

October 5, 2016

**A Proposal for Economic Growth in Puerto Rico
Submitted to the Congressional Task Force on Economic Growth in Puerto Rico
By the Puerto Rico Statehood Council**

Updated to include legislative text

Introduction

The Puerto Rico Statehood Council (PRSC) appreciates the opportunity to submit this policy proposal to stimulate economic growth in Puerto Rico by building on and adapting established tax law.

The proposal outlined below is based on three policy criteria: first, an approach that is designed to create jobs and economic opportunity in Puerto Rico for those individuals residing and those businesses actually employing people on the island; second, the utilization of various tax incentives present in current U.S. law that have been enacted for other economically-distressed areas or Empowerment Zones; and, third, proposals advanced in a manner compatible with and as a “down-payment” for broad tax reform as reflected in the tax reform “blueprint” released by House Speaker Paul Ryan (R-WI) and Ways and Means Chairman Kevin Brady (R-TX) in June of 2016.

Thus, this proposal attempts to advance job-creation policies that are consistent with (1) precedents of current tax law for distressed areas or (2) as a “down-payment” for major tax reform.

Puerto Rico Economic Growth and Investment Incentives

- 1. Empowerment Zones:** Puerto Rico would be statutorily designated as an Empowerment Zone for a set period of 10 years, regardless of any change in the status of Puerto Rico during the ten-year period. After the ten-year period, the Empowerment Zone benefits would be determined and continue to be available for areas of the island under the qualification rules applicable to economically distressed areas throughout the states under present law. As a statutorily designated Empowerment Zone, the following incentives would be available to encourage economic growth and investment in Puerto Rico. (Legislative draft modeled on [26 U.S.C § 1400](#))
 - A. Business investment incentives:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone, entities that invest in Puerto Rico (corporations or pass-through entities) would be eligible to receive the following tax benefits (similar to Ryan/Brady tax blueprint or existing tax code distressed areas investment incentives):
 - **Lower tax rate:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone, 20% tax rate for both corporations and pass-through entities on Puerto Rico-sourced earnings.
 - **Employment tax credit:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone (Legislative draft modelled on [26 U.S.C. § 1396](#)):
 - (a) 20% for new hires in first 5 years
 - (b) 15% for new hires in years 6-8; and
 - (c) 10% for new hires in years 9 and 10.

- **R&D credit:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone, a 20% R&D credit (increased from current 14% “alternative simplified credit”). (Legislative draft modelled on [26 U.S.C. § 41\(c\)\(5\)](#))
- **New markets tax credit (NMTC):**
 - (a) Puerto Rico designated as eligible for NMTC
 - (b) NMTC extended for Puerto Rico investments for life of Puerto Rico Empowerment Zone designation.
- **Expensing:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone, full 100% expensing provided for Puerto Rico Empowerment Zone investments, including in personal property, real property and property that would otherwise be amortizable (similar to Gulf Opportunity (GO) zone incentives contained in Code section [1400N](#)).
- **Zero capital gains tax rate:** businesses that invest in Puerto Rico Empowerment Zone assets, held for more than 5 years, would receive a zero percent capital gains tax rate (similar to the treatment of investments in DC Empowerment Zones under Code section [1400B](#)).
- **Encouragement of Infrastructure Investment:** The Task Force should consider and endorse mechanisms that encourage investment in infrastructure projects on the island as an additional means of job creation and economic growth.

B. Individual investment incentives

- **Zero capital gains tax rate:** Similar to the business tax incentive described above, during the period in which Puerto Rico is a statutorily designated Empowerment Zone, individuals who invest in Puerto Rico Empowerment Zone assets, held for more than 5 years, would receive a zero percent capital gains tax rate upon the sale or exchange of such assets (similar to the treatment of investments in DC Empowerment Zones under Code section [1400B](#)).
- **Tax deferral and zero capital gains rate:** During the period in which Puerto Rico is a statutorily designated Empowerment Zone, a zero percent capital gains rate would also apply to individuals who establish 5-year residency in Puerto Rico and who invest any U.S. source gain in the Puerto Rico Empowerment Zone. U.S. tax would be deferred on any such gain while 5-year Puerto Rico residency is established.

