Required Puerto Rico Qualified Retirement Plan Amendments and Determination Letter Filing Deadline

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This Note provides a summary of required Puerto Rico qualified retirement plan amendments that must be adopted generally by April 15, 2014, under the Puerto Rico Internal Revenue Code of 2011 (PR Code) and an overview of the requirements for applying for a determination letter under the PR Code.

Plan sponsors of qualified plans covering employees in Puerto Rico must take action to maintain their plans' qualification status for Puerto Rico tax purposes. Specifically, these plan sponsors must:

- Amend their retirement plans on or before the due date of the employer's Puerto Rico income tax return for 2013, including any extension, to comply with provisions of the Puerto Rico Internal Revenue Code of 2011 (PR Code) (April 15, 2014, for a calendar year taxpayer, and July 15, 2014, if a calendar year taxpayer timely requests an automatic extension to file).
- Apply for a Puerto Rico determination letter by the same due date.

This Note addresses these requirements and explains:

- Who must adopt amendments and apply for a Puerto Rico determination letter.
- The amendments that Puerto Rico qualified plans must adopt.
- The requirements for a Puerto Rico determination letter application.

QUALIFICATION OF PUERTO RICO RETIREMENT PLANS

Employees who are residents of Puerto Rico or who perform labor or services primarily within Puerto Rico, regardless of residence for other purposes (Puerto Rico employees), may be either allowed to participate in a plan qualified under the Internal Revenue Code (IRC) or participate in a separate plan qualified only in Puerto Rico (PR-only plan). In either case, the plan must comply with the qualification provisions of the PR Code. A plan qualified under the IRC that is intended to also be qualified in Puerto Rico is amended to adopt a supplement or appendix including the PR Code's qualification provisions (dual-qualified plan). In addition, the PR Code requires that a plan intended to be qualified in Puerto Rico obtain a favorable determination letter from the Puerto Rico Treasury Department (PR Treasury).

REQUIRED PLAN AMENDMENTS UNDER THE PR CODE

In Circular Letter No. 11-10 (CL 11-10), as modified by Circular Letter No. 13-02 (CL 13-02), the PR Treasury describes the statutory changes that must be included in a plan document under the PR Code. Plan sponsors of either PR-only or dual-qualified plans must adopt the following amendments to comply with the PR Code by the due date, including any extension, of the employer's Puerto Rico income tax return for the 2013 taxable year (April 15, 2014, for a calendar year taxpayer and July 15, 2014, if a calendar year taxpayer timely requests an automatic extension to file).

In addition to complying with the changes to the PR Code qualification requirements, a Puerto Rico qualified retirement plan must also be amended before the end of the current plan year to:

- Comply with changes in Title I of the Employee Retirement Income Security Act of 1974 (ERISA).
- Comply with changes in the IRC to the extent the plan is a dual-qualified plan.
- Reflect any discretionary plan design changes the plan sponsor made during the year.

For an overview qualified pension plan design alternatives for employers based in the US that establish or expand operations in Puerto Rico, see *Practice Note, Pension Plan Alternatives for US Employers with Operations in Puerto Rico (http://us.practicallaw.com/7-520-2947)*.

DEFINED BENEFIT AND DEFINED CONTRIBUTION PLAN AMENDMENTS

Plan sponsors of defined benefit and defined contribution plans that intend to be qualified in Puerto Rico generally must adopt the following amendments by April 15, 2014:

- **Annual compensation limitation.** Effective for plan years beginning on or after January 1, 2012, the PR Code imposes an annual limitation on compensation that must be considered in contribution or benefit formulas equal to the amount determined in IRC Section 401(a)(17), as adjusted by the Internal Revenue Service (IRS) (for example, $255,000 for 2013).
- **Definition of employer.** Effective for plan years beginning on or after January 1, 2012, the PR Code requires that for the Puerto Rico qualification requirements and non-discrimination and coverage testing, the Puerto Rico employees of all corporations, partnerships or other entities operating in Puerto Rico that are members of a controlled group or an affiliated service group (both as defined in the PR Code) are deemed to be employees of the same employer.
- **Rollovers.** Although not specifically required by the PR Code, CL 11-10 requires plans to include provisions regarding the type of distributions that may be rolled over. Under the PR Code, rollovers are available only for lump-sum distributions on account of separation of service or the termination of the plan.

