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## How US Employers Provide Health Plans to Puerto Rico Employees

By Carlos Gonzales

*US companies operating in Puerto Rico generally can offer their local employees the same health care benefits they offer their US employees but need to consider differences in the tax rules and be aware of tax savings opportunities, says Carlos Gonzalez of BenefitsPuertoRico.com.*

Probably because of their prior experiences and challenges with the operation of retirement plans in Puerto Rico, plus the lack of written guidance on the subject, oftentimes the employee benefits and human resources officials of US and international companies operating on the Island inquire whether health or medical plans can be operated in Puerto Rico just as they are operated in the United States. Recurrent questions include: Can Puerto Rico employees be included as participants in the company's US health plan, or must they be covered in a separate Puerto Rico-based plan? Are the rules governing health plans in Puerto Rico comparable to, or different from, the rules in effect in the United States? Does the Affordable Care Act (ACA or "Obamacare")—the Patient Protection and Affordable Care Act of 2010 and the Health Care and Education Reconciliation Act of 2010—apply in Puerto Rico? Are the healthcare-related tax benefits available to Puerto Rico employers and employees similar to those available in the United States? Is it necessary to file or "qualify" with the local government the health plans covering Puerto Rico employees?

Generally, US and international companies operating in Puerto Rico can legally and safely offer their Puerto Rico employees the same health care benefits they offer their US employees, and follow the same statutory rules and administrative practices, with just a few minor exceptions (e.g., possibly having to translate some documents to Spanish). Also, although not the norm, Puerto Rico employees may be included as participants in the company's US-based health plan.

Consequently, the substantive provisions and design features of health plans in Puerto Rico—such as eligibility for participation, covered and excluded healthcare services and procedures, process for reviewing claim denials, and employer and employee shares of monthly premiums and other cost-sharing elements—may be similar, if not identical, to those used in the United States.

On the other hand, Puerto Rico's income tax rules on healthcare-related savings and funding accounts are noticeably different from those that apply in the United States, and that could have a material impact on how the healthcare benefits of Puerto Rico employees are financed. For example, some of the savings accounts commonly used in the United States are currently unavailable in Puerto Rico, while others are available but subject to different tax rules and dollar limitations. In some cases, it may even be necessary, or at least advisable, to file the underlying savings account documents with the local government for administrative review and approval.

Furthermore, regarding the employee share of health insurance premiums, some companies confuse the Puerto Rico tax rules governing *local income tax* treatment with the US tax rules governing the *FICA taxation* (i.e., withholding and payment of Social Security and Medicare). As a result, US and international companies operating in Puerto Rico oftentimes fail to take full advantage of the FICA tax savings generally available to employer-based health plans in Puerto Rico. This article will shed light on these tax problems and related opportunities.

### ***Overview of Health Plans in Puerto Rico***

How common is it for private employers to provide healthcare benefits to their Puerto Rico employees and what type of health plans are generally used for such purposes?

Private employers are not legally required to offer healthcare benefits to their Puerto Rico employees, and they do not face any adverse US or Puerto Rico tax consequences for failing to do so. For example, the ACA's employer mandate does not apply in Puerto Rico, and local law does not include any sort of employer mandate on healthcare benefits. The Statement

of Motives and Article 8.020 of the [Puerto Rico Health Insurance Code \(online in Spanish\)](#) announced the local government’s objective of encouraging local employers to establish health plans but staying clear of mandating such action. Therefore, at least on paper, private employers have ample discretion on whether to offer healthcare benefits to their Puerto Rico employees.

In practice, however, providing employee healthcare benefits may be necessary for a company doing business in Puerto Rico. The principles and realities of hiring, retaining, and motivating employees in Puerto Rico are just like those in the United States, and employers unwilling or unable to offer healthcare benefits to their local workforce frequently face employee relations problems and quite simply cannot operate successfully. To get an idea, as of May 2023, Puerto Rico had an unemployment rate of 6.1% and a labor participation rate of 43%, according to its [labor report \(in Spanish\)](#) (at pages 3 and 10), and an estimated 38% of the local population is covered by private health insurance, according to a [Congressional Research Services report](#) (page 29). Therefore, it is reasonable to assume that most private sector employees, particularly the full-time employees of US and international companies, whose jobs tend to be well-paying and include benefits, receive some level of healthcare benefits.

Fortunately, it is generally less expensive to offer healthcare benefits in Puerto Rico than in the United States. To illustrate this point, following is a sample of the 2023 data issued by the US Office of Personnel Management on the employee share of monthly premiums paid by federal employees for coverage in an ACA-compliant Health Management Organization (all of them standard HMOs, not high-deductible health plans), comparing [Puerto Rico](#), [Florida](#), [New York](#), and [Texas](#):

Jurisdiction	Self-Only Coverage	Family Coverage
Puerto Rico	\$123.20	\$277.19
Florida	\$143.32	\$322.46
New York	\$260.13	\$896.98
Texas	\$164.66	\$395.18

Note that Puerto Rico’s figures are about 15% lower than Florida’s, 25% lower than Texas’s, and 50% lower than New York’s. Likewise, the 2023 monthly premiums, without any sort of premium tax assistance credit or subsidy, for an ACA-compliant silver plan in Puerto Rico are around \$200 (see, for example, [individual rate information](#) for a 45-year-old non-tobacco user under Puerto Rico’s Essential Health Benefit (EHB) Benchmark Plan), while in the United States a similar plan averages around \$500 (see Kaiser Family Foundation’s [Health Insurance Marketplace Calculator](#)).