2. **Domestic manufacturing tax encouragement.** Section 199, which encourages manufacturing activities throughout the United States, currently applies to manufacturing activity in Puerto Rico. The applicability of Section 199 to Puerto Rico is scheduled to expire at the end of 2016. The application of Section 199 should be made permanent. (Legislative draft modelled on [H.R. 5400](#))

3. **Earned income tax credit (EITC):** The EITC, which does not apply in Puerto Rico, would be extended to residents of Puerto Rico, administered federally, and strengthened to reduce error and fraud. (Legislative draft modelled on [S. 2675](#))

Conclusion

The PRSC is pleased to present this job creation, economic growth and investment package to the Task Force. We believe that this package, or a package of similar incentives, would produce the kind of growth that Puerto Rico needs to emerge out of its lengthy recession and recent financial crisis.

For too long, Puerto Rico has lagged behind the rest of the United States on job creation and economic growth. We are confident that the right mix of pro-growth, job-creating policy changes which are contained in this Empowerment Zone plan will create jobs, lower unemployment, increase labor force participation, grow business fixed investment, result in capital in all forms rushing to Puerto Rico, and ultimately raise the standard of living and prosperity for all. There is no reason why Puerto Rico cannot become an economic powerhouse of the Caribbean if unshackled from onerous tax and regulatory policies.

This plan incorporates investment incentives in current federal law which have not been fully and effectively extended to Puerto Rico, limiting its growth. For Puerto Rico to overcome its economic challenges and achieve its full potential, however, history has shown and the simple fact must be recognized that it must be treated equally with the rest of the nation in all respects. Repeated initiatives for different treatment have left the territory underdeveloped and poor compared with the states and have encouraged its U.S. citizens to relocate to a state for greater opportunities. By a majority vote of more than three-fifths, Puerto Ricans have also petitioned the Congress to phase in the equal treatment that they could achieve through statehood.

We would be happy to meet with members of the Task Force to discuss the various recommendations contained in this proposal at your convenience. Thank you again for this opportunity to provide our input.

Puerto Rico Economic Growth Proposal: Legislative Text

Purpose: Establish new Code section 1400V to designate Puerto Rico as an Empowerment Zone and to provide additional tax benefits available to businesses and individuals who reside or conduct business within the Puerto Rico Empowerment Zone. Additionally, provisions would make Puerto Rico eligible for the domestic manufacturing tax credit and would make residents eligible for the earned income tax credit.

SECTION 1. DESIGNATION OF PUERTO RICO AS AN EMPOWERMENT ZONE; APPLICABLE PUERTO RICO EMPOWERMENT ZONE INCENTIVES .

Establish new Code section 1400V as follows:

(a) In general, for purposes of this title Puerto Rico is hereby designated as the Puerto Rico Empowerment Zone.

(b) Applicable Puerto Rico area

For purposes of subsection (a), the term “Puerto Rico Empowerment Zone” means the entirety of Puerto Rico.

(c) Time for which designation applicable

(1) In general

The designation made by subsection (a) shall apply for the period beginning December 31, 2016 and ending after a period of 10 years. Thereafter, Puerto Rico or portions thereof shall be eligible for the provisions of Subchapter U.

(d) Tax Rate for Puerto Rico Empowerment Zone Business Income

(1) During the ten-year period in which Puerto Rico is designated an Empowerment Zone, Puerto Rico-sourced business earnings shall be taxed at the rate of 20 percent.

(2) For the purposes of this subchapter, “Puerto Rico-sourced business earnings” shall mean income generated by businesses resident in Puerto Rico, provided that such income is active trade or business income with a substantial physical and economic nexus in Puerto Rico, and is not generated by activities meeting the definition of “passive activity” under section 469.

(e) Employment Credit

For purposes of this subchapter, the amount of the employment credit determined under section 1396 with respect to any employer for any taxable year is the applicable percentage of the qualified Puerto Rico Empowerment Zone wages paid or incurred during the calendar year which ends with or within such taxable year.

