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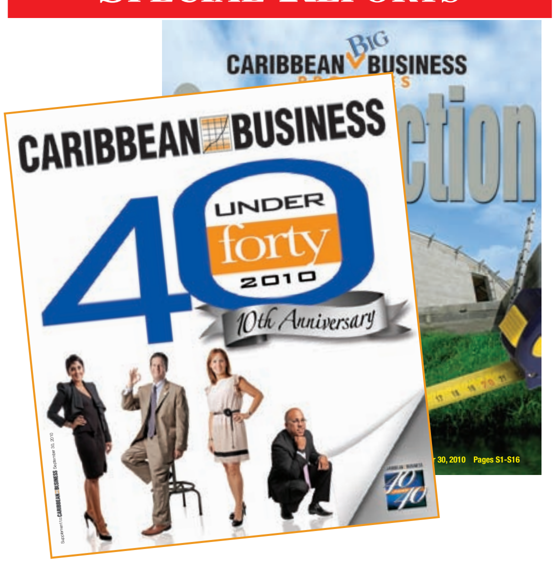

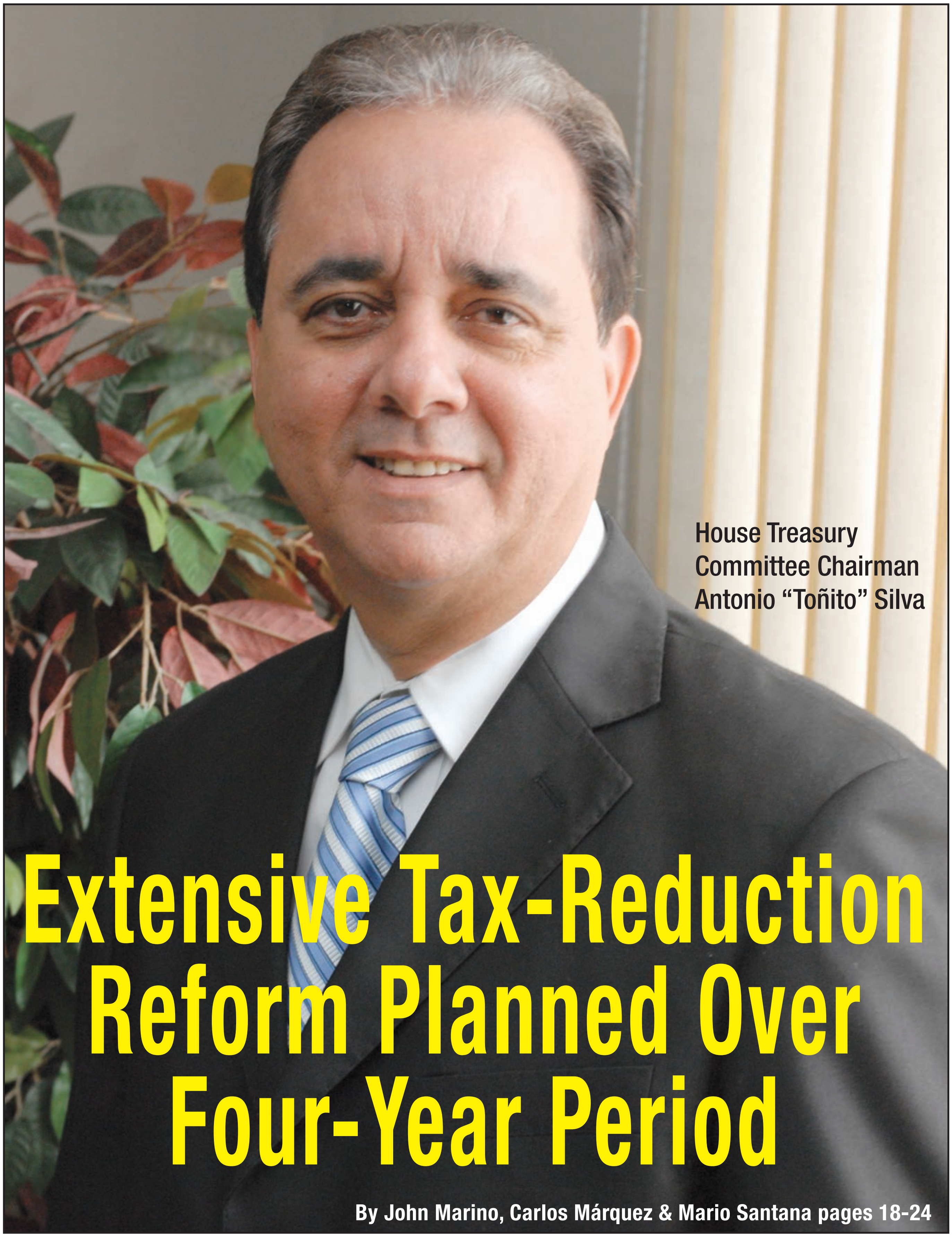

House Treasury Committee Chairman Antonio "Toñito" Silva

Extensive Tax-Reduction Reform Planned Over Four-Year Period

By John Marino, Carlos Márquez & Mario Santana pages 18-24

Front-Page STORY

Tax relief promises reduced withholding, hefty rebates starting Jan. 1, 2011

Reform will lower rates, streamline write-offs and include relief for overburdened local businesses

BY JOHN MARINO, CARLOS MÁRQUEZ & MARIO SANTANA
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Tax reform is coming, and it will put more money in taxpayers' pockets starting Jan. 1, 2011.

That is the word from House Treasury Committee Chairman Antonio "Toñito" Silva, who in an exclusive CARIBBEAN BUSINESS interview pledged to ensure the reform would bring relief to all taxpayers.

Once the Fortuño administration files legislation implementing the reform, which is expected to happen next week, the Treasury Committee chief said he would push forward with an aggressive hearing schedule so that legislation can be approved by the Nov. 11 end of the session. That would ensure that the relief would begin to take effect for the current tax year and for the tax filing due April 15, 2011.

That means taxpayers would experience reduced withholding from their paychecks starting Jan. 1, 2011 and most should expect fat refunds on the returns due April 15, 2011, since current withholding rates are above those that the administration and the Legislature are pledging to apply retroactively to the current tax year.

"There has been some talk that people earning above $60,000 a year will not see a reduction in tax rates, but we can't do that. There has got to be relief for everyone. I'm going to make sure that happens," Silva said.

Tax reform is one of the major campaign pledges of Gov. Luis Fortuño and the New Progressive Party (NPP), and a La Fortaleza committee headed by former Treasury Secretary Xenia Vélez has been working for most of this year to draw up a proposal. The NPP platform also discusses the issue in detail, and Silva said lawmakers have also been analyzing tax-reform specifics and general approaches while awaiting the official administration proposal.

Besides Vélez, the tax-reform committee includes Silva, Senate Treasury Committee Chairwoman Migdalia Padilla, Treasury Secretary Juan Carlos Puig, Government Development Bank President Carlos García, Economic Development & Commerce Secretary José Ramón Pérez-Riera and La Fortaleza Chief of Staff Marcos Rodríguez-Ema.

