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Retirement Plans in Puerto Rico — Recent Changes to Annual Informative Filings With Hacienda

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On March 11, 2016, the Puerto Rico Department of the Treasury (commonly known by its Spanish name as “Hacienda”) issued Administrative Determination No. 16-05 (AD 16-05) announcing that, effective for plan years commenced after December 31, 2014, plan sponsors no longer have to either: (1) file with Hacienda local Form 480.70(OE), *Informative Return for Income Tax Exempt Organization*,² or (2) mail to Hacienda a copy of the plan’s Form 5500.³ In lieu of having to file Form 480.70(OE) and/or mail a copy of

Form 5500, plan sponsors are now required to file with Hacienda a copy of local Form AS 6042.1, *Deduction for Contributions to Qualified Retirement Plans and Tax on Certain Contributions*.⁴

For the vast majority of companies that sponsor, maintain, or operate a qualified retirement plan in P.R. this is a welcome development, which does not present any new or additional duties or administrative challenges. The reason is that Form AS 6042.1, which is a schedule to the P.R. income tax return,⁵ has been in place since 2012.⁶ In other words, beginning with plan year 2015, AD 16-05 simply replaced the filing of Form 480.70(OE) with the filing of another local tax form that has been in effect, and which most plan sponsors and/or their subsidiaries operating in P.R. have already been filing, since 2012. To those companies (i.e., the ones required to file a P.R. income tax return) nothing new was added. They will simply keep preparing Form AS 6042.1 as usual and include it as part of their P.R. income tax return.

It is expected that, going forward, Hacienda’s Internal Revenue Area (i.e., the function within Hacienda with primary jurisdiction over retirement plan matters) will rely on Form AS 6042.1 as one of the pri-

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² The Spanish version of Form 480.70(OE) is Form 480.7(OE), *Planilla Informativa de Organización Exenta de Contribución sobre Ingresos*. Both the English and Spanish versions no longer apply to qualified retirement plans. An electronic copy of Form 480.70(OE) may be found in Hacienda’s website at: http://www.hacienda.gobierno.pr/sites/default/files/documentos/480.70oe_0.pdf.

³ Pursuant to Hacienda Circular Letter No. 12-02 (Feb. 13,

2012), in lieu of having to file a complete Form 480.70(OE), plan sponsors had the option of mailing to Hacienda a copy of the corresponding Form 5500 for the plan, together with a few pages of Form 480.70(OE). AD 16-05 expressly eliminated both the filing of Form 480.70(OE) and the mailing of a copy of Form 5500.

⁴ A copy of Form AS 6042.1 is included at the end of this article. An electronic copy of Form AS 6042.1 may also be found on Hacienda’s website at: http://www.hacienda.gobierno.pr/sites/default/files/documentos/as_6042_1_2015.pdf.

⁵ For purposes of this article, the term “P.R. income tax return” includes both the local corporate income tax return (i.e., Hacienda Form 480.2) and the local informative or “pass-through” return for partnerships and LLCs (i.e., Hacienda Form 480.2(OE)).

⁶ See, e.g., Instructions to the 2012 version of Form 480.2, at page 4.

mary tools for gathering general information about the operation, funding, and qualification of retirement plans on the Island. Fortunately, Form AS 6042.1 is a fairly simple, short, and straight-forward tax form, and preparing it only requires some basic information about the plan, its tax qualified status in P.R., the number of P.R. participants in the plan, and the employer and employee contributions made to the trust fund forming part of the plan during the relevant tax year. In the author's experience, since Form AS 6042.1 was first implemented back in 2012, companies operating in P.R. and/or their tax professionals have not run into problems or complications with its preparation or filing. The same could not be said about Form 480.70(OE), which required substantially more information and preparation time.

For those companies or organizations that have a retirement plan qualified in P.R. and are required to file a P.R. income tax return, or have a subsidiary or affiliated company that is required to file a P.R. income tax return (*P.R. Tax Filers*), the first order of business regarding the changes brought by AD 16-05 should be to contact the CPA, internal group or function that prepares the P.R. income tax return to confirm that Form AS 6042.1 is being prepared and filed together with the return. If the answer is "yes," nothing else needs to be done regarding this matter. If the answer is "no," then a larger conversation needs to be had as soon as administratively practicable, because, as noted above, Form AS 6042.1 has been a necessary part of the P.R. income tax return since 2012.

