NATIONAL TAXPAYERS UNION

July 19, 2022

The Honorable Raul Grijalva, Chairman
The Honorable Bruce Westerman, Ranking Member
Committee on Natural Resources
U.S. House of Representatives
1324 Longworth House Office Building
Washington, DC 20515

Dear Chairman Grijalva, Ranking Member Westerman, and Members of the Committee:

On behalf of the National Taxpayers Union's (NTU's) supporters in Puerto Rico and throughout the rest of the United States, I write to offer our brief comments regarding H.R. 8393, the Puerto Rico Status Act, which is scheduled for markup tomorrow.

Introduction. As many Members of the Committee may recall, NTU has a deep and abiding concern for taxpayers residing in Puerto Rico as well as their fellow taxpayers across the country. For nearly a decade now, NTU has been actively involved in the development of a legislative response to aid Puerto Rico's recovery and establish long-term fiscal stability. During the formulation of the PROMESA bill, the subsequent Congressional Task Force on Economic Growth in Puerto Rico, the Tax Cuts and Jobs Act (TCJA) of 2017, and the operations of the Financial Oversight and Management Board, we have offered advice, on a granular level, concerning tax, budget, regulatory, and economic policy affecting the Commonwealth (and by extension the rest of the United States).[1] Consistently, NTU has observed that federal fiscal policy has fallen short in providing a mutually respectful partnership that would deliver the promise of prosperity to the people of Puerto Rico. It remains Congress's special responsibility to establish such a measure of justice today.

[1] See, for example: Sepp, Pete. "NTU President Comments to the House Committee on Natural Resources Regarding Puerto Rico's Fiscal Oversight, Economic Growth, and Financial Stability." NTU, February 14, 2016. Retrieved from: https://www.ntu.org/publications/detail/ntu-president-comments-to-the-house-committee-on-natural-resources-regarding-puerto-ricos-fiscal-oversight-economic-growth-and-financial-stability; Sepp, Pete. "Legislative Memorandum: Puerto Rico's Finances." NTU, October 9, 2016. Retrieved from: https://www.ntu.org/publications/detail/legislative-memorandum-puerto-ricos-finances; Sepp, Pete. "To Address Puerto Rico's Debt Problems, Look Beyond Chapter 9, Support Comprehensive Reforms." NTU, July 8, 2015. Retrieved from: https://www.ntu.org/publications/detail/to-address-puerto-ricos-debt-problems-look-beyond-chapter-9-support-comprehensive-reforms; Sepp, Pete. "NTU Offers Comments to Puerto Rico Economic Task Force." NTU, September 2, 2016. Retrieved from: https://www.ntu.org/publications/detail/ntu-offers-comments-to-puerto-rico-economic-task-force

We appreciate the Committee's work at establishing a bipartisan framework for establishing Puerto Rico's future political status, which will likely take place sooner rather than later. In the process, additional thought needs to be given to the fiscal implications of each of the three status pathways envisioned under H.R. 8393.

Federal Transfer Payments and Debt. We note that under the independence or free association options, Puerto Rico would be guaranteed 10 years of full funding from the federal government for any transfer programs in effect prior to proclamation of either status, followed by another 10 years of prorated funding. We would observe that this timeframe is quite protracted for political status arrangements that are intended to confer upon Puerto Rico even greater degrees of autonomy over its affairs than statehood would provide. And while the bill wisely provides structured guidance on the need for Puerto Rico to provide guarantees to Social Security participants on the Island, the 20-year federal funding process is related to other federal transfer payments amounting to several billion dollars annually. By our reading of the legislation, there are no offsetting reductions in other federal spending to maintain a neutral impact on annual U.S. budget deficits or the accumulated U.S. federal debt. This effect will be compounded by the fact that certain valuable holdings of the United States in Puerto Rico would be relinquished under independence or free association.

In its relations with San Juan, Washington, D.C. has hardly acted as a paragon of fiscal virtue or discipline. That notion will only be reinforced unless H.R. 8393 provides a more compact timeframe for winding down transfer payments as well as a realistic offset strategy.