(1) Applicable percentage

For purposes of this section, the applicable percentage is

- (A) 20% for new employees hired within the first five years of designation;
- (B) 15% for new employees hired in years six through eight; and
- (C) 10% for new employees hired in years nine and ten.

(2) Qualified Puerto Rico Empowerment Zone wages

(A) In general

For purposes of this section, the term “qualified Puerto Rico Empowerment Zone wages” means any wages paid or incurred by an employer for services performed by an employee while such employee is a qualified Puerto Rico Empowerment Zone employee.

(B) Only first \$15,000 of wages per year taken into account

With respect to each qualified Puerto Rico Empowerment Zone employee, the amount of qualified Puerto Rico Empowerment Zone wages which may be taken into account for a calendar year shall not exceed \$15,000.

(C) Coordination with work opportunity credit

(i) In general

The term “qualified zone wages” shall not include wages taken into account in determining the credit under section 51

(ii) Coordination with paragraph (2)

The \$15,000 amount in paragraph (2) shall be reduced for any calendar year by the amount of wages paid or incurred during such year which are taken into account in determining the credit under section 51.

(3) Qualified Puerto Rico Empowerment Zone employee

For purposes of this section—

(A) In general

Except as otherwise provided in this subsection, the term “qualified Puerto Rico Empowerment Zone employee” means, with respect to any period, any employee of an employer if—

(i) substantially all of the services performed during such period by such employee for such employer are performed within the Puerto Rico Empowerment Zone in a trade or business of the employer, and

(ii) the principal place of abode of such employee while performing such services is within the Puerto Rico Empowerment Zone.

(B) Certain individuals not eligible

The term “qualified Puerto Rico Empowerment Zone employee” shall not include—

(i) any individual described in subparagraph (A), (B), or (C) of section 51(i)(1),

(ii) any 5-percent owner (as defined in section 416(i)(1)(B)),

(iii) any individual employed by the employer for less than 90 days,

(iv) any individual employed by the employer at any facility described in section 144(c)(6)(B), and

(v) any individual employed by the employer in a trade or business the principal activity of which is farming (within the meaning of subparagraph (A) or (B) of section 2032A(e)(5)), but only if, as of the close of the taxable year, the sum of—

(I) the aggregate unadjusted bases (or, if greater, the fair market value) of the assets owned by the employer which are used in such a trade or business, and

(II) the aggregate value of assets leased by the employer which are used in such a trade or business (as determined under regulations prescribed by the Secretary),

exceeds \$500,000.

(C) Special rules related to termination of employment

(i) In general subparagraph (B)(iii) shall not apply to—

(I) a termination of employment of an individual who before the close of the period referred to in paragraph (B)(iii) becomes disabled to perform the services of such employment unless such disability is removed before the close of such period and the taxpayer fails to offer reemployment to such individual, or

(II) a termination of employment of an individual if it is determined under the applicable State unemployment compensation law that the termination was due to the misconduct of such individual.

(ii) Changes in form of business

For purposes of paragraph (B)(iii), the employment relationship between the taxpayer and an employee shall not be treated as terminated—

(I) by a transaction to which section 381(a) applies if the employee continues to be employed by the acquiring corporation, or

(II) by reason of a mere change in the form of conducting the trade or business of the taxpayer if the employee continues to be employed in such trade or business and the taxpayer retains a substantial interest in such trade or business.

(f) Research and Development Credit

(1) The credit available under section 41 shall be made available to all taxpayers within the Puerto Rico Empowerment Zone.

(2) Election of alternative simplified credit

With respect to the alternative simplified credit under section 41(c)(5), the credit shall be equal to 20 percent of so much of the qualified research expenses for the taxable year as exceeds 50 percent of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

(g) Application of new markets tax credit to investments in community development entities serving the Puerto Rico Empowerment Zone

For purposes of section 45D—

(1) a qualified community development entity shall be eligible for an allocation under subsection (f)(2) if a significant mission of such entity is the recovery and redevelopment of the Puerto Rico Empowerment Zone. Such eligibility shall extend for the duration of the Puerto Rico Empowerment Zone designation.

