Puerto Rico Fighting to Keep Its Tax Breaks for Businesses

By LARRY ROHTER

New York Times, Sept, 1, 2018

Page 00001 The New York Times Archives

The New York Times

Puerto Rico Fighting to Keep Its Tax Breaks for Businesses

Abolish the exemption, the government of Puerto Rico says, and the economy of this Caribbean commonwealth will be crippled for years to come. But the Clinton Administration, intent on raising new revenue to reduce the Federal deficit, is nonetheless moving to revoke a multibillion-dollar tax break for American mainland companies operating here.

At issue is Section 936 of the Internal Revenue Code, which gives mainland United States companies an exemption from Federal taxes on income earned in Puerto Rico, whether it comes from operations or interest on local bank deposits. Critics here and in Washington assail the exemption as nothing more than an expensive giveaway.

Puerto Rico's new Governor, Dr. Pedro J. Rossello, and business groups contend that eliminating the provision will virtually destroy the island's manufacturing industries, which employs about 165,000. It would also deprive the local government of a big revenue source: a tax of up to 10 percent on profits that mainland companies send home from their Puerto Rican operations. If the Clinton plan is adopted, many in Puerto Rico fear that businesses will leave the island and take their bank deposits with them. Rebuffed by the Treasury and the White House, Puerto Rico's leaders have come up with an alternative plan and are taking their case to Congress.

"We recognize that, as American citizens, we Puerto Ricans will have to participate in the President's call to sacrifice," said Daniel Lebron, president of the Puerto Rico Manufacturers' Association, in an interview here. "But we are asking that our sacrifice be proportional to our economic situation and that additional unemployment not be created on an island where 18 percent of the people already are without jobs and the per-capita income is only one-third that of the mainland."

But some Puerto Ricans say they would welcome the elimination of the tax breaks, which, they contend, have long outlived their usefulness. They say that the corporate beneficiaries of the system are exaggerating the impact the changes would have on Puerto Rico's economy and that the companies' vows to abandon the island if Section 936 is abolished are empty threats.

The tax exemption is for corporations only. Individuals on the United States mainland, for example, could not use Section 936 to shelter money by placing it in Puerto Rican banks. United States citizens residing in Puerto Rico pay no Federal income taxes on income derived from Puerto Rican sources.

Section 936 is "nothing but a welfare program for the Fortune 500," said Luis Costas, a tax attorney here who has written extensively on the program. "It's a profit-shifting operation that allows companies based in Puerto Rico to purchase supplies and materials from their corporate headquarters at a much lower than usual rate, while selling the finished product back at the highest price, thus inflating profits."

And Miriam Ramirez de Ferrer, president of Puerto Ricans in Civic Action, a pro-statehood group opposed to the tax-incentive program, asserted: "It has had a long trial and it hasn't worked. Section 936 has cost the United States Treasury billions of dollars, and yet in Puerto Rico we still have 18 percent unemployment and a per capita income of just over $6,000 a year."

During the cold war, a tax-incentive program was the principal instrument used by Washington to build Puerto Rico as a free-market, democratic alternative to Cuba. Supporters of the tax-exemption system argue that as a result of the program, Puerto Rico has the highest standard of living in the Caribbean. Credits for Wages

But the Treasury now wants businesses here to pay taxes on profits and interest income. To ease the burden, it is willing to grant companies income tax credits for workers' wages and credits against a tax on interest income based on investments in plants and equipment. Under the Clinton plan, the Treasury estimated that it would raise $7.3 billion over five years from Puerto Rico.

Among the companies operating in Puerto Rico are Abbott Laboratories, General Electric, Hewlett-Packard, Upjohn and Westinghouse Electric.

A proposal by Puerto Rico's Governor would permit Washington to tax income earned here but would offset that with a 100 percent credit for wages and a partial credit for fringe benefits, local taxes, interest earned on bank deposits and capital investment. Alternatively, the plan would allow for 80 percent of a company's profits to be tax exempt.

