

(H.J.R. 1177)

JOINT RESOLUTION

To establish the objectives, principles and parameters that shall frame and govern the evaluation and approval of a Tax Reform and a Fiscal Reform in order to do tax justice to the citizenry, to broaden the base of revenues of the public treasury and to establish controls to achieve savings in the expenses of the Government of Puerto Rico.

STATEMENT OF MOTIVES

The Legislature of Puerto Rico, in compliance with its commitment with the people of Puerto Rico to promote a fair, equitable and efficient tax system, and with the intention of providing the mechanisms needed to rehabilitate government finances, adopts this Joint Resolution as a first step in restructuring the present situation of the State Treasury, by establishing controls to ensure the fiscal solvency of the Government of Puerto Rico and to promote savings. This initiative represents a transcendental step towards the execution of affirmative actions that shall guarantee the financial stability of the public treasury, and the trust of investors and that shall further provide the basis for capturing the resources needed for rendering direct services to our people.

The Executive Branch and the Legislative Branch recognize the need to solve the deficit problems of the government through effective measures that shall begin to bear fruit in a short or medium term. For such purposes, they commit themselves to implementing an encompassing Tax Reform that shall enable the attainment of two main objectives: the establishment of tax justice through the equitable distribution of the economic burden among taxpayers; and an increase in the total collections by capturing revenues

proceeding from the informal economy, through the imposition of a tax on broad base consumption. By achieving the objectives described above, the Tax Reform shall also constitute a mechanism to collect funds for the public treasury and a means to stimulate the sustained economic development of Puerto Rico. It shall also be a tool for social justice for all Puerto Ricans, particularly for the middle class and salaried workers which for years have served as the backbone of the tax system of the Island.

The Legislature also recognizes the importance of restructuring the current tax system in order to transform the same into a fairer, more equitable and transparent one. The purpose of this Joint Resolution is to adopt the objectives, principles and parameters that shall frame and govern the consideration of a Tax Reform and a Fiscal Reform during the Third Regular Session of the Fifteenth Legislature. At present, the House of Representatives has under its consideration H.B. 2193 and the Senate of Puerto Rico has under its consideration S. B. 1177, through which we intend to begin the discussion of an encompassing Tax Reform with the participation of the Executive Branch, the financial, social and political sectors of Puerto Rico and the general citizenry. Furthermore, we concur in stressing the importance of these Reforms to eliminate the structural budgetary deficit and the fiscal imbalance that affect the finances of our government.

Therefore, we recognize the pressing need to establish a thorough Fiscal Reform to integrate the mechanisms that shall guarantee the responsible management of public funds pursuant to the governing criteria set forth in Section 9 of Article VI of the Constitution of the Commonwealth of Puerto Rico. To do so, it is essential that the government direct its financial resources in a coordinated and strategic manner through the strict

control of expenses in the dependencies. The will and commitment to make extraordinary efforts to optimize the use of the revenues and resources of the public treasury shall be essential factors in achieving the proposed objectives and parameters. Thus, it is indispensable to adopt measures to ensure that every distribution of funds is made within a framework of austerity and with the greatest diligence, identifying the less expensive manner in which to achieve the public purpose towards which government activity is directed. As an integral part of the Fiscal Reform, upon the effectiveness of this Joint Resolution, uniform norms shall be established to regulate the control of expenses, which shall require strict compliance by the government entities. This entails the adoption of criteria based on the public policy of generating savings to achieve greater economy, efficiency and effectiveness in public administration. In attention to the preceding, this Joint Resolution establishes the principles, objectives and parameters needed to reduce government spending and establishes the public policy which shall guarantee the responsible and effective management of the resources of the State. The Executive Branch has also assured that some of the measures that it intends to enforce constitute a reduction of expenses in the agencies, including publicity expenses, the limitation of public notices for new jobs, the freezing of nonessential positions, the promotion of employee retirement, the consolidation of agencies as well as any other measure that may reduce government spending.

Through this Joint Resolution, the Legislature of Puerto Rico reiterates its commitment to promote a Tax Reform to do justice to the middle class and salaried workers and that shall ensure that the Government of Puerto Rico have sufficient revenues to provide essential services to our citizenry. Likewise, this Resolution sets forth the commitment to adopt the

Fiscal Reform in order to promote a government culture of fiscal responsibility and control of government spending. Undoubtedly, the Reforms to be adopted shall have the effect of encouraging savings and the reduction of the public debt, thus ensuring the financial solvency and the trust in the credit of the Government of Puerto Rico.

BE IT RESOLVED BY THE LEGISLATURE OF PUERTO RICO:

Section 1.—Title.—

This Joint Resolution shall be known as the “Resolution to Establish the Objectives, Principles and Parameters for the Tax Reform and Fiscal Reform of 2006.”

Section 2.—Statement of Public Policy.—

This Joint Resolution establishes the basis for the Legislative Branch and the Executive Branch to promote and adopt legislation to allow the restructuring of government finances and to establish the controls needed to address the fiscal imbalance that has a bearing on the other problems that affect our People. This entails the adoption of a reform of the tax system which shall provide real tax justice so that the natural and juridical persons contribute to the public treasury according to their ability to pay taxes and which shall guarantee a significant tax relief for the benefit of the middle class and salaried workers.

In order to broaden the basis for the capture of revenues for the public treasury, it is essential that the legislation to be adopted, in addition to being equitable, enables the expansion of the tax base, reduces to the maximum tax evasion and stimulates the sustained economic development of Puerto Rico, in order to achieve greater competitive conditions in the world markets. The Tax Reform shall provide the mechanisms to effectively minimize tax evasion and increase the total of collections by capturing revenues

proceeding from the underground or informal economy that at present enjoys the services and benefits provided by the State without contributing to defray the cost thereof. This is achieved through the imposition of a broad based tax on consumption.

