

**SUGGESTED REFORMS NEEDED TO GROW THE PUERTO RICAN ECONOMY AND
PROMOTE PROSPERITY ON THE ISLAND**

By: MINERVA I. CENTENO ROSSY, ESQ, CPA, LLM

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SUMMARY OF RECOMMENDATIONS

- A. ELIMINATE TAX EXEMPTION GRANTS AND PROVIDE A LOWER BUSINESS INCOME TAX RATE THAT WILL APPLY TO ALL BUSINESS NET INCOME IN PUERTO RICO.
- B. ELIMINATE COMPLEXITY FROM PUERTO RICO INTERNAL REVENUE CODE OF 2011, AS AMENDED (the "P.R. CODE")
- C. IF NECESSARY, MOVE TAX EXEMPTION GRANTEES OUT OF CONTRACTUAL TAX EXEMPTION GRANTS BY PROVIDING AN INCENTIVE UNDER THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (the "FEDERAL CODE")
- D. PROMOTE FAIR COMPETITION, EQUAL OPPORTUNITIES TO SUCCEED AND ELIMINATE DISCRIMINATION AND GIVING TAX BENEFITS AND UNFAIR ADVANTAGES TO SELECTED COMPANIES AND PERSONS
- E. LIMIT OR ELIMINATE THE CERTIFIED PROMOTER PROGRAM UNDER ACT 20-2012 EXPORTATION OF SERVICES, ACT 77-1957 (ACT 399) INTERNATIONAL INSURANCE COMPANIES AND ACT 273-2012 INTERNATIONAL FINANCIAL ENTITIES
- F. ROOM TAX PROCEEDS SHOULD GO TO THE GENERAL FUND
- G. REVIEW ALL PUERTO RICO AGENCIES FOR SPECIAL FUNDS AND CONSIDER ALLOCATION OF MONEYS TO THE GENERAL FUND
- H. REQUEST CONGRESS TO PROVIDE UNDER ESTATE TAX LAW AN OPTION FOR PUERTO RICANS BORN IN PUERTO RICO AND THAT ARE DOMICILED IN PUERTO RICO AT THE TIME OF DEATH TO BE TREATED AS UNITED STATES CITIZENS

- I. STREAMLINE THE PERMISSION PROCESS TO OPEN A BUSINESS
- J. OTHER INCENTIVES THAT COULD BE PROVIDED UNDER THE FEDERAL CODE TO MOVE TAX EXEMPTION GRANTEES OUT OF CONTRACTUAL TAX EXEMPTION GRANTS AND TO PROMOTE INVESTMENT AND ECONOMIC DEVELOPMENT IN PUERTO RICO.

ANALYSIS OF RECOMMENDATIONS

- A. **ELIMINATE TAX EXEMPTION GRANTS AND PROVIDE A LOWER BUSINESS INCOME TAX RATE THAT WILL APPLY TO ALL BUSINESS NET INCOME IN PUERTO RICO.**
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- C. **IF NECESSARY, MOVE TAX EXEMPTION GRANTEES OUT OF CONTRACTUAL TAX EXEMPTION GRANTS BY PROVIDING AN INCENTIVE UNDER THE U.S. INTERNAL REVENUE CODE OF 1986, AS AMENDED (the “FEDERAL CODE”)**
- D. **PROMOTE FAIR COMPETITION, EQUAL OPPORTUNITIES TO SUCCEED AND ELIMINATE DISCRIMINATION AND GIVING TAX BENEFITS AND UNFAIR ADVANTAGES TO SELECTED COMPANIES AND PERSONS**

The current tax exemption model is not working in Puerto Rico, although there are more than thirty four (34) special tax exemption laws in Puerto Rico and over 50 tax exemptions and exclusions in the P.R. Code, the economy is in a deep recession, and all those tax incentives are not helping the economy grow and are not promoting prosperity in Puerto Rico.