(h) Special allowance for certain property acquired on or after December 31, 2016

(1) Additional allowance

In the case of any qualified Puerto Rico Empowerment Zone property—

(A) the depreciation deduction provided by section 167(a) for the taxable year in which such property is placed in service shall include an allowance equal to 100 percent of the adjusted basis of such property, and

(B) the adjusted basis of the qualified Puerto Rico Empowerment Zone property shall be reduced by the amount of such deduction before computing the amount otherwise allowable as a depreciation deduction under this chapter for such taxable year and any subsequent taxable year.

(2) Qualified Puerto Rico Empowerment Zone property

For purposes of this subsection—

(A) In general

(i) The term “qualified Puerto Rico Empowerment Zone property” means any property to which section 168 applies (or would apply but for section 179), or expenses that otherwise would be required to be capitalized, if—

(I) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after the date on which the designation of the Puerto Rico Empowerment Zone took effect,

(II) the original use of which in the Puerto Rico Empowerment Zone commences with the taxpayer, and

(III) substantially all of the use of which is in the Puerto Rico Empowerment Zone and is in the active conduct of a qualified business by the taxpayer in such zone.

(ii) Special rule for substantial renovations

In the case of any property which is substantially renovated by the taxpayer, the requirements of subparagraphs (A) and (B) of paragraph (1) shall be treated as satisfied. For purposes of the preceding sentence, property shall be treated as substantially renovated by the taxpayer if, during any 24-month period beginning after the date on which the designation of the Empowerment Zone took effect, additions to basis with respect to such property in the hands of the taxpayer exceed the greater of (i) an amount equal to the adjusted basis at the beginning of such 24-month period in the hands of the taxpayer, or (ii) \$5,000.

(B) Exceptions

(i) Alternative depreciation property

Such term shall not include any property described in section 168(k)(2)(D)(i).

(ii) Tax-exempt bond-financed property

Such term shall not include any property any portion of which is financed with the proceeds of any obligation the interest on which is exempt from tax under section 103.

(iii) Qualified revitalization buildings

Such term shall not include any qualified revitalization building with respect to which the taxpayer has elected the application of paragraph (1) or (2) of section 1400I(a).

(iv) Election out

If a taxpayer makes an election under this clause with respect to any class of property for any taxable year, this subsection shall not apply to all property in such class placed in service during such taxable year.

(3) Special rules

For purposes of this subsection, rules similar to the rules of subparagraph (E) of section 168(k)(2) shall apply, except that such subparagraph shall be applied—

(A) by substituting “August 27, 2005” for “December 31, 2007” each place it appears therein,

(B) without regard to “and before January 1, 2015” in clause (i) thereof, and

(C) by substituting “qualified Puerto Rico Empowerment Zone property” for “qualified property” in clause (iv) thereof.

(4) Allowance against alternative minimum tax

For purposes of this subsection, rules similar to the rules of section 168(k)(2)(G) shall apply.

(5) Recapture

For purposes of this subsection, rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified Puerto Rico Empowerment Zone property which ceases to be qualified Puerto Rico Empowerment Zone property.

(6) Extension for certain property

(A) In general

In the case of any specified Puerto Rico Empowerment Zone extension property, paragraph (2)(A) shall be applied without regard to clause (v) thereof.

(B) Specified Puerto Rico Empowerment Zone extension property

For purposes of this paragraph, the term “specified Puerto Rico Empowerment Zone extension property” means property—

(i) substantially all of the use of which is in the Puerto Rico Empowerment Zone, and

(ii) which is—

(I) nonresidential real property or residential rental property which is placed in service by the taxpayer on or before December 31, 2026, or

(II) in the case of a taxpayer who places a building described in subclause (I) in service on or before December 31, 2026, property described in section 168(k)(2)(A)(i) if substantially all of the use of such property is in such building and such property is

placed in service by the taxpayer not later than 90 days after such building is placed in service.

(C) Exception for bonus depreciation property under section 168(k)

The term “specified Puerto Rico Empowerment Zone extension property” shall not include any property to which section 168(k) applies.

(i) Exclusion of Capital Gain Income

Gross income shall not include qualified capital gain from the sale or exchange of any Puerto Rico Empowerment Zone asset held for more than 5 years.