As this edition went to press, final details were still being worked out on the tax reform, but it will embrace many of the common aspects that the different proposals share, according to lawmakers and administration officials. Vélez also said last week that the tax reform recommendations released last week by the Puerto Rico Certified Public Accountants (CPA) Association are in the "same direction" as her committee's recommendations to Gov. Luis Fortuño (see related article). The governor was expected to get a draft of the committee's recommendations today, Sept. 30.

The governor has the final say on what is included in the proposed legislation, and he was still deliberating between options on several fronts at press time, CARIBBEAN BUSINESS sources said.

Also, both the House and Senate will leave a substantial imprint on the process, particularly Silva and his committee, which has the constitutional mandate to originate all tax legislation. Besides ensuring that all taxpayers get relief, Silva told CARIBBEAN BUSINESS last week he would also push for new sources of income to allow for a "real reform," weed out unproductive tax credits and increase productive ones, and ensure the reform is realistic and paid for. Vélez has also pledged to undertake these actions.

Much also was still riding on how

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much the various proposals would cost, and the revenue picture at the Treasury Department, to see how much could be done and how fast, Silva said. That is especially the case with the local economic stagnation and recession persisting longer than expected.

Regardless of the final shape the reform will take, it will reduce the tax burden on individuals and corporations, with particular emphasis on the middle class and salaried workers, reward work and success, and spark economic development in Puerto Rico by fomenting savings and productive investment. And it will be comprehensive in its scope, even though it will be implemented in stages to deal with fiscal realities.

"The most important and crucial aspect of the reform is that it reactivates our economy, so that our people can find work, so that everyone who wants to earn a livelihood honestly can do so," Vélez said last week. "A very important aspect of our analysis is what the economic impact will be of putting this money into the hands of taxpayers, and that is what we are doing."