For those companies or organizations that have a retirement plan qualified in P.R., but are not required to file a P.R. income tax return, nor have a subsidiary or affiliated company that is required to file a P.R. income tax return (*P.R. Non-Filers*), the substitution of the filing of Form 480.70(OE) with the filing of Form AS 6042.1 should result in some new duties, albeit fairly simple ones. AD 16-05 provides that, beginning with the 2015 plan year, the requirement to file Form AS 6042.1 also applies to those companies or entities that sponsor or maintain a qualified retirement plan in P.R., but which are not otherwise required to file a P.R. income tax return. For example, that would include U.S. unions not directly engaged in trade or business in Puerto Rico which have P.R. companies as participating employers in their U.S. multiemployer pension plans, and the pension boards of U.S. religious organizations that have P.R. churches and other affiliated organizations as participating employers in their U.S. church plans. Ordinarily, those U.S. plan sponsors are not required to file a P.R. income tax return, thus have not previously prepared a Form AS 6042.1. In the past, U.S. unions that have qualified their U.S. pension plans in P.R. have complied with the local informative requirements on qualified retirement plans by mailing a copy of the Form 5500 to Hacienda, and U.S. religious organizations have complied by preparing and filing with Hacienda a full Form 480.70(OE). Given that those options are no longer available, they will now have to file Form AS 6042.1.

The following are some additional observations and recommendations about the preparation and filing of Form AS 6042.1.

AMOUNT OF FORMS TO BE PREPARED

A Form AS 6042.1 needs to be prepared with respect to each retirement plan that has been qualified with Hacienda and remains in operation in P.R. For example, if a company maintains a frozen pension plan and an active I.R.C. §401(k) plan, both of which cover some P.R. participants, two Forms AS 6042.1 would need to be filed; one for the pension plan and another for the I.R.C. §401(k) plan.

A Form AS 6042.1 is needed even if no deductible contributions were made to the plan during the relevant tax year. As long as a retirement plan that has been previously qualified in P.R. has not been officially terminated with Hacienda, which, technically, requires the completion of a plan termination filing with Hacienda (i.e., the local equivalent to a Form 5310 filing with the IRS), a Form AS 6042.1 needs to be prepared and filed annually with regard to the plan.

SECTIONS OF THE FORM TO BE COMPLETED

In the case of P.R. Tax Filers, the sections of Form AS 6042.1 to be completed are the basic taxpayer and plan identifying information at the top of the form, *Part I — Computation of the Deduction for Contributions to the Plan*, and *Part V — General Information Regarding the Plan*. *Part II — Tax on Nondeductible Contributions*, *Part III — Capital Gain on Property Contributions*, and *Part IV — Tax on Excess Contributions*, are intended to address some problems with the operation and funding of self-employed or Keogh plans, and, ordinarily, do not apply to corporate plans. For most corporate plans, Parts II, III, and IV should be left blank.

The information to be used in completing Parts I and V should relate to the P.R. participants in the plan, not the U.S. participants. For example, the contributions to the plan reported in Line 2 of Part I are those made by, or with respect to, the P.R. participants, and the employee and participant headcount included in Lines 5, 6, and 7 of Part V is limited to P.R. employees and participants.

While the local rules on the maximum limits on deductible contributions to retirement plans qualified in P.R. are beyond the scope of this article,⁷ ordinarily the amounts included in Line 1 of Part I are (1) for defined contribution plans, 25% of the compensation paid to the P.R. participants in the plan during the relevant tax year (i.e., the same amount that is reported in Line 8 of Part V), and (2) for defined benefit pension plans, the same amount that would be deductible under I.R.C. §404(o) with regard to the P.R. participants in the plan.

In the case of P.R. Non-Filers, the only sections of Form AS 6042.1 to be completed are the basic tax-

⁷ A detailed description of the local rules on the deduction of contributions to qualified plans is included in Gonzalez, 324 T.M., *International Pension Planning — Puerto Rico*, at VIII.

payer and plan identifying information at the top of the form and Lines 1, 2, 3, 4, and 7 of Part V. Parts I, II, III, and IV, and Lines 5, 6, 8, and 9 of Part V do not apply to P.R. Non-Filers.

