April 10, 2000

Secretary Lawrence H. Summers
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Summers:

As I am sure you will agree, the federal budget surplus must both be preciously guarded and maintained. The current fiscal situation should not diminish our scrutiny of the costs borne by the U.S. taxpayer. In particular, the cost implications of federal tax policy in the possessions should be made transparent.

I am writing in regard to a critical issue which affects our federal tax policy as it relates to Puerto Rico. Specifically, I am concerned with the Treasury Department's failure to issue regular reports on the operation and effect of the current system of taxation in U.S. territories.

The Tax Reform Act of 1976 required the issuance of an annual report, and the Deficit Reduction Act of 1984 amended the requirement that Treasury issue the report every two years.[1] No report has been issued for 10 years. The Department of Treasury should immediately resume the issuance of regular reports on the operation and effect of the possessions corporation system of taxation in the U.S. territories, as provided by Congress to evaluate whether the on-going phase-out of section 936 is generating the revenues Congress anticipated when it repealed the credit in 1996.

To continue to shelter taxes most section 936 corporations in Puerto Rico are now restructuring as controlled foreign corporations (CFCs). The report should examine the changing tax structure of U.S. corporations operating in the territories, and determine the potential income that might be shielded from taxation through this technique and how it will affect revenues to the Treasury. The need for this CFC reporting is heightened by the broader implications of the United States Court of Claims July 7, 1999 $180 million National Westminster Bank LPC refund ruling by Judge James T. Turner.

You may be aware of the alarming and increasing loss of revenue to the US Treasury from US-headquartered CFCs operating in Puerto Rico. The number of US-owned CFCs operating in Puerto Rico have grown from six in 1998 to 46 in 1999. The

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1 "The Treasury is to submit an annual report to the committee setting forth an analysis of the operation and effect of the possessions corporation system of taxation. Among other things, the report is to include an analysis of the revenue effects of the provision as well as the effects on investment and employment in the possessions." (S. Rept. 94-938, p. 282, also H. Rept. 94-658, p. 259).

estimated annual revenue losses to the US Treasury range between \$1.72 – \$2.53 billion each year over the next five years. If these taxes were deferred for ten years the annual revenue losses in present value terms would be more than \$1.2 billion per year. The above 46 corporations, representing less than one percent of the 7,500 US-owned CFCs worldwide, account for a significant percentage of the US Treasury's estimate of total revenue loss of between \$2.2 – \$3.4 billion per year.

By providing transparency on the possessions corporation tax system, Treasury reports played a critical role in informing federal tax policy in the past. Given the significant recent changes in federal tax policy in the possessions, I consider the resumption of regular reports on the effects of federal tax policy in the possessions a matter of the highest priority.

You have expressed concern over the slow growth of US corporate tax revenue. It would seem important to eliminate a major foreign tax haven on US soil. A solid suggestion would be to disallow immediately CFC status for US headquartered corporations operating in Puerto Rico.

Thank you in advance for your consideration of this critical matter. I look forward to hearing from you in the near future in regard to the status of these reports.

Sincerely,