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Puerto Rico Treasury Department Provides Helpful Clarification of Deduction Limit for Contributions to Defined Benefit Plans

On September 14, 2012, the Puerto Rico Treasury Department ("PR Treasury") issued Administrative Determination No. 12-13 ("A.D. 12-13") to clarify the application of the limits on allowable deductions for contributions to defined benefit plans under the Puerto Rico Internal Revenue Code of 2011, as amended (the "2011 PR Code").

Effective for taxable years beginning on or after January 1, 2011, the 2011 PR Code now imposes a 10% excise tax on contributions in excess of the 2011 PR Code applicable limits ("Non-Deductible Contributions"). The 2011 PR Code includes an exception to the applicable percentage limitation on contributions, allowing a deduction for contributions up to the amount required to comply with the minimum funding standards of Sections 302(a)(2)(A) and (C) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Since the 2011 PR Code was enacted, plan sponsors and providers had requested clarification from the PR Treasury as to the application of this exception.

In A.D. 12-13, the PR Treasury has taken the position that the public policy of the Government of Puerto Rico is to incentivize the funding of Puerto Rico qualified retirement plans and recently clarified that under the 2011 PR Code (*i.e.*, effective for plan years beginning after December 31, 2010) a deduction would be allowed for contributions made to a Puerto Rico qualified retirement plan up to the amount required to comply with: (i) the minimum funding standards of Sections 412, 430, 431, and 432 of the U.S. Internal Revenue Code of 1986, as amended (the "US Code"), and ERISA Sections 302 to 305, (ii) the provisions related to the funding-based limits on benefits and benefit accruals of US Code Section 436, and ERISA Section 206(g), (iii) the 80% funding target attainment percentage threshold plans already must meet to avoid the "at-risk status" limitations and requirements of U.S. Code Section 430(i) and ERISA Section 303(i), respectively, (iv) avoid the requirements of ERISA Section 4010, and (v) generally, maintain the full funding of a plan.

Thus, for Puerto Rico income tax purposes, a deduction for contributions made to a Puerto Rico qualified plan to comply with these requirements would be allowed even if in excess of the applicable percentage limitation on contributions under Puerto Rico law. Consequently, such contributions would not be subject to the new 10% excise tax on non-deductible contributions. This guidance should be helpful to U.S. companies with defined benefit retirement plans (whether "dual-qualified" or "Puerto Rico-only qualified") covering employees in Puerto Rico.

A.D. 12-13 in English is available at:

<http://www.hacienda.gobierno.pr/downloads/pdf/determinaciones/12-13-English.pdf>.

A.D. 12-13 in Spanish is available at:

<http://www.hacienda.gobierno.pr/downloads/pdf/determinaciones/12-13.pdf>.