The tax exemption grant system discriminates in favor of particular industries, in favor of foreigners and nonresidents of Puerto Rico, and discriminates against small business, discriminates against entrepreneurship, discriminates against residents of Puerto Rico, discriminates on basis of age, and against older entrepreneurs. It provides privilege to certain business sectors, and penalizes other business sectors with extremely high taxes. The suggestion is to eliminate all discrimination, and let all businesses sectors the same opportunities to flourish and to develop freely.

Currently, the corporate income tax that applies in Puerto Rico without a tax exemption

grant is the second highest corporate tax rate in the world at 39%. ¹ That is without

¹ The Tax Foundation, FISCAL FACT no. 525: Corporate Income Tax Rates around the World, 2016 : By Kyle Pomerleau and Emily Potosky (August 18, 2016)

The United States has the third highest general top marginal corporate income tax rate in the world, at 38.92 percent. Due to the recent reduction in Chad's corporate tax rate, the U.S. rate is exceeded only by the United Arab Emirates and Puerto Rico

Table 1. Twenty Highest Top Marginal Corporate Tax Rates in the World

<u>Country</u>	<u>Top Rate</u>	<u>Region</u>
United Arab Emirates	55.0%	Asia
Puerto Rico	39.0%	North America
United States	38.9%	North America
Argentina	35.0%	South America
Chad	35.0%	Africa
Congo, Democratic Republic Of The	35.0%	Africa
Equatorial Guinea	35.0%	Africa
Guinea	35.0%	Africa
Malta	35.0%	Europe
Virgin Islands, U.S.	35.0%	North America
Zambia	35.0%	Africa
India	34.6%	Asia
Sint Maarten	34.5%	North America
France	34.4%	Europe
Brazil	34.0%	South America
Venezuela	34.0%	South America
Belgium	34.0%	Europe
Monaco	33.3%	Europe
Saint Lucia	33.3%	North America
Cameroon	33.0%	Africa
Worldwide Average	22.5%	N/A
Worldwide Weighted Average (by GDP)	29.5%	N/A

Among countries with corporate income taxes, Turkmenistan and Uzbekistan have the lowest top marginal rate at 8 percent and 7.5 percent respectively (Table 2). Nine countries have top rates of 10 percent, most of them small nations in Europe (Bosnia and Herzegovina, Macedonia, Gibraltar, Andorra, Bulgaria). The only major industrialized nation among the bottom 20 countries is Ireland, which is known for its low 12.5 percent rate.

There Are Few Countries with Corporate Tax Rates above 35 Percent

The United States stands as one of the few nations in the world with a top corporate income tax rate above 35 percent. ... A plurality (43) of the countries in the world have corporate income tax rates between 25 and 30 percent.

taking into consideration the recent amendments designated to generate revenue that have complicated the P.R. Code, and that are purely local inventions which are not familiar to tax practitioners in the rest of the world, such as was the Patente Nacional (Gross Income Tax), and the currently applicable Alternative Minimum Tax provisions which incorporate provisions to address transfer pricing which do not follow the international treatment usually provided to transfer pricing issues in the global economy and related party and home office allocation of costs which do not follow the usually applied principles of related party transactions and branch taxation. These strange rules that were adopted for purely income generating activities, clearly place Puerto Rico in a competitive disadvantage, are hurting Puerto Rico businesses, and instead of rising money are having the opposite effect.

The suggestion to correct this problem is to provide a low business income tax rate of 12.5% that will apply to all business (including service income) net income. Everyone that wants to establish a business in Puerto Rico will qualify for the lower tax rate. This will eliminate the bureaucracy of applying and qualifying for a tax exemption grant.² The bureaucracy to establish a business with tax exemption is very lengthy, subject to the approval of government officials that sometimes exercise control and that demand lengthy documentation that is burdensome, especially to small businesses, and entrepreneurs. Also during tax exemption grant procedures usually big businesses with more bargaining power are able to obtain, excessive incentives and grants from the Puerto Rico government. With the lower tax rate across the board, without out tax exemption grant, if a foreign investor or a local person wants to establish a business there is no need to have a burdensome procedure, nor to be courting local government officials, and can go ahead and establish the business as soon as desired.