The Governor said that his "eminently reasonable" proposal, which has received a cool reception from the White House, would produce $3 billion to $4 billion in revenue for the Treasury Department over five years -- less than the Clinton proposal -- without inflicting unnecessary hardships on Puerto Rico's 3.6 million residents. 'Numbers Game'

"What has emerged thus far from the Administration, specifically the Treasury Department, is a numbers game that doesn't take people into account," said Dr. Rossello, a physician who took office in January vowing to lead the island toward statehood.

Of the 975,000 people employed in Puerto Rico, about 110,000, or more than 11 percent, are in manufacturing jobs generated by about 300 companies that enjoy the benefits of Section 936. An additional 55,000 jobs, including many in businesses that supply the tax-exempt companies, make up the rest of the manufacturing sector.

Although manufacturing accounts for less than 17 percent of all jobs in Puerto Rico, it generates 40 percent of the island's $34 billion in yearly gross product.

While the Federal Government has provided some form of tax incentive in Puerto Rico since 1921, a tax-exemption policy became the main engine of growth here only in the period after after World War II, when Operation Bootstrap was begun. Proponents of Section 936, which has been in place since 1976, argue that without the measure and its predecessors, Puerto Rico would never have been able to industrialize or to achieve its relatively high standard of living. The uncertain outlook for Section 936 has generated considerable alarm and resentment here, dominating headlines and intensifying the debate leading up to a plebiscite on statehood scheduled for November. In March, an estimated 100,000 people marched to protest the changes favored by Washington, and it is not unusual to spot "I Support Section 936" bumper stickers.

Evelyn Berrios was one of those marchers in March. She has worked in tax-exempt factories since 1966, the last 11 years at the Puerto Rico plant of Electro-Biology Inc., a medical instruments company based in Parsippany, N.J., with a plant in the San Juan suburb of Guaynabo. She said any system of incentives that enabled people like her to send two daughters to college and to buy stock in her employer had to be beneficial to Puerto Rico. Drastic Effect Feared

"We are all very much aware of what is going on and worried that it will affect us drastically," she said. "We don't know what we would do if we lose that. We are willing to sacrifice, but we want to conserve our jobs."

Companies receive as much as $70,000 a year in tax write-offs for each job created under Section 936. Such jobs pay $6.25 an hour on average, excluding fringe benefits, compared with an average wage of more than $12 an hour for manufacturing jobs on the mainland.

Nearly 60 percent of tax benefits -- estimated at $2.7 billion a year -- go to some 60 drug companies that account for 18 percent of the jobs provided by Section 936.

The Clinton proposal strikes especially hard at the drug, electrical equipment and food processing industries that Puerto Rico's government sees as the most promising engines of future industrial growth. Marcos Rodriguez-Ema, president of the Government Economic Development Bank, said his bank concluded that high-tech companies would end up paying an effective tax rate of more than 30 percent under the Clinton proposal -- slightly less than the mainland's tax rate and more than the 20 percent rate under Dr. Rossello's plan.

"That knocks us out of the race" with Mexico to attract mainland companies if the North American Free Trade Agreement passes, the Governor said.

The Clinton Administration plan would also affect some $16 billion in deposits that mainland companies keep in local banks or have reinvested here. That money, large in relation to the size of the Puerto Rican economy, has allowed banks sufficient liquidity to pay low interest rates on deposits, to offer loans at rates slightly lower than on the mainland, to make loans to businesses and to finance the construction of schools, hospitals and roads. Taxing Interest on Deposits

The Administration wants to tax the interest from the deposits, but companies can offset that with an 80 percent credit for the value of their equipment, machinery and facilities here, which total more than $5 billion. The $5 billion in assets would allow for a credit of $4 billion, meaning that the interest earned on $12 billion of the $16 billion in deposits would be taxed.

Officials predicted that the $12 billion in deposits would flee the island; the withdrawal would seriously affect the ability of the commonwealth's government to function. A local "tollgate tax" of up to 10 percent on profits repatriated to the mainland provides the Government with about 12 percent of its total revenue, some $500 million, for which there is currently no substitute.

"It would definitely cause us a gigantic decline," Governor Rossello said of a tax on interest earnings. "It would immediately cost us half a billion dollars a year, a loss that would be reflected in services. If we're already cutting programs because of a budget deficit, and we would have half a billion less, it would mean chaos in Puerto Rico."