Given the lower costs of local health care insurance, rather than include their Puerto Rico employees as participants in their US-based health plans, most US and international companies operating on the Island provide healthcare benefits to their local employees through a separate Puerto Rico-based health plan covering only those employees who live and work in Puerto Rico (plus spouses and eligible dependents). Since neither US nor local law requires employers to offer healthcare benefits to their Puerto Rico employees, in principle employers have discretion to decide whom to cover in their plans, although, in the case of fully insured plans, the underlying insurance policy could impose specific eligibility conditions and minimum participation requirements. For example, fully insured health plans sponsored by small employers (up to 50 local employees) must allow participation by full-time employees regularly scheduled to work at least 30 hours per week and part-time employees regularly scheduled to work at least 17.5 hours per week. Also, as a condition to issue or renew the underlying insurance policy, the insurer may require a minimum participation of up to 75% of all eligible local employees (13 L.P.R.A. §9163G and §9127C(7)).

In practice, however, US and international companies tend to use in Puerto Rico the same eligibility and participation rules that they follow in the United States. Puerto Rico employees are, therefore, generally eligible for similar, or at least comparable, benefits as their US counterparts. In this regard, it should be noted that the US Supreme Court’s *Windsor* and *Obergefell* decisions recognizing the equality of same-sex spouses [also apply in Puerto Rico](#). Thus, health plans in operation in Puerto Rico that provide for spousal coverage must allow opposite- and same-sex spouses to participate under equal terms and conditions.

Although it is technically possible to include Puerto Rico employees as participants in a US-based health plan, that is seldom done in practice. Often a US-based plan cannot be effectively offered in Puerto Rico because the insurance company or third-party administrator managing it does not have a contracted network of local hospitals, physicians, and other healthcare providers readily available to treat participants living in Puerto Rico. Such participants would, therefore, be required to get their healthcare benefits through reimbursements on an out-of-network basis, which would significantly decrease the scope and value of the benefits and could generate employee dissatisfaction with company-provided benefits. Moreover, only a [handful](#) of US health insurers are licensed to sell policies in Puerto Rico. While third-party administrators of self-funded US-based plans do not have to obtain a license from the local government, insurers of fully insured US-based health plans [need](#)

to obtain a license from the Office of the Insurance Commissioner of Puerto Rico (commonly known by its Spanish acronym as “OCS”) to insure Island residents. Failure to obtain a license could expose a US insurer to a fine of up to \$50,000.

Another consequence of the employer preference for local-based plans is that Puerto Rico is mainly a fully insured healthcare market. Except for a handful of manufacturers, pharmaceutical companies, and large US retailers, the local operations of most US and international companies are fairly small with not more than a few hundred employees. Covering those employees within a Puerto Rico-based plan solely for local residents, which, again, is generally less expensive and more effective than using a US-based plan, makes self-funding an expensive and risky proposition. That is particularly true if, as is frequently the case, the employer cannot find an insurer willing and able to issue on reasonable terms a stop-loss policy for such a small population. While Puerto Rico-specific data is currently unavailable, in the United States only 21% of small firm employees are enrolled in self-funded health plans. Given the small size of most local operations and the preference for Puerto Rico-based plans, it is safe to assume that most local employees receive their healthcare benefits through fully insured plans.

### **Regulatory Framework**

Just as in the United States, health plans covering the local employees of companies doing business in Puerto Rico are governed by a combination of federal and local or “state” laws and regulations.

#### **ERISA**

Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), applies in Puerto Rico exactly as it does in the United States. Accordingly, all private employer health plans in operation in Puerto Rico, whether fully insured or self-funded, US-based or local, must comply with all the relevant provisions of Title I of ERISA. (Governmental and church-associated plans are excepted.)

As in the United States, health plans operating in Puerto Rico are exempt from ERISA’s participation, vesting and funding rules, but are subject to general ERISA rules on reporting and disclosure, fiduciary responsibilities, and administration and enforcement. Plans must be established and maintained pursuant to an official plan document, plan participants must be provided with a summary plan description (SPD), and plans that cover at least 100 participants or are funded through a trust fund must file a Form 5500 with the US Labor Department’s Employee Benefits Services Administration (EBSA). While English and Spanish are Puerto Rico’s official languages, Spanish is clearly the vernacular. Nevertheless, employers may validly

and safely prepare in English the plan documents, SPDs and all other documents related to their employee health benefits in Puerto Rico—29 C.F.R. §2520.102-2(c) requires only that, when a certain percentage of the participants in an ERISA-covered plan are literate in the same non-English language, a notice be displayed in that language informing them how to obtain information about their rights and obligations under the plan. Neither ERISA nor local law require that plan documents be prepared in or translated to Spanish, and general practice is to prepare them in English to eliminate the possibility of, as the saying goes, things getting lost in translation.