The blueprint for real reform now

While the final numbers were not in at press time, there was still general agreement on several points, the most important being the need to provide individual taxpayers with relief. To that end, the legislation will apply retroactively to the current 2010 tax year so that the relief can be felt through reduced withholding from paychecks starting Jan. 1, 2011 and through tax refunds for tax returns due April 15, 2011.

The executive proposal was expected to call for a $218 million annual relief package targeting individual taxpayers, meaning that other sources of revenue would need to be found to cover that amount. Subsequent reductions would be made over a four-year period until the reform was fully phased in, Silva said.

There is also general agreement that corporate business tax rates—at a sky-high 39%—also need to come down, but it was not clear whether such reductions could apply to 2010 or might have to wait for the 2011 tax year, Silva said.

The first phase of the reform is also expected to increase the benefit under the local Earned Income Tax Credit (EITC), which is aimed at helping the working poor. This will be accomplished by raising the floor, establishing at what income level taxes kick in. Currently, the level is at $20,000.

The reform, the implementation of which is expected through several different bills, will lay out a comprehensive prescription for tax reform, including substantial relief, particularly for the middle class, even if the plan has to be spread out over several years, Silva said, adding he expected a four-year plan to be filed.

The reform will also substantially streamline both the amount of deductions available to individuals and those for business expenses without eliminating the benefits of these write-offs, largely through new standard deductions or increases in surviving write-offs, the veteran Bayamón lawmaker said. Only "core deductions," like mortgage interest and student loan interest, are expected to survive.

Paid for, but not revenue neutral

The reform needs to offer real relief to taxpayers, which means that other sources of income must be identified to finance a genuine reform effort, Silva said.

"Otherwise, you are just cutting a benefit from one place and putting it somewhere else," said Raúl Candelario, the longtime executive director of the House Treasury Committee and a veteran of the annual budget wars it must negotiate. "A real tax reform can't be revenue neutral."

"I don't want someone to have to try to do the math to figure out if he is better off now than under the reform and at the end of the day find out he saved $9," Silva said. "Then all this effort is not worth it."

While certain moves contemplated in the reform will save money, they will just be absorbed by rate deductions in other areas. That is why Silva insists that the reform has to include an effort to increase tax collections in new ways, and all players involved appear to be making efforts at boosting tax compliance.

Of course a major area of focus will be on the sales & use tax (IVU by its Spanish acronym), which has an estimated collection rate as low as 52%, meaning authorities are collecting only about half the amount they should be collecting from this important revenue source.

An IVU-Loto is one strategy aimed at increasing IVU revenue by some $400 million annually. The idea is to have small $1,000 drawings twice a week based on numbers printed on purchase receipts. Customers will ask for receipts in order to participate, which would ensure that merchants are charging the IVU and sending it to Treasury.

Candelario also said that Treasury should be cracking down on businesses across the island that only accept cash, which he said was a "big red flag" that tax evasion is occurring. The informal or underground economy is estimated at approximately $14 billion a year, according to a recent Estudios Técnicos study prepared for the Government Development Bank.

And while the video lottery has been killed, Silva said licensing fees on existing adult-entertainment machines could still be a future source of revenue with improved oversight from Treasury, which is in the middle of a mass hiring effort to try to collect back taxes.

One major initiative Silva will push for is an attempt to tax Internet purchases, electronics and other items shipped to Puerto Rico. While taxation legally applies to such purchases, collections are nonexistent.

In the case of Internet purchases, it is up to the individual to report such purchases and pay the tax on them, but there is no incentive to do so. Contacting online retailers about either charging or notifying island consumers about their responsibility might change that, along with other oversight methods Treasury could begin to employ, Silva said.

While air cargo carriers successfully sued the commonwealth government in federal court to stop it from forcing them to collect taxes on shipments made to the island, the government could negotiate with them to share revenue on charging the current sales tax, Silva argued. Nothing in the law impedes the government from doing so.

Antonio 'Toñito' Silva, House Treasury Committee chairman

The administration has discarded attempting to tax multinational firms, which even with tax-exemption incentives for more than 90% of their earnings, still wind up paying a whopping portion of local corporate tax, which in 2009 added up to $1.262 billion, nearly 25% of all corporate taxes paid. Silva said, however, that Puerto Rico should step up compliance efforts involving multinationals operating on the island to maximize this important revenue source for Treasury.

