



New Provisions Applicable to Qualified Retirement Plans in Puerto Rico

By: José E. Villamarzo-Santiago

With the intent to halt the exodus of professionals from Puerto Rico, the Government of Puerto Rico enacted Act No. 9 of February 8, 2017 to amend the Puerto Rico Trust Act (the “Trust Act”) and certain sections of the Puerto Rico Internal Revenue Code of 2011, as amended (the “PR Code”) (“Act No. 9.”)

These changes are applicable to all retirement plans adopted in Puerto Rico that are qualified under the provisions of the PR Code, including those plans which are also qualified under the provisions of the United States Internal Revenue Code of 1986, as amended (the “IRC”) and the PR Code.

We hereby provide a brief synopsis of Act No. 9’s most relevant changes.

I. Limits on deductions by employer/sponsor for contributions made to qualified retirement plans. Deductions claimed by reason of contributions made to defined contribution plans by an employer/sponsor will be limited to 25% of the aggregate compensation paid or accumulated to all employees in the plan within a taxable year. However, those contributions that do not exceed the annual addition limit provided by the PR Code (as described below), excluding rollover amounts, will also be deductible, even if they exceed the 25% limit described above. Please note that this annual addition limit was also updated by reason of Act No. 9 as it will be explained below.

II. Limits on annual additions for employees. Act No. 9 provides that annual additions made on behalf of a participant in a defined contribution plan will not exceed the lower of 25% of net income or \$75,000. This is of utmost importance since prior to this change, the limit on annual additions applicable to qualified defined contribution retirement plans in Puerto Rico was tied up to its federal counterpart in the IRC (i.e., the lesser of 100% of the participant’s compensation or \$54,000 for 2017). Even though the local dollar limit will now be higher than the federal IRC limit, the local limit amount will not be indexed as it is with its federal counterpart.

III. A new safe harbor alternative for ADP testing. This is a significant change to be considered by employers in Puerto Rico, as Act No. 9 has introduced a new safe harbor alternative for plans in Puerto Rico. In the case of a plan that has less than 100 participants and the business generates less than 10 million dollars of gross income, if a benefit of at least 3% of his/her compensation is offered to all eligible employees, these plans will not be required to comply with the average actual deferral compensation percentage test on a yearly basis.



IV. Highly compensated employee. The definition of who will be a highly compensated employee was also amended. Now, a highly compensated employee will be an employee who owns: (i) more than 5% of the shares of stocks with voting rights or of the total value of all classes of shares of stock of the corporation that is the sponsoring employer; (ii) more than 5% of the capital or interest in the profits of the employer in the case of an entity other than a corporation; or (iii) that has earned in excess of \$150,000 of compensation during the prior taxable year. To determine this 5%, the rules of affiliated entities provided in the PR Code will be considered.

The above is also a departure of current federal/IRC rules, in that now the dollar limit amount under the PR Code will not be coupled with its federal/IRC counterpart. Also, this dollar limit will not be indexed under the PR Code. Finally, an employee who is considered an officer of the entity will no longer be automatically considered as a highly compensated employee.

V. Designation of a Beneficiary. Act No. 9 provides that if a participant is married, his/her spouse will have an exclusive right to the total amount of benefits payable under a plan in the event of the participant's death. Notwithstanding the latter, the participant could designate another beneficiary that is not his/her spouse, subject to the compliance with any applicable provisions under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), such as obtaining the spouse's written consent.

Moreover, Act No. 9 clarifies that if a plan is not covered by ERISA and the participant is a party to a prenuptial agreement providing for a total economic separation, spousal consent will not be needed to name another beneficiary.

The above is an area of law already covered by ERISA, which with its strong preemption provisions will likely prevail over Act No. 9; therefore, plans which are covered by ERISA should keep a lookout for any discrepancies that could arise.

VI. Estate and Inheritance Provisions. Act No. 9 further provides that all assets in a qualified retirement trust will be excluded or exempt from all of the Puerto Rico Civil Code (the "PR Civil Code's") forced heirship provisions. Please note that the term "qualified retirement trust" as used throughout this communication also includes trusts that are part of retirement plans established by self-employed individuals.

It is our understanding that this change makes qualified retirement plans a more attractive savings/investment vehicle, and should cause for individuals to review and/or update their current asset investment strategies and estate planning documentation.



Final Comments. The enactment of Act No. 9 is a departure of the recent years’ trend of mirroring Puerto Rico plan provisions to their federal counterparts. However, its intent could be perceived as beneficial to some Puerto Rico participants and sponsors due to the increase of amounts to be contributed and/or for allowing greater flexibility in the administration of their plans.

Plans which are already qualified under the PR Code should review the above changes and determine the impact they will have in its documents, participant communications and administration. Furthermore, in the event that amendments to the plan are needed, it is very likely they will be considered “qualification amendments,” as such term is defined by the Puerto Rico Treasury Department, which will require a governmental filing to request approval.



The above summary is intended for information purposes only. It cannot be considered a legal opinion, and it does not intend to consider all the tax and legal considerations that could be relevant to any particular person or entity

The contents of PUERTO RICO BUSINESS LAW NOTES may not be reproduced, transmitted, or distributed without the express written consent of Adsuar Muñiz Goyco Seda & Pérez-Ochoa, P.S.C. (“AMG”). The material contained herein is intended for information purposes only and is not to be considered legal advice. Qualified counsel should be consulted based on individual circumstances.

Members of our Tax Department

Ricardo Muñiz 787.281.1818 muniz@amgprlaw.com	César R. Rosario 787.281.1820 rosario@amgprlaw.com	José E. Villamarzo-Santiago 787.281.1801 jvillamarzo@amgprlaw.com	Caridad Muñiz-Padilla 787.281.1817 cmuniz@amgprlaw.com	Mariangely González-Tobaja 787.281.1804 mgonzalez@amgprlaw.com
---	--	---	--	--