Also, to reduce the number of Forms 5500 that need to be filed with EBSA, the 2022 Instructions for Lines 5 and 6 explain that an employer can aggregate its US and Puerto Rico healthcare and other welfare benefit plans and/or insurance policies within a single “wrap” ERISA employee welfare benefits plan document and then file one Form 5500 just for that plan. The fact that the Puerto Rico employees receive their healthcare benefits through an insurance policy or a third-party administration arrangement different from that of its US employees does not preclude this cost-savings alternative, which requires only that the benefits or program available to Puerto Rico employees be formally incorporated within the US-based wrap plan and that the associated Form 5500 include Schedule A, *Insurance Information*, from the insurer.

The continuation coverage requirements of Internal Revenue Code §4980B(f) and (g) are similar to ERISA’s at 29 U.S.C. §1161–§1168 in addressing COBRA issues in Puerto Rico. Health plan sponsors and benefits practitioners in Puerto Rico may safely refer to Labor and Treasury regulations and other guidance under ERISA and Code §4980B (but should not follow that section’s excise tax, which does not apply in Puerto Rico).

Applicable pre-ACA provisions include the qualified medical child support order rules, the HIPAA and GINA nondiscrimination rules (*i.e.*, health plans cannot discriminate in eligibility, coverage, or premium payments based on an individual’s health status or genetic information), the standards for minimum hospital stay following birth for mothers and newborns, and the restrictions on limits on mental health and substance use disorder benefits. Consistent with the general rule on the validity of English language SPDs, federal courts have held that COBRA notices provided to Spanish-speaking qualified beneficiaries do not need to be translated to Spanish. But employers that voluntarily decide to use Spanish-language documents may use Spanish versions available on the EBSA website.

Various ACA amendments to the health insurance coverage provisions of Part A of Title XXVII of the



Public Health Services Act (PHSA), through ERISA §715, were formally incorporated as part of Title I of ERISA such that they apply in Puerto Rico. Accordingly, private sector health plans operating in Puerto Rico must comply with PHSA/ERISA rules as follows.

All health plans (whether fully insured or self-funded, US- or Puerto Rico-based, and regardless of the employer's size) must provide for:

- Elimination of pre-existing condition exclusions.
- Prohibition on discrimination against participants and beneficiaries based on health status-related factors.
- Prohibition of eligibility waiting periods exceeding 90 days.
- Removal of lifetime and annual limits on essential health benefits.
- Prohibition of retroactive rescission or termination of coverage absent fraud or intentional misrepresentation of material facts.
- For plans that offer dependent coverage, the requirement to allow children of employees to remain eligible dependents until age 26.
- The requirement to provide plan participants with a summary of benefits and coverage (SBC) describing the key features of the plan (*e.g.*, covered and excluded benefits, cost-sharing provision, and contact information for answers to questions regarding the plan). EBSA provides a sample SBC. Health plans operating in Puerto Rico are required to distribute SBCs in addition to SPDs and (unlike SPDs) they may have to be prepared in Spanish under certain circumstances—for example, if more than 10% of the employer's Puerto Rico employees are not literate in English.
- Except for grandfathered plans (those already in existence as of the ACA enactment date of March 23, 2010), the requirements to (a) provide coverage for various preventive health care services without cost-sharing requirements on the individual, (b) implement and follow enhanced internal and external claims and appeals procedures for reviewing adverse benefit determinations (even grandfathered plans must do so for plan years beginning after 2021 in certain out-of-network situations), and (c) allow participants to designate their primary care provider and remove various restrictions on access to out-of-network emergency services.

*Additionally, for fully insured plans* (whether US- or Puerto Rico-based and regardless of the employer's size):

- Insurance companies that offer health policies within the corresponding US jurisdiction (in the instant case, Puerto Rico) are required to (a) issue a policy to every applicant employer, regardless of the health status of its employees, subject to certain permissible restrictions (*e.g.*, covered individuals must live in Puerto Rico), and (b) renew the policy at the employer's option, except in case of certain events, such as failure to pay premiums, fraud or intentional misrepresentation of facts, etc.
- Those that do not meet the relevant medical loss ratio requirements (*i.e.*, spending a minimum portion of premium revenues on certain health care services and quality control and improvement activities), must provide a premium rebate to the individuals covered under their health insurance policies. To avoid paying this rebate, insurers in the large group market (*i.e.*, employers with more than 50 employees) must spend at least 85% of premiums on eligible healthcare services and activities; those in the small group market must spend at least 80%.
- Insurance companies must use the universal modified community rating system for determining the premiums to be charged under their small group market policies.
- Except in the case of grandfathered plans, insurance companies must include essential health benefits in their small group market policies.

