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[THE MJR REPORT](#)

Statement for the June 24, 2015 Hearings On Puerto Rico  
Subcommittee On Indian, Insular, And Alaskan Native Affairs

Honorable Chairman Young and members of the Committee: My name is Miriam Ramirez, I am a medical doctor, former Senator of the New Progressive Party in Puerto Rico, and founder of a non-partisan grassroots movement, called Puerto Ricans in Civic Action, which gathered more than 350,000 individually signed petitions for statehood and delivered them to Congress in the 1980s.

Mr. Chairman, it is has been a privilege to know you and count on your solid and courageous support to advance our struggle to achieve equal rights for the almost 4 million disenfranchised US citizens in Puerto Rico. Decades ago you responded with your full support when more than 350,000 Puerto Ricans petitioned Congress for Statehood. Today you are again giving us an opportunity to obtain our equal rights and obligations as U.S. citizens of this great Nation.

In my testimony to this Committee in May 22, 1986, when Congressman Morris Udall was the Chairman, the focus of the hearing was the lack of economic growth and welfare dependency in Puerto Rico. Back then I identified our lack of full rights as US citizens as the fundamental reason for the poor economic performance of Puerto Rico, compared to other states. Today I want to focus my testimony on the negative consequences of the federal tax regime that has kept Puerto Rico labeled as a “foreign” jurisdiction for almost 100 years.

There are two federal tax acts which have defined Puerto Rico’s tax identity since it became a U.S. territory in 1898. The first law – the Revenue Act of 1921 – classified Puerto Rico as a “foreign country” for tax purposes. The second law, enacted by Congress in 1996, eliminated Section 936 of the tax code, which was used then to promote new manufacturing jobs and investments in Puerto Rico.

What happened in Puerto Rico after 1996? The former Section 936 firms used Puerto Rico’s “foreign” tax status to obtain the benefits of tax deferral, converting to Controlled Foreign Corporations (CFCs). Unlike the former Section 936 program, however, the CFCs in Puerto Rico do not have to create jobs and generate real investments to benefit from federal tax deferral. Worse, the U.S. Treasury does not produce reports that inform Congress whether the CFCs create jobs and real investment in Puerto Rico. Today we know they don’t.

The CFC regime in Puerto Rico has become a significant drain of tax revenue and a formidable opponent of statehood for Puerto Rico. Using transfer pricing abuses, the CFCs in the Island are causing the US Treasury to lose billions in federal tax revenue without creating jobs and investment in the Island. One company in Puerto Rico was identified by the Senate’s Permanent Subcommittee on Investigations with tax savings of \$22 million per employee, and only generated 177 employees. Other details of this tax abuse are presented in the Appendix.

Keeping Puerto Rico as a “foreign” country inside the United States undermines the U.S. federal tax base and creates unfair competition against local communities in the 50 states. For example, in 2010 the Puerto Rico government imposed a 4% **excise** tax on CFCs in PR in order to pay for a significant reduction in income taxes at the local level. Normally, excise taxes cannot be used as foreign tax

credits that reduce the U.S. tax liability dollar for dollar. However, in the case of the Puerto Rico's 4% excise tax on the US CFCs, the IRS took the position that it would not challenge if US corporations claim a U.S. foreign tax credit. In contrast, taxes imposed in the 50 states can be deducted when calculating federal income tax, provided they are attributable to the conduct of the corporation's business. **Effectively, the U.S. Treasury subsidized Puerto Rico's 4% excise tax increase almost dollar for dollar. This unrecorded tax expenditure is not available in the 50 states.**

Politically, the CFCs are effectively in control of our major political parties and their governing agenda. **Whenever the people put pressure for a process of self determination, millions of dollars appear out of nowhere to campaign against statehood, since it will be the death knoll for the CFC scam.**

There are hundreds of CFCs in Puerto Rico that make enormous campaign donations to the political leaders in Puerto Rico, many of whom are here today in this hearing. I have concluded it is impossible to fight the CFCs if we want to achieve statehood in Puerto Rico. We have to make the CFCs part of the political status solution.

**Mr. Chairman, I propose that the statehood bill for Puerto Rico that comes out of your Committee include at a 20-year transition for maintaining the CFCs in Puerto Rico. There is a precedent for adding temporary tax benefits in statehood bills and a transition period was included in the Senate Bill 712 in 1990.**

There is another tax provision that goes back almost 100 years that is keeping Puerto Rico back, preventing us from receiving the full benefits of US citizenship, namely Section 933 of the Internal Revenue Code (IRC).

As you know, Mr. Chairman, Congress in 1917 granted U.S. citizenship to individuals born in Puerto Rico. Thus, a person born in Puerto Rico is subject to the U.S. tax laws. However, section 933 of the IRC exempts from U.S. taxation the Puerto Rico-source income obtained by bona fide residents of Puerto Rico.

To exploit this special federal tax status the "pro-statehood" administration of former Governor Fortuño adopted two laws in 2012. Act 20 entices millionaires who reside in the 50 states to locate to Puerto Rico by taxing their corporate profits from exported services at a flat 4% rate and allowing those profits to be paid out to the owners free of Puerto Rico income tax.

Act 22 grants new Puerto Rico residents a 0% rate on locally sourced interest and dividends as well as all capital gains accrued after they become residents, in order to attract hedge fund managers and active traders. So far 509 tax refugees have been granted Act 22 status and another 600 will get it this year, according to the Puerto Rico's Department of Economic Development & Commerce.

This egregious legislation is effectively eroding the federal and state income tax base and converting Puerto Rico into a tax haven in the US backyard. We are despised by the members of the US Congress of New York, California, Connecticut and other states where these millionaires used to live. This is what our political leaders, of both major parties, have turned Puerto Rico into – a tax haven in the US backyard for a few hundred millionaires.