A parallel effort would involve cracking down on "transfer-pricing" practices by offshore firms operating in Puerto Rico that are not tax-exempt. The practice, which often involves large retailers, is when businesses jack up the prices of products purchased by island outfits to artificially drive down their profits and tax burden locally, transferring the profitability to other jurisdictions that sold the locally overpriced goods, Candelario explained.

And while Silva describes himself

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as "pro cooperative," he acknowledged that limits should be placed on what businesses can truly organize under this tax-exempt structure, saying that many businesses, from shopping malls to hotels, operate under the cooperative concept only to avoid taxation.

There will be also a tightening of accounting regarding special partnerships and other tax structures, and a push to harmonize commonwealth tax determinations with those of the federal government.

The lawmaker said Treasury could adopt technology used in the food-purchase cards by beneficiaries of the federal Nutritional Assistance Program (PAN by its Spanish acronym), which only allows qualified purchases on the card. In this way, local merchants, who get exemptions on "raw products" they buy such as uncooked food for restaurants or wood for carpentry shops, would be able to receive a tax exemption at the moment of purchasing goods needed for their business, but not when they buy personal items.

"Right now, every time a merchant buys a plasma television, they get a tax exemption on that too, and that's not right," Silva said.

Other measures being considered include boosting the withholding on professional services to 10%, and making top executives criminally and civilly responsible for withholding taxes from employees' paychecks and not depositing them with the Treasury Department.

Raúl Candelario, House Treasury Committee executive director

CARIBBEAN BUSINESS staff members discuss tax reform. From left are Executive Editor José L. Nieto, Economics Executive Editor Carlos Márquez and Legislative Affairs Editor Mario Santana.

RELIEF FOR THE SALARIED WORKER

At the start of this legislative session last month, House Speaker Jenniffer González said the tax reform would be in line with what the NPP outlined in its 2008 platform.

The NPP pledged in its platform that individuals and families with an annual income of $20,000 or less would pay no taxes whatsoever, while those with an annual income from $20,001 to $30,000 would pay taxes at a 7% rate, those with an annual income from $30,001 to $70,000 would pay at a 15% rate and those with an annual income from $70,001 to $125,000 would pay at a 25% rate.

Right now, individuals and families with an annual income of $2,000 to $17,000 pay taxes at a 7% rate, those with an annual income from $17,001 to $30,000 pay at a 14% rate, those with an annual income from $30,001 to $50,000 pay at a 25% rate and those with an income higher than $50,000 pay at a 33% rate.

However, Silva put the price tag on the campaign pledge at about $1 billion, a reduction that could not be implemented all at once, but that instead would be phased in over a four-year period. Silva said that much would depend on the Treasury Department, the Planning Board and the Office of Management & Budget estimates on government revenue, economic development and budget expenditures.

Preliminary figures indicate that $218 million would be available to pay for relief applied to the current tax year, and Tax Reform Committee Chief Vélez told lawmakers recently that the administration plan was to split that money for both paying for the EITC and to lower tax rates and create new tax brackets.

While there has been talk of limiting the relief offered this year to taxpayers (including married couples filing jointly) earning less than $60,000 annually, Silva pledged to amend any legislation to ensure relief is granted to all taxpayers.

Silva noted that in 2008, only 4.6% of individual taxpayers reported income over $75,000, but that their tax contribution equaled almost 53.2% of all income tax paid that year.

"Definitely, I disagree with this. I cannot penalize those who work hard, study and prepare themselves to get ahead," Silva said. "We must do justice for all taxpayers."

The first phase of the tax reform would also include a boost of the EITC created under 2006 tax legislation. Right now, the credit is capped to a gross adjusted income of $20,000 and the top tax credit available is $300.

As with the federal EITC, the local EITC is designed to help low-income workers, reducing their tax liability on income earned in order to incentivize their working, rather than relying on social programs for survival. To receive the credit, an individual must file a tax return.

In its platform, the NPP promised to create an EITC of $300 to $600 for individuals with an annual income of up to $20,000. Right now, the gross adjusted income cap to qualify for the credit is at $20,000 and the top tax credit available is $300.

It has yet to be decided whether to increase the maximum gross adjusted income to qualify for the credit, to increase the credit itself or to do both, Candelario said.

Silva said lawmakers would also weigh in on how much of the available $218 million in funding would go to reducing tax rates and how much would go to boosting the EITC.

