Tax Alert: Changes to Puerto Rico trusts, retirement plans and certain estate matters

On February 8, 2017, the Governor of Puerto Rico signed H.R. Bill No. 3 into law, Act No. 9 of 2017 ("Act 9"), which amends the Puerto Rico Trust Law of 2012 (the "Trust Act"), as well as the 2011 Internal Revenue Code for a New Puerto Rico (the "Code"), with the intention to provide a "better and broader protection of assets" under trusts and create a more favorable environment for employers to offer their employees retirement plans. Please refer to our January 13, 2017 Tax Alert in which we summarize the provisions of H.R. Bill No. 3.

Changes to Trust Act

Act 9 amends the Trust Act to, among other matters, enhance the protection currently available to trust assets and to incorporate the concept of Retirement Plan Trusts.

Moreover, Act 9 establishes that upon the participant's death, the beneficiary of the retirement plan benefits will be the surviving spouse, unless a designation is made to the contrary with the spouse's approval.

Changes to the Code

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. This deduction is limited 25% of the compensation paid or accrued to all employees in the plan during the taxable year.

Under the approved language of Act 9, reference to the US Internal Revenue Code's yearly limitation is excluded, and the maximum amount of employer and employee contributions to a defined benefit plan is capped to the lesser of the following amounts:

- $75,000;
- 25% of Net Income (it is not defined whose "net income" is this referred to – employer or employee),

Act 9 also modifies the definition of *highly compensated employee* to exclude officers of the participating employer and include any employee that for the prior taxable year received compensation from the employer in excess of $150,000.

Changes to Estate Matters

Act 9 establishes that assets within a Retirement Plan Trust will be exempt from the estate and inheritance provisions of the Puerto Rico Civil Code and, therefore, the distribution of its assets will be in accordance with Trust's documents.

Also, the value of property transferred to a Puerto Rico Trust by a Puerto Rico resident, where the trustee is not the decedent, will not be included in the decedent's gross estate even if decedent is the beneficiary of the Trust.

Contact us

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Lastly, stock issued by any domestic corporation or partnership will be considered "*property located in Puerto Rico*" regardless of whether or not the decedent owned 10% or more, nor that the entity met the 80% gross income test (pervious tests that were in the Code)

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As indicated in the Statement of Motives, Act 9 is another cog in the current Administration's machine to jumpstart the Puerto Rico economy and stem the tide of professionals leaving the island. The legislation's objectives are noteworthy and necessary – nonetheless, careful consideration must be afforded to its implementation in order to avoid administrative issues deriving from this substantive change.

Note: As highlighted in our Tax Alert dated July 1, 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, among other things. Virtually every fiscal decision by the Government of Puerto Rico will be made or approved by the Oversight 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.

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