments on account of separation from service or plan termination, the 10% withholding will only apply to distributions in excess of \$19,500 (\$23,500, if participant is age 60 or older as of 12/31/11):
 - \$11,000/\$15,000 (annual exemption) + \$5,000 (0% tax bracket) + \$3,500 (personal exemption) = \$19,500/\$23,500 (exemption from withholding in 2011)

Taxation of Plan Distributions *(cont'd.)*

- 10% Withholding Applicable to Other Distributions (§1081.01(b)(3)(B)) (Effective 1/1/2011) *(cont'd.)*
 - 10% withholding will only apply to distributions in the form of an annuity or in installments on account of separation from service or plan termination in excess of:
 - \$19,500 (\$23,500, if participant is age 60 or older as of 12/31/11) in 2011;
 - \$21,000 (\$25,000, if participant is age 60 or older as of 12/31/12) in 2012;
 - \$23,500 (\$27,500, if participant is age 60 or older as of 12/31/13) in 2013;
 - \$26,500 (\$30,500, if participant is age 60 or older as of 12/31/14) in 2014; and
 - \$31,000 (\$35,000, if participant is age 60 or older as of 12/31/2015) in 2015

Taxation of Plan Distributions *(cont'd.)*

- Rollovers (§1081.01(b)(2)(A)) (Effective 1/1/2011)
 - Partial rollovers allowed under 2011 PR Code
 - No withholding on direct rollovers (§1081.01(b)(3)(D))

Taxation of Plan Distributions *(cont'd.)*

- Plan Sponsor's Withholding Obligation (§1081.01(b)(2)(A))
(Effective 1/1/2011)
 - The employer sponsoring the plan is jointly responsible with trustee for complying with withholding and reporting obligations under 2011 PR Code

Deductibility of Contributions

- Defined Contribution Plans (§1033.09(a)(1)(C)) (Effective 1/1/2011)
 - Contributions to profit sharing and stock bonus plans can be deducted up to 25% (increased from 15%) of the paid or accrued compensation during the taxable year of all employees participating in the plan
- Defined Benefit Plans (§1033.09(a)(1)(A)(i)(IV)) (Effective 1/1/2011)
 - The employer may take a deduction of the full amount required by §§302(a)(2)(A) and (C) of the Employee Retirement Income Security Act of 1974 (ERISA) to be contributed to the plan in order to maintain the plan's funded status

Deductibility of Contributions *(cont'd.)*

- 10% Tax for Non-Deductible Contributions (§1033.09(a)(5))
(Effective 1/1/2011)
 - A 10% tax will be imposed on non-deductible contributions made by the employer to a qualified plan unless non-deductible contributions are returned to employer before due date of employer's income tax return (including extension)
 - Payable by employer regardless non-deductible contributions are not claimed as a deduction
 - Similar to US Code §4972

Other Provisions

- 10% Excise Tax on Excess Contributions (§1081.01(d)(6)(D))
(Effective 1/1/2011)
 - 10% excise tax on excess contributions if a plan does not correct excess contributions (resulting from failing 2011 PR Code ADP Test) on or before the plan sponsor's due date for filing its income tax return (including extension)
 - Similar to US Code §4979

Other Provisions *(cont'd.)*

- Plan Loans Treated as Distributions (§1081.01(b)(3)(E) (Effective 1/1/2011)
 - A plan loan will be treated as a taxable distribution if by its terms, and in operation, the loan is:
 - not substantially level amortized with payments not less frequently than quarterly, and
 - not repaid within 5 years (or as provided in the plan document for loans for the purchase of the participant's principal residence)
- Similar to US Code §72(p)

Other Provisions *(cont'd.)*

- Form 480.70 (OE) (§1061.10(a)(2)) (Effective TBD)
 - Puerto Rico Secretary of the Treasury has discretion to allow retirement plans covered under Title I of ERISA to file with the PR Treasury copy of U.S. DOL Form 5500 instead of the local annual return (Form 480.70(OE))
 - Retirement plans not covered under Title I of ERISA would have to continue filing Form 480.70(OE) with the PR Treasury

Qs & As