"Ultimately, people may feel the tax credit more, but it's easier to see the tax rate reduction. When you reduce rates to 25% from 38%, people are impressed even if it ends up not being much money," he added.

Because of the government's fiscal condition, this lowering of tax rates for individuals will be also phased

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in, most likely over a four-year period, Silva said.

Phases of reform

To bring the immediate relief applicable to the current tax year, which will consist of individual income tax rate cuts and an increase in the EITC, lawmakers will likely amend current legislation.

More sweeping changes will be included in the new tax law that will take effect Jan. 1, 2011, as well as new laws regarding municipal and property taxes, Silva said. All these new laws will have sunset provisions, requiring lawmakers to judge their effectiveness at a determined time in the future.

Besides reducing rates, the reform would also expand the tax brackets used by Treasury. Right now, the top tax rate is anything more than $50,000, but proposals include creating at least two additional brackets, which would be capped at income levels of $70,000 and $125,000.

Candelario, however, said the House Treasury Committee would work hard to ensure that taxpayers are not harmed by the creation of new scales, saying that some taxpayers pushed into a higher bracket could conceivably see their tax burden increase.

"Expanding tax brackets is the ideal thing to do, but we have to make sure they do not impose a higher tax responsibility on some taxpayers," Candelario said.

The expansion of tax brackets, like the planned reductions in tax rates, will be also phased in over a few years.

The tax reform will also look to streamline deductions to a "core few," which include mortgage interest and student loan interest write-offs. The mortgage deduction will be limited to 30% of a taxpayer's gross adjusted income. The reform would also allow deductions for contributions to Individual Retirement Accounts (IRAs) or Educational Contribution Accounts, charitable donations, rent and medical expenses.

Any lost benefits taxpayers may experience through this streamlining would be offset by increases in the standard deduction, personal exemption and deduction to dependents available to taxpayers, Silva said. Under the administration plan, the standard deduction for married couples is expected to increase to $5,000 from $3,150, while the personal exemption for married couples would skyrocket to $12,000 from $3,000. Deductions for dependents, meanwhile, should increase to $3,000 from $2,500.

The first year of the reform will center on providing salaried taxpayers with relief, although the mortgage deduction limit to 30% of gross adjusted income will also be included, Candelario said.

For the reform's second year—meaning the income earned during 2011 and the tax forms to be filed on April 2012—the Tax Reform Committee has proposed to further reduce tax rates and expand tax brackets, and to begin phasing in increases in the personal exemptions, Silva said.

All these changes will continue to be phased in during the reform's third year, while the write-offs for dependents will increase to $3,000 from $2,500, Silva said. The reform's fourth year may further reduce tax rates and expand tax brackets, but no increases in automatic deductions are expected, Silva added.

The reform will also streamline filing status options from five to three, with the new options being married filing jointly, married filing separately and individual taxpayers.

The reform will offer new, quick filing alternatives for individual and business filers, as well as incentives for taxpayers to file early.

Corporate tax relief

While all the tax reform players are in agreement that corporate income taxes—among the world's highest at 39% —need to come down, the Tax Reform Committee is expected to announce they will be cut starting in 2011, the second year of the tax-reform plan.

Silva, however, said that if the administration bill does not lower corporate tax rates, his Committee might end up amending the bill to include some tax relief to corporations. Candelario said Treasury Department finances would ultimately define how quickly relief can be granted to corporations.

House Treasury Committee Chairman Antonio 'Tonito' Silva shares a moment with CARIBBEAN BUSINESS Publisher & Editor in Chief Manuel A. Casiano.

The NPP platform pledged to lower the corporate tax rate cap from today's 39% to 30%, and that is expected to be the tax reform's goal.

The tax-reform effort is also expected to simplify corporate tax filing, so that all state and municipal taxes can be paid via a single return without affecting municipal finances. In fact, it should relieve municipalities of some of the administrative burdens of collecting taxes, according to the administration. Taxes on fixed equipment and related taxes will be also reformed with an aim of increasing liquidity for businesses.

The Tax Reform Committee and lawmakers have been also analyzing the effectiveness of the dozens of tax credits available to businesses, with an eye toward eliminating the ineffective credits and increasing the productive ones, Candelario said.

One tax credit likely to be rescinded is that provided under Law 212, or the Law for the Revitalization of Urban Centers, which grants 75% to 100% tax credits for "hard" construction costs, including workforce, materials and equipment expenditures, and allows for their transferability.