(1) Puerto Rico Empowerment Zone asset

For purposes of this section—

(A) In general

The term “Puerto Rico Empowerment Zone asset” means—

- (i) any Puerto Rico Empowerment Zone business stock,
- (ii) any Puerto Rico Empowerment Zone partnership interest, and
- (iii) any Puerto Rico Empowerment Zone business property.

(B) Puerto Rico Empowerment Zone business stock

(i) In general

The term “Puerto Rico Empowerment Zone business stock” means any stock in a domestic corporation which is originally issued after December 31, 2016, if—

(I) such stock is acquired by the taxpayer, before January 1, 2027, at its original issue (directly or through an underwriter) solely in exchange for cash,

(II) as of the time such stock was issued, such corporation was a Puerto Rico Empowerment Zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a Puerto Rico Empowerment Zone business), and

(III) during substantially all of the taxpayer’s holding period for such stock, such corporation qualified as a Puerto Rico Empowerment Zone business.

(ii) Redemptions

A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

(C) Puerto Rico Empowerment Zone partnership interest

The term “Puerto Rico Empowerment Zone partnership interest” means any capital or profits interest in a domestic partnership which is originally issued after December 31, 2016, if—

- (i) such interest is acquired by the taxpayer, before January 1, 2027, from the partnership solely in exchange for cash,
- (ii) as of the time such interest was acquired, such partnership was a Puerto Rico Empowerment Zone business (or, in the case of a new partnership, such partnership was being organized for purposes of being a Puerto Rico Empowerment Zone business), and
- (iii) during substantially all of the taxpayer’s holding period for such interest, such partnership qualified as a Puerto Rico Empowerment Zone business. A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

(D) Puerto Rico Empowerment Zone business property

(i) In general

The term “Puerto Rico Empowerment Zone business property” means tangible property if—

- (I) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 2016, and before January 1, 2027,
- (II) the original use of such property in the Puerto Rico Empowerment Zone commences with the taxpayer, and
- (III) during substantially all of the taxpayer’s holding period for such property, substantially all of the use of such property was in a Puerto Rico Empowerment Zone business of the taxpayer.

(ii) Special rule for buildings which are substantially improved

(I) In general

The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as met with respect to—

- (aa) property which is substantially improved by the taxpayer before January 1, 2027, and
- (bb) any land on which such property is located.

(II) Substantial improvement

For purposes of clause (i), property shall be treated as substantially improved by the taxpayer only if, during any 24-month period beginning after December 31, 2016,

additions to basis with respect to such property in the hands of the taxpayer exceed the greater of—

(aa) an amount equal to the adjusted basis of such property at the beginning of such 24-month period in the hands of the taxpayer, or

(bb) \$5,000.

(E) Treatment of Puerto Rico Empowerment Zone termination

The termination of the designation of the Puerto Rico Empowerment Zone shall be disregarded for purposes of determining whether any property is a Puerto Rico Empowerment Zone asset.

(F) Treatment of subsequent purchasers, etc.

The term “Puerto Rico Empowerment Zone asset” includes any property which would be a Puerto Rico Empowerment Zone asset but for paragraph (2)(A)(i), (3)(A), or (4)(A)(i) or (ii) in the hands of the taxpayer if such property was a Puerto Rico Empowerment Zone asset in the hands of a prior holder.

(G) 5-year safe harbor

If any property ceases to be a Puerto Rico Empowerment Zone asset by reason of paragraph (2)(A)(iii), (3)(C), or (4)(A)(iii) after the 5-year period beginning on the date the taxpayer acquired such property, such property shall continue to be treated as meeting the requirements of such paragraph; except that the amount of gain to which subsection (a) applies on any sale or exchange of such property shall not exceed the amount which would be qualified capital gain had such property been sold on the date of such cessation.

(2) Puerto Rico Empowerment Zone business

For purposes of this section, the term “Puerto Rico Empowerment Zone business” means any enterprise zone business (as defined in section 1397C), determined—

(A) after the application of section 1400(e),

(B) by substituting “80 percent” for “50 percent” in subsections (b)(2) and (c)(1) of section 1397C, and

(C) by treating no area other than the Puerto Rico Empowerment Zone as an Empowerment Zone or enterprise community.