The post-ACA amendments to the group health plan requirements of Part 7 of Title I of ERISA provide for restrictions on surprise medical bills for emergency services, the requirement to provide price comparison guidance to plan participants and beneficiaries, and the removal of gag clauses on pricing and quality of care information from agreements between group health plans and third-party administrators or health care providers.

#### ***Puerto Rico Healthcare Insurance Code***

In direct response to the ACA's enactment, on August 29, 2011, the Puerto Rico government approved the Puerto Rico Health Care Insurance Code (commonly known by its Spanish acronym CSSPR). Prior to 2011, the local insurance laws provided almost no substantive rules or guidance on the design, issuance, and administration of health insurance policies used by private employers to fund and operate their local health plans. Fashioned after model health insurance laws and regulations issued by the National Association of Insurance Commissioners, the CSSPR substantially changed the local healthcare regulatory landscape by adopting several, but not all, of the ACA

rules and mandates, and imposing civil penalties of up to \$10,000 on each violation thereof (CSSPR art. 2.080).

Consistent with ERISA's general pre-emption principles, the CSSPR applies in full to those private employer health plans operating in Puerto Rico that are fully insured, but not at all to self-funded plans. Since, as noted above, most local health plans are fully insured, the CSSPR plays an important role in the design and administration of healthcare benefits for Puerto Rico employees, because the underlying insurance policies must be CSSPR-compliant. Moreover, employers with fully insured plans are generally required to purchase and implement the underlying policy "as is," which substantially restricts their ability to customize the healthcare benefits of their local employees.

OCS has primary authority over the CSSPR. Some health care-related documents and information available on the Spanish version of the OCS website (e.g., the CSSPR and OCS's guidance on the ACA's application in Puerto Rico) are unfortunately not available on the English version currently. OCS has not yet enacted formal regulations under the CSSPR, but, through a series of Letter Rulings and Circular Letters, it has issued legally binding and enforceable rules. One such letter sets rules and procedures for determining the "metal" levels of health insurance policies offered in Puerto Rico, allowing participants and beneficiaries to enroll outside of the regular enrollment period set forth under the plan, and for disclosing medical records in connection with claim reviews and appeals. Proper evaluation of legal and regulatory matters related to the local operation of a fully insured plan should include a review of this guidance.

Following is a list of the specific ACA rules and mandates that have been formally adopted within the CSSPR.

*All fully insured plans* (regardless of employer's size):

- Elimination of pre-existing condition exclusions of PHSA §2704 (CSSPR art. 2.050I).
- Removal of lifetime or annual limits on essential health benefits of PHSA §2711 (art. 2.050A).
- Prohibition on rescission of coverage of PHSA §2712 (art. 2.050J).
- Requirement of providing preventive health care services without cost-sharing of PHSA §2713 (art. 2.050C). Grandfathered plans are not exempt from this local rule.
- Extension of dependent coverage rule of PHSA §2714 (art. 2.030G(2)).
- Prohibition on discrimination in favor of highly compensated individuals of PHSA §2716 (art. 2.050L).

- Rules on primary care provider designations and availability of out-of-network emergency services of PHSA §2719A (art. 2.050F, G, H). Grandfathered plans are not exempt from this local rule.

*Plus, for fully insured plans sponsored by small employers (50 or fewer employees):*

- Fair health insurance premiums requirements of PHSA §2701 (CSSPR art. 8.050A). Grandfathered plans are exempt from this local rule.
- Guaranteed availability of coverage requirements of PHSA §2702 (art. 8.070A).
- Guaranteed renewability of coverage requirements of PHSA §2703 (art. 8.060).
- Prohibition of discrimination based on health status-related factors of PHSA §2705 (art. 8.070C).
- Coverage for essential health benefits package rule of PHSA §2707(a) (art. 2.050D).
- Prohibition of excessive waiting periods of PHSA §2708 (art. 8.030O).
- Medical loss ratios requirements of PHSA §2718(b) (art. 2.050K).

In interpreting and applying all these CSSPR rules, employers, insurance companies, and benefits practitioners can safely rely on and follow the relevant PHSA rules and their enacting federal regulations and related administrative guidance (CSSPR art. 2.020). The ACA rules that have been adopted within the CSSPR are supposed to function in Puerto Rico just as they do in the United States.

