Congressman Pedro R. Pierluisi
Statement as Prepared for Delivery
"Federal Tax Reform and Its Effect on Puerto Rico"
Puerto Rico Manufacturers Association (Asociación de Industriales de Puerto Rico)
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Thank you. And welcome to all of you.

I want to begin by thanking both Waleska Rivera and Jaime Garcia, the President and Vice-President of the Puerto Rico Manufacturers Association, for inviting me to speak today. I also want to thank Carlos Bonilla, the President of PRMA's tax division, for moderating this panel. And I want to thank—and to welcome to Puerto Rico—my fellow panelist, Peter Merrill, from PricewaterhouseCoopers. I would note that, prior to joining PWC, Dr. Merrill was the chief economist at the Joint Committee on Taxation, a nonpartisan committee that assists the U.S. Congress as we develop and debate tax legislation. Given his professional experience, Dr. Merrill is particularly well-suited to shine light on what can be an opaque, complex and at times bewildering process.

I have been asked to offer some brief remarks about the ongoing effort in Washington to reform the U.S. tax code, particularly its international corporate provisions, and to discuss the potential

impact that such reform may have on Puerto Rico. I am happy to do so and I look forward to answering any questions you may have.

As all of you are well aware, President Obama and leaders in the Republican-controlled U.S. House of Representatives and the Democratic-controlled U.S. Senate all generally agree on the need to reform the U.S. tax system for both individuals and corporations. Goals of reform include, but are not limited to, simplifying the tax code, raising revenue for the federal government (in the case of the Democrats), encouraging investment in American jurisdictions, creating American jobs, and modifying the way in which we tax U.S. companies so they can better compete in the global economy.

It remains to be seen whether a consensus can be reached among all the stakeholders in government and the business community on a specific path forward that will result in comprehensive tax reform legislation being enacted into law either this year or in the foreseeable future. While the desire for action is certainly there, the devil—as always—is in the details. The challenges and obstacles that lie ahead are substantial, given the variety, complexity and interdependence of the issues, the amount of money at stake, the fact that powerful stakeholders often have divergent interests and goals, and the divisions between Democrats and Republicans. Nevertheless, I have been operating—and will continue to operate—on the assumption that tax reform legislation will gain traction, and I am taking the steps necessary to ensure that Puerto Rico will be fairly treated in such legislation. In Congress, as in life more generally, it is always better to be over-prepared than under-prepared.

My remarks will focus on the corporate side, rather than the individual side, of tax reform. And within the corporate side, I will focus on the international, rather than the domestic, provisions under discussion. I do so because Puerto Rico is considered to be outside of the United States for many purposes under the U.S. tax code.

The current U.S. system subjects foreign subsidiaries of U.S.-based multinationals—known as Controlled Foreign Corporations or CFCs—to taxes on income they earn outside of the United States, including in Puerto Rico, while allowing those companies to claim a tax credit for foreign or territorial taxes paid. However, corporations generally are not required to pay U.S. taxes on that non-U.S. income unless they repatriate it to their U.S. parent in the form of a dividend, a rule known as "deferral." Because companies reinvest, rather than repatriate, a significant portion of their income earned outside of the United States, many never pay U.S. taxes on such income.

In February 2012, the Obama Administration released a document entitled "The President's Framework for Business Tax Reform." The document argued as follows: "Although the U.S. tax system is often described as 'worldwide' because it taxes U.S. companies on profits earned abroad, opportunities for deferral can make it effectively much closer to a territorial system—a system in which taxes are never paid on foreign income—for many companies."

The Administration document further stated that President Obama "believes we must prevent companies from reaping the benefits of locating profits in low-tax countries, put the United States on a more level playing field with our international competitors, and help end the race to the bottom in corporate tax rates."

To advance these stated goals, the Administration has put forward several proposals. One proposal is to subject CFC income to a minimum rate of tax, so that foreign income deferred in a low-tax jurisdiction would be subject to immediate U.S. taxation up to the minimum tax rate, with a foreign tax credit allowed for income taxes paid to the host country. The Administration has not specified what the minimum tax rate would be, although there is some talk about a rate of 15 percent or so. Parenthetically, I should note that the Administration has also proposed several new tax incentives to reward companies that choose to invest and create jobs in the United States, including a tax credit for companies that move operations from outside the United States to inside the United States, a process known as "insourcing." As soon as these tax incentives were proposed in early 2012, I wrote a letter to President Obama and held a telephone call with Jason Furman, a senior economic advisor to the President, to urge that Puerto Rico be included within the definition of the "United States"—and the request was granted. Unfortunately, the President's proposals have not been enacted into law by Congress.