FILING DUE DATE

Technically, Form AS 6042.1 is due on the last day of the seventh month immediately following the end of the plan year (i.e., for calendar plan years, July 31), but an automatic 2-and-a-half-month extension may be obtained (i.e., for calendar plan years, October 15th) by filing Form AS 2644, *Request for Extension to File the Income Tax Return*.⁸ Those are the same filing due dates that apply to Form 5500.

In practice, these filing due date dates are pretty much irrelevant for P.R. Tax Filers, because they are likely to continue including Form AS 6042.1 as a schedule to their P.R. income tax return. For corporations, the local income tax return, Hacienda Form 480.2,⁹ is due on 15th day of the fourth month immediately following the end of the taxable year (i.e., for calendar tax years, April 15th), but an automatic 3-month extension may be obtained (i.e., for calendar tax years, July 15th) by filing Form AS 2644. For partnerships and LLCs, the local informative tax return, Hacienda Form 408.2(EC),¹⁰ is due on the 15th day of the third month immediately following the end of the taxable year (i.e., for calendar tax years, March 15th), but an automatic 3-month extension may be obtained (i.e., for calendar tax years, June 15th) by filing Form AS 2644. As long as Form AS 6042.1 has been included as part of a timely filed P.R. income tax return, there is no need to send a separate copy thereof to Hacienda by the due dates particular to Form AS 6042.1. The author has unofficially confirmed with Hacienda that such is the case even if, due to differences between the plan year and tax year, the due date for filing Form AS 6042.1 (which, technically, is based on the plan year) were to fall before the due date for filing the P.R. income tax return (which is always based on the company's tax year). If a P.R. income tax return includes a Form AS 6042.1, Hacienda is already obtaining the information it needs, making unnecessary the mailing of an individual copy of Form AS 6042.1 containing the same information.

On the other hand, P.R. Non-Filers need to be aware that, beginning with the 2015 plan year (i.e., the filings due during 2016), Form AS 6042.1 needs to be filed with Hacienda, most likely by July 31st, or, if an extension is timely requested, by October 15th.

FILING METHOD AND ADDRESS

As of summer 2016, P.R. Tax Filers that are corporations, partnerships, or LLCs are allowed to file their

⁸ An electronic copy of Form AS 2644 may be found in Hacienda's website at: http://www.hacienda.gobierno.pr/sites/default/files/documentos/sc_2644_2015_0.pdf.

⁹ An electronic copy of Form 480.2 may be found in Hacienda's website at: http://www.hacienda.gobierno.pr/sites/default/files/documentos/corporations_2015_.pdf.

¹⁰ An electronic copy of Form 480.2(EC) (in Spanish) may be found in Hacienda's website at: http://www.hacienda.gobierno.pr/sites/default/files/documentos/formulario_480.2ec.pdf.

P.R. income tax returns on paper by mailing the return, which should include a copy of Form AS 6042.1, to the Hacienda postal address noted in the corresponding instructions to the return.¹¹

On the other hand, P.R. Non-Filers should mail a copy of Form AS 6042.1, using USPS certified mail, to:

Departamento de Hacienda
P.O. Box 9022501
San Juan, PR 00902-2501

Note that Hacienda is currently working on eliminating paper filings and implementing mandatory electronic filings, so paper filings may not be available for much longer. But, for the 2016 filing season, only individuals are required to file electronically. Corporations, partnerships, and LLCs are still allowed to file on paper. That applies to both the P.R. income tax return and Form AS 6042.1, if filed separately.

However, Form AS 2644 (i.e., the form to be used for requesting an extension for filing either the P.R. income tax return or Form AS 6042.1, if filed separately) has to be filed electronically by using Hacienda's tax filing webpage (commonly known by its Spanish name as the "*Colecturía Virtual*"), which is found at: <https://colecturiavirtual.hacienda.pr.gov/portal/>.

P.R. Non-Filers that need additional time to file a Form AS 6042.1, would have to file a Form AS 2644 electronically. And, in order to do so, they would first have to set up a user account within the *Colecturía Virtual*. For first time users of the *Colecturía Virtual*, the setup process may require a bit of time, so this is not something that should be left for the last minute. Ideally, P.R. Non-Filers should file Form AS 6042.1 by the initial due date of July 31st, and thus avoid having to access the *Colecturía Virtual* to request an extension.