Mr. Chairman, the citizens of Puerto Rico are outraged by these shameful tax benefits given to a few hundred millionaires, while the rest of us have been subject to multiple tax increases by the present

Administration in the last three years. **We ask Congress to end this tax abuse, and eliminate Section 933 of the Internal Revenue Code immediately.**

Some observers in the past 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.<sup>1</sup>
- 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.<sup>2</sup>

Mr. Chairman, this is the right moment to draft legislation to resolve the political status of Puerto Rico, and include Puerto Rico in the U.S. tax code, with all the responsibilities and privileges of US citizens. This historic change can be achieved by **deleting** Section 933 of the Internal Revenue Code, and **defining** corporations incorporated in Puerto Rico as U.S. Corporations, for tax and other purposes.

With Puerto Rico's full inclusion in the tax code, Congress can stop transfer pricing abuses and create effective tax benefits that generate real jobs and promotes tangible investments in Puerto Rico through specific legislation that treat US citizens in the Island in a manner similar to other communities in the 50 states. There is a real opportunity to draft effective legislation for Puerto Rico that creates a direct link between each dollar of federal tax benefits to a job, similar to the Earned Income Tax Credit that have benefitted residents in the 50 states since 1975. In addition, Federal tax benefits to generate real

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<sup>1</sup> See Caribbean Business, "The real story behind Puerto Rico's low 40.6% labor-participation rate," May 10, 2011.

<sup>2</sup> Government Accountability Office, *Tax Policy Analysis of Certain Potential Effects of Extending Federal Income Taxation to Puerto Rico*, GGD-96-127.

investments in Puerto Rico can be designed similar to the provisions in Enterprise Zone acts and the Promise Zones legislative proposals of President Obama.

Bringing back Puerto Rico as a full partner into the federal tax system would carry significant benefits to the People of Puerto Rico and the US Treasury, but are not possible without your strong commitment to carry them through to the final budget agreement. As you know, there are formidable moneyed interests that benefit from using Puerto Rico as a tax heaven, and they would not give up the hugely inefficient tax deferral benefits without a fight. The almost 4 million disenfranchised US citizens in Puerto Rico count on your support to secure our equal rights and responsibilities.

### **THE STATUS ISSUE: The 2012 PLEBISCITE AND STATEHOOD**

Regarding the status issue, as you well know, Statehood won the 2012 plebiscite. In that same election, with the same officials, in the same voting areas, with the same requirements. People voted for the Governor, the Resident Commissioner, Legislators, Mayors who were elected and sit in their positions. No one challenged their victories or re-interpreted them.

However, I should not have been surprised when the results were challenged by the spokespersons and hired guns from the economic powers that rule the island, among them a well known Republican corporate lobbyist who sent out a statement to Congress and others, (Attached) against the results of statehood's win. It is not the first time he does this, but then who wouldn't, if you're getting paid to the tune of >2.745 million, just from Puerto Rico. I am sure there is even more \$\$\$ to fight attacks against offshore corporations from their "corporate clients" with vested interest in keeping their business free of tax in the US "FOREIGN" colony of US Citizens in Puerto Rico.

Mr. Chairman, we thank for your support, and ask that Congress does not hold any more plebiscites on status.

We ask that you present a Puerto Rico statehood admission bill with the above terms and others that are consider fair, and ask the US citizens in Puerto Rico to vote if they agree to Congress' terms and conditions.

I am submitting a draft admission act prepared by my constitutional counsel, Attorney Roberto Santana, which also includes what I call the Costas amendment, in honor of Attorney Luis Costas who first educated me on these issues. To get the CFC's on our side, (or rather off our backs ) award the Corporations special tax incentives for a period of 20 years in the transition process. Then Congress and the people of Puerto Rico would negotiate the details of the transition process, which may or may not be submitted again to the people for final approval.

This is the way we designed it in the original Young bill.

**C'MON FELLOW AMERICAN CITIZENS HERE IN CONGRESS!!  
LET'S DO THIS!**

## APPENDIX 1

### Draft of Bill to Include Puerto Rico as Part of the United States

#### 26 §7701. Definitions

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

...

##### (4) Domestic

The term “domestic” when applied to a corporation or partnership means created or organized in the United States or under the law of the United States, or of any State, or Puerto Rico unless, in the case of a partnership, the Secretary provides otherwise by regulations.

...

##### (9) United States

The term “United States” when used in a geographical sense includes only the States, the District of Columbia and Puerto Rico.

~~26 USC § 933 – Income from sources within Puerto Rico is deleted.~~

## PUERTO RICO – A “FOREIGN” TAX HAVEN IN THE US BACKYARD

This brief describes the unexpected results of two Federal tax acts which have defined Puerto Rico’s tax identity since it became a U.S. territory in 1898. The first law – the Revenue Act of 1921 – classified Puerto Rico as a “foreign country” for tax purposes. The second piece – the Small Business Job Protection Act of 1996 Act – eliminated the main Federal tax incentive, known as Section 936, that the U.S. Congress used to promote new manufacturing jobs and investments in Puerto Rico until 1996.

What remained untouched after 1996 was Puerto Rico’s “foreign” tax label, which was embraced by former Section 936 firms in order to obtain the benefits of tax deferral, converting to Controlled Foreign Corporations (CFCs). Unlike the former Section 936 program, however, the CFCs in Puerto Rico do not have to create jobs and generate real investments to benefit from tax deferral, and the U.S. Treasury does not have formal indicators to measure their cost effectiveness. This brief takes a first step to restore accountability and transparency for the CFCs in Puerto Rico, providing the evidence to assess growing CFC Federal tax benefits at a time of decreasing jobs and investments in Puerto Rico.