#### ***US Tax Code***

The Code sections regarding the operation of private employer health plans, the deductibility of contributions to such plans, and the federal income taxation of healthcare benefits generally do not apply to health plans operating in Puerto Rico. This is because, among other reasons, Puerto Rico is not part of the United States for most purposes of the Code (§7701(a)(9) and (10)); bona fide Puerto Rico residents are not required to pay federal income taxes on their wages and other items of compensation earned on account of services rendered within Puerto Rico; and wages paid to private sector employees who are bona fide Puerto Rico residents are exempt from the withholding of federal income tax (Code §3401(a)(8)(C)). Therefore, except for those sections that cover or are extensible to Puerto Rico, healthcare-related transactions occurring within Puerto Rico with respect to Island residents are exempt from the Code provisions on payment of federal income tax (§§1-1564) and miscellaneous excise taxes (§§4001-

5000D). On the other hand, as addressed below, the sections regarding the assessment and payment of FICA) taxes apply just as in the United States, as Code §3121(e) includes Puerto Rico in the Code's definitions of "United States" and "State" for FICA tax purposes.

As a result of Puerto Rico's general exclusion from the Code's income and excise tax provisions, local health plans are exempt from certain US tax rules as follows.

*ACA's Employer Mandate.* The employer shared-responsibility requirement of Code §4980H does not apply in Puerto Rico (PPACA §1513). Treas. Reg. §54.4980H-1(a)(24), defining "hours of service" for purposes of the ACA's employer mandate, excludes hours the compensation for which is considered income from Puerto Rico sources, according to a letter from the Secretary of Health and Human Services to governors of US possessions and territories. As noted above, local insurance and tax laws do not impose any sort of mandate for healthcare benefits nor penalties for failure to offer them to Puerto Rico employees. However, such failure could undermine their chances of operating successfully in Puerto Rico. Likewise, the employer healthcare-related reporting requirements of Code §6056 do not apply with regards to Puerto Rico participants in local health plans. Instructions for Forms 1094-C and 1095-C (2022), in describing the employers who must file these forms, refers to those that "are subject to the employer shared responsibility provisions of [Code] section 4980H." Instructions for Forms 1094-B and 1095-B (2022) indicates that applicable agencies in Puerto Rico are not required to report Medicaid and CHIP coverage.

*ACA's Individual Mandate.* The provisions of Code §5000A, which before 2018 required most individuals living in the United States to maintain a minimum level of healthcare coverage or pay a tax penalty, never applied to Puerto Rico residents (Code §5000A(f)(4)(B)). Local tax law does not provide any sort of healthcare-related mandate or penalty on individuals. Also, the premium assistance tax credits set forth in Code §36B are generally unavailable to Puerto Rico residents. While the ACA allows US territories to establish an Exchange or Marketplace for residents to buy individual health insurance, the Puerto Rico government has not done so and there is no indication that it plans to.

*Nondiscrimination Testing.* Puerto Rico-based self-funded health plans are exempt from the prohibitions on discrimination and related testing requirements of Code §105(h), and local insurance and tax laws do not impose any sort of prohibitions or nondiscrimination testing requirements on self-funded health plans. An employer can, therefore, validly set up a Puerto Rico-based self-funded health plan solely for the benefit of

its local executives and other highly compensated employees or set up a richer self-funded health plan for them and a regular fully insured plan for rank-and-file employees. In practice, however, that sort of healthcare-related planning is not used.

Currently, Puerto Rico-based fully insured plans are also free from nondiscrimination requirements, but that may change. The PHSAs expressly applies in Puerto Rico (42 U.S.C. §300gg-91(d)(14)), and the ACA amended the PHSAs to require fully insured health plans to comply with the Code §105(h) prohibition of discrimination (Code §9815(a)). Moreover, the CSSPR requires group health plans funded through a local insurance policy to comply with the Code's nondiscrimination requirements (art. 2050L). The ACA rule was to go into effect with the issuance of enacting regulations under PHSAs §2716(a) or Code §9815 (IRS Notice 2011-1). Given the CSSPR's explicit adoption of the US rules on the subject, once enacting regulations under PHSAs §2716(a) or Code §9815 are issued, local fully insured plans will have to comply with Code §105(h), which, in turn, might require employers to implement new procedures for administering their local health plans. The extent and scope of any such procedures will depend on the enacting regulations, which, again, have yet to be issued.

On a related matter, it should be noted that the Puerto Rico employees of a US and international company operating on the Island need to be considered when testing if the company's US-based health plans comply with Code §105(h), because US and Puerto Rico employees generally belong to the same controlled group.

#### *Puerto Rico Tax Code*

The Puerto Rico Internal Revenue Code of 2011, as amended (the "PRIRC"), governs the income tax aspects of business transactions taking place in and compensation related to services rendered in Puerto Rico.

#### *ACA*

Now it is time to answer the recurrent question of whether the ACA applies to health plans sponsored by private employers in Puerto Rico. Based on the information above, it can reasonably be concluded that:

- Through ERISA §715, the ACA rules enacted within PHSAs §§2701 through 2708 and 2711 through 2719 are equally applicable to health plans in Puerto Rico.
- Moreover, except for PHSAs §§2706, 2709, 2710, 2717, and 2719, the CSSPR expressly adopted within local insurance law the ACA rules covered by ERISA §715. Therefore, if a fully insured health plan in Puerto Rico fails to comply with, for example, the prohibition of pre-existing con-



dition exclusions of PHS §2704 or the prohibition of health status discrimination of PHS §2705, the plan sponsor and the insurer could be subject to a federal claim under ERISA and the insurer to a fine under the CSSPR.

