Synopsis and Reaction to H.R. 2550 (Crane-Rangel Bill for Amending Section 956, Puerto Rico Tax Incentive Bill)

1. **H.R. 2550 proposes that the U.S. Congress revive the tax incentive-based economic development strategy it eschewed with the phase-out of Section 936.** The bill calls for a permanent tax exemption for U.S. firms in Puerto Rico, financed by the U.S. taxpayer.

2. **Funded by the U.S. taxpayer, H.R. 2550 would alter deferral of federal taxation to a 90% exemption.** Many Section 936 firms in Puerto Rico have already shifted to Controlled Foreign Corporations (CFCs) under Section 956 of the Internal Revenue Code, thereby legally avoiding federal taxation until profits are repatriated to the U.S. parent corporation. The Crane-Rangel Bill (H.R. 2550) would effectively restore Section 936 incentives by exempting U.S. CFCs in Puerto Rico from federal taxation on 90% of profits generated in Puerto Rico and reinvested in the U.S. in an undefined category, "property." As CFCs under current law, U.S. companies would eventually have face federal tax on their income in Puerto Rico. Under this bill, the U.S. Treasury relinquishes even these deferred taxes.

3. **The loss of revenue to the U.S. Treasury would be enormous.** If all the 936 firms switched to CFCs, the loss in 1999 would range from $3.5 to $4 billion. Another indication of the loss is that in 1999, under current IRS regulations, 10 of the 46 CFCs operating in Puerto Rico "deferred" $1.72 billion, which would translate into $1.5 billion exemption under the current proposal.

4. **The Puerto Rican economy has not declined with the phase-out of Section 936.** Since Congress voted to phase out Section 936 in 1996, employment in Puerto Rico has increased and the economy has grown. Manufacturing jobs have declined, but at the same pace as in the mainland U.S. Economic performance during the phase-out confirms that Puerto Rico is not and has not been dependent on federal tax incentives.

5. **A return to manufacturing tax incentives will not help the people and economy of Puerto Rico.** Federal tax incentives for industry proved effective in the 1950's and 1960's, when Puerto Rico enjoyed protective tariffs and comparatively low labor costs. With trade liberalization and intense global competition, manufacturing tax

incentives have long since proved ineffective tools for development in Puerto Rico. Economic growth has stagnated since the early 1970's and unemployment has consistently exceeded 10%, belying the objective of the tax incentives – job creation.

6. **Exempting U.S. CFCs in Puerto Rico from federal tax would expose the U.S. Treasury to the same transfer pricing abuses as occurred under Section 936.** Congress eventually curbed the worst transfer pricing violations under Section 936 with regulations in 1991 and 1993. The U.S. Treasury would again be susceptible to the costly abuses under this new proposal that the 1991 and 1993 regulations curbed.

7. **The many U.S. firms in Puerto Rico already operating as CFCs receive identical tax haven benefits on U.S. soil as they do in foreign tax havens**. These firms will quite logically want to extend the privileges granted in Puerto Rico to their CFCs worldwide (e.g., Ireland, Holland, etc.) Therefore, to the U.S. taxpayer H.R 2550 opens the door for even greater global tax sheltering which would represent a potentially staggering loss in tax dollars.