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EMPLOYEE BENEFITS ALERT

2011 PR Code Qualified Retirement Plan Provisions are finally Amended

On December 10, 2011, Governor Luis Fortuño signed into law Act No. 232-2011 (formerly, House Bill No. 3410), a technical amendments bill to the Internal Revenue Code for a New Puerto Rico (the "2011 PR Code", and now also known as the Puerto Rico Internal Revenue Code of 2011). The Act introduces, among many other changes to the 2011 PR Code, several amendments related with Puerto Rico tax qualified retirement plans. See our prior Alerts the [2011 PR Code](#), and on [House Bill No. 3410](#).

Act No. 232-2011 brings, among others, the following major changes to Puerto Rico qualified retirement plans:

1. Trust Situs - Effective January 1, 2011, a trust funding a Puerto Rico tax qualified plan must be established pursuant to the laws of the Commonwealth of Puerto Rico or be a domestic trust, as defined by the U.S. Internal Revenue Code of 1986, as amended (the "US Code").
2. Coverage Testing - Effective January 1, 2011, the 2011 PR Code contains special rules for meeting the Average Benefit Percentage Test in the "transition period" after a merger or acquisition. (Similar to US Code Section 410(b)(6)(C).)
3. Aggregation Requirements - Effective for plan year beginning on or after January 1, 2012, the 2011 PR Code includes aggregation rules for all testing purposes which are applicable only with respect to participating employers with employees in Puerto Rico. (Similar to US Code Section 410(b)(6)(C).)
4. Highly Compensated Employee ("HCE") - Effective January 1, 2011, the definition of HCE under the 2011 PR Code is similar to the HCE definition under US Code Section 414(q). The 2011 PR Code also provides that the dollar threshold to be considered a HCE in Puerto Rico will follow the US Code indexed dollar threshold (e.g., \$110,000 in 2011, and \$115,000 in 2012).
5. Annual Benefit, Compensation and Contribution Limitations - Effective for plan years beginning on or after January 1, 2012, annual benefit, compensation and contribution limitations are in effect under the 2011 PR Code. These limits will follow the indexed limits under US Code Sections 415 (b) and (c) and 401(a) (17), respectively (e.g., \$200,000, \$50,000, and \$250,000, respectively, in 2012). Implementation of the new annual benefit limitation should not reduce any accrued benefit as of December 31, 2011.

6. Pre-Tax Contributions Limit:
 - Puerto Rico-Only Qualified Plan: 2012 = \$13,000; 2013 = \$15,000 (no indexing)
 - U.S Federal Employees: 2012 = \$17,000; 2013 = US Code §402(g) (indexed)
 - Dual-Qualified Plans: 2012 = \$17,000; 2013 = US Code §402(g) (indexed)

However, the sum of the contributions made by a Puerto Rico participant to a dual-qualified retirement plan and to an IRA 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 (e.g., 2012 = \$13,000 + \$5,000 = \$18,000; 2013 = \$15,000 + \$5,000 = \$20,000).
7. Catch-up Contributions Limit:
 - Puerto Rico-Only Qualified Plan: 2012 = \$1,500 (no indexing)
 - U.S. Federal - I Employees: 2012 = \$5,500 (indexing)
 - Dual-Qualified Plans: 2012 = \$1,500 (no indexing)
8. After-Tax Contributions Limit: All plans: 10% of the employee's aggregate compensation during the time the employee is a participant in the plan (This limitation was previously included in the Regulations issued under the Puerto Rico Internal Revenue Code of 1994, as amended (the "1994 PR Code").)
9. Rollovers— Effective January 1, 2011, partial rollovers are allowed on distributions on account of separation from service or plan termination.
10. Annual Tax Exemption on Certain Distributions - Effective January 1, 2011, the 2011 PR Code provides a tax exemption on the first \$11,000 (\$15,000 for participants age 60 or older as of 12/31) of distribution received from each Puerto Rico qualified plan on account of separation from service or plan termination in the form of an annuity or in installments. The 2011 PR Code defines distributions in installments, as annual payments made during a fixed period of time of no less than 5 years in substantially equal payments, or a required minimum distribution under US Code Section 401(a)(9).
11. 10% Tax Withholding on Certain Distributions - Effective January 1, 2011, the PR Code provides that distributions other than lump-sum distributions on account of separation from service or plan termination are subject to 10% tax withholding.
12. Exemption from 10% Tax Withholding - Effective January 1, 2011, the 2011 PR Code exempts from the 10% Puerto Rico income tax withholding distributions on account of separation from employment or plan termination only if the distribution is made in the form of an annuity or installments, up to certain annual amount (i.e., 2011 = \$19,500 (\$23,500, if participant is age 60 or older at year-end); 2012 = \$21,000/\$25,000; 2013 = \$23,500/\$27,500; 2014 = \$26,500/\$30,500; and, 2015 and years thereafter = \$31,000/\$35,000).
13. 20% Tax Withholding and Special Tax Rate – Effective January 1, 2011, the 2011 PR Code provides that the 20% tax withholding rate and 20% 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).
14. Withholding and Reporting Requirements - Effective January 1, 2011, the employer sponsoring the plan is jointly responsible with the trustee for complying with the withholding and reporting requirements under the 2011 PR Code.
15. 10% Tax for Non-Deductible Contributions - Effective January 1, 2011, the 2011 PR Code imposes a 10% tax on non-deductible contributions made by the employer to a qualified plan unless the non-deductible contributions are returned to the employer before the due date of employer's Puerto Rico income tax return (including extension). (Similar to US Code Section 4972.)
16. 10% Excise Tax on Excess Contributions - Effective January 1, 2011, the 2011 PR Code imposes a 10% tax on excess contributions if a plan does not correct excess contributions (resulting from failing the 2011 PR Code ADP Test) on or before the plan sponsor's due date for filing its Puerto Rico income tax return (including extension). (Similar to US Code Section 4979.)

17. Plan Loans Treated as Distributions - Effective January 1, 2011, the 2011 PR Code provides that a plan loan will be treated as a taxable distribution if by its terms, and in its operation, the loan is: (i) not substantially level amortized with payments not less frequently than quarterly, and, (ii) 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 Section 72 (p).)
18. Qualification Letter Requirement - The 2011 PR Code expressly provides that for taxable years beginning on or after January 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. The request must be filed no later than the Puerto Rico employer's deadline (including any extension) to file its Puerto Rico income tax return for the first year in which the plan begins to cover Puerto Rico residents (15th day of 4th following close of taxable year – 3 mos. automatic extensions is available, if timely requested /e.g., 4/15 or 7/15).

Plans that as of December 31, 2011, have obtained, or have filed for, a determination letter from the PR Treasury under the 1994 PR Code will be deemed to be in compliance with the requirement to obtain a qualification letter under the 2011 PR Code. Such plans 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., April 15, 2013 (July 15, 2013, with extension) for a calendar year taxpayer).

Under the 2011 PR Code, the 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). Now that Act No. 232-2011 has been enacted, it is expected that the PR Treasury will issue a Circular Letter providing guidance on the procedures and deadlines for the qualification of retirement plans, including relief for the retroactive qualification of plans that have never been filed under the 1994 PR Code. In the next days, we will be issuing an Alert regarding the proposed Circular Letter

If you have any questions or would like our assistance regarding this matter, you may contact any of the following members of our Employee Benefits Practice Team:

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