- On the other hand, the employer mandate of Code §4980H and its related IRS tax reporting requirements do not apply in Puerto Rico.

On July 16, 2014, HHS's Centers for Medicare and Medicaid Services (CMS) issued an [informational letter](#) that seemed to exempt health plans in Puerto Rico from some, but not all, of the ACA health insurance provisions. In the author's opinion, unless and until Congress amends the PHS or HHS enacts regulations under the PHS providing otherwise, plan sponsors should disregard this letter and administer their Puerto Rico health plans in full compliance with the various ACA provisions incorporated by ERISA §715 and, for fully insured plans, the CSSPR.

Basically, the letter states that, to address the adverse impact that some of the ACA mandates were having on the health insurance markets of some US territories, HHS was taking the position that the following ACA requirements (among others) did not apply to group health insurance issuers in the territories: the fair health insurance premium requirements of PHS §2701, the guaranteed availability of coverage requirements of PHS §2702, the coverage of essential health benefits rule of PHS §2707, and the medical loss ratio requirements of PHS §2718. Since the CSSPR expressly incorporated the aforementioned ACA rules within local insurance law, the letter's holding appears neither applicable nor relevant to the design and operation of fully insured health plans in Puerto Rico. The CSSPR is clear in that insurance companies selling health insurance on the Island must comply with these ACA rules. Perhaps HHS's position impacts fully insured plans in other US territories, but not in Puerto Rico.

### ***Puerto Rico Income Tax Rules on Health Plans***

#### ***Employer Tax Deduction***

Employer contributions to health plans operating in Puerto Rico are fully deductible in the employer's Puerto Rico income tax return as an ordinary and necessary trade or business expense (PRIRC §1031.04(a)(1), §1033.01(a)(1)). The amount deductible includes both the employer and the employee shares of healthcare premiums. To be deductible, technically, health plan contributions, together with employees' overall wages and compensation, must be reasonable under the circumstances. In practice, the Puerto Rico Department of the Treasury ("Hacienda") seldom challenges the deductibility of these contributions. Employers operating on the Island do

not use health plans as a tax avoidance strategy, and the possibility of their being audited on account of the amount or timing of their health plan contributions is quite remote.

Employers using the cash method of accounting must claim the deduction for their taxable year during which the amount was actually paid to the plan, whereas employers using the accrual method of accounting must do so for their taxable year in which the expense was properly accrued (PRIRC §1040.04(a)). For employers filing as for-profit corporations, the deduction is claimed on line 9 of Part III of [Hacienda Form 480.2](#), and for employers filing as pass-through entities (*e.g.*, partnerships and limited liability companies), the deduction is claimed on line 8 Part XI of [Hacienda Form 480.2\(EC\)](#).

While the contributions must relate to US and/or Puerto Rico employees (and spouses and eligible dependents thereof) working for or in connection with the employer's operations in Puerto Rico, the underlying health plan does not have to be based in or funded through an insurance policy or trust fund issued or established in Puerto Rico. An employer operating in Puerto Rico may deduct its contributions to a US-based health plan for the benefit of its US and/or Puerto Rico participants. For corporations not organized in Puerto Rico, tax filing obligations to Puerto Rico are limited to income, deductions, and other tax items related to operations on the Island (PRIRC §1022.01(a)).

While retirement plans that cover Puerto Rico employees need to be filed with Hacienda to secure their local tax qualification, no such filing is needed for health plans (PRIRC §1081.01(a)(13)(A), Hacienda Circular Letter of Tax Policy No. [16-08](#) (Spanish)).

#### ***Taxation of Healthcare Benefits and Contributions***

Puerto Rico employees do not pay local income tax on the amount of employer contributions to a health plan covering the employee and his/her spouse and eligible dependents, nor on the amount or value of the healthcare benefits that the employee, spouse, or eligible dependents receive under the plan (PRIRC §1031.01(b)(3)). Healthcare coverage and benefits are fully exempt from Puerto Rico taxes.

***Health Reimbursement Arrangements.*** Amounts Puerto Rico employees receive under a health reimbursement arrangement (HRA) are also fully exempt from the payment of local income tax (PRIRC §1032.08(b)). Basically, an HRA is an arrangement that an employer establishes for the benefit of its eligible employees, is funded solely through employer contributions (*i.e.*, employee contributions are disallowed) (PRIRC §1032.08(c)(3)), and reimburses participating employees for certain medical expenses incurred by the employee and, at the employer's discre-

tion, his/her spouse and eligible dependents (PRIRC §1032.08(c)(1)). Employers also have ample discretion to establish, among other things, the eligibility requirements for HRA participation, the process to be followed and conditions to be met for HRA reimbursements, the limits on reimbursable amounts, and the disposition of unused HRA funds (*i.e.*, whether the funds are forfeited or carried over to future plan years) (PRIRC §1032.08(c)(2), (4), (9)).

