



October 2012

# PENSION ANALYST COMPLIANCE BULLETIN



**Prudential**  
Bring Your Challenges™

## Deadlines loom for plans covering Puerto Rico employees

In 2011, the Governor of Puerto Rico signed into law a revised Puerto Rico Internal Revenue Code (2011 PR IRC). This new tax code brings the Puerto Rico qualified plan rules even closer to the US IRC qualified plan rules, but also **requires all U.S.-qualified plans that allow participation by Puerto Rico employees** to satisfy the requirements of the PR IRC.

The enactment of the 2011 PR IRC helps clarify long-held questions regarding the participation of Puerto Rico employees in U.S.-qualified plans. To now create a dual-qualified plan, these plan sponsors will typically need to adopt an addendum to their existing plan document, containing the appropriate PR IRC provisions. The amended plan must then be filed with the Puerto Rico Treasury Department (“Hacienda”) to request a determination letter. Unlike the U.S. qualification process, a plan must obtain a determination letter from Hacienda in order to be qualified under the PR IRC; it cannot simply contain the appropriate plan provisions.

### Hacienda filing deadlines

Requests for a determination letter reflecting the provisions of the 2011 PR IRC generally must be submitted to Hacienda by the due date of the employer’s 2012 Puerto Rico tax return, including extensions. For a calendar year taxpayer, this would be **April 15, 2013**, if no extension is granted.

However, sponsors of plans that covered Puerto Rico employees before January 1, 2011 may want to request a determination letter covering the 1994 PR IRC as well. In that case, the deadline for submitting an application to Hacienda is **December 31, 2012**, and the resulting determination letter would cover both the 1994 and 2011 requirements. Note that adoption of an amendment effective prior to the beginning of a plan year may also require filing under the IRS’s Voluntary Compliance Program (“VCP”) as a late amender.

### Inaction is not a viable option

While some plan sponsors may be tempted to simply maintain the status quo, failure to obtain Puerto Rico qualification will likely result in all benefits accrued and contributions made to date that have not already been taxed becoming immediately subject to Puerto Rico income tax. Going forward, employer contributions for Puerto Rico employees would have to be made on a “post-tax” basis, and additional earnings will be taxed as vested.

### Ongoing plan design options

Once a plan becomes dual-qualified, it may continue operating as a single, dual-qualified plan that covers Puerto Rico employees. Since a dual-qualified plan can continue to operate using just a U.S. trust, and the Puerto Rico qualification requirements are now so similar to the U.S. rules, this is a relatively attractive solution. The only drawback is that this plan design cannot be supported on a prototype plan document.

Alternatively, the Puerto Rico participants may be spun-off into a stand-alone Puerto Rico-only qualified plan. This new plan would require the use of a Puerto Rico trust, and would need to be implemented with a determination letter application submitted to Hacienda **no later than December 31, 2012**, in order to preserve certain tax advantages for Puerto Rico participants. Given the remaining differences between the US IRC and PR IRC qualification rules (see our November 2011 publication titled [“New Puerto Rico tax code impacts retirement plans”](#)), the establishment of separate plans may ease plan administration. It would also allow the sponsor to use a Prototype document for the U.S. plan.

©2012 Prudential Financial, Inc. and its related entities.

Prudential, the Prudential logo, the Rock symbol and Bring Your Challenges are service marks of Prudential Financial, Inc., and its related entities, registered in many jurisdictions worldwide.

RSMH078

However, ongoing maintenance of multiple plans and trusts may be more expensive, especially if the Puerto Rico population is small.

Finally, we understand that some plan sponsors have determined that inclusion of Puerto Rico employees in their U.S.-qualified plan was simply an unintended operational error. In these situations, plan sponsors are exploring correction under the IRS's EPCRS, through either VCP or the Self-Correction Program (SCP).

### **Determining if an employer has Puerto Rico employees affected by these rules**

An employer may have employees working in Puerto Rico that do not subject its qualified plan to the PR IRC qualification rules. The key to determining if the PR IRC rules apply is whether the employees are bona fide residents of Puerto Rico.

An employee who is a Puerto Rico citizen and lives and works fulltime in Puerto Rico is a bona fide resident of Puerto Rico. An employee who is a U.S. citizen but not a Puerto Rico citizen and is employed in Puerto Rico may or may not be considered a bona fide resident of Puerto Rico, depending on the length of time he or she actually lives in Puerto Rico and other factors.

### **Plan sponsor action required**

An employer that sponsors a U.S.-qualified defined contribution or defined benefit plan that does not specifically exclude Puerto Rico employees from participation and has even one employee working in Puerto Rico should take immediate action to determine if the plan must now comply with PR IRC qualification rules. This action includes determining whether the employees are bona fide residents of Puerto Rico and whether they have made or received contributions to the plan, or otherwise accrued benefits under the plan. Sponsors should also take note if their plans have no active Puerto Rico participants but are holding accounts or accrued benefits of vested terminated Puerto Rico employees, as this situation could require compliance with the PR IRC. In addition, frozen plans may need to be amended to comply with Puerto Rico requirements, even though there are no new benefit accruals.

Prudential is able to offer document and determination filing solutions for plan sponsors that use our Prototype and Volume Submitter documents. Sponsors of plans that use individually designed documents should contact their document providers for assistance with these items.

#### **Compliance Bulletin by Prudential Retirement**

The Pension Analyst is published by Prudential Retirement, a Prudential Financial business, to provide clients with information on current legislation and regulatory developments affecting qualified retirement plans. This publication is distributed with the understanding that Prudential Retirement is not rendering legal advice. Plan sponsors should consult their attorneys about the application of any law to their retirement plans.

©2012 Prudential Financial, Inc. and its related entities.

Prudential, the Prudential logo, the Rock symbol and Bring Your Challenges are service marks of Prudential Financial, Inc., and its related entities, registered in many jurisdictions worldwide.