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Recent and Expected Developments Affecting Retirement Plans in Puerto Rico

We summarize below three recent and expected developments affecting sponsors of retirement plans covering Puerto Rico residents.

New Due Dates to Amend and File Puerto Rico Tax Qualified Plans

There have been unofficial indications from the Puerto Rico Treasury Department ("PR Treasury") that guidance should be forthcoming that further extends the deadline for: (i) the adoption of amendments to retirement plans in compliance with the provisions of Section 1081.01(a) of the Puerto Rico Internal Revenue Code of 2011, as amended ("2011-PR Code"), and Section 1165(a) of the former Puerto Rico Internal Revenue Code of 1994, as amended ("1994-PR Code"), if applicable; and (ii) the filing of retirement plans for both qualification under the 2011-PR Code and retroactive qualification under the 1994-PR Code.

Under PR Treasury Circular Letter No. 11-10, plans qualified only in Puerto Rico (PR-Only Plans) and plans qualified both in Puerto Rico and the U.S. (Dual-Qualified Plans) were required to be amended for compliance with the new qualification provisions of the 2011-PR Code on or before the last day of the plan year beginning on or after January 1, 2012 (e.g., December 31, 2012, for a calendar year plan). In Circular Letter No. 12-09 (CL 12-09), the PR Treasury extended the original deadline to amend plans in compliance with the 2011-PR Code to the later of: (i) June 30, 2013, or (ii) the last day of the first plan year beginning on or after January 1, 2012 (e.g., October 31, 2013 for plan with a plan year beginning on November 1, 2012). In addition, CL 12-09 also extended the period to submit a request for qualification not only under the 2011-PR Code, but also for retroactive qualification under the 1994-PR Code for both PR-Only or Dual-Qualified Plans until the later of: (i) September 30, 2013, or (ii) the deadline to file the income tax return of the employer for the first taxable year commencing after December 31, 2011.

Under the expected guidance, the period to submit a request for qualification under the 2011-PR Code and/or retroactive qualification under the 1994-PR Code, if applicable, for both PR-Only or Dual-Qualified Plans would be extended until the due date, including any extension, to file the Puerto Rico income tax return of the Puerto Rico employer for the first taxable year commencing on or after January 1, 2013. In the case of a calendar year Puerto Rico employer, the due date would be April 15, 2014 (June 15, 2014, if the employer files for an automatic extension to file its 2013 Puerto Rico income tax return).

Notwithstanding the foregoing, it is important to note that retirement plans intended to be Puerto Rico tax qualified must have been operated in compliance with the provisions of the 1994-PR Code, in plan years beginning before January 1, 2011, and must continue to be operated in compliance with the provisions of the 2011-PR Code in plan years beginning on or after January 1, 2011.

New Tax Amnesty Program Covers Certain Plan Taxes and Reports

On May 13, 2013, the "Get Current Act - Plan to Incentivize the Payment of Outstanding Tax Liabilities," Act No. 12-2013 (the "Tax Amnesty Program"), became effective. In very general terms, the Tax Amnesty Program provides for the waiver of the payment of interest, penalties, surcharges and any other additions to the tax, but not the underlying taxes due, if certain steps are taken. The Tax Amnesty Program is available to trustees and sponsors of Puerto Rico tax qualified retirement plans that may have failed to comply with the 2011-PR Code and the 1994-PR Code tax withholding and reporting requirements on distributions to participants in Puerto Rico in calendar years beginning before January 1, 2012.

In order to enjoy the full benefits of the Tax Amnesty Program, among certain other requirements, on or before June 30, 2013, the taxpayer must pay the total Puerto Rico income taxes due under the 1994-PR Code and/or 2011-PR Code. The Tax Amnesty Program also provides for payment plans over a period of up to 4 years with an initial payment of at least 10% of the taxes due. Taxes paid under a payment plan are subject to annual interest at a rate of up to 10%.

Retirement plans that have not complied in years prior to 2012 with the withholding and reporting requirements under the 1994-PR Code and the 2011-PR Code are strongly encouraged to take advantage of the Tax Amnesty Program in order to avoid, or lower, the payment of interest, penalties and surcharges on such failures. In our experience, a number of plan administrators may not have withheld Puerto Rico income taxes on distributions to participants in PR-Only and Dual-Qualified Plans or omitted reports of such distributions and withholdings to the PR Treasury and participants (e.g., PR Treasury Form 480.70C). The Amnesty Program is available to cover these potential liabilities.

Are PR-Only Plans Covered by PBGC Insurance? Stay Tuned.

The Pension Benefit Guaranty Corporation ("PBGC") recently withdrew an old opinion letter providing that defined benefit pension plans qualified only under the provisions of the Puerto Rico Internal Revenue Code are subject to the provisions of Title IV of the Employee Retirement Income Security Act of 1974 ("ERISA") – including the mandatory plan termination insurance premiums and coverage – when the pension plan, in practice, met the tax qualification requirements of Section 401(a) of the US Code (PBGC Opinion Letter No. 77-172). It is expected that the PBGC will be issuing new guidance on Puerto Rico plans, although PBGC officials have not indicated what it might say or when it may be released. At present, it is unclear whether such guidance would reduce the number of plans subject to PBGC premiums and insurance, e.g., by limiting coverage to dual-qualified plans. Sponsors of Puerto Rico-only qualified plans that have paid premiums in the past may want to consider filing protective refund claims with the PBGC.

This PBGC development appears to be unrelated to the ongoing IRS project concerning whether trusts for Puerto Rico-only qualified plans may invest in domestic group trusts. In general, under Rev. Rul. 2011-1 and IRS Notice 2012-6, such plans may continue to invest in group trusts until further IRS guidance is issued if (1) they were so invested on January 10, 2011, or (2) the PR-only plan resulted from a Rev. Rul. 2008-40 spinoff from a dual-qualified plan before the end of 2012. We understand IRS and Treasury continue to work on final guidance.