



November 7, 2017

## **An Open Letter to the House Ways & Means Committee: Here's How Tax Reform Can Deliver for Puerto Rico!**

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

On behalf of National Taxpayers Union's (NTU) members across the country, I would like to offer our congratulations and appreciation for your hard work on HR 1, the Tax Cuts and Jobs Act. This legislation has great promise to provide tax relief, economic growth, and a simpler, more administrable tax law for all Americans. As the Committee continues its markup of HR 1, I write to commend your attention to a particular matter: provisions in the legislation that will help to facilitate long-term investment and prosperity for the Commonwealth of Puerto Rico and other U.S. territories. No other single expression or act of federal policy is more critical to Puerto Rico's future than ensuring that the precepts of H.R. 1 recognize Puerto Rico's longstanding status in the Tax Code and supporting (within the boundaries of sound policymaking) the economic activity necessary for the island's rebirth.

NTU has been actively involved in the development of a legislative response to aid Puerto Rico's recovery, including the PROMESA bill. We have offered advice, on a granular level, concerning tax, budget, regulatory, and economic policy affecting the Commonwealth (and by extension the rest of the United States). We urge you to access those documents online [here](#), [here](#), and [here](#), along with our comments to the Task Force on Economic Growth in Puerto Rico [here](#).

Current Committee proceedings, however, are focused on tax policy. NTU applauds Members of the Committee for provisions such as Section 4401 (extending the domestic production activities deduction); you now have the opportunity for thoughtful additions that are consistent with the intent of the overall bill yet will mean so much for the families and businesses of Puerto Rico. To this end we urge the Committee to effect the following policies:

- Reduce the U.S. tax rate on Puerto Rico-sourced income. Doing so could be made consistent with Titles III and IV of the bill, recognizing that as a U.S. possession, it would be desirable to provide Puerto Rico a tax rate better than those afforded our trading partners making foreign direct investment.
- Address base erosion concerns with circumspection. Critics of the long-repealed Section 936 of the Tax Code contended that it contributed to the deterioration of the U.S.-Puerto Rico tax base. Regardless of the degree of truth to that argument, NTU has joined with many organizations urging policymakers not to go to extremes, such as embracing the Base Erosion and Profit Shifting (BEPS) strictures from the OECD. Any rules for Puerto Rico should be easily harmonized with whatever limited alternative is developed under international tax reform, again recognizing that as a U.S. territory, Puerto Rico's tax base is more familiar to U.S. policymakers than those of many foreign nations.
- Deal in a reasonable manner with treatment of Subpart F income as it relates to broadly-defined investment in the island. In the specific case of Puerto Rico, some kind of temporary deferred status for passive Subpart F income may be desirable to reduce disincentives for local investment. Such provisions can be made as simple and broad-based as possible.
- Set a Puerto Rico repatriation or dividend deduction at a similar or better level to what policymakers have proposed recently for HR 1. Among the models for reaching this objective would be the American Jobs Creation Act of 2004 and the Economic Revitalization Tax Act of 2001, as well as the Tax Reform Act of 2014. All of these proposals set the dividend exemption at 85 percent.

These provisions would tend to affect companies with a large presence on the island, and for good reason. These firms, led by the pharmaceutical, retail, and hi-tech industries, comprise the vast majority of the Commonwealth's tax base and private sector employment. Biopharmaceutical firms alone account for nearly one-third of Puerto Rico's GDP, and one-third of its income tax collections. Ensuring that these and other job creators in the Commonwealth have the tax policy tools they need to assist with post-disaster recovery and long-term growth is essential.

Nonetheless, the Committee can and should consider additional options, with the objective of creating a sound environment for expansion of locally-formed and -domiciled businesses. An additional proposal to boost employment, which could function quite effectively with the federal tax reforms mentioned above, suggests itself through legislation offered more than a decade ago. In 2005, Delegate Fortuno and Representative Paul Ryan introduced the National Enterprise Zone Act (HR 2182, 109<sup>th</sup> Congress), which would have allowed Governors of all states and territories to nominate areas in their jurisdictions experiencing particularly difficult economic circumstances for less burdensome federal tax rates on individuals and businesses. Qualifications included a population of more than 10,000, a median household income below 60 percent of the national median, and an unemployment rate at least 2.5 times the national average. Areas whose nominations were approved by the Secretary of the Treasury could offer a low tax rate of 17 percent on the enterprise zone income that individuals and active businesses residing within the jurisdiction earn. Other desirable policies included a 0 percent rate on long-term capital gains attributable to assets held and sold within the zone, and a low 17 percent estate tax rate.

For its part, the Committee could simply decide that the framework of HR 2182 be adapted and confined to Puerto Rico, as well as updated to reflect proposals now in Congress for tax reform. Granted, some types of tax relief would be more effective than others. For instance, individuals in Puerto Rico are generally not liable for federal personal income tax unless they have reportable income off the island. Yet the concept is a powerful one that can be molded to many circumstances. Workers on the island are subject to federal payroll taxes – offering a favorably low rate (rather than more ephemeral rebates) through Puerto Rico enterprise zone legislation could be a helpful alternative. At the same time, a federal enterprise zone could provide guidance to officials in Puerto Rico seeking to optimize the Commonwealth's own tax system.

To be clear, NTU has always maintained that the best type of “national enterprise zone” would be one that, indeed, covers the entire nation – providing tax and regulatory relief for all. We do recognize, however, practical realities that counsel the relief to be implemented where it is needed most.

Other tax policies – for instance, the applicability of the Earned Income Credit to Puerto Rico residents – may merit the Committee's discussion, yet we cannot overstate the importance of enacting tax policies in HR 1 that will do more to foster a more hospitable climate for economic growth in Puerto Rico. As an October editorial I co-authored for *Investor's Business Daily* noted, “Federal officials must, in a bipartisan manner, make the island a forethought rather than an afterthought [in] designing tax policy.” Now is the time, HR 1 is the place, and your leadership is the catalyst for doing so. We humbly and eagerly offer all assistance in the days ahead toward fulfilling this task.

Sincerely,

A handwritten signature in black ink, appearing to read 'Pete Sepp', written in a cursive style.

Pete Sepp, President