December 11, 2017

An Open Letter to Tax Cuts and Jobs Act Conferees: Your Leadership Now Can Allow Puerto Rico to Heal!

Dear Chairman Brady and Members of the Conference Committee:

As you confer over the Tax Cuts and Jobs Act (TCJA), you will be deciding upon how the legislation's numerous pro-growth, pro-taxpayer elements will be reconciled – and which might be added. Few are as urgent or appropriate as those pertaining to Puerto Rico's near term recovery and long term well-being. On behalf of National Taxpayers Union's (NTU) members across the nation, including those in the Commonwealth, I urge you to support sensible, immediate steps in TCJA that will help stabilize the fiscal and economic crisis on the island.

NTU has been actively involved in the development of a legislative response to Puerto Rico's recovery, including the PROMESA bill. We have offered advice concerning tax, budget, regulatory, and economic policy affecting the Commonwealth (and by extension the rest of the United States). We encourage 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.

NTU applauded Members of the House for TCJA provisions such as Section 4401 (extending the domestic production activities deduction). We understand that Conferees may soon be presented with a proposal developed between Speaker Ryan and Resident Commissioner Gonzalez that will be consistent with the intent of the overall bill yet will mean so much for the families and businesses of Puerto Rico. We urge Conferees to keep moving in this direction, and consider the following as the most important priorities.

Stop the Taxpayer Exodus Before It Starts. Both the House and Senate versions of TCJA introduce low rates and territoriality while aiming to address base erosion through versions of a tax on transactions between domestically-situated businesses and foreign affiliates or entities. Defining the "base" to be protected is vital for Puerto Rico's survival. Subjecting financial flows between the island and the mainland to the new corporate tax is highly predatory. Although tax law has treated it partially as a foreign country, Puerto Rico remains a U.S. jurisdiction. Precisely because of this hybrid tax status, any provision pertaining to base erosion should acknowledge that Puerto Rico is not some EU, Caribbean, or Pacific Rim trading partner whose laws are alien to our own.

NTU believes Conferees should simply clarify that current policy toward common transfers between mainland and Puerto Rico affiliates of U.S. firms will be maintained rather than mangled with the introduction of a discriminatory tax. Unless this definition is established here and now, American job creators in an American territory will have little choice but to reevaluate their future business plans – resulting in the very flight of capital to other locales that the bills seek to avoid. Fleeing with that capital will be the companies that are responsible for the majority of Puerto Rico's government revenues, producing the most tragically ironic of situations: erosion of the Commonwealth's tax base.

Several proposals have been drafted to harmonize the proposed foreign tax with the reality in Puerto Rico today. For example, language in the conference bill could allow existing firms engaged in active business transactions in Puerto Rico to continue to do so under *current* tax law. Also, Resident Commissioner Gonzalez has mentioned an approach, tied to the House bill's excise tax concept, whereby controlled foreign corporations (CFCs) would be treated as if they were domestic entities in regard to Puerto Rico. The result of that course should *not* be to force CFCs to reorganize. Regardless, even partial recognition of Puerto Rico's distinct situation for any base erosion tax regime would be helpful.

Criticisms that plans such as these are tantamount to resurrecting the long-repealed Section 936 of the Tax Code can be addressed in a straightforward manner, by providing "guardrails" that delineate active versus phantom business activities.

Conferees should consider further steps to rationalize federal tax policy so as to help make Puerto Rico an economic standout. Among these options:

- Reduce the U.S. tax rate on Puerto Rico-sourced income. Doing so could be made consistent with the conference bill, again recognizing that as a U.S. possession, it would be desirable to provide Puerto Rico a tax rate lower than those afforded our trading partners making foreign direct investment.
- Set a Puerto Rico repatriation or dividend deduction at a better level to what policymakers have proposed recently for HR 1 overall. 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.
- Create a sound environment for expansion of locally-formed and -domiciled businesses. In 2005, Delegate Fortuno and Representative Paul Ryan introduced the National Enterprise Zone Act (HR 2182, 109^{th}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. Although federal individual income tax liabilities are relatively narrow for Puerto Rico residents, workers on the island are subject to federal payroll taxes. Resident Commissioner Gonzalez's proposed "investment zone," reportedly with a 40 percent wage credit, certainly captures the essence of HR 2182.

We understand the need for alacrity in the conference process, which places constraints on what the Committee can consider at this late hour. NTU therefore urges you to concentrate on measures that will at least prevent further hemorrhaging of jobs and capital from the island, which is already acute due to Puerto Rico's debt crisis and natural disaster recovery. Waiting until 2018 to stanch this bleeding could doom the Commonwealth's economy to an unrecoverable plight, one that the PROMESA bill was intended to help prevent.

On the other hand, by thoughtfully embracing revisions to the foreign tax provisions now, Conferees will be conveying a compassionate message that it intends to help Puerto Rico and its people heal.

In a November 16 colloquy on the House floor with Representative Curbelo, Chairman Brady said that he "look[ed] forward to continue working on ideas to best serve the people on the island." Also on November 16, Resident Commissioner Gonzalez and Speaker Ryan released a joint statement that affirmed, "It is our intention to make improvements to our tax reform legislation as it relates to Puerto Rico when we go to conference." More imperative words have never been spoken. Translating those words into legislative language that provides a fairer opportunity for Puerto Rico will allow millions more Americans to share in the historic endeavor you have undertaken. Toward this end, we offer all assistance and encouragement to you.

Sincerely,

Pete Sepp
President

25 Massachusetts Avenue, NW, Suite 140 * Washington, DC 20001 * Phone: (703) 683-5700 * Fax: (703) 683-5722 *Web: www.ntu.org