

# Tax Alert: Proposed rules to allow for more flexibility in the creation of retirement plans

On January 2, 2017, House Bill No. 3 (“Bill 3”) was filed in the Puerto Rico House of Representatives. The legislative piece aims to promote the retention and return of professionals to Puerto Rico by providing more flexibility and continuing to expand the creation of retirement plans.

## Background of the proposed Bill 3

Since 2004, Puerto Rico’s fiscal and economic crisis, as well as the absence of employment opportunities, has resulted in a massive exodus of Puerto Rico residents.

As described in the Statement of Motives, the cost of living in Puerto Rico has reached unprecedented levels – sparked in part by the myriad of taxes that have been levied upon the inhabitants of the Island.

With economic indicators dwindling due to the absence of opportunities for human capital, and seeking to stem massive exit of Puerto Rican professionals by safeguarding their future as well as their families, Bill 3 proposes various amendments to the 2011 Internal Revenue Code for a New Puerto Rico (the “Code”).

## Proposed amendments to the Code

Employer Contributions to Employee’s trust or annuity plan and compensation under a deferred-payment plan

Pursuant to Section 1033.09 of the Code, contributions made by an employer to an employee’s trust or annuity plan and

compensation under a deferred payment plan are deductible expenses against gross income from the trade or business.

The amount of deduction under Section 1033.09(a)(1)(A)(ii)(I) of the Code for any taxable year is subject to limitations based on the compensation otherwise paid or accrued by the employer during such taxable year to employees who are beneficiaries of trust funds accumulated under the plan. The primary limitation on deductions for a taxable year is twenty-five (25) percent of the compensation, otherwise paid or accrued by the employer during such taxable year to the employees who are beneficiaries of trust funds accumulated under the plan.

Bill 3 effectively proposes to amend the aforementioned section to increase the allowed deduction ceiling to \$75,000 or twenty-five (25) percent of the compensation, whichever is less.

## Employee’s Trusts

Pursuant to Section 1081.01(a)(11)(B) of the Code, defined contribution plans provide that contributions and additions cannot exceed the lesser of the following amounts:

- The applicable limit for a particular taxable year as established under Section 415(c) of the United States Internal Revenue Code of 1986, as amended, or any successor law provision, as adjusted by the United States Internal Revenue Service, or



## Contact us

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- One-hundred (100) percent of the participant's compensation paid by the employer during the calendar year or the plan year, as selected by the employer.

In order to increase the allowable contributions to the pension plans, Bill 3 proposes to increase the optional deductible, by the lesser of the following two amounts:

- \$75,000; or
- Twenty-five (25) percent of the Net Income.

### **Employee's Trusts**

What is a highly compensated employee?

Bill 3 provides a tool for employees to increase their contributions to their respective trusts, by symplifying the definition of a *highly compensated employee*.

This is achieved by amending Section 1081.01(d)(3)(E)(iii) of the Code, as follows:

*any employee who for the preceding taxable year had compensation from the employer in excess of the applicable limit for the particular taxable year under Section 414(q)(1)(B) of the United States Internal Revenue Code of 1986, as amended, any other sucesor law provision, as adjusted by the United States Internal Revenue Service; or \$250,000.*

**Note:** As highlighted in our July 1, 2016 Tax Alert, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), seeks, among other things, to provide Puerto Rico with fiscal and economic discipline through the creation of a control board. Virtually every fiscal decision by the Government of Puerto Rico will be made or approved by the Oversight Board (the "Board") created by PROMESA. On this regard, the Board has authority to prevent the execution or enforcement of a contract, rule, executive order or regulation to the extent that it is inconsistent with the approved fiscal plan.

We will monitor the development of this proposal and keep you updated through our Tax Alerts.

**Please contact our Tax Department should additional information is required regarding this or any other tax issue. We will be glad to assist you.**

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