

Update on Recent Legislation Impacting PR Tax Qualified Retirement Plans

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PRACTICE AREAS

- Employee Benefits

An McV Employee Benefits Alert

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As stated in our Employee Benefits Alert of February 10, 2017, the Governor of Puerto Rico signed into law Act No. 9-2017 on February 8, 2017 (the “Act”), which modified certain Puerto Rico retirement plan qualification requirements under the Puerto Rico Internal Revenue Code of 2011, as amended (“PR Code”), in an attempt to ease the establishment and operation of retirement plans adopted by small-business owners and owner-employees. The Act as enacted, however, applies to all retirement plans, regardless of the employer.

For your ready reference, some of the main changes adopted by the Act include the following:

- New Maximum on Contributions: The maximum limit on employer and employee contributions, excluding rollovers, to a defined contribution plan is the lesser of \$75,000 or 25% of “Net Income.” The new limitation does not allow for cost-of-living adjustments, and is not clear on how the dollar limitation will be computed. In addition, the new maximum limitation does not consider the provisions of PR Code Section 1081.01(a)(12) that limit the “compensation” that can be used to determine benefits under a qualified retirement plan to the amount allowed under Section 401(a)(17) of the U.S. Internal Revenue Code of 1986, as amended (the “US Code”) (for 2017, \$270,000).
- New Definition of Highly Compensated Employee (“HCE”): The new HCE definition excludes officers of the participating employer and includes any employee that for the prior taxable year received compensation from the employer over \$150,000. This compensation limit is fixed and no longer determined by reference to the dollar limitation under Section 414(q)(1)(B) of the US Code as determined annually by the U.S. Internal Revenue Service for cost-of-living adjustments (for 2017, \$120,000).
- New Safe Harbor for Cash or Deferred Arrangement (“CODA”) Plans: Plans containing a CODA will be exempt from complying with the Average Deferral Percentage Test of PR Code Section 1081.01(d) (3), if: i) the plan has fewer than 100 participants, ii) the business generates less than \$10 million in annual gross income, and iii) the employer provides to all eligible employees a benefit of no less than 3% of their compensation. Notwithstanding this safe

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harbor rule, all retirement plans must continue to comply with the coverage and participation requirements of PR Code Section 1081.01(a)(3), and the non-discrimination provisions of PR Code Section 1081.01(a)(4) .

Although the Act was effective immediately and, technically speaking, requires Puerto Rico qualified plans to adopt amendments incorporating its provisions (inasmuch they are considered “Qualification Amendments” under current guidance issued by the Puerto Rico Treasury Department (“PR Treasury”)), following the enactment of the Act, PR Treasury officials informally instructed employee benefits law practitioners to advise their clients to wait before adopting and implementing the Act until PR Treasury examines the scope of the new qualification requirements and issues guidance regarding their implementation.

To bring certainty and to address the potential issues raised by the Act, PR Treasury recently consulted with employee benefits attorneys, industry members and other interest groups, to identify areas of the Act that may require clarification or guidance. Action to this effect, either through an official PR Treasury’s publication or new legislation, is expected to be taken in the forthcoming weeks.

Until guidance or legislation is adopted, we recommend that sponsors of Puerto Rico qualified retirement plans to take no further action. To keep our clients updated, we will issue an Employee Benefits Alert once additional official information or legislation to this effect is available.

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