Aspects of The Economic Incentives for the Development of Puerto Rico Act Law 73 would also likely be repealed. While much of the law is positive, one provision granting a credit for raw materials has become "a big hole," costing some $75 million and not producing anything, Silva said.

Both Silva and Vélez, however, said that because the tax reform was aimed at spurring the economy, productive tax credits for businesses would be expanded and increased.

With a bill slated to be filed next week, Silva said he will hold hearings on Tuesdays, Wednesdays and Fridays, to push the reform forward before the Nov. 11 deadline to pass new legislation. While the reform could be discussed in a special session, Silva said he felt pressure to pass the legislation in the regular session to give the Treasury Department enough time to print up the new tax forms the reform will require.

"We need a substantial reform. If we can't do it all in one year, then we will legislate now for three years," Silva said. "We have to stop penalizing those who work hard to get ahead. We need a tax reform for everyone." ■

Silva: 'This is a committee that calls things as they see them'

House Treasury Committee chairman gathers group of private-sector advisors to bring their unique perspective to the upcoming tax reform

Agnes Suárez, financial lines vice president of Carrión Lafitte Casellas and Economic Development Bank president under former Gov. Pedro Rosselló; Héctor Bernier of PricewaterhouseCoopers LLP; Jerry De Córdova, partner of Aquino, De Córdova, Alfaro & Co. LLP; Jorge L. Padilla, CFO & senior vice president of Universal Group; Juan Acosta Reboyras of Acosta & Ramírez CSP; and Rafael Del Valle of UHY Group Del Valle & Nieves PSC.

BY MARIO SANTANA
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Almost every Tuesday evening for the past several weeks, while the Capitol building seems almost empty and a bit haunted as night arrives, there is a lot of activity at Rep. Antonio "Toñito" Silva's office.

The light that pierces the darkness of the hallways, the talk and occasional bursts of laughter that break the silence mean that Silva's advisory committee is holding a meeting.

"This is a committee that calls things as they see them, and that's what I like about them," said Silva, chairman of the House Treasury Committee.

The meetings have become more frequent in the past month in preparation for one of the greatest challenges before Silva's powerful Treasury Committee during this legislative term: the tax reform soon to be filed by the Fortuño administration.

That tax reform constitutes Gov. Luis Fortuño's main campaign pledge.

Last Tuesday night, and on several Tuesday nights before that, Silva, his staff, House Speaker Jenniffer González's advisors, and advisors recruited from the private sector sat around the same table and discussed how Puerto Rico could have a fairer income tax system.

At the meeting that night were Agnes Suárez, financial lines vice president of Carrión Lafitte Casellas and Economic Development Bank president under former Gov. Pedro Rosselló; Héctor Bernier of PricewaterhouseCoopers LLP; Jerry De Córdova, partner of Aquino, De Córdova, Alfaro & Co. LLP; Jorge L. Padilla, CFO & senior vice president of Universal Group; Juan Acosta Reboyras of Acosta & Ramírez CSP; and Rafael Del Valle of UHY Group Del Valle & Nieves PSC.

Five of the six are former presidents of the Puerto Rico Society of Certified Public Accountants (CPAs), and together the group brings to the table vast experience in tax filings, tax law, insurance, banking and business in general. All advise Silva on a voluntary basis.

"In Puerto Rico many times people complain that lawmakers see things only from their perspective," said Acosta Reboyras, a lawyer and CPA, "but here we are contributing with our perspective."

CPA Del Valle recalled that during his more than 20 years in tax work, he has witnessed the difficulties businesses face to comply with the law. He wants to bring those struggles to the table.

"We would like to see a system that is easier to comply with," he said.

Silva recalled that part of the group served as advisors during the 2006 tax reform that levied the sales & use tax (IVU by its Spanish acronym).

"We have worked together for a long time. There is a friendship among us," he said.

The New Progressive Party lawmaker's right hand and Treasury Committee Executive Director Raúl Candelario said the group has held around 17 meetings since Sept. 2009. Together, he recalled, they have spent many hours considering the revenue-generating measures—other than taxes—available to finance the reform.

Silva emphasized the diversity of the group.

"Here are people from all political affiliations," he said.

CPA Bernier said he considers his role in the advisory committee as a way to fulfill his social responsibility.

He believes that the reform should correct some of the unfairness of the system, such as when two taxpayers with similar income and obligations do not pay the same amount of taxes because of the way one of them has structured his business.

"The reform should be comprehensive and should include corporations," he added.

