IRS Permits Puerto Rico-Qualified Plans to Participate in U.S. Group and Master Trusts for Transition Period, Extends Deadline for Puerto Rico Spin-Offs

January 7, 2011

The U.S. Internal Revenue Service (IRS) announced tax-qualified retirement plans in Puerto Rico may continue to pool assets with U.S.-qualified plans in group and master trusts described in Revenue Ruling 81-100 until further guidance is issued. The IRS also extended the deadline to December 31, 2011, for sponsors of retirement plans qualified in both the United States and Puerto Rico to make a tax-free transfer of benefits for Puerto Rico employees to a Puerto Rico-only qualified plan.

On December 16, 2010, the U.S. Internal Revenue Service (IRS) issued Revenue Ruling 2011-1, which permits employers sponsoring employee retirement plans that are tax-qualified only in Puerto Rico to continue to pool assets with U.S.-qualified plans in group and master trusts described in Revenue Ruling 81-100 until further notice. Revenue Ruling 2011-1 also extends the deadline previously provided in Revenue Ruling 2008-40 from December 31, 2010, to December 31, 2011, for sponsors of retirement plans qualified in both the United States and Puerto Rico to spin off and transfer assets attributable to Puerto Rico employees to Puerto Rico-only qualified plans. The ruling provides Puerto Rico plan sponsors, institutional investors and trustees with certainty that plans qualified only in Puerto Rico can continue to participate in U.S. group and master trusts until further notice without facing potential disqualification of the participating U.S. plans and trusts. However, the ruling only provides transition relief. Permanent relief is needed to allow Puerto Rico-only plans to continue to pool assets with U.S. plans in group and master trusts.

Puerto Rico Plan Participation in Group and Master Trusts

Prior to Revenue Ruling 2011-1, there was uncertainty regarding the ability of Puerto Rico-only plans to participate in group trusts and master trusts. The uncertainty followed the publication of a September 14, 2010, letter from the IRS to Senator Arlen Spector, which suggested that the assets from a Puerto Rico-only qualified plan could not be invested with the assets of U.S.-qualified plans without disqualifying the U.S. plans and trusts. The IRS' surprising change in position contradicted numerous prior favorable private letter rulings. This position also was not discussed in Revenue Ruling 2008-40, a recent ruling that provided a transition period that was to end December 31, 2010, for plan sponsors to transfer benefits tax-free from a dual-qualified plan to a Puerto Rico-only qualified plan.

Representatives from a number of law firms (including McDermott Will & Emery LLP) and trade associations recently asked the IRS to clarify its position on the participation of Puerto Rico-qualified plans in Revenue Ruling 81-100

group and master trusts. Resolution of this issue is critical for employers that sponsor Puerto Rico-qualified plans. For example, many of these Puerto Rico plans currently participate, and would like to continue participating, in investments such as stable value and collective funds and employer stock funds that pool Puerto Rico- and U.S.-qualified plan assets in group or master trusts. As a result of the current uncertainty, some institutional investment sponsors and trustees have begun taking steps to prevent Puerto Rico-only qualified retirement plans from participating in these types of investments. But Puerto Rico retirement plan assets on their own are often too small to meet minimum investment requirements and cannot obtain these same investments at the same cost as U.S.-qualified plans. Similarly, maintaining a separate employer stock fund on a unitized accounting basis only for Puerto Rico participants may no longer be cost effective, and employers may be forced to discontinue such funds or maintain them on a less benefit-responsive share accounting basis. Many Puerto Rico plan trusts also participate in master trust arrangements with U.S. plans in order to simplify trust administration and reduce costs. Unfortunately, preventing Puerto Rico-only qualified plans from participating in these pooled arrangements with U.S. plans inevitably leads to fewer options and/or higher retirement plan fees for Puerto Rico participants.

With the release of Revenue Ruling 2011-1, sponsors of Puerto Rico-qualified retirement plans, institutional investment sponsors and trustees can feel confident that, at least for the time being, existing group and master trust arrangements will not be disqualified by the IRS simply because they permit participation by Puerto Rico-only qualified plans. Revenue Ruling 2011-1 specifically provides that sponsors of Puerto Rico-qualified retirement plans described in Section 1022(i)(1) of the Employee Retirement Income Security Act of 1974 (ERISA), as amended, that are not also qualified under the U.S. Internal Revenue Code may participate in group trusts described in Revenue Ruling 81-100 with U.S.-qualified plans until further guidance is issued to the contrary. However, because the deadline for sponsors of dual-qualified plans to spin off and transfer assets from dual-qualified plans to Puerto Rico-only qualified plans was extended for just one year, it appears the IRS intends to issue additional guidance on this issue in 2011. Employers that sponsor Puerto Rico-only qualified retirement plans should consider efforts to convince the IRS of the importance of group and master trusts in the administration of Puerto Rico-qualified retirement plans.

Deadline for Spin-Offs from Dual-Qualified Plans to U.S.-Qualified Plans Extended

As previously announced in Revenue Ruling 2008-40, plan sponsors can make a tax-free transfer of benefits attributable to Puerto Rico participants from a dual-qualified plan to a Puerto Rico-only qualified plan for a transition period that has now been extended to December 31, 2011. Following the end of this transition period, plan assets from dual-qualified plans cannot be transferred to Puerto Rico-only qualified plans without triggering taxation of the assets and the potential disqualification of the dual-qualified plan under the U.S. Internal Revenue Code. View IRS Sets Deadline for Transfers from Dual-Qualified to Puerto Rico-Only Qualified Plans for more information on the

benefits of transferring assets from dual-qualified plans to Puerto Rico-only qualified plans prior to the December 31, 2011, deadline under Revenue Ruling 2008-40.

The extension of the deadline to spin off and transfer assets from a dual-qualified plan to a Puerto Rico-only qualified plan was made in large part because of the uncertainty surrounding the ability of Puerto Rico-only plans to participate in group and master trusts. As a result, sponsors of dual-qualified plans delayed taking advantage of the Revenue Ruling 2008-40 transition period and spinning off plan benefits. The deadline extension under Revenue Ruling 2011-01 gives plan sponsors time to consider the impact of these issues on their employee benefit plans before deciding whether to spin off dual-qualified plan assets to a Puerto Rico-only qualified plan.

Conclusion

Employers that sponsor Puerto Rico-qualified retirement plans can expect future guidance from the IRS on whether those plans can pool assets with U.S.-qualified plans in Revenue Ruling 81-100 group or master trust arrangements. Permanent relief is needed to permit Puerto Rico-only qualified retirement plans to continue to participate in group and master trusts with U.S. plans. If the IRS ultimately rules Puerto Rico plan assets cannot be pooled with U.S. plan assets it will likely increase the costs and limit the benefit options available to Puerto Rico employees, and may cause plan sponsors to reconsider spinning off plan assets from dual-qualified to Puerto Rico-only qualified plans in 2011. Sponsors of dual-qualified plans may want to wait for further IRS guidance before spinning off their plan assets to a Puerto Rico-only qualified plan under Revenue Ruling 2008-40.

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