HRAs operating in Puerto Rico must do so in accordance with an SPD or certificate of coverage, a copy of which must be furnished to all Puerto Rico participants and filed with Hacienda (PRIRC §1032.08(c)(11)). Provided the document is timely filed with Hacienda, an employer may safely use in Puerto Rico the same HRA it uses in the United States.

*Health Savings Accounts.* Employers that operate a high-deductible health plan (HDHP) in Puerto Rico may also establish health savings accounts (HSAs) allowing Puerto Rico participants to save money to cover the HDHP's deductible and other out-of-pocket expenses (PRIRC §1081.04(a)). The local rules on HDHPs and HSAs are modeled on, and intended to be consistent with, the equivalent US rules of Code §223. US or international companies operating in Puerto Rico may, therefore, allow their local employees to participate in their US-based HDHPs and/or HSAs subject to the same terms and conditions that apply to US participants. Alternatively, an employer may establish a Puerto Rico-based HDHP/HSA arrangement solely for the benefit of its eligible Puerto Rico employees and their beneficiaries. Local law does not impose nondiscrimination testing requirements on HSAs but provides that participants must have full ownership of their HSA funds, and such funds must not be subject to forfeiture or cancellation (PRIRC §1081.04(d)(1)(E)).

Whether an employer uses its US HDHP/HSA arrangement or a separate Puerto Rico-based arrangement, if (as is usually the case) the Puerto Rico participants' assets are held and administered by an entity not based in Puerto Rico, the governing documents for the HSA, but not those for the HDHP, must be filed with Hacienda (PRIRC §1081.04(d)(1)(D)). The main purpose of this filing is to demonstrate to Hacienda official that the US entity holding the HSA funds has in place proper administrative practices and procedures for safeguarding the funds and reimbursing them to participants upon request in accordance with the relevant terms of the HSA. Such filing is not necessary if the HSA's administrator, custodian, or trustee is an insurance company, bank, or financial institution duly licensed to operate in Puerto Rico (PRIRC §1081.01(d)(1)(B)).

Employee and employer contributions to the HSA of a Puerto Rico employee are fully exempt local

taxation (*i.e.*, Puerto Rico income tax is not withheld at source and employee contributions are excluded from wages in the employee's local Form W-2) (PRIRC §1081.04(b)(2)(C)). Moreover, in the case of a US-based HSA established and operated in accordance with Code §223, but not for a Puerto Rico-based HSA, employee and employer contributions to the HSA are exempt from the withholding and payment of FUTA and FICA taxes. It follows that from a payroll tax standpoint, a US or international employer doing business in Puerto Rico is better off including its Island employees as participants in its US-based HSA, rather than creating a separate Puerto Rico-based HSA just for those employees.

The withdrawal of HSA funds for the payment or reimbursement of the qualified healthcare expenses incurred by the participant or his/her spouse and eligible dependents are fully exempt from the withholding and payment of Puerto Rico income tax (PRIRC §1081.04(f)(1)).

*Cafeteria Plans and Flexible Spending Accounts.* Presently, Puerto Rico tax law does not regulate nor provide income tax benefits on cafeteria plans or Flexible Spending Accounts (FSAs). There used to be somewhat limited rules allowing for the operation of very basic cafeteria plans (PRIRC §1032.06), but those rules were repealed effective December 10, 2018 (Article 23 of P.R. Act No. 257-2018). Given the absence of local tax rules and the fact that the constructive receipt doctrine applies in Puerto Rico (*Ramos v. Secretario de Hacienda*), Island employees cannot exempt a portion of their wages from the payment of local income tax by making elective deferrals under a cafeteria plan or FSA. Moreover, Hacienda Circular Letter of Internal Revenue No. 04-07 indicated (at IV) that the employee share of health plan premiums cannot be paid on a pre-tax basis. That is, while the employer share is totally tax-free for Puerto Rico employees, the employee share is not excluded from wages in their local Form W-2 (Hacienda Form 499R-2/W-2PR), and Puerto Rico income tax is withheld thereon.

### ***Puerto Rico Operation of US-Based Cafeteria Plans***

The fact that Puerto Rico tax laws do not afford local income tax benefits on cafeteria plans does not mean that Puerto Rico employees cannot participate in a US-based cafeteria plan (*i.e.*, one established and operated in accordance with Code §125 and regulations). Neither US nor Puerto Rico tax laws preclude Island employees from participating in a US-based cafeteria plan. But if, as noted above, Puerto Rico employees would not derive local income tax benefits on account of their participation in a cafeteria plan (*i.e.*, their share of premiums cannot be made on a pre-tax



basis), why would an employer include its Puerto Rico employees as participants in its US-based cafeteria plan? *Answer:* Because of the potential FICA tax savings that both the employer and its Puerto Rico employees would generate if the employee share of premiums is paid through a US cafeteria plan.