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Xenia Vélez: 'We reach the same destination, but through different paths'

Head of governor's Tax Reform Committee reacts to Society of CPAs Foundation recommendations

BY JOSÉ L. CARMONA
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Reacting to the tax-reform recommendations announced Sept. 21 by the Society of CPAs Foundation, Xenia Vélez, executive director of Gov. Fortuño's Tax Reform Committee, said the foundation's report was part of the ongoing efforts by different sectors to analyze and simplify Puerto Rico's complex tax system.

The former Treasury secretary said she is looking forward to getting the full report from the Society of CPAs Foundation to closely evaluate it against preliminary recommendations by the governor's committee.

"The Society of CPAs Foundation report is what it is…As the old saying goes, 'great minds think alike.' Obviously there are many instances where the foundation's recommendations, made by brilliant people that I respect very much, will coincide with the recommendations of the Tax Reform Committee," Vélez said without elaborating on the foundation's recommendations. "We reach the same destination, but through different paths."

Vélez noted it is important to explore if the path suggested by the Society of CPAs Foundation is more efficient than the path recommended by other experts. In that sense, she said the foundation's report is a great working tool.

"In the process of evaluating the island's tax code, we ran hundreds, if not thousands of dynamic models, and certainly we would like to see if the foundation's proposed solutions mix with the ones we are contemplating in order to see which ones are more efficient," Vélez said. "Certainly the foundation's report will help us in that process."

Tax relief for businesses too

The Tax Reform Committee chief said she foresees the local Legislature considering a tax-reform bill that includes tax relief for individuals as well as for businesses during the current legislative session.

While Vélez concurred with the Society of CPAs Foundation that the tax reform must occur in phases, she recognized it was important to also provide tax relief to the business sector during the initial phase, since one of the objectives of the reform is to help reactivate the stalled local economy.

"Therefore, it is imperative that the business sector also sees some type of tax relief so that they can begin to invest and create jobs so that Puerto Rico can get out of this recession, which has lingered for too long and done so much harm to the island," Vélez said. "Certainly the best tax justice we can do to the good people of Puerto Rico is to help them find a job. Therefore, it is crucial to get the economy reactivated so that our people can find jobs and those who want to earn a living honestly can do so through their hard work. That's why it is so important to do the analysis as to the impact this tax reform will have on the economy."

Xenia Vélez, executive director of the governor's Tax Reform Committee

The more money people have in their pockets, the more they will spend, therefore fostering economic activity that will ultimately result in businesses selling more and buying additional inventory, hiring additional staff and increasing sales tax revenue, she said.

"The economy is a system, and part of what the governor's Tax Reform Committee has been doing is to run dynamic models to see the effects of the different changes in the system that could result in economic activity, not only in the short term but also in the long term," Vélez said, adding that the Tax Reform Committee commissioned a study with several local economists to evaluate the effectiveness of the current tax credits.

Differentiation between various business types

Without giving away specific details of the Tax Reform Committee's main recommendations, Vélez did say one of the things the group has been evaluating is how small businesses should be treated tax wise.

"You cannot treat a small business that sells less than $1 million the same way as a business that makes $10 million in sales. You have to make a distinction in terms of what is the role of that business within the various types of businesses," she said. "Part of what we're doing is precisely making distinctions in terms of small, medium and large businesses."

While the tax code treats small and midsize businesses differently from larger ones, Vélez indicated it is possible there will be greater differentiation within the universe of small and midsize firms.

"Again, a mom and pop business that sells less than $1 million a year is not the same as one that sells $4 million, $5 million a year," the former Treasury secretary said. "We're talking about businesses at a very different stage in terms of their development and capability." ■

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Silva stressed that no member of the group ever defends the interests of their employers, companies or clients during the meetings.

"None has never even dared to insinuate something that may benefit the companies they work for," he said.

Silva noted that the role of the committee members is to make recommendations.

"We cannot claim paternity for the good nor for the bad that may result from the reform," Acosta Reboyras said.

Universal Group's Padilla said the advisory team brings to the table their particular experience as businesspeople. In that role, they raise whatever flags they deem necessary.

A real tax reform, Padilla said, should have a long-range plan that answers tough questions such as what economic activities should be encouraged through tax incentives and what tax incentives should be repealed because they do not render the social benefits that justify their cost.

CPA Suárez stressed the importance of providing Puerto Rico with the fairest income tax system possible.

