



COMMONWEALTH OF
PUERTO RICO

Government Development Bank
for Puerto Rico

PRESS RELEASE

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Government Development Bank (GDB) President Melba Acosta Makes Firm Defense of Tax Reform Act for Puerto Rico

San, Juan, P.R. - With hard facts, comparative figures and a comprehensive explanation of Puerto Rico's financial situation, GDB President Melba Acosta-Febo today steadfastly defended the proposed tax reform act, which she described as "the most significant change needed to stimulate the commonwealth's economic development to confront the Island's fiscal challenges.

During her testimony today to the PR Senate -Taxes and Public Finance Committee, Acosta answered the main concerns of critics and emphasized that Governor Garcia Padilla's proposal for a new tax system in Puerto Rico should not be perceived as a proposal to increase a sales tax of 7% to a VAT of 16%.

"It is a major transformation on the way the Island obtains its revenues and an opportunity to fight tax evasion and eliminate the unfair burden that exists under the current income tax system for the working class," Acosta stated. "The bill aims to shift revenue now obtained through income tax to a revenue that will come from a tax imposed to goods and services," former Treasury Secretary stated. Bill 1304 includes a major reduction of income tax to close to 850,000 Puerto Ricans that make up the Island's middle class and shifts the weight to a Value Added Tax, which by nature regulates itself.

Acosta explains the debt and the actions taken

In her testimony Acosta mentioned, that in the past, other government administrations had balanced the budget by increasing debt "most of the additional income was used for the payment of recurring operating expenses and refinancing old debt."

Acosta revealed that as an example that "during the period of 2009-2012, the past administration issued approximately \$16,500 million in new debt, which is equivalent -in only four (4) years- to the debt issued in Puerto Rico in 50 years (1941 and 1991). "This way of running government finances has undermined our ability to allocate more resources to the development of our economy," Acosta stated during her presentation.

"Besides not being accountable to our future generations, the pattern of chronic indebtedness with the fragility of our economy has degraded the commonwealth's credit to speculative level, which has raised the cost of financing for the Government and has limited our access to capital markets," said Acosta.

The Caribbean island of 3.6 million is struggling with debt of more than \$70 billion, an economy near recession for eight years, and a budget that for the first time in two decades was balanced. Some estimates say up to 25 percent of Puerto Rico's economy is informal with an underground economy of \$20 billion.

Regarding critics of government spending and the opposition's demands of reducing public payroll, before implementing a VAT, Acosta noted that General Fund expenditures have been reduced from an average of \$10,962 million during fiscal years 2009-2012 to \$9,885 million in fiscal year 2013 and \$9,376 million in fiscal 2014. This implies a reduction in expenses of \$ 1,586 million or approximately 14.47%. She also explained public employees, paid from the General Fund have declined dramatically, from 139,640 jobs in 2007 to about 89,600 in December 2014, a reduction of about 34% if compared to incumbency during 2007 and 2014, and approximately 12% when compared between the month of December 2012 to December 2014.

We already live under VAT – Acosta defends Treasury Dept.'s capabilities

Acosta debated critics that insist the US Territory is not ready for a VAT system, which exists in over 160 countries around the world excluding the continental US. The GDB President explained that Puerto Rico has been operating 75% under VAT since August 2014, "when we started the collection of Service and Use Tax (SUT) at the docks. We implemented a VAT in terms of assets, although we didn't call it by its name, we live under VAT in practice."

The 25% of the rest of the implementation of VAT will be phased and will include a restructuring of several divisions of the Treasury Department, she explained. In a firm defense of the capabilities of the Department she led the first years of García Padilla's incumbency, Acosta said "it is incorrect to state that the Treasury Department does not have the management capacity or the resources to implement a VAT system." Currently, this Treasury division has about 1,000 employees, of which 176 are auditors and 215 are assigned to the payroll processing area. By eliminating accounting for about 850,000 income tax returns, it is contemplated that part of this staff, mostly dedicated to processing refunds, will be relocated to other duties to assist in the collection of VAT at the docks, oversee credits and secure VAT refunds process, Acosta explained.

Regressivity Relief

One of the aspects of the tax transformation that has been under fire is the regressivity relief for lower income citizens and the growing elderly population. Critics have raised doubts about how it will be implemented and questioned the readiness of the Treasury Department.

"This is a fundamental part of the transformation of the tax system. It is important to understand that in order to make final determinations regarding the operation of the regressivity relief, we have to determine what products or services will be exempt: the fewer exemptions, the greater the VAT refund; the more exemptions, the lower the VAT refund. So to make final determinations, it is important to know how the Bill will eventually be approved," said Acosta. After several weeks of public hearings the Bill is expected to go to the voting floor at the end of the month.

Treasury Department hired the economist Maria Enchautegui, from the Urban Institute, a specialist who is working on a survey about conditions of low-wage workers, and is completing profiles based on criteria such as age, dependents, income, family composition and other facts. The model is being constructed based on household and relevant databases, including exempt goods and services. It also develops recommendations on criteria for determining the amount of the regressivity relief. Part of the results of this analysis would be inserted in the Act as an amended, and part would be included in regulations." But she reiterated that to make final determinations, it is vital to "understand what the final exemptions will be."

VAT and the use of its revenues

"To say you are against the VAT, taking only in consideration, in an isolated manner, the difference of 9% between the current 7% of SUT and the proposed 16% VAT, leaves out the most important part of the proposal Tax Transformation, the unprecedented reduction in the rates of income tax. Therefore, limiting the opposition to an increase between the SUT and VAT, is saying you are against a more robust taxation system, used by 19 of the 20 largest economies in the world.

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