Senator Orrin G. Hatch
Chairman
Finance Committee
United States Senate
Washington, DC 20510

April 3, 2015

Dear Senator Hatch:

With regards to your and Senator Wyden announcement requesting ideas on how best to overhaul the nation's tax code, I would like to add my support to Dr. Miriam Ramirez's idea of fully extending the IRS code to Puerto Rico.

Extending the IRS code to Puerto Rico is in the best interests of the United States and Puerto Rico.

As Dr. Ramirez explains,

"Some observers have expressed the opinion that the residents of Puerto Rico are better off because Federal income tax laws do not apply in the Island. This opinion is not correct for two reasons:

"1) The Federal income tax provides job incentives that are lacking in Federal direct spending programs. For example, the exclusion of Puerto Rico residents from the Federal income tax has prevented almost 60 percent of working families from receiving the Federal Earned Income Tax Credit (EITCs). The Federal income tax could be used as an effective tool to increase Puerto Rico´s 40 percent labor force participation rate, which is the lowest in the United States. [1]

"2) The introduction of the Federal income tax, with the administrative support of the Internal Revenue Service, would increase the effectiveness of the local tax administration in Puerto Rico. Local tax auditors in the Department of Hacienda have experienced a 50 percent decrease in the last six years, at the time when the underground economy in Puerto Rico has grown to about 25 percent of the market economy.

"Previous congressional studies have already shown the benefits of participating in the Federal tax system. For example, GAO in 1996 found that if IRC tax rules are applied to residents of Puerto Rico, the average EITC earned by eligible taxpayers would be $1,494,

taxpayers would owe around $623 million in federal income tax before taking into account the earned income tax credit (EITC), and the aggregate amount of EITC would total $574 million. About 59 percent of the population filing individual income tax returns would earn some EITC, and 41 percent of the households filing income tax returns would have positive federal income tax liabilities, greater than the EITC received. Thus, the introduction of the Federal income tax in Puerto Rico for individuals would generate a wealth transfer from higher-income individuals who would pay Federal income taxes, to lower-income earners who would receive a refundable credit. [2]

"Conclusion

ñThis brief demonstrated the importance of incorporating Puerto Rico back into the United States for income tax purposes. This fundamental change is necessary to protect the U.S. tax base from the abuses in the ill-defined CFC regime in Puerto Rico. Furthermore, the inclusion of individual taxpayers into the Federal income tax regime would allow families in the Island to receive significant incentives that are likely to increase Puerto Rico´s low labor force participation rate. and restore economic growth in the Island. "

For almost a decade since 2006, and two years ahead before the collapse of Lehman Brothers ushered the worst financial crisis since the 1930's, the economy of Puerto Rico has been contracting to the point that the local government is finding it difficult to comply with its basic responsibilities and financial obligations.

Incorporating Puerto Rico into the US Tax code would be fundamental for turning this trend around.

Thank you for your consideration to this important matter.

Sincerely,

Carlos H. Padilla, PhD.
Adjunct Professor of Economics
[redacted]

[1] See Caribbean Business, ñThe real story behind Puerto Ricoôs low 40.6% labor-participation rate,ò May 10, 2011.

[2] Government Accountability Office, Tax Policy Analysis of Certain Potential Effects of Extending Federal Income Taxation to Puerto R