(3) Other definitions and special rules

For purposes of this section—

(A) Qualified capital gain

Except as otherwise provided in this subsection, the term “qualified capital gain” means any gain recognized on the sale or exchange of—

(i) a capital asset, or

(ii) property used in the trade or business (as defined in section 1231(b)).

(B) Gain before 2017 or after 2027 not qualified

The term “qualified capital gain” shall not include any gain attributable to periods before January 1, 2017, or after December 31, 2026.

(C) Certain gain not qualified

The term “qualified capital gain” shall not include any gain which would be treated as ordinary income under section 1245 or under section 1250 if section 1250 applied to all depreciation rather than the additional depreciation.

(D) Intangibles and land not integral part of Puerto Rico Empowerment Zone business

The term “qualified capital gain” shall not include any gain which is attributable to real property, or an intangible asset, which is not an integral part of a Puerto Rico Empowerment Zone business.

(E) Related party transactions

The term “qualified capital gain” shall not include any gain attributable, directly or indirectly, in whole or in part, to a transaction with a related person. For purposes of this paragraph, persons are related to each other if such persons are described in section 267(b) or 707(b)(1).

(4) Certain other rules to apply

Rules similar to the rules of subsections (g), (h), (i)(2), and (j) of section 1202 shall apply for purposes of this section.

(5) Sales and exchanges of interests in partnerships and S corporations which are Puerto Rico Empowerment Zone businesses In the case of the sale or exchange of an interest in a partnership, or of stock in an S corporation, which was a Puerto Rico Empowerment Zone business during substantially all of the period the taxpayer held such interest or stock, the amount of qualified capital gain shall be determined without regard to—

(A) any gain which is attributable to real property, or an intangible asset, which is not an integral part of a Puerto Rico Empowerment Zone business, and

(B) any gain attributable to periods before January 1, 2017, or after December 31, 2026.

(j) Individual Capital Gains Exclusion

(1) During the period in which Puerto Rico is designated Empowerment Zone, individuals who invest in Puerto Rico Empowerment Zone assets, held for more than 5 years, shall receive a zero percent capital gains tax rate upon the sale or exchange of such assets.

(2) During the period in which Puerto Rico is a designated Empowerment Zone, a zero percent capital gains tax rate shall apply to individuals who establish residency in Puerto Rico for five years or more and who invest any U.S. source gain in the Puerto Rico Empowerment Zone. Such individuals may defer U.S. taxation on any such gain while the 5-year Puerto Rico residency is established.

SECTION 2. DOMESTIC MANUFACTURING CREDIT.

(a) In General.—Section 199(d)(8) of the Internal Revenue Code of 1986 is amended by striking subparagraph (C).

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after December 31, 2016.

SECTION 3. PUERTO RICO RESIDENTS ELIGIBLE FOR EARNED INCOME TAX CREDIT

(a) In General.—Section 32 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsection:

“(n) Residents Of Puerto Rico.—

“(1) IN GENERAL.—In the case of residents of Puerto Rico—

“(A) the United States shall be treated as including Puerto Rico for purposes of subsections (c)(1)(A)(ii)(I) and (c)(3)(C),

“(B) subsection (c)(1)(D) shall not apply to nonresident alien individuals who are residents of Puerto Rico, and

“(C) adjusted gross income and gross income shall be computed without regard to section 933 for purposes of subsections (a)(2)(B) and (c)(2)(A)(i).

“(2) LIMITATION.—The credit allowed under this section by reason of this subsection for any taxable year shall not exceed the amount, determined under regulations or other guidance promulgated by the Secretary, that a similarly situated taxpayer would receive if residing in a State.”.

(b) Child Tax Credit Not Reduced.—Subclause (II) of section 24(d)(1)(B)(ii) of such Code is amended by inserting before the period “(determined without regard to section 32(n) in the case of residents of Puerto Rico)”.

(c) Effective Date.—The amendment made shall apply to taxable years beginning after December 31, 2016.