DEFINED CONTRIBUTION PLAN AMENDMENTS

For defined contribution plans that intend to be qualified in Puerto Rico, plan sponsors generally must also adopt the following amendments by April 15, 2014:

- **Highly compensated employees.** Effective for plan years beginning on or after January 1, 2011, the definition of a highly compensated employee under the PR Code (HCE-PR) changed to:
  - an officer of a participating employer (to be defined by the PR Treasury in future regulations);
  - a 5% owner; or
  - an employee who for the previous year received more compensation from the employer than the amount determined in IRC Section 414(q)(1)(B), as adjusted by the IRS ($115,000 for 2013).

  Before January 1, 2011, HCE-PR was defined as an employee with annual compensation higher than two-thirds of all other employees.
- **Pre-tax contributions.** The pre-tax contribution limit depends on whether the plan is a PR-only or dual-qualified plan. Effective for calendar years beginning on or after January 1, 2011, the PR Code limits pre-tax contributions made under:
  - a PR-only plan to $10,000, $13,000 and $15,000, for 2011, 2012 and 2013, respectively; and
  - a dual-qualified plan are the same limits applicable to US tax qualified plans under IRC Section 402(g) ($16,500 in 2011, $17,000 in 2012 and $17,500 in 2013).

  The annual limit on contributions by a Puerto Rico participant in a dual-qualified plan is reduced by the participant's contributions to a Puerto Rico individual retirement account (IRA) in that year.
- **Catch-up contributions.** Effective for calendar years beginning on or after January 1, 2011, the PR Code limits on catch-up contributions made under a Puerto Rico qualified plan (either dual-qualified or PR-only) to $1,000 and $1,500, for 2011 and 2012 and years thereafter, respectively.
- **After-tax contributions.** After-tax contributions made under a Puerto Rico qualified plan (either dual-qualified or PR-only) are limited to 10% of the employee's aggregate compensation during the time the employee is a participant in the plan.
- **Plan loans.** Effective January 1, 2012, CL 11-10 requires plans that allow participants to obtain a plan loan to provide that the loan will be treated as a taxable distribution if by its terms and in operation, the loan is not amortized with substantially level payments made at least quarterly or is not repaid within five years (or longer for principal residence loans).

DEFINED BENEFIT PLAN AMENDMENTS

Plan sponsors of defined benefit plans that intend to be qualified in Puerto Rico must also adopt the following amendment, generally, by April 15, 2014, effective for plan years beginning on or after January 1, 2012, the annual benefit accrued under a Puerto Rico qualified defined benefit plan (either dual-qualified or PR-only) cannot exceed the lesser of:

- The amount determined under IRC Section 415(b), as adjusted by the IRS ($205,000 for 2013).
- 100% of the participant's average compensation for the participant's three highest years of service.

DEFINITIONS OF SPOUSE AND MARRIAGE

Effective September 16, 2013, under the IRC, a spouse includes a person of the same sex if the participant is lawfully married to that individual under state law. However, individuals (whether of the opposite sex or same sex) who have entered into a registered domestic partnership, civil union or other similar formal relationship recognized under state law that is not denominated as a marriage under the laws of that state are not considered spouses.

On September 18, 2013, the Department of Labor (DOL) issued similar guidance on the meaning of "spouse" and "marriage" under ERISA. Both the IRS and the DOL have indicated that they will issue further guidance, including guidance on the retroactive application of these rules to employee benefit plans. (*United States v. Windsor, 133 S. Ct. 2675 (2013)*, *IRS Rev. Rul. 2013-17*, *DOL Technical Release 2013-04* (TR 2013-04) and see *Answers to Frequently Asked Questions for Individuals of the Same Sex Who Are Married under State Law*.)

