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The New Puerto Rico Internal Revenue Code – Plan Sponsors May Need to Take Action in 2011

On January 31, 2011, the Governor of Puerto Rico signed into law a new Puerto Rico Internal Revenue Code.¹ This 2011 PR Code replaces the 1994 PR Code, and among its tax changes are a substantial overhaul of the tax qualification requirements for pension plans covering Puerto Rico employees. Many of the provisions of the new law are effective January 1, 2011, though some are effective January 1, 2012. Consequently, for plans that are intended to be tax qualified under the PR tax code and covering Puerto Rico employees (including "dual-qualified plans"), sponsors will generally need to amend their plans for the new law and submit them to the PR Treasury Department (also known as the "Hacienda") by the end of 2011.

Important Differences Remain Between US and PR Tax Qualification Requirements

The provisions governing tax-qualified plans in Puerto Rico, previously found in Section 1165 of the 1994 PR Code, are now generally found in Section 1081 of the 2011 PR Code. Though many of the changes from the 2011 PR Code for pension plans take their cues from current US Internal Revenue Code governing US Code Section 401(a) plans, including increases to the pre-tax contribution limits for Puerto Rico plans, many important differences remain.

Some of the changes include:

- Changes to minimum coverage and nondiscrimination testing
- Adoption of controlled group rules for nondiscrimination testing
- A new definition of highly compensated employee
- New benefit and contribution limits (effective January 1, 2012), similar to (but not the same as) 415
- A compensation limit similar to (but not the same as) 401(a)(17)
- New pre-tax salary reduction limits (currently \$10,000 for 2011, going up to \$13,000 in 2012 and \$15,000 in 2013) and age 50 catch-up contributions (currently \$1000 for 2011, going up to \$1500 in 2012)
- New deduction rules
- New tax withholding requirements on certain distributions to participants and beneficiaries, with joint responsibility imposed on the employer and the paying agent

¹ While we cannot advise clients with respect to Puerto Rico law, this note reflects our general understanding of the major implications of the Puerto Rico Internal Revenue Code. For Puerto Rico tax and legal advice, readers should consult with Puerto Rico counsel.

In many cases, the new PR limits are not subject to COLAs, unlike their US tax code counterparts. Also, the 2011 PR Code did not adopt versions of the US top-heavy or required minimum distribution rules.

New Requirement for Submission to PR Treasury Department for Determination Letter – Employers Need to Take Action in 2011

One important requirement of the new law is that employers of plans intended to be qualified under the 2011 PR Code will be required to file for determination letters with the PR Treasury Department beginning January 1, 2012. The deadline for doing so is the deadline (including extensions) for the plan sponsor's filing its PR income tax return for the first plan year in which the plan began to cover Puerto Rico residents. Currently, therefore, it appears that 2011 will be the last year that the PR Treasury will accept requests for retroactive approval of pension plans, though exactly how the new determination letter process will work is to be the subject of forthcoming guidance.

This revision of the PR tax code must be viewed by US plan sponsors in the context of recent IRS Rev. Rul. 2011-1, with its implications for PR plans, including "dual-qualified" plans (i.e., qualified under both the US and PR tax codes), and PR plans invested in master and group trusts (which also may have a 2011 deadline for taking action). For more information on that, see our prior Groom memorandum on Rev. Rul. 2011-1 and the actions plan sponsors should be considering for those plans.

Whether a plan is PR-qualified only or a dual-qualified plan, currently, it appears that the plan will need to be amended and submitted to the PR Treasury Department for a determination letter by the end of 2011. It would be best to do this in conjunction with any planning this year to take into account the impact of Rev. Rul. 2011-1. Employee communications, too, will need to be updated for the changes in the plans.

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