### Section 1 – Controlled Foreign Corporations (CFCs) in Puerto Rico

Puerto Rico has been an unincorporated territory of the United States under the jurisdiction of the U.S. Congress since the Spanish-American War of 1898.<sup>3</sup> Although major U.S. taxes apply in Puerto Rico as in the 50 states, e.g. Social Security taxes, for income tax purposes the U.S. Congress has excluded Puerto Rico since 1921 from the definition of “United States”.<sup>4</sup> As a result, although Puerto Rico belongs to the United States and most of its residents are U.S. citizens, the income earned in Puerto Rico is considered “foreign-source income” and Puerto Rico corporations are considered “foreign”. This category includes the CFCs with a US parent entity, which are analyzed in this brief.

The 1921 Revenue Act also created the predecessor of the IRC Section 936, which became the preferred alternative to operate a US subsidiary in the Island because it possessed two ideal features of a tax haven: Puerto Rico-source income was spared 100% of the U.S. federal tax and it was subject to a minuscule P.R. tax, right inside the U.S. borders.<sup>5</sup>

U.S. electronic and pharmaceutical firms with significant intangible assets tried to maximize their tax benefits in Puerto Rico, engaging in transfer pricing practices which spawned important court cases and scathing U.S. Treasury reports. In order to curtail the abuses of Section 936 firms, Congress in 1993 tied tax benefits to payroll and depreciation expenses, in an effort to channel more of the Section 936 benefits to the U.S. citizens residing in Puerto Rico.

Finally, the U.S. Congress replaced Section 936 with a temporary Section 30A credit, and initiated a 10-year phaseout of existing 936 subsidiaries. This momentous decision has created a massive

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<sup>3</sup> The website [www.puertoricoreport.com](http://www.puertoricoreport.com) provides summaries of federal commissions that examined Puerto Rico’s territorial status subject to Congressional powers.

<sup>4</sup> IRC Sec 7701(a)(9) defines the term “United States” in a geographical sense to include “only the States and the District of Columbia.” In contrast, *The Revenue Act of 1916* (Part III, Sec. 15), defines the word “State” or “United States” to include any Territory, the District of Columbia, Porto Rico, and the Phillippine Islands. *The Revenue Act of 1921* (Title I, Sec. 1), excludes Porto Rico and the Philippines from the definition of the “United States”.

<sup>5</sup> See Joint Committee on Taxation, *An Overview of Special Tax Rules Related to Puerto Rico and an Analysis of the Tax and Economic Policy Implications of Recent Legislative Opinions*, (JCX-24-06), June 23, 2006.

conversion of Section 936 US corporations to CFC status, and left U.S. Treasury without a congressional reporting mandate and performance indicators to assess the tax effectiveness and efficiency of CFCs in Puerto Rico.

The CFC conversions have triggered a significant increase in CFC activity in PR, shown in tables 1 to 5:

- There was a **122 percent increase in the reported Earnings and Profits (E&P) of CFCs in Puerto Rico**, to \$6.6 billion in 2008, which is the most recent year of available CFC data (table 1).
- The average tax rate of CFCs in Puerto Rico was 3.9% in 2008, **which was 10.2% lower than the average tax rate by CFCs operating in the world** in 2008 (table 2).
- The U.S. corporations with CFCs in Puerto Rico received in just three years **\$3.5 billion of tax benefits**, relative to the 35% tax rate of U.S. domestic firms (table 3).
- There was a wide variation in tax rates across industries. **Manufacturing CFCs in PR had a 2.3% tax rate, compared to the 14.9% tax rate of CFCs in finance** (table 4).
- The distribution of the tax benefits of CFCs is most likely highly concentrated in a few specific firms with significant intangible patents, trademarks and copyrights. Congressional investigators found that one CFC reported \$4 billion in profits, and provided 177 direct jobs, or \$22.5 million per job.

IRS and Congressional investigations have started to uncover significant transfer pricing abuses that lie behind the growing trend in earnings of US CFCs in Puerto Rico. As early as 1997, the IRS designated Section 936 conversions to CFCs as a Tier I issue, with high potential compliance risks.<sup>6</sup> In 2011 IRS sent notices of deficiency to Medtronic for \$958 million and to Boston Scientific for \$452 million over their Section 936 conversions to CFC status.<sup>7</sup>

In 2012 the staff of the U.S. Senate Permanent Subcommittee on Investigations analyzed the complex layers of tax haven subsidiaries created by Microsoft to minimize its tax on sales of products manufactured in Puerto Rico and sold in the United States. According to the congressional report, in 2011 the CFC of Microsoft in Puerto Rico reported \$4 billion in profits, and provided 177 direct jobs earning an average salary of \$44,000 a year, or \$22.5 million per person. This example shows the low ineffectiveness of a specific CFC in Puerto Rico. Ideally, the U.S. Treasury should conduct an in-depth examination of the whole program of CFC tax incentives in Puerto Rico, as was done of the Section 936 tax program.

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<sup>6</sup> See *Audit Guidelines Related to Section 936 Conversion Issues* in [www.irs.gov](http://www.irs.gov).

<sup>7</sup> See *Puerto Rico Tax Break Shifts to Cayman Islands*, in [www.bloomberg.com](http://www.bloomberg.com) , and docket number 006944-11 in [www.taxcourt.gov](http://www.taxcourt.gov)

Table 1: Assets, Receipts, Earnings & Profits, and Taxes of CFCs in Puerto Rico

Indicators	Years			Percent change '04 - '08
	'04	'06	'08	
\$ in billion				
Number of CFCs in PR	395	401	423	7%
Total assets	\$25.9	\$26.7	\$31.4	21%
Total receipts	\$17.2	\$26.7	\$27.7	61%
<b>Earnings and profits (E&amp;P) before income taxes</b>	<b>\$2.996</b>	<b>\$2.756</b>	<b>\$6.639</b>	<b>122%</b>
Income taxes	\$0.265	\$0.275	\$0.262	0%
<b>Average tax rate</b>	<b>8.9%</b>	<b>10.0%</b>	<b>3.9%</b>	

Source: IRS Statistics of Income (SOI) Bulletin, "Controlled Foreign Corporations", Table 3, Summer 2008, Winter 2011, Winter 2013.

Note: Data are based on the SOI corporate sample. Since 2004 this sample is far more inclusive than earlier SOI studies of CFCs.

Table 2: Average tax rates of CFCs in PR and in other countries

Average tax rates	'04	'06	'08
<b>CFCs in Puerto Rico</b>	<b>8.9%</b>	<b>10.0%</b>	<b>3.9%</b>
CFCs in other countries	15.7%	16.4%	14.1%
Difference in tax rates	(6.8%)	(6.4%)	(10.2%)

Note: Average tax rate is defined as income tax divided by E&P before income taxes.

Source: IRS Statistics of Income Bulletin, "Controlled Foreign Corporations", Summer 2008, Winter 2011, Winter 2013.

Table 3: Tax benefits of operating in Puerto Rico as CFC, compared to operating as a US domestic firm, annually and average figures in latest 3 years.

	'04	'06	'08	Total, 3 yrs
Top US corporate tax rate	35.0%	35.0%	35.0%	
<b>Minus: PR CFC average tax rate</b>	<b>8.9%</b>	<b>10.0%</b>	<b>3.9%</b>	
Equals: tax rate advantage of PR CFCs over domestic US firms	26.1%	25.0%	31.1%	
Multiplied by: Earnings & profits of PR CFCs before income tax (millions)	\$2,996	\$2,756	\$6,639	<b>\$12,391</b>
<b>Equals: Federal tax benefit of CFCs in Puerto Rico over domestic US firms (millions)</b>	<b>\$782</b>	<b>\$689</b>	<b>\$2,065</b>	<b>\$3,536</b>

Note: Author’s calculation, based on data reported in IRS Statistics of Income Bulletin, “Controlled Foreign Corporations”, Summer 2008, Winter 2011, Winter 2013.

Table 4: Average tax rates of CFCs in PR in 2008

Industrial sector	# of PR CFCs	Earnings and profits before tax (\$million)	Average tax rate in 2008
Goods production (manufacture)	101	1,352	2.3%
Finance, insurance, real estate	69	426	14.9%
Distribution and transportation	108	259	37.6%
Services	105	4,550	1.4%
Other sectors	40	53	14.9%
Total	423	6,640	3.9%

Note: Average tax rate is defined as income tax divided by E&P before income taxes.

Source: IRS Statistics of Income Bulletin, “Controlled Foreign Corporations”, Summer 2008, Winter 2011, Winter 2013.

Given the trend in Federal tax benefits received by CFCs operating in Puerto Rico, it is appropriate to assess how this Federal tax program has contributed to the economic well-being of the almost 4 million U.S. citizens in Puerto Rico. Measures of effectiveness and efficiency of the tax benefits of manufacturing CFCs are discussed in the next section of this brief.

## Section 2 – Measuring the cost effectiveness of the CFCs in Puerto Rico

CFCs were introduced in 1921 in Puerto Rico “primarily to help U.S. corporations compete with foreign firms in the Philippines”.<sup>8</sup> There is no question that for U.S. multinationals the benefits of tax deferral can be significant, since indefinite deferral of U.S. tax liability generates a complete tax exemption on the foreign-source income. As was shown in Section 1 of this brief, tax deferral is a powerful tax tool to enhance the financial capacity of U.S. multinationals to compete against all firms, especially the domestic U.S. firms that pay the 35% maximum federal corporate tax rate.

However, utilizing the 1921 tax law criterion – “help U.S. businesses to compete in foreign countries against foreign firms” – is not appropriate for determining the CFC benefits in Puerto Rico for three reasons: the Island is a territory of the United States, almost all of its 3.7 million residents are U.S. citizens, and the 423 CFCs in Puerto Rico represent less than one percent of the 83,642 CFCs in the World.

Congress did introduced a different objective when it enacted Section 936 tax benefits for Puerto Rico, namely, “**to assist the U.S. possession in obtaining employment producing investments by U.S. corporations.**”<sup>9</sup> In order to obtain a precise estimate of tax benefits per employee it is necessary to obtain firm-specific tax and jobs data, which is not available to the public.

<sup>8</sup> Joint Committee on Taxation, JCX-24-06, op. cit., page 50.

<sup>9</sup> Joint Committee on Taxation, JCX-24-06, op. cit., page 50.

An imprecise estimate of tax benefits per employee is obtained with U.S. Bureau of census data of manufacturing establishments in Puerto Rico, which are owned by CFCs and others. For example, in 2008 there were 2,064 manufacturing establishments with 106,132 employees in Puerto Rico, shown in Table 5. Estimates of the average CFC earnings before income taxes of manufacturing establishments range from \$12,739 (if all jobs are assigned to the CFCs) to \$25,477 per employee (if 50% of the jobs are assigned to CFCs) in 2008. **These averages, in contrast to the \$22 million per job earned by Microsoft Puerto Rico in 2011, show that the distribution of the tax benefits of CFCs is most likely highly concentrated in a few specific firms with significant intangible patents, trademarks and copyrights.**

Table 5: Manufacturing Operations in Puerto Rico, Tax Benefits of CFCs and Jobs, 2008

Sources		2008
Census	Number of manufacturing establishments in PR	2,064
	Employees in manufacturing establishments	<b>106,132</b>
SOI	Earnings before income taxes of manufacturing CFCs (million)	\$1,352
	CFC earnings before income tax per employee in manufacturing establishments in Puerto Rico	
	100% of jobs were in US CFCs	\$12,739
	50% of jobs were in US CFCs	\$25,477

Sources: (1) U.S. Bureau of Census, *County Business Patterns*, published annually. (2) Federal tax benefits estimated using IRS SOI Bulletin, “Controlled Foreign Corporations”, published in even years.

Keeping Puerto Rico as a “foreign” country inside the United States undermines the U.S. federal tax base and creates unfair competition against local communities in the 50 states. For example, in 2010 the Puerto Rico government imposed a 4% **excise** tax on CFCs in PR in order to pay for a significant reduction in income taxes at the local level. Normally, excise taxes cannot be used as foreign tax credits that reduce the U.S. tax liability dollar for dollar. However, in the case of the Puerto Rico’s 4% excise tax on the US CFCs, the IRS took the position that it would not challenge if US corporations claim a U.S. foreign tax credit. In contrast, taxes imposed in the 50 states can be deducted when calculating federal income tax, provided they are attributable to the conduct of the corporation's business. **Effectively, the U.S. Treasury subsidized Puerto Rico’s 4% excise tax increase almost dollar for dollar. This tax expenditure is not available in the 50 states.**

How do these estimated federal cost estimates compare to another Federal credit that is directly linked to job creation, namely, the Earned Income Tax Credit (EITC), is discussed in the next section of this brief.

### **Section 3 – Incorporating Puerto Rico residents into the Federal Income Tax System and I.R.C. Section 933**

Congress in 1917 granted U.S. citizenship to individuals born in Puerto Rico. Thus, a person born in Puerto Rico is subject to the U.S. tax laws. However, section 933 of the IRC exempts from U.S. taxation the Puerto Rico-source income obtained by bona fide residents of Puerto Rico. 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:

- 3) 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.<sup>10</sup>
- 4) 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.<sup>11</sup>

## Conclusion

This brief has 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.

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<sup>10</sup> See Caribbean Business, "The real story behind Puerto Rico's low 40.6% labor-participation rate," May 10, 2011.

<sup>11</sup> Government Accountability Office, *Tax Policy Analysis of Certain Potential Effects of Extending Federal Income Taxation to Puerto Rico*, GGD-96-127.

# **Admission of State**

## **Section 1**

### **AN ACT**

#### **To provide for the admission of the Commonwealth of Puerto Rico into the Union**

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, subject to the provisions of this Act, Congress consents that the territory properly included within and rightfully belonging to the territory of Puerto Rico, officially known and hereinafter referred to as the "Commonwealth of Puerto Rico", may be erected into a new State, with the consent of the existing Government in order that the same may be admitted as one of the States of this Union on an equal footing with the other States in all respects whatever, subject to the affirmative vote of the eligible voters of the Commonwealth of Puerto Rico accepting the terms and conditions of this Act.

## **Territory**

### **Section 2**

The official name of the State of Puerto Rico shall remain to be "Commonwealth of Puerto Rico" and the newly admitted State shall consist of all its islands, together with their appurtenant reefs and territorial waters, including but not limited to the main island of Puerto Rico, and the islands of Vieques, Culebra, Mona, Monito, Ratones, Caja de Muertos, Palomino, Palominito, Luis Peña, Lobos, Icacos, Isleta Marina and other smaller islands, atolls and reefs presently under the jurisdiction of the Commonwealth of Puerto Rico and including a ten and thirty five hundredths of a mile (10.35) mile Exclusive Economic Zone (EEZ) which is the sea zone over which the Commonwealth of Puerto Rico has special rights over the exploration and use of marine resources and stretching from the seaward edge of the Commonwealth of Puerto Rico's territorial sea out to 10.35 nautical miles from its coast and including the territorial sea and the continental shelf beyond the 10.35 nautical mile limit.

## **Constitution**

### **Section 3**

Congress finds that the Constitution of the Commonwealth of Puerto Rico is republican in form; it is not repugnant to the Constitution of the United States and the principles of the Declaration of Independence and is the functional equivalent of a state constitution.

## **Agreement with United States**

### **Section 4**

The Commonwealth of Puerto Rico and its people, by the affirmative vote of the eligible voters of the Commonwealth of Puerto Rico accepting the terms and conditions of this Act do agree and declare that they forever disclaim all right and title to any lands or other property not

granted or confirmed to the State or its political subdivisions by or under the authority of this Act, the right or title to which is held by the United States or is subject to disposition by the United States, and to any lands or other property, (including fishing rights); that all such lands or other property, belonging to the United States shall be and remain under the absolute jurisdiction and control of the United States until disposed of under its authority, except to such extent as the Congress has prescribed or may hereafter prescribe. Provided, That nothing contained in this Act shall recognize, deny, enlarge, impair, or otherwise affect any claim against the United States, and any such claim shall be governed by the laws of the United States applicable thereto; and nothing in this Act is intended or shall be construed as a finding, interpretation, or construction by the Congress that any law applicable thereto authorizes, establishes, recognizes, or confirms the validity or invalidity of any such claim, and the determination of the applicability or effect of any law to any such claim shall be unaffected by anything in this Act: And provided further, That no taxes shall be imposed by said State upon any lands or other property now owned or hereafter acquired by the United States, except to such extent as the Congress has prescribed or may hereafter prescribe.

## **Title to Property; Land Grants; Reservation of Lands; Public School Support; Submerged Lands.**

### **Section 5**

The Commonwealth of Puerto Rico and its political subdivisions, respectively, shall have and retain title to all property, real and personal, within the Commonwealth of Puerto Rico or any of the subdivisions. Except as provided herein, the United States shall retain title to all property, real and personal, to which it has title, including public lands. Provided that:

(a) Except as provided in subsection (c) of this section, the Commonwealth of Puerto Rico and its political subdivisions, as the case may be, shall retain title of its properties before the passing of this Act and its subdivisions in those lands and other properties in which the Territory and its subdivisions now hold title.

(b) Except as provided in subsection (c) and (d) of this section, the United States grants to the Commonwealth of Puerto Rico, effective upon its admission into the Union, the United States' title to all the public lands and other public property, in the Island of Vieques after certification by the secretary of the Interior that any and all of such lands have been cleaned of all debris and unexploded ordinance used by the Armed Forces of the United States in training of the Military, title to which is held by the United States immediately prior to the Commonwealth of Puerto Rico's admission into the Union. The grant hereby made shall be in lieu of any and all grants provided for new States by provisions of law other than this Act, and such grants shall not extend to the Commonwealth of Puerto Rico.

(c) Any lands and other properties that, on the date Puerto Rico is admitted into the Union, are set aside pursuant to law for the use of the United States under any (1) Act of Congress, (2) Executive order, (3) proclamation of the President, or (4) proclamation of the

Governor of Puerto Rico shall remain the property of the United States subject only to the limitations, if any, imposed under (1), (2), (3), or (4), as the case may be.

(d) Any public lands or other public property that is conveyed to the Commonwealth of Puerto Rico by subsection (b) of this section but that, immediately prior to the admission of said State into the Union, is controlled by the United States pursuant to permit, license, or permission, written or verbal, from the Commonwealth of Puerto Rico or any department thereof may, at any time during the five years following the admission of Puerto Rico into the Union, be set aside by Act of Congress or by Executive order of the President, made pursuant to law, for the use of the United States, and the lands or property so set aside shall, subject only to valid rights then existing, be the property of the United States.

(e) Within five years from the date Commonwealth of Puerto Rico is admitted into the Union, each Federal agency having control over any land or property that is retained by the United States pursuant to subsections (c) and (d) of this section shall report to the President the facts regarding its continued need for such land or property, and if the President determines that the land or property is no longer needed by the United States it shall be conveyed to the Commonwealth of Puerto Rico.

(f) The lands granted to the Commonwealth of Puerto Rico by subsection (b) of this section and public lands retained by the United States under subsections (c) and (d) and later conveyed to the State under subsection (e), together with the proceeds from the sale or other disposition of any such lands and the income therefrom, shall be held by said State as a public trust for the support of the public schools and other public educational institutions, for the betterment of the conditions of Puerto Ricans. Such lands, proceeds, and income shall be managed and disposed of for one or more of the foregoing purposes in such manner as the constitution and laws of said State may provide, and their use for any other object shall constitute a breach of trust for which suit may be brought by the United States. The schools and other educational institutions supported, in whole or in part, out of such public trust shall forever remain under the exclusive control of said State; and no part of the proceeds or income from the lands granted under this Act shall be used for the support of any sectarian or denominational school, college, or university.

(g) As used in this Act, the term 'lands and other properties' includes public lands and other public property, and the term 'public lands and other public property' means, and is limited to, the lands and properties that were ceded to the United States by Spain under the Treaty of Paris of 1898, or that have been acquired in exchange for lands or properties so ceded.

(h) All laws of the United States reserving to the United States the free use or enjoyment of property which vests in or is conveyed to the Commonwealth of Puerto Rico or its political subdivisions pursuant to subsection (a), (b), or (e) of this section or reserving the right to alter, amend, or repeal laws relating thereto shall cease to be effective upon the admission of the Commonwealth of Puerto Rico into the Union.

(i) The Submerged Lands Act of 1953 (Public Law 31, Eighty-third Congress, first session; 67 Stat. 29) and the Outer Continental Shelf Lands Act of 1953 (Public Law 212, Eighty-third Congress, first session, 67 Stat. 462) shall be applicable to the Commonwealth of Puerto Rico, and the said State shall have the same rights as do existing States thereunder. (As amended Pub. L. 86-624, Sec. 41, July 12, 1960, 74 Stat. 422, Pub.L. 95-372, Title II, § 202, 92 Stat. 634; Apr. 7, 1986, Pub.L. 99-272, Title VIII, § 8002, 100 Stat. 148)

## **Assumption of Public Debt**

### **Section 6**

For the purposes of furthering the development of the new State, and the expansion of its economy, and in exchange of the citizens of the Commonwealth of Puerto Rico acquiring as taxpaying citizens of the United States their corresponding share of the National Debt of the United States, the Public Debt of the Commonwealth of Puerto Rico, as of the date of Admission, is hereby acquired by the Treasury of the United States and shall be paid according to its terms and as it becomes due.

## **Presidential Certification**

### **Section 7**

Upon enactment of this Act, it shall be the duty of the President of the United States, not later than 30 days thereafter, to certify such fact to the Governor of the Commonwealth of Puerto Rico and to the presidents of the Senate and of the House of Representatives of Puerto Rico. Thereupon, 1) the legislature of the Commonwealth of Puerto Rico shall enact legislation to provide for the vote by the eligible voters of the Commonwealth of Puerto Rico as defined by law to accept or reject the terms and conditions of this Act, by simple majority vote, which referendum will take place not later than 180 days after the Presidential Certification made pursuant to this section and 2) The State Elections Commission of Puerto Rico is authorized to provide for a vote on the admission of Puerto Rico into the Union as a State within one hundred and eighty days from the date of the Presidential Certification made pursuant to this section, in accordance with rules and regulations determined by the Commission, including qualifications for voter eligibility. The ballot shall ask the following question: “Shall Puerto Rico be admitted as a State of the United States pursuant to the Act of Congress dated (the date of this Act)?”

Yes\_\_ No\_\_”.

The funds made available pursuant to Public Law 113–76 may be used to conduct the vote.

The Governor of the Commonwealth of Puerto Rico is hereby authorized and directed to take such action as may be necessary or appropriate to insure the submission of said proposition to the people. The return of the votes cast on said referendum shall be made by the election officers directly to the State Elections Commission, which entity shall certify the results to the

Governor. The Governor shall certify the results of said referendum, as so ascertained, to the President of the United States, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate.

## **Election, Certification, Proclamation, Laws in Effect**

### **Section 8**

(a) Upon the affirmative vote of the eligible voters of the Commonwealth of Puerto Rico accepting the offer of Statehood, the Governor of the Commonwealth of Puerto Rico shall call for the holding of a Primary Election for Federal office and a General Election to elect such federal elected official, on dates to be fixed by the Governor of the Commonwealth of Puerto Rico. Provided, that the elections for Federal office shall not be held later than the date already legislated by the laws of the Commonwealth for the holding of the next regular General Elections that are held on November on the same year as that of the Presidential Elections of the United States and at such elections there shall be elected 2 Senators and 5 Representatives, each of whom shall first take office on the first day of the next Congress commencing immediately after said election. The Legislature of Puerto Rico shall delineate and enact the corresponding congressional districts. The officers required to be elected as provided in this section shall be chosen by the eligible voters of the Commonwealth of Puerto Rico. Such elections shall be held, and the qualifications of voters thereat shall be, as prescribed by the Constitution of the Commonwealth of Puerto Rico for the election of members of the State legislature. The Legislature of Puerto Rico shall delineate and enact the corresponding congressional districts. The returns thereof shall be made and certified in such manner as the constitution and laws of the Commonwealth of Puerto Rico may prescribe. The Governor of the Commonwealth of Puerto Rico shall certify the results of said elections to the President of the United States, the Speaker of the House of Representatives, and the President Pro Tempore of the Senate.

(b) In the election of Senators from Puerto Rico pursuant to this section, , the 2 Senate offices shall be separately identified and designated, and no person may be a candidate for both offices. No such identification or designation of either of the offices shall refer to or be taken to refer to the terms of such offices, or in any way impair the privilege of the Senate to determine the class to which each of the Senators elected shall be assigned.

(c) The President of the United States, once notified by the Governor of the election of the federal officials prescribed pursuant to this section, upon certification of the returns of the election of the officers required to be elected as provided herein, shall thereupon issue his proclamation announcing the results of said election as so ascertained. Upon the issuance of said proclamation by the President, the Commonwealth of Puerto Rico shall be deemed admitted into the Union as provided in this Act.

(d) Until Puerto Rico is so admitted into the Union, all of the officers of the Commonwealth of Puerto Rico, including its Resident Commissioner, shall continue to discharge the duties of their respective offices. Upon the issuance of said proclamation by the President of

the United States and the admission of the Commonwealth of Puerto Rico into the Union, the officers elected at said election, and qualified under the provisions of the constitution and laws of said State, shall proceed to exercise all the functions pertaining to their offices in or under or by authority of the government of said State, and officers not required to be elected at said initial election shall be selected or continued in office as provided by the constitution and laws of said State.

(e) The State Elections Commission of Puerto Rico shall certify the election of the Senators and Representative in the manner required by law, and the said Senators and Representative shall be entitled to be admitted to seats in Congress and to all the rights and privileges of Senators and Representatives of other States in the Congress of the United States.

(f) Upon admission of the Commonwealth of Puerto Rico into the Union as herein provided, all of the territorial laws then in force in the Commonwealth of Puerto Rico shall be and continue in full force and effect throughout said State except as modified or changed by this Act, or by the Constitution of the State, or as thereafter modified or changed by the legislature of the State. All of the laws of the United States shall have the same force and effect within said State as elsewhere within the United States. As used in this paragraph, the term "territorial laws" includes (in addition to laws enacted by the Legislature of Puerto Rico) all laws or parts thereof enacted by Congress, the validity of which is dependent solely upon the authority of Congress to provide for the government of prior to the admission of the Commonwealth of Puerto Rico into the Union, and the term "laws of the United States" includes all laws or parts thereof enacted by Congress that (1) apply to or within Puerto Rico at the time of the admission of the Commonwealth of Puerto Rico into the Union, (2) are not "Territorial laws" as defined in this paragraph, and (3) are not in conflict with any other provisions of this Act.

## **House of Representatives Membership**

### **Section 9**

(a) The Commonwealth of Puerto Rico upon its admission into the Union shall be entitled to the number of Representatives mentioned in Section 8 of this Act until the taking effect of the next reapportionment, and such Representatives shall be in addition to the membership of the House of Representatives as now prescribed by law: Provided, That such temporary increase in the membership shall not operate to either increase or decrease the permanent membership of the House of Representatives as prescribed in the Act of August 8, 1911 (37 Stat. 13) nor shall such temporary increase affect the basis of apportionment established by the Act of November 15, 1941 (55 Stat. 761; 2 U.S.C., section 2a), for the Eighty-third Congress and each Congress thereafter.

(b) Effective on the date on which a Representative from Puerto Rico first takes office in accordance with this subsection, the Office of the Resident Commissioner to the United States, as described in section 36 of the Act of March 2, 1917 (48 U.S.C. 891 et seq.), is terminated.

# **Continuation of Civil Cases and Criminal Proceedings**

## **Section 10**

No writ, action, indictment, cause, or proceeding pending in the United States District Court for the District of Puerto Rico on the date when said Territory shall become a State, and no case pending in an appellate court upon appeal from the United States District Court for the district of Puerto Rico at the time said Territory shall become a State, shall abate by the admission of the Commonwealth of Puerto Rico into the Union, but the same shall be transferred and proceeded with as hereinafter provided.

All civil causes of action and all criminal offenses which shall have arisen or been committed prior to the admission of said State, but as to which no suit, action, or prosecution shall be pending at the date of such admission, shall be subject to prosecution in the appropriate State courts or in the United States District Court for the District of Puerto Rico in like manner, to the same extent, and with like right of appellate review, as if said State had been created and said courts had been established prior to the accrual of said causes of action or the commission of such offenses; and such of said criminal offenses as shall have been committed against the laws of the Territory shall be tried and punished by the appropriate courts of said State, and such as shall have been committed against the laws of the United States shall be tried and punished in the United States District Court for the District of Puerto Rico.

## **Appeals**

### **Section 11**

All appeals taken from the United States District Court District of Puerto Rico to the Supreme Court of the United States or the United States Court of Appeals for the First Circuit, previous to the admission of Puerto Rico as a State, shall be prosecuted to final determination as though this Act had not been passed. All cases in which final judgment has been rendered in such district court, and in which appeals might be had except for the admission of such State, may still be sued out, taken, and prosecuted to the Supreme Court of the United States or the United States Court of Appeals for the First Circuit under the provisions of then existing law, and there held and determined in like manner; and in either case, the Supreme Court of the United States, or the United States Court of Appeals, in the event of reversal, shall remand the said cause to either the Puerto Rico Supreme Court, or the United States District Court for the District of Puerto Rico, as the case may require: Provided, That the time allowed by existing law for appeals from the district court for said Territory shall not be enlarged thereby.

## **Continuation of Cases**

### **Section 12**

All causes pending or determined in the United States District Court for the District of Puerto Rico at the time of the admission of Puerto Rico as a State shall continue under the

jurisdiction of the United States District Court for the District of Puerto Rico for final disposition and enforcement in the same manner as is now provided by law with reference to the judgments and decrees. All other causes pending or determined in the State Courts of the Commonwealth of Puerto Rico at the time of the admission of Puerto Rico as a State shall continue under the jurisdiction of the State Courts of the Commonwealth of Puerto Rico. All final judgments and decrees rendered in the United States District Court for the District of Puerto Rico may be reviewed by the Supreme Court of the United States or by the United States Court of Appeals for the First Circuit in the same manner as is now provided by law with reference to the judgments and decrees in existing United States district courts.

## **Retention of Jurisdiction and Appeals in State Court**

### **Section 13**

Jurisdiction of all cases pending or determined in the General Court of Justice of the Commonwealth of Puerto Rico shall devolve upon and be exercised by said court and, as such, it shall retain custody of all records, dockets, journals, and files pertaining to such cases. All appeals taken from the Supreme Court of Puerto Rico to the Supreme Court of the United States, previous to the admission of Puerto Rico as a State, shall be prosecuted to final determination as though this Act had not been passed. All cases in which final judgment has been rendered in such court, and in which appeals might be had except for the admission of such State, may still be sued out, taken, and prosecuted to the Supreme Court of the United States under the provisions of then existing law, and there held and determined in like manner; and in either case, the Supreme Court of the United States, in the event of reversal, shall remand the said cause to the Puerto Rico Supreme Court as the case may require: Provided, That the time allowed by existing law for appeals from the Supreme Court of Puerto Rico shall not be enlarged thereby.

## **Federal Reserve Act; Amendment**

### **Section 14**

The next to last sentence of the first paragraph of section 2 of the Federal Reserve Act (38 Stat. 251) as amended, is hereby amended by inserting after the word 'Hawaii' the words 'or Puerto Rico.'

## **Maritime Matters**

### **Section 15**

Nothing contained in this Act shall be construed as depriving the Federal Maritime Board of the exclusive jurisdiction heretofore conferred on it over common carriers engaged in transportation by water between any port in the Commonwealth of Puerto Rico and other ports in the United States, or possessions, or as conferring on the Interstate Commerce Commission jurisdiction over transportation by water between any such ports.

## **Taxation**

### **Section 16**

Upon the effective date of the Admission of the Commonwealth of Puerto Rico as the 51<sup>st</sup> State of the Union, those individuals and corporations then currently enjoying tax status and tax benefits existing under Puerto Rico Income, Gift and Estate Tax Statutes and the U.S. Internal Revenue Code on that date, shall continue in that status and with those benefits for a period of twenty (20) years from that effective date of Admission. The U.S. Internal Revenue Service shall promulgate such Rules and Regulations as may be deemed necessary and/or convenient in order to carry out this Statutory Provision.

## **Repeal**

### **Section 17**

All parts of the Puerto Rican Federal Relations Act, Pub. L. No. 81-600, 64 Stat. 3 19 (1950) (codified at 48 U.S.C §§ 731b-731e (1994)) ("Public Law 600") and any remaining sections in effect of the Act of Apr. 12, 1900, 31 Stat. 77 ("Foraker Act") and of the Act of Mar. 2, 1917, 39 Stat. 961, as amended, ("the Puerto Rican Federal Relations" Act, also popularly known as the "Jones Act"), which are in conflict with the provisions of this Act, are hereby repealed

## **United States Citizenship**

### **Section 18**

Nothing contained in this Act shall operate to confer United States citizenship, nor to terminate citizenship heretofore lawfully acquired, nor restore citizenship heretofore lost under any law of the United States or under any treaty to which the United States may have been a party.

## **Separability**

### **Section 19**

If any provision of this Act, or any section, subsection, sentence, clause, phrase, or individual word, or the application thereof to any person or circumstance is held invalid, the validity of the remainder of the Act and of the application of any such provision, section, subsection, sentence, clause, phrase, or individual word to other persons and circumstances shall not be affected thereby.

## **General Amendment and General Repeal**

### **Section 20**

All Acts or parts of Acts referring to "the 50 states" shall be amended to read "the 51 states" and all such Acts or parts of Acts referring to the Islands and Territories of Guam,

American Samoa, Northern Mariana Islands, Puerto Rico and the Virgin Islands shall be amended to exclude the words “Puerto Rico”, whether such Acts or parts of Acts were passed by the legislature of Puerto Rico or by Congress.

All Acts or parts of Acts in conflict with the provisions of this Act, whether passed by the legislature of Puerto Rico or by Congress, are hereby repealed.