

LEGAL UPDATES

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## Services

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# Action Required in 2011 for Employer-Sponsored Retirement Plans Covering Puerto Rico Employees

The new 2011 Puerto Rico Internal Revenue Code makes substantial changes to the tax qualification requirements for retirement plans that cover Puerto Rico residents. Employers offering retirement plans to Puerto Rico employees should familiarize themselves with the new law and prepare to comply with its qualification standards. Employers may also want to consider spinning off the portion of their plans that cover Puerto Rico residents to a Puerto Rico-only plan for ease in administration and compliance.

On January 31, 2011, a new Puerto Rico Internal Revenue Code (PR Code) was signed into law, replacing the 1994 PR Code. The 2011 PR Code makes substantial changes to the tax qualification requirements for retirement plans covering Puerto Rico employees. The retirement plan provisions are generally effective as of January 1, 2011, although some provisions will go into effect for tax years beginning on or after January 1, 2012. The changes include the following:

New definition of highly compensated employee

Mandatory aggregation of controlled groups and affiliated service groups

New benefit, contribution and compensation limits, which are similar to those under the U.S. Internal Revenue Code (U.S. Code) generally but do not provide for cost of living adjustments

New taxation and rollover rules on distributions

New withholding requirements on distributions

New 10 percent tax on excess contributions that are not timely corrected

Certain requirements under the U.S. Code will apply to dual-qualified plans (i.e., plans that are qualified under both the U.S. and the PR Codes), including compensation and elective deferral limits and the compensation threshold to qualify as a highly compensated employee.

Aside from these substantive changes, the 2011 PR Code provides that, beginning January 1, 2012, the Puerto Rico Treasury Department (Hacienda) will not accept requests for retroactive plan approval, and any plan that is intended to be qualified under the 2011 PR Code must request and obtain a determination letter from Hacienda. As a result, both the changes that are effective in 2011 and those that are effective in 2012 must be reflected in plan amendments that are adopted by December 31, 2011. Future guidance is expected on the new determination letter process.

The complication of compliance with the 2011 PR Code changes, while continuing to juggle the challenges of maintaining qualified status under the US Code, may provide additional incentive for an employer with a dual-qualified plan to spin off the portion of the plan that covers Puerto Rico employees to a Puerto Rico-only plan. However, spinoffs face an IRS-imposed deadline of December 31, 2011 to avoid adverse tax consequences to Puerto Rico participants and potentially to the tax-qualified status of the plans under the U.S. Code. See our previous client communication on Puerto Rico Dual-Qualified Plans in the Qualified Retirement Plans Section of 2010 Year-End Action Items for Employee Plans (note however that, subsequent to that communication, the deadline for spinoffs was extended from December 31, 2010 to December 31, 2011).

### **What This Means to You**

If your company sponsors a retirement plan that covers Puerto Rico employees, it is likely that the plan must be amended in 2011 to reflect the 2011 PR Code, and a submission to the Hacienda during 2011 may be required, whether the plan is dual-qualified or qualified only in Puerto Rico. If the plan is dual-qualified, you should consider spinning off the portion of the plan covering Puerto Rico employees to a new Puerto Rico-only plan by December 31, 2011. In addition, summary plan descriptions and other participant communications should be reviewed and updated with the changes made to the plans.

### **Contact Info**

Please contact a member of the Employee Benefits and Executive Compensation practice group if you have questions or if we can assist in any way.

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