In addition, the P.R. Code, should be revised and the Alternative Minimum Tax should be amended to eliminate the strange transfer pricing provisions and instead the PR Code should be amended to include transfer pricing provision and regulations similar to those provided under the Federal Code or under the OECD Transfer Pricing Guidelines. Also, the strange home office and related party allocation rules, should be eliminated, and instead should be amended to include the related party rules and branch accounting rules under the Federal Code which are more aligned to international business usage. The P.R. Code should be revised and other unusual provisions that do not follow usually accepted international tax rules and that jeopardize our

Twenty-eight countries have tax rates between 30 and 35 percent. The United States is one of only three countries in the world with a corporate tax rate above 35 percent. Seventy-five countries have corporate tax rates between 0 and 20 percent.

² The proposed elimination of tax exemption grants is suggested only for for-profit businesses and does not apply to determinations of tax exemption for not-for-profit organizations recognized as tax exempt under the P.R. Code and the Federal Code, which because of the contributions that they make to Puerto Rico, shall maintain their status as tax exempt under P.R. law.

participation in the global economy should be eliminated. When an investor wants to invest in a business, they are interested in knowing clearly how much is going to be the return in such investment, complicated and original rules that do not follow international standards do not produce an easy answer that will facilitate economic growth and investment.

Law and CPA firms that profit from providing tax advice for obtaining a tax exemption grants will probably be initially against this proposal, but they will not be affected by these changes, because they will benefit from the increased amount of work that will be generated by facilitating the establishment of new businesses.

Tax exemption grants are currently being granted as a contract, between the government of Puerto Rico and the holder of the grant. That is very burdensome to the PR government, if a prior government official granted tax incentives to a business, even beyond what was approved by law, and then it is very difficult to correct those errors. If, you decide to keep some tax exemption grants in place, do not allow them to be granted as a contract.

There must be many tax exemption grants with a tax rate lower than the suggested 12.5% income tax rate. My understanding is that under PROMESA probably current contractual obligations with tax exemption grantees will have to be respected, therefore, in order to motivate current tax exemption grantees to relinquish the tax exemption grants, they will have to be offered an attractive incentive to do so. My understanding is that United States investors and corporations will have no problem with paying a higher 12.5% income tax rate to the government of Puerto Rico, because this will be the type of tax that clearly qualifies for a direct or indirect foreign tax credit under the Federal Code. The Puerto Rico government will be receiving a higher share of income revenue from Puerto Rico business operations (income that should clearly belong to Puerto Rico under U.S. and international tax standards), and that will be beneficial to the government, bondholders and to the Puerto Rico economy. The federal government could help to move out tax exemption grantees from the burdensome contractual tax exemption grants and help to grow the economy by providing Puerto Rico businesses a lower dividend income tax rate in the United States, to all those businesses form U.S. investors that relinquish the Puerto Rico tax exemption grant and qualify for the 12.5% tax rate. This could be done by providing a dividend received deduction to Puerto Rico corporations at an effective rate of 15% similar to the qualified dividend tax rate that applies to individuals, trusts and estates. (A more aggressive proposal would be for a 100% dividend received deduction similar to the ones provided to US corporations.) (See, more alternative incentives under the Federal Code, below.)

E. LIMIT OR ELIMINATE THE CERTIFIED PROMOTER PROGRAM UNDER ACT 20-2012 EXPORTATION OF SERVICES, ACT 77-1957 (ACT 399) INTERNATIONAL INSURANCE COMPANIES AND ACT 273-2012 INTERNATIONAL FINANCIAL ENTITIES

The attractive tax incentives under such Puerto Rico laws should be enough to promote the establishment of such businesses in Puerto Rico. Puerto Rico should not be paying as compensation 10% annually (under Act 20 and Act 399) or 7.5% (under Act 273) of what it collects in income taxes to a promoter that helps establish a business in Puerto Rico under a tax exemption law for the lengthy period of 15 years. At a time when our teachers and policemen are receiving very low wages for the types of jobs they are realizing, and when there have been cuts to their retirement compensation, a promotion service (that must probably does not require a big amount of effort due to the attractive incentive) to establish an industry in Puerto Rico should not be paid a compensation for a period of 15 years. Traditionally, the promotion of Puerto Rico has been done by the Puerto Rico development bank, and by CPAs and attorneys in the industry, without this type of lengthy and limitless compensation. Actually, this type of open ended compensation for services not related to actual services could be illegal and unconstitutional under Puerto Rico law, therefore any certifications or contracts that have been authorized under Regulation 8642 of September 10, 2015 should be limited or eliminated.

