



ESTATE PLANNING FOR ACT 22 PUERTO RICO RESIDENTS, IMPLICATIONS OF PUERTO RICO FORCED HEIRSHIP RULES

By: Ricardo Muñiz

The assets of Puerto Rico (“PR”) residents will be subject to the forced heirship and inheritance rules of the PR Civil Code (“PRCC”) upon their demise. This includes those PR residents holding grants of tax exemption under the Act to Promote the Transfer of Investors to Puerto Rico, Act 22 of January 17, 2012, as amended (“Act 22”), which are hereinafter referred to as “Act 22 PR Residents”.

The right of PR residents to freely determine through a valid Will how most of their estates will be distributed is significantly limited by the PRCC’s forced heirship rules. The PRCC provides that certain family members (i.e., “forced heirs”) are entitled to a fixed portion (i.e., the legitime portion) of the estate of a decedent that was a resident of PR at the time of his/her demise. This is contrary to the laws of most states of the United States (“US”), where the usual limitation on how to distribute your assets upon death through a Will is that a portion of the estate must be left to the surviving spouse.

Even if a PR resident has a valid Will, the children (and the children of a child that predeceases), or the ascendants (in the absence of descendants), will be considered the “forced heirs”, and as such they are entitled under PR law, and must receive, two thirds or one half of the estate, respectively.

The surviving spouse is also considered a forced heir, but only with respect to the limited right of dower (“usufructo viudal” in Spanish). Such right represents a life interest over a portion of the decedent’s estate, regardless of whether the PR resident dies testate or intestate, and regardless of the provisions of any prenuptial agreement. The right of dower does not qualify for the PR estate tax marital deduction; and in order to qualify for the US estate tax marital deduction a “qualified terminable interest property election” (i.e., “QTIP election”), will be required.



Act 22 PR Residents must be sure that their Wills are considered valid in PR, otherwise their estates will be intestate (i.e., when the decedent dies without a Will, or without a valid Will). When a PR resident dies without having executed a Will, or when the Will is not considered valid under PR law, the estate assets must go to the children in equal shares, and if child has predeceased his/her share will go to such child's nearest descendants (collectively, the "descendants"). In the absence of surviving descendants, the estate assets must go to the parents in equal shares, or the nearest surviving grandparents, or great-grandparents, in the absence of both parents (collectively, the "ascendants"). All of the above is subject to the "right of dower" that corresponds to the surviving spouse of the decedent.

When a PR resident is married, one of the principal estate planning objectives is trying to maximize the portion of the estate that goes to the surviving spouse through various means, in order to benefit the survivor and reduce the estate's exposure to US and/or PR estate taxes. However, pursuant to the PRCC, even if a PR resident has a Will, only one third of the estate (plus the right of dower under certain circumstances) can be given to the surviving spouse.

An important benefit of being Act 22 PR Residents is that they can make lifetime transfers of assets to trusts, while retaining rights over such assets, and when these transfers and trusts are properly structured they can avoid the PRCC's forced heirship and inheritance rules. This is a unique PR estate planning opportunity that is not available to other PR residents. However, whenever any PR resident (including an Act 22 PR Resident) transfers assets to trusts, he/she must be careful of which assets are being transferred, and how these transfers are structured, in order to avoid transfers that are subject to PR and/or US gift taxes.

Individuals planning to move to PR, and becoming Act 22 PR Residents, should consider the above described PRCC provisions and the implications on their estate plans, particularly the most effective use of the US estate tax marital and charitable deductions, while avoiding the PR forced heirship rules. There is a larger scope of alternatives on transfers to trusts prior to moving to PR. However, even after they have moved to PR, there are still significant estate planning opportunities to be considered and implemented.



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Ricardo Muñiz
787-281-1818
muniz@amgprlaw.com

Caridad Muñiz-Padilla
787-281-1817
cmuniz@amgprlaw.com

César R. Rosario
787-281-1820
rosario@amgprlaw.com

Miguel Carbonell
787-281-1968
mcarbonell@amgprlaw.com