Puerto Rico law requires a legal marriage to be between persons of the opposite sex. Same-sex marriages are not recognized in Puerto Rico even when performed in a domestic or foreign jurisdiction having the legal authority to sanction those marriages. However, the updated definitions of "spouse" and "marriage" (including same-sex couples) in TR 2013-04 are applicable to PR-only plans for the requirements under Title I of ERISA (for example, the spousal consent requirements and beneficiary designations).

Although the PR Treasury has not issued any additional guidance,

it appears that the current definitions of "spouse" and "marriage" under Puerto Rico law (no same-sex marriages and no domestic partnerships or civil unions) continue to apply to those provisions and requirements of the PR Code that are not subject to ERISA (for example, hardship withdrawals).

Plan sponsors should review both dual-qualified and PR-only plans, which may need to be amended to comply with the DOL's interpretations of the terms "spouse" and "marriage." Currently there is no specific timetable for the adoption of the required amendments for compliance with TR 2013-04.

PUERTO RICO DETERMINATION LETTER APPLICATION

A Puerto Rico determination letter application must be filed with the PR Treasury by the due date of the employer's Puerto Rico income tax return for 2013, including any extension (April 15, 2014, for a calendar year taxpayer, and July 15, 2014, if a calendar year taxpayer timely requests an automatic extension to file). Plans that were amended to comply with the PR Code and filed with the PR Treasury before CL 11-10 was issued may rely on the favorable determination letter issued by the PR Treasury to the extent in full compliance with the requirements of the PR Code and CL 11-10. Otherwise, plans may need additional amendments and filings.

CONTENTS OF APPLICATION FOR QUALIFICATION

CL 11-10 requires that an application for qualification under the PR Code for an individually designed plan include:

- A copy of the plan document or plan restatement, including any amendments.
- The employer identification number (EIN) issued by the IRS for the trust funding the plan, and the plan identification number used in the plan's Form 5500. PR-only plans also must file Form 5500 with the DOL.
- A copy of the trust agreement, deed of trust or any other contract entered into in connection with the funding of the plan, including any amendments.
- A copy of the most recent Puerto Rico Treasury and IRS determination letters issued for the plan. An IRS determination letter is only applicable to dual-qualified plans.
- The name, EIN, mailing address and telephone number of each participating employer with Puerto Rico resident participants under the plan and relationship among them (whether the participating employers are subsidiaries or affiliates).
- The name, EIN and relationship of any member of the same controlled group of entities or related persons (as defined in the PR Code) that are not participating employers under the plan, and the names of the Puerto Rico qualified plans in which their respective Puerto Rico employees participate.
- The number of participants who are residents of Puerto Rico at the beginning of the plan year in which the plan is submitted for a determination letter.
- A schedule demonstrating compliance with the minimum coverage requirement under the PR Code.
- Confirmation that the plan is not currently under audit by the IRS, the DOL or the PR Treasury. Otherwise, the application must provide a description of the details of the audit.
- Completed Form AS 2745-A, Power and Declaration of Representation.
- The applicable filing fees in CL 13-02.

For information on submitting an individually designed plan to the IRS for a determination letter, see *Retirement Plan Determination Letters Toolkit (http://us.practicallaw.com/7-501-3923)*.

RETROACTIVE QUALIFICATION AND FAILURE TO OBTAIN PUERTO RICO QUALIFICATION

CL 11-10 grants relief for the retroactive qualification of plans under the former Puerto Rico Internal Revenue Code of 1994. A plan covering Puerto Rico employees before January 1, 2011, generally must be also filed for retroactive qualification by April 15, 2014. In addition to the items listed in *Required Plan Amendments under the PR Code*, other requirements apply when requesting retroactive qualification.

Plans that do not comply with the Puerto Rico Code and the qualification requirements in CL 11-10 are deemed non-qualified funded plans for Puerto Rico tax purposes, which generally results in adverse consequences, including:

- Current taxation of employee and employer contributions.
- The disallowance of deductions for contributions in the employer's Puerto Rico income tax return.