The Certified Promoter program could jeopardize economic development, because this could lead to persons having to obtain a certified promoter in order to have the tax exemption approved by the Agency, becoming an obstacle, and lengthy approval process to those business that do not which to have a promoter.

Eliminate the special promotion funds under Act 20, Act 399, and Act 273 in which 10% of the income taxes collected (7.5% under Act 273) are separated by Puerto Rico Treasury for promotional activities of the Puerto Rico Development Bank. The funds should go to the general fund and the Puerto Rico Development Bank should compete for their funds under the budget as any other agency.

F. ROOM TAX PROCEEDS SHOULD GO TO THE GENERAL FUND

Room Tax proceeds are currently administered by the Puerto Rico Tourism Agency, before room tax was administered by the Puerto Rico Treasury Department. Taking into consideration any bond obligations, and other contractual obligations, an examination should be done to see how the funds collected by the Room Tax should return to be administered by the general fund in order to more effectively use the resources.

G. REVIEW ALL PUERTO RICO AGENCIES FOR SPECIAL FUNDS AND CONSIDER ALLOCATION OF MONEYS TO THE GENERAL FUND

Review all Puerto Rico for special funds, and determine whether they are efficiently used or if those funds should be allocated to the General Fund.

H. REQUEST CONGRESS TO PROVIDE UNDER ESTATE TAX LAW AN OPTION FOR PUERTO RICANS BORN IN PUERTO RICO AND THAT ARE DOMICILED IN PUERTO RICO AT THE TIME OF DEATH TO BE TREATED AS UNITED STATES CITIZENS

Under Section 2209 of the Federal Code for estate tax purposes a decedent who was a citizen of the U.S. and a resident of a possession at the time of his death shall be considered a "nonresident not a citizen of the United States" but only if such person acquired his U.S. citizenship solely by reason of (1) his being a citizen of such possession of the United States, or (2) his birth or residence within such possession of the United States.

Under Section 2209, the estate of a United States citizen born or naturalized and domiciled in Puerto Rico is subject to federal estate tax only if the property is situated in the United States. For these purposes, the term 'United States', includes only the States and the District of Columbia and it does not include Puerto Rico.

Under Section 2102(b)(1) of the Federal Code, a nonresident alien's estate is entitled to unified credits equal to the greater of (a) \$13,000 (represents estate tax due on an estate valued at \$60,000) or (b) the portion of \$46,800 (which offsets the tax on the first \$175,000 of the decedent's estate) which the value of the decedent's US situs assets bears to the value of his/her gross estate.

Since the economy in Puerto Rico is very deteriorated, many Puerto Rican are making their investments in United States properties. Since, if they are domiciled in Puerto Rico the unified credit will apply to exclude only \$60,000 of their U.S. property some of the wealthier individuals with investments in U.S. property are opting into changing their domicile to the United States where the unified credit will exclude \$5,000,000 of the U.S. property. If an option were included under Section 2209, in which the individuals addressed under such Section would have an option to be treated as any other United States citizen, then such individuals would be able to stay in Puerto Rico.

I. STREAMLINE THE PERMISSION PROCESS TO OPEN A BUSINESS

I have been working in the business sector since 1981, and before the process to open a business was not that complicated. Every year the Puerto Rico government makes it more and more complex. During 2001-2004, when the Puerto Rican economy started

to slow down, more requirements were established to open a business in Puerto Rico. They added to the process that in order to open a business you need a certification that you do not owe child support, that you do not owe Puerto Rico Tax, Municipal or property tax, that you have filed income tax for the past five years. People need to work, the government should allow people to start a business and produce money even if they owe money to the government. Allow those businesses a reasonable period of time to establish themselves, and demand a payment plan, but allow the business to open. During these rough economic times all people in Puerto Rico should be allowed to open a business under the law.