Are Past Models Suited to the Present? The bill understandably models its travel, work, and residence procedures for Puerto Rico inhabitants affected by independence or free association after those established for the Federated States of Micronesia, the Republic of Palau, and the Republic of the Marshall Islands. Yet, one must concede that Puerto Rico's population, economy, and fiscal impact on federal finances dwarfs those of Micronesia, Palau, and the Marshall Islands. Accordingly, more consideration should be given to this area.

One instructive document in this regard is doubtless familiar to Members of the Committee, but it bears citation here for fiscal context. On October 4, 2000, Robert E. Dalton, Assistant Legal Adviser for Treaty Affairs with the U.S. Department of State, provided the Clinton Administration's perspective on H.R. 4751, which was at that time before the Committee.[2] H.R. 8393 differs in many materials respects from H.R. 4751 – the bill currently before the Committee provides for a range of status options through plebiscite, and offers some (limited) clarity on questions such as federal grant payments, Social Security, and disposition of federally owned assets.

[2] "Statement of Robert E. Dalton, Assistant Legal Adviser for Treaty Affairs, U.S. Department of State, Before the House Resources Committee Regarding Foreign Relations and Citizenship Issues Presented by H.R. 4751 on Status of Puerto Rico." October 2, 2000. Retrieved from: https://www.puertoricoreport.com/wp-content/uploads/2010/03/Dalton.pdf (Accessed July 19, 2022.)

Yet, both bills wrestled, to one degree or another, with questions of continued U.S. citizenship for Puerto Rico residents, whether under a "non-territorial permanent union" (H.R. 4751) or as an independent nation or compact of free association (H.R. 8393). Just as they did 22 years ago, the answers remain elusive. While H.R. 8393 helpfully establishes criteria of citizenship by birthright if Puerto Rico does not join the Union as a state, what, practically, does this mean for taxpayers? Dalton's testimony remains relevant:

> "It is difficult to overestimate the size or complexity of the undertaking that would be necessary on the part of the United States Government to provide consular protection to United States citizens in Puerto Rico in the framework envisioned by this legislation. … Our consular officials would be asked to intervene in the day-to-day actions of local government. In this untenable state of affairs, the U.S. Embassy in San Juan, were there to be one, would function as a "shadow government," in effect, ever watchful of the interests and concerns of the millions of U.S. citizens in Puerto Rico. In addition, given Sec. 3 para. 6 of the proposed legislation, which mandates that all persons born in Puerto Rico receive U.S. citizenship, the United States would be required to confer U.S. citizenship on persons whose admission to Puerto Rico it apparently would not control. This is an unacceptable surrender of sovereignty by the United States with profound consequences since birth in Puerto Rico would guarantee the right to enter, live, and work in any part of the United States."[3]

Here again, H.R. 8393 attempts to create some firewalls around U.S. citizenship guarantees, especially in the case of independence, but there would be instances where citizenship is extended to the children of two U.S. citizens under the free association model. We must point out, however, that determining such citizenship criteria, while enforcing certain work requirements that already apply to Micronesia, Palau, and the Marshall Islands, will involve a much greater commitment of U.S. taxpayer resources than current policy toward free association arrangements might entail.

Tax Policy Should Not Be an Afterthought. We hasten to add that under at least one, and possibly two, of the plebiscite options under H.R. 8393, great care would be required to avoid worsening the problem of "accidental Americans" who have become subject to the Foreign Account Tax Compliance Act and other highly complex U.S. tax laws affecting individuals of dual nationality. It would be tragic to subject more residents of Puerto Rico to these very heavy administrative burdens even as they attempt to build a new structure of self-government. Important matters such as these cannot, and should not, wait until after legislation is passed to deliberate solutions.

Whatever status Puerto Rico's people decide upon, the federal government must do a better job of fashioning a workable and cooperative tax policy with San Juan. Throughout the debate over the Tax Cuts and Jobs Act of 2017, NTU pleaded with tax-writers to rationalize whatever international tax changes in the bill with Washington's often-convoluted treatment of business and individual income earned in Puerto Rico. Under statehood, this could largely entail clearing away bifurcated U.S. federal tax status of income earned within Puerto Rico as opposed to off its

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[3] *Ibid*.

shores. It would also mean applying current federal corporation tax laws as they would toward any other state.