"We want a true tax reform," she said, adding that the reform should soften the regressive effect of the IVU on low-income taxpayers.

CPA and lawyer De Córdova said the reform must be implemented in stages, beginning with income tax rates for individuals. ■

Society of CPAs Foundation proposes $377 million tax reform for individuals

Suggests important structural changes to individual income taxes; leaves corporate, real property and sales tax modifications for future phases

BY JOSÉ L. CARMONA
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The Society of CPAs Foundation presented last week the recommendations contained in its "Study for the Design of an Integrated Tax Reform," the second phase of a study the organization began in 2009 to evaluate the performance of the sales & use tax (IVU by its Spanish acronym) and a methodology to measure the current tax incentives.

The new study was commissioned by the foundation and developed by a group led by local economists Ramón Cao García and José Cao Alvira of Asesoría y Consulta Inc. and Juan Lara of Advantage Business Consulting.

"The vision of the Society of CPAs Foundation on tax reform is an integrated one that includes all the components of the tax structure that aspires to achieve tax efficiency and fairness leading to economic development on the island," explained Society of CPAs Foundation President Rolando López. "This is a good time to present our initial recommendations so that we can contribute to the evaluation process by the legislative and executive branches with concrete and well-documented proposals."

In this second phase of the study, the foundation proposes a tax reform in phases, beginning with changes to the individual income taxes and in successive phases make the necessary modifications to other taxes, especially those applicable to corporations and real property, the IVU and specific excise taxes.

"The foundation recognizes that currently the government of Puerto Rico is in no condition to make a sizable fiscal investment required for an integrated tax reform," López said. "That's why we are proposing a tax reform in phases, starting with important structural changes to the individual income taxes."

Once all the phases of the tax reform are implemented in the not-too-distant future, the island should have a tax system that rests proportionally more than the current one on the consumption-based tax, assigns a fair contribution to the real property tax and optimizes the incentives given to corporations, the foundation president said.

"An optimal tax system should be guided by the tax principles of sufficiency, simplicity, efficiency, neutrality and fairness. Under these principles we propose to: redistribute the tax load through a significant reduction in the tax rates for income and revenue, to bring to the tax system those individuals and corporations that currently don't pay taxes and to redistribute the tax load in order to increase sales tax participation," López said.

Rolando López, president of Society of CPAs Foundation

KEY RECOMMENDATIONS ON TAX REFORM FOR INDIVIDUALS

For the initial phase of the tax reform involving individuals, the foundation is proposing: a nonrefundable Earned Income Tax Credit of up to 10% of the adjusted gross income, or up to $2,500; no marriage penalty by maintaining the disposition in Schedule CO for married working taxpayers as an initial step in recognizing the individuality of being productive; mortgage interest deductions remain in place for up to two residences, but limited to 25% of the adjusted gross income; deductions to individual retirement accounts as well as preferential treatment to certain passive and agricultural income remain the same; tax brackets are reduced to three with tax rates reduced accordingly.

For taxpayers earning up to $50,000, the marginal tax rate will be 15%; for those with incomes between $50,000 and $75,000, the marginal tax rate will be 25%, and for those making $75,000 or more, the marginal tax rate will be 30%.

All tax groups would benefit from the proposed tax reform as well as have some type of tax responsibility to pay, including those earning up to $25,000 a year. However, the effective tax rate for this group will be 2%.

The average tax benefit per taxpayer as a percentage of their tax obligation under the current law would be 14%.

To finance the government's investment in this first phase of the tax reform, estimated to cost $377 million, the foundation is recommending other fiscal revenue sources through agency consolidation and greater cost reductions in the government, better tax compliance, elimination of ineffective tax incentives and expanding the tax base through greater economic activity.

While the government has made considerable progress in reducing expenses over the past two years, it could generate further savings through more efficient management, the foundation recommendations say.

"The executive and legislative branches should set forth as soon as possible plans to reform the government's structure so as to consolidate agencies, eliminate duplicate functions and apply information technology to improve productivity in the delivery of public services," López said. "The optimization of the available resources in public administration should produce substantial and permanent savings in the central government's general budget."

The government should not underestimate the possibility of obtaining substantial additional revenue through greater caption of the IVU, the foundation president said. In addition, the simplification of the income tax for individuals reduces oversight costs, which should free resources at the Treasury Department that could be used to strengthen measures against tax evasion. On the other hand, the simplification of the tax system should reduce taxpayer's compliance costs as well as discourage tax evasion, he said. ■