The wages of Puerto Rico employees are subject to the payment of FICA taxes following exactly the same rules that apply in the United States, according to Code §3121(a), (d), and (e), and the IRS provides administrative guidance on reporting and withholding these taxes in Puerto Rico. Accordingly, wages up to the Social Security wage base (\$160,200 for 2023) are subject to a FICA tax of 15.3%, and wages above the Social Security wage bases are subject to a FICA tax of 2.9%. Half of the tax is withheld from the employee's wages and deposited with the IRS and employer pays the other half to the IRS out of its general assets, according to the IRS's *Employer's Tax Guide* (at Section 9). Neither the PRIRC nor Hacienda have anything to do with the withholding, payment, or reporting of FICA taxes, which are exclusively within the IRS's jurisdiction.

The portion of an employee's wages that is withheld at source and used to help cover the cost of "qualified benefits" under a US-based cafeteria plan is exempt from FICA taxation (Code §3121(a)(5)(G), §125(f)(1); Prop. Reg. §1.125-1(a)(3)(B)). For these purposes, the accident and health plan through which the qualified benefits are provided does not have to be established, located, or operated in the United States and the employees participating in such plan do not have to work or reside within the United States. Consequently, premiums paid through a US-based cafeteria plan would be exempt from employees' wages for purposes of FICA taxation, which, in turn, would result in tax savings for them and their employer. For example, if a Puerto Rico employee's share of health insurance premiums is \$300/month, allowing such employee to participate in a US-based cafeteria plan and processing premium payments in accordance with the relevant US tax rules would yield of annual FICA tax savings of \$550.80 (15.4% of \$3,600), of which \$275.40 would go to the employee and \$275.40 to the employer. The fact that the employee would not generate a Puerto Rico income tax savings on account of its participation in the US-based cafeteria plan is immaterial for these purposes, as, again, FICA taxation is governed by the tax rules of the United States, not Puerto Rico.

Comparatively, Code §105(a) and §106(a) do not limit "accident and health plans" to those established, located, or operated in the United States; Treas. Reg. §1.105-5(a), in describing healthcare benefits exempt from US income taxation, includes amounts received through an employee sickness or disability fund main-

tained under the laws of (among others) a US territory such as Puerto Rico; and Code §125(g)(4) requires that all employees (including Puerto Rico-based) of companies within the controlled group of an employer operating a cafeteria plan be considered in determining whether the plan meets the applicable nondiscrimination requirements.

For this opportunity to be available, however, it is important that Puerto Rico employees' participation in the cafeteria plan comply with the various formal and operational requirements of Code §125. For example, the official cafeteria plan document must expressly allow for their participation, their premium payment elections must generally be made before the beginning of the current plan year, and they are allowed to make mid-year changes to their elections only upon a "change in status" (Prop. Reg. §1.125-1(c)(1)(ii), (a)(2)(ii), (c)(1)). Since cafeteria plans are seldom used in Puerto Rico, local employees are unfamiliar with, and may be surprised by, the relevant operational requirements, in particular the change-in-status limitations, and likely will need guidance. Neither the official cafeteria plan document nor related employee communications would have to be filed with Hacienda or any other local government agency.

To avoid potential problems with the Puerto Rico income tax rules, which, again, do not provide any sort of local tax benefits on cafeteria plans, the Puerto Rico participants in a US-based cafeteria plan should be allowed to make contributions only with regards to their share of health insurance premiums. Other qualified benefits—such as dependent care assistance, adoption assistance, elective deferrals under a 401(k) plan, and vacation benefits—should be unavailable to them. Accordingly, with regards to its Puerto Rico participants, a US-based cafeteria plan would essentially be operated as a premium-only plan providing for healthcare benefits.

### **Conclusion**

In summary, in administering the healthcare benefits of its Puerto Rico employees, US and international companies doing business on the Island must comply with of Title I of ERISA, including the ACA-related amendments to Part A of Title XXVII of the PHSa that were adopted by ERISA §715 (*i.e.*, PHSa §§2701 to 2708 and 2711 to 2919). Insofar as the CSSPR is intended to operate in accordance with the equivalent ACA rules, complying with the ACA automatically satisfies the CSSPR. Just as in the United States, failure to operate a local health plan in accordance with Title I of ERISA could result in a federal lawsuit against the employer.

Health plans covering Puerto Rico employees do not have to be filed or "qualified" with Hacienda. Puerto Rico employees may be allowed to participate

in HRAs and HSAs, but not in FSAs. Some Hacienda filings may be needed in connection with the local operation of HRAs and HSAs. To save on FICA taxes, employers should consider using a US-based cafeteria plan for processing the employee share of healthcare premiums by its Puerto Rico employees. No Hacienda filings would be needed in connection with this approach.

Finally, the ACA's employer mandate and related IRS filing requirements do not apply to health plans in operation in Puerto Rico and local employees are not eligible for any sort of federal or local tax subsidies for the purchase of private employer healthcare coverage.

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