In order that Puerto Rico may avail itself of the main sources of capital under competitive conditions, it is also necessary that the Government adopt efficient, effective and economic mechanisms of budgetary and fiscal discipline, attuned to the standards of world financial centers. Therefore, the Fiscal Reform should provide for real control of public spending, which shall be a determining factor in confronting and solving the deficit problems faced by the Government of Puerto Rico.

The legislation to be adopted to enforce the Tax Reform and the Fiscal Reform should be based on the provisions, principles and parameters to be established in this Joint Resolution. Thus, the Legislative Branch and the Executive Branch, within the framework of their constitutional responsibilities, shall consider alternatives that guarantee the financial stability of the Island and its social serenity, moving the economy towards the capability of generating employment.

Section 3.—Essential Principles that Shall Govern the Tax Reform.—

The essential principles that shall be taken into consideration for the development and adoption of the Tax Reform are the following:

(a) The tax system to be adopted shall apply to natural and juridical persons and to the transactions conducted by them.

(b) The tax system shall reduce the tax rates on the income of individuals, particularly those applicable to middle class and salaried workers taxpayers.

(c) The tax system shall provide for the broadening of the tax base through a tax on the retail sale of articles of use and consumption that allows for the reduction of tax evasion, particularly that which is the product of the informal or underground economy, thus incorporating the natural and juridical persons that at present do not contribute to the financing of public programs and services rendered by the State.

(d) The tax system shall be simple, with an oversight and supervisory structure more agile than the present one.

Section 4.—Parameters of the Tax Reform.—

On the basis of the statement of public policy and the principles set forth, the Tax Reform shall:

(a) Substitute the general excise tax on articles of use and consumption with a broad based tax on the retail sale of said articles to capture revenues from the informal or underground economy, and impose the tax burden in a fair and equitable manner.

(b) Fix those compensatory credits needed to address the regressive effect of the system, particularly in favor of the economically disadvantaged sectors and pensioners.

(c) Devote a portion of the revenues on account of the taxes on the retail sale of articles of use and consumption to be distributed among the municipalities of Puerto Rico. The use of these funds shall conform to the principles, objectives and parameters of the Fiscal Reform which shall be executed in order to address public spending.

(d) Eliminate the tax penalty on married couples which still persists in the income tax system applicable to individuals.

(e) Establish an earned income tax credit to do justice to the salaried workers and to promote the financial independence of the individuals.

(f) Increase the deduction allowed for contributions to nonprofit entities.

(g) Restructure the descendant's estate and donation tax systems to establish more efficient and less complex administrative mechanisms for taxpayers, in addition to attaining greater expediency and efficiency.

(h) Establish incentives to promote investment in technological infrastructure and in research and development activities.

(i) Evaluate the various laws that grant tax credits in order to determine whether the same are meeting the purpose for which they were created.

(j) Adopt mechanisms that foster savings, such as contributions to public and private retirement plans, in addition to those that already exist.

(k) Establish mechanisms to redirect the resources of the Department of the Treasury in order to improve its overseeing functions and be able to tackle tax evasion.

Section 5.—Revenues and Expenses Report.—

Not later than January 15, 2006, and May 30, 2006, the Secretary of the Treasury and the Director of the Office of Management and Budget shall render to the Speaker of the House of Representatives and the President of the Senate a report in the form, through the means and as detailed as they require, including specific figures and data on the revenues generated and the expenses incurred during the first five (5) months, and an estimate for the sixth month, and the revenues generated and the expenses incurred for ten (10) months, respectively, of the current fiscal year, as well as the expenses and revenues projected for the end of Fiscal Year 2005-2006.

The Secretary of the Treasury and the Director of the Office of Management and Budget shall designate officials to integrate the permanent

liaison groups in representation of their agencies to provide the details and analysis that the technicians and advisors of the Legislature may request regarding said Reports.

Section 6.—Approval of the Tax Reform.—

Taking into account the public policy, the principles and the parameters established in this Joint Resolution, the legislation to enforce the Tax Reform shall be approved before the closing of the Third Regular Session of the Fifteenth Legislature.

Section 7.—Contribution to the Public Improvements Fund.—

With the measures to be adopted to enforce the Tax Reform and the Fiscal Reform, projections show that the structural deficit in the finances of the Government of Puerto Rico should be corrected by fiscal year 2007-2008. This fact shall be consigned through a Certification issued jointly by the Secretary of the Treasury, the President of the Government Development Bank, and the Director of the Office of Management and Budget. Said Certification shall be submitted to the Legislature of Puerto Rico and be formally filed with the Office of the Secretary of the Senate and the Office of the Clerk of the House.

Once the Certification has been issued, the general budget of expenses for each of the subsequent fiscal years, until 2017-2018, shall include an ascending contribution from the General Fund to the Public Improvements Fund. In the general budget of expenses corresponding to the fiscal year for which said Certification is issued, the contribution shall be equal to two (2) percent of the total amount of the general obligation bond issue destined for the Public Improvements Fund corresponding to that fiscal year. In the general budget of expenses corresponding to each subsequent fiscal year until fiscal year 2017-2018, the percentage used to compute the amount of

this contribution shall increase at a rate of an additional two (2) percent each year, up to a maximum of twenty (20) percent within a ten (10)-year term. This contribution has the purpose of reducing proportionally the general obligation issue, with the objective of reducing the Public Debt to twenty-five (25) percent in relation of said balance to the Gross Product. In addition, it has the purpose of reducing the