ENTITY THAT COMPLETES THE FILING

A recurring question regarding Form AS 6042.1 is which entity within the controlled group is responsible for its filing. In the case of P.R. Tax Filers, the answer is easy; the controlled group member(s) required to file a P.R. income tax return is/are the one(s) that would file Form AS 6042.1 together with the P.R. income tax return. For example, if U.S. parent, which is not required to file a P.R. income tax return, sponsors a retirement plan qualified only in P.R. (i.e., what is commonly known as a "P.R.-only qualified plan" or "ERISA §1022(i)(1) plan") covering the eligible employees of a P.R. subsidiary, which is required to file a P.R. income tax return, P.R. subsidiary would include a copy of Form AS 6042.1 with its P.R. income tax return. Even though U.S. parent is the plan sponsor, it does not have to file a Form AS 6042.1 with

¹¹ The postal address varies depending on the type of P.R. income tax return and whether or not the return includes a payment.

Hacienda. The Form AS 6042.1 filed by P.R. subsidiary is all that is needed. The same result would apply if the plan was a U.S. plan qualified both in the U.S. and P.R. covering the eligible U.S. employees of U.S. parent and the eligible P.R. employees of P.R. subsidiary (i.e., what is commonly known as a “dual-qualified plan” or an “ERISA §1022(i)(2) plan”).

If the same qualified plan has more than one P.R. participating employer, each P.R. participating employer would have to prepare a Form AS 6042.1 with regard to its own participation in the plan.¹² For example, if U.S. parent, which is not required to file a P.R. income tax return, sponsors a P.R.-only qualified plan covering the eligible employees of P.R. subsidiary No. 1 and P.R. subsidiary No. 2, both subsidiaries would have to include a copy of Form AS 6042.1 with their P.R. income tax return. The information on Part I and Lines 5 through 8 of Part V would be specific to the contributions, employees, and participants of each of the P.R. subsidiaries, whereas the information on Lines 1 through 4 of Part V would be the same for both subsidiaries.

¹² Administratively, Hacienda follows the long-standing IRS rule to the effect that a company can claim a deduction on account of contributions to a qualified retirement plan only if the contributions relate to benefits accrued by, or amounts allocated to the accounts of, its own employees. *See, e.g.*, TAM 8012005. Therefore, in the case of a controlled group of corporations or businesses under common control, each member has to claim its own deduction for its contributions related to its employees that participate in the plan. The member claiming the deduction can either make the contributions directly to the plan or reimburse another member of the group for the contributions this other member made to the plan on behalf of the member claiming the deduction (e.g., through an intercompany charge or transfer of funds).

In the case of P.R. Non-Filers, the answer is a bit more elaborated. The U.S. plan sponsor would always file a Form AS 6042.1 following the streamlined rules for P.R. Non-Filers described above. In addition, the P.R. participating employers in the plan, which, by definition, are not subsidiaries or companies affiliated to the U.S. plan sponsor, would have to file their own Form AS 6042.1. If the P.R. participating employers are required to file a P.R. income tax return (e.g., for-profit P.R. companies that participate in a U.S. multi-employer pension plan), in preparing the form they would need to follow the rules for P.R. Tax Filers. If the P.R. participating employers are not required to file a P.R. income tax return (e.g., a P.R. church participating in a U.S. church plan), in preparing the form they would need to follow the rules for P.R. Non-Filers.

FINAL OBSERVATIONS

Form AS 6042.1 was not designed nor intended to be similar to Form 5500. In size, scope, complexity, and even related penalties,¹³ Form AS 6042.1 is designed to be far easier to complete and less substantial than Form 5500. Therefore, plan sponsors and their service providers do not need to approach Form AS 6042.1 as if it were a local equivalent to Form 5500. In the author's opinion, the key action items with regard to Form AS 6042.1 are to do a good faith effort to prepare it as completely as reasonably possible, file it by the relevant due date, and keep proper evidence of filing. All-in-all, preparing and filing Form AS 6042.1 should not take more than a couple of hours.

¹³ While the penalty for failure to file Form 5500 may be up to \$1,100/day [ERISA §502(c)(2)], the penalty for failure to file Form AS 6042.1 is only \$500 [PRIRC §6041.11(b)(4)].