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EMPLOYEE BENEFITS ALERT

Enactment of 2011 PR Code Technical Amendments Bill Could Bring Additional Changes to Retirement Plans in Puerto Rico

Pending consideration in the Puerto Rico Legislative Assembly is House Bill No.3410 ("HB 3410"), a technical corrections bill to the Internal Revenue Code for a New Puerto Rico, Act No. 1 of January 31, 2011 (the "2011 PR Code"). HB 3410, introduces, among other changes to the 2011 PR Code, some related to Puerto Rico tax qualified retirement plans. See our [EmployeeBenefits Alert on the 2011 PR Code](#).

We have been actively involved in conferences with officials of both the Puerto Rico Tax Reform Committee and the Puerto Rico Treasury Department to provide comments on, and additional amendments to, the 2011 PR Code retirement plan provisions. We expect to participate in any public hearings to be held at the Puerto Rico Legislative Assembly on HB 3410. At this time, we are cautiously optimistic that at the end of the day many of the following suggested changes will be incorporated into the 2011 PR Code:

1. Trust Situs – Require that a trust funding a Puerto Rico tax qualified plan 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. Annual Benefit, Compensation and Contribution Limitations – Under the 2011 PR Code, these limitations become effective for plan years beginning on or after January 1, 2012, at the current limits for 2011 under the US Code with no indexing. We are recommending that the limits in the 2011 PR Code be indexed consistently with the applicable limits under the US Code.
3. Annual Benefit Limitation – Implementation of new annual benefit limitation should not reduce any protected accrued benefit under the Employee Retirement Income Security Act of 1974, as amended.
4. Aggregation Rules – Clarify that new aggregation rules for all testing purposes under the 2011 PR Code are applicable only with respect to participating employers with employees in Puerto Rico.
5. Highly Compensated Employee ("HCE") – Modify the 2011 PR Code definition of HCE to resemble the US Code HCE definition, and provide that the dollar threshold to be considered a HCE under the 2011 PR Code would follow the US Code indexed threshold.
6. Rollovers– Allow partial rollovers on distributions on account of separation from service or plan termination.

7. Pre-Tax and Catch-up Contributions – Currently, the applicable US Code pre-tax contribution limitation applies under the 2011 Code only with respect to federal governmental employees in Puerto Rico. HB 3410 would further allow federal governmental employees in Puerto Rico to make catch-up contributions up to the applicable US Code limit. Suggested language would also allow Puerto Rico resident participants in plans qualified in the U.S. and Puerto Rico (i.e., dual qualified plans) to follow the US Code limits for Puerto Rico tax purposes.
8. Exemption from 10% tax withholding – Allow exemption from 10% Puerto Rico income tax withholding (up to applicable annual thresholds) to distributions in the form of an annuity or installments to apply only on distributions on account of separation from employment. The 2011 PR Code currently refers to distributions upon reaching retirement age which is defined in the 2011 PR code.
9. Qualification Letter Requirement – Provide that Puerto Rico qualification letter is required to be obtained (or file) prior to the due date (including any extension thereof) of the participating employer's Puerto Rico income tax return in which the employer claims a deduction for employer contributions made to such retirement plan. Also, would allow the Puerto Rico Secretary of the Treasury to establish alternate procedures for the retroactive Puerto Rico tax qualification of retirement plans.

We recommend that your Review of Puerto Rico qualified plans for compliance with the 2011 PR Code be held off until HB 3140 or a similar bill is enacted into law, which we expect to be in late August or early September. Although at the present time there is no specific deadline to submit updated existing plans which already have received a qualification letter from the PR Treasury under the Puerto Rico Internal Revenue Code of 1994, as amended, we recommend that they be filed for an updated qualification letter before the end of 2011.

Assuming our suggested change regarding the qualification letter deadline is incorporated into the 2011 PR Code, new plans established in 2011 would have to be submitted for qualification on or before the due date of the participating employer's Puerto Rico income tax return for taxable year 2011. Finally, existing plans with Puerto Rico resident participants prior to January 1, 2011, and which have never been submitted for qualification with the PR Treasury should do so on or before December 31, 2011, since there is no clear guidance as to the availability of retroactive qualification through the regular qualification process after said date.

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:

Juan Luis Alonso
Ariadna Alvarez

787-250-5655
787-250-2602

jla@mcvpr.com
aar@mcvpr.com

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