Separately from the President, the Republican Chairman of the House Ways and Means Committee, Dave Camp, released a discussion draft in October 2011 that set forth his proposals regarding international tax reform. Under the Camp draft, the U.S. corporate rate would be cut from 35 percent to 25 percent, a tax deduction would be provided that is equal to 95 percent of the dividend that a U.S. parent receives from a CFC, and foreign branches of U.S. parent companies would be treated as CFCs. The effect of the 95 percent dividend deduction, when combined with a 25 percent corporate tax rate, would be to impose a tax on repatriated CFC earnings of 1.25 percent.

Chairman Camp has concerns, however, that low tax rates in certain foreign jurisdictions, in combination with the 95 percent exclusion, could result in the erosion of the U.S. tax base. Accordingly, he has included three options in his discussion draft designed to prevent base erosion. I will not bore you with the details of each option, which are highly technical. For present purposes, I will simply note that Chairman Camp has asked for input from stakeholders regarding the pros and cons of these options, and certain CFCs with operations in Puerto Rico have provided such input.

So, where does tax reform stand now? In February, Chairman Camp and Ranking Democratic Member Sander Levin—with whom I met last month—announced the creation of 11 working groups on different tax subjects, each co-chaired by a Republican and Democratic member of the Ways and Means Committee. The co-chairs of the working group on international taxation are Devin Nunes from California and Earl Blumenauer from Oregon, both of whom I have met with. I have also spoken to the co-chairs of the working group on manufacturing, Jim Gerlach of Pennsylvania and Linda Sanchez of California, given the important role that manufacturing plays in Puerto Rico's economy. And Waleska Rivera testified at a hearing held by the manufacturing working group in April, and I am told her presentation was excellent.

The job of each of the working groups was to collect information from stakeholders and to provide that information to the Joint Committee on Taxation, the special committee in Congress for whom Dr. Merrill used to work. The JCT, armed with that information, prepared a nearly-600-page report earlier this month that described current tax law and summarized the thousands

of suggestions for reform that were submitted to the tax reform working groups. One of the submissions was a clear and concise submission from the Puerto Rico Manufacturers Association. My office met with the chief of staff of the JCT while the report was being drafted and requested that the final report expressly address the issue of taxation in Puerto Rico and the other territories. As a result, the final report does include a helpful 11-page synopsis of this subject. I should note, parenthetically, that the Senate Finance Committee held a hearing in May 2012 on the implications of tax reform for the territories. So both the House and the Senate are aware of the need to ensure that tax reform legislation addresses Puerto Rico.

In general, my north star is to ensure that Puerto Rico's interests are protected and promoted in any tax reform legislation that moves forward. For that reason, I have been educating key members of Congress and Obama Administration officials on this issue for over two years. My broad message—which has been well-received—has been simple and consistent. Puerto Rico is a U.S. jurisdiction and jobs in Puerto Rico are U.S. jobs. Therefore, tax reform legislation should help, not hurt, Puerto Rico.

I have further explained that Puerto Rico is underdeveloped in comparison to the states and has a much higher unemployment rate, which has resulted in an exodus of talented Puerto Ricans to the states in search of better economic opportunities. I have also noted that manufacturing constitutes a substantial percentage of Puerto Rico's economy and tax base, and that Puerto Rico—unlike certain foreign countries—is not a tax haven.

In addition, I have explained to federal officials that Puerto Rico is treated differently than the states under federal tax law, and that federal tax law has played a major role in Puerto Rico's industrialization. I expressed concern that certain tax reform proposals that have been floated could, absent appropriate modification, jeopardize investment and job creation in Puerto Rico and make it more difficult for the territory to compete with other jurisdictions. I have made clear that provisions should be included in any tax reform legislation to prevent such an adverse impact and, instead, to help the island's economy grow.

How the House and Senate will move forward, now that the JCT has published its working group report, is not entirely clear. It can be expected that additional hearings will be held and that Chairman Camp may release a new draft in the coming months. While the situation remains fluid, you can be assured that I have been, and will remain, vigilant to ensure that Puerto Rico's interests are protected and promoted in any tax bill. I look forward to continuing to work shoulder to shoulder with you all in that effort.

Thank you.