

## FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO



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### **BY ELECTRONIC MAIL**

October 18, 2018

The Honorable Ricardo A. Rosselló Nevares  
Governor of Puerto Rico

The Honorable Thomas Rivera Schatz  
President of the Senate of Puerto Rico

The Honorable Carlos J. Méndez Núñez  
Speaker of the House of Representatives of Puerto Rico

Dear Governor Rosselló Nevares, President Rivera Schatz, and Speaker Méndez Núñez:

I write to you today regarding the tax initiatives legislation, House Bill 1544, currently under consideration by the Legislature.

This legislation has the potential to significantly impact the tax structure and revenue collections of the Government. It includes more than 100 individual changes to the Puerto Rico Internal Revenue Code of 2011 (the “Code”), including the imposition of new tax regimes, new tax rate structures, new tax categories, changes to tax exemptions and deductions, and the elimination of certain tax provisions in the Code, all of which, if signed into law, would have to be implemented in a matter of weeks. While the additional enforcement provisions in the bill are encouraging, the late timing of adoption of these changes will increase complexity in the administration of the tax system.

Consequently, the Oversight Board will closely evaluate each provision of the legislation for its consistency with the Commonwealth of Puerto Rico Fiscal Plan certified by the Oversight Board (the “Fiscal Plan”), with a particular focus on the revenue neutrality of the proposal. As you know, the Principle of Revenue Neutrality in Section 14.3.2 of the Fiscal Plan states:

“Puerto Rico needs to drive toward more formality and increased compliance within the tax base, but it cannot lose revenues in the process. Therefore, any tax reform or tax law initiatives that the Government undertakes or pursues during the fiscal plan year must be revenue neutral. To ensure revenue neutrality, the

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implementation of any tax law initiatives must occur sequentially, with the Government ensuring that initiatives are paid for before rates are reduced.”

Although the Legislature is still deliberating the final provisions and amendments to the bill, given the tax policy changes this legislation will inevitably introduce, we would like to clarify certain elements the Oversight Board will require as part of our review in determining the legislation’s consistency with the Fiscal Plan and revenue neutrality.

First, we require a copy of the final draft legislation to complete our assessment. We understand the Legislature is still considering a multitude of amendments to the Governor’s original proposal. The Oversight Board will need the Legislature to provide the final list of proposed amendments for review along with a detailed cost estimate for each of the changes.

Second, we will need a list of the specific, quantifiable measures over the next five years that will be used to pay for any proposed reductions in revenue so the Oversight Board can conclude with a high degree of confidence that any proposed tax reduction will be offset by an increase in taxes elsewhere. All measures proposed to pay for the proposed reductions in revenues must also include adequate risk adjustments, for considerations such as behavioral risks, economic risks, demographic risks, substitution risks, and implementation risks. Proposals with uncertain levels of revenue gains will be scored as zero until at least one year of collections have occurred and their revenues can be measured. Similarly, improvements in compliance related activities, or general changes that cannot be explicitly quantified, will not be scored as measures to pay for the proposed reductions in revenues. Lastly, any proposed decrease to the sales and use tax on prepared foods will be closely evaluated in light of the proposed plan of adjustment for COFINA.

Finally, I would like to remind you the tax initiatives legislation currently under consideration does not address the need to shift away from the Act 154-2010 tax to a broader, more progressive tax regime. The proposed initiatives also do not address the Government’s need to reform its broader tax structure in response to the federal government’s Tax Cuts and Jobs Act that was recently enacted. Building a simpler, more broad based, competitive tax environment remains a challenge to be addressed in the future.

Sincerely,



Natalie A. Jaresko

CC: Christian Sobrino Vega  
Raúl Maldonado Gautier  
Teresita Fuentes Marimón