J. OTHER INCENTIVES THAT COULD BE PROVIDED UNDER THE FEDERAL CODE TO MOVE TAX EXEMPTION GRANTEES OUT OF CONTRACTUAL TAX EXEMPTION GRANTS AND TO PROMOTE INVESTMENT AND ECONOMIC DEVELOPMENT IN PUERTO RICO.

1. Amend Section 367 of the Federal Code.

a) Amend Section 367(a) of the Federal Code to provide for the tax free transfer of property of a United States person into a foreign corporation operating in Puerto Rico in connection with an exchange described in Sections 332, 351, 354, 356 and 361 of the Federal Code. A foreign corporation operating in Puerto Rico will be a corporation organized in Puerto Rico and which derives 80 percent or more of its gross income from sources within Puerto Rico.

b) Another alternative will be to amend Section 367(a) of the Federal Code to provide for the tax free transfer of intangibles a United States person into a foreign corporation operating in Puerto Rico in connection with an exchange described in Sections 332, 351, 354, 356 and 361 of the Federal Code.

2. Proposal alternatives with respect to dividend and deemed dividend distributions from controlled foreign corporations operating in Puerto Rico.

a) To provide for the deferral of income from controlled foreign corporations operating in Puerto Rico to the extent that such income has not been repatriated through a dividend distribution. Such deferral can be accomplished by amending 951(a)(2) in order to exclude foreign corporations operating in Puerto Rico from the deemed dividend distribution imposed by Section 951(a)(2)(A) of the Federal Code.

b) To provide for an attractive lower income tax rate applicable for deemed dividend distributions taxable under Subpart F and other dividends actually distributed by the taxpayer from earnings and profits derived from a controlled foreign corporation operating in Puerto Rico. (This will provide an incentive to invest in controlled foreign corporations operating in Puerto Rico, and at the same time by providing an attractive

lower tax rate on dividend distributions, such corporations may be encouraged to repatriate their earnings to the United States. This will also promote domestic U.S. investment, will help U.S. corporations to be competitive and allow Treasury to collect tax at the lower federal income tax rate.)

c) To eliminate the deemed dividend distribution imposed by Section 951(a) of the Federal Code to the extent that the income is invested in United States property or in certain Puerto Rico investments.

d) To amend the Federal Code to provide for a dividend received deduction from dividends paid by Puerto Rico corporations to United States corporate shareholders, as described above.

3. Amend the term “controlled foreign corporation”

Amend the term “controlled foreign corporation “ under Section 957 of the Federal Code to exclude from the term any corporation created or organized in the Commonwealth of Puerto Rico if:

(1) 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Commonwealth of Puerto Rico, and

(2) 50 percent or more of the gross income of such corporation for such period, or for such part thereof, was derived from the active conduct within the Commonwealth of Puerto Rico or a possession of the United States of any trades or businesses constituting the manufacture or processing of goods, wares, merchandise, or other tangible personal property; the processing of agricultural or horticultural products or commodities (including but not limited to livestock, poultry, or fur-bearing animals); the catching or taking of any kind of fish or the mining or extraction of natural resources, or any manufacturing or processing of any products or commodities obtained from such activities; or the ownership or operation of hotels.

4. Other new investment proposals

a) Treaty parity. The United States has income tax treaties or conventions with several foreign countries under which the corporations considered a resident of such foreign countries are pursuant to such income tax treaties or conventions taxed at a reduced rate or are exempt from United States income taxes on certain items of income received from within the United States. The proposal will amend the Federal Code to provide for treaty parity to corporations organized under the laws of Puerto Rico. The Puerto Rico corporation will be able to claim the most favorable reduced

rates or exemptions available to the United States treaty partners. (This will give Puerto Rico corporations, which are considered foreign corporations under the Federal Code, the same treatment that is provided to foreign corporations residents of other foreign countries such as Ireland, Netherlands and Switzerland.)

Prepared by:

Minerva I. Centeno Rossy, Esq, CPA, LLM.