Under independence or free association, at a minimum the United States, which would likely remain a major economic partner with Puerto Rico, would need to initiate tax treaty negotiations to codify numerous tax administration issues. Yet, especially under free association, other policies to encourage economic growth for Puerto Rico might be advisable.

In 2019, when it appeared that Congress was prepared to advance statehood legislation for Puerto Rico, NTU Foundation (a sister organization) delineated a number of policy considerations of interest to taxpayers – again, to those on the Island as well as the rest of the United States.[4] Among them:

> "[B]arring the completion of the incorporation process, Congress will need to enact policies to reduce the unintended disincentives for local investment. One option would be to reduce the U.S. tax rate on Puerto Rico-sourced income, either permanently if Puerto Rico remains a territory, or as a transition during incorporation since presumably companies would not be operating as CFCs [controlled foreign corporations] in an American state. Whatever the duration of such a rate, it would be desirable to provide Puerto Rico a federal tax climate more hospitable than those afforded our trading partners making foreign direct investment.
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> …Changing to a more conventional profit tax for CFCs would mean a significant Puerto Rico-level tax hike, but according to supporters of the plan it would allow fuller deductibility against federal corporate liabilities for CFCs and their parents than current TCJA [Tax Cuts and Jobs Act] law might provide. Whatever pluses and minuses of this complex strategy, it would only be workable over the long run if Puerto Rico remained a territory, but it could be fashioned as a temporary provision if the island was put on a path to statehood. Federal lawmakers could also simply set a Puerto Rico repatriation rate at a similar or better level to what policymakers included in the TCJA. These provisions would tend to affect companies with a large presence in the territory, and for good reason. These firms, led by the pharmaceutical, retail, and hi-tech industries, comprise the vast majority of Puerto Rico's tax base and private sector employment. Regardless of the short-term strategies that might be employed to retain job creators in Puerto Rico, the long-run focus must be on clear rules that attract jobs and investment to the island from all sectors and nations."

The paper also noted that Puerto Rico was already making strides with tax and regulatory reforms of its own, including business tax rate reductions and streamlining various permit processes. These actions, and more recent policies, can serve as a basis for more progress, whichever political status that Puerto Rico's taxpayers may eventually choose.

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[4] Brady, Demian. "Puerto Rico's Challenges Present an Opportunity for Tax Reform." NTU Foundation, March 26, 2019. Retrieved from: https://www.ntu.org/foundation/detail/puerto-ricos-challenges-present-an-opportunity-for-tax-reform

Nonetheless, we quote liberally from this 2019 publication to illustrate that sorting out tax issues alone – irrespective of trade, transfer payments, or regulatory interactions – would be a protracted exercise under at least two, and likely all, of the status options presented by H.R. 8393. In our experience, policymakers in Washington as well as San Juan have consistently underestimated the time and effort that must be put into these fiscal minutiae to ensure that the people of Puerto Rico have greater economic opportunity and stability. Strengthening the transition provisions in H.R. 8393 transition, as well as involving other committees of jurisdiction now rather than later, could avoid a repetition of this unfortunate past.

Conclusion. There are many other fiscal elements of H.R. 8393 that merit further exploration – to give but one example, how much detail on the tax, budgetary, and regulatory pros and cons of each status option will be provided in the voter education materials under Section 6(b)(3)? In many U.S. states as well as other countries, the thoroughness and balance presented in official ballot measure materials, whether printed or online, can be critical to taxpayers' complete awareness of the proposals on which they are being asked to evaluate at the polls.

Because fiscal matters are weighty and complex regardless of the time, place, or circumstances of any community, public officials and other actors in civil society owe taxpayers the most thoughtful, measured approach to legislation affecting their future. For the sake of Puerto Rico's taxpayers, in particular, we hope these comments will prove a helpful starting point to the Committee. NTU stands ready to assist you and your staff in the future. Thank you for your consideration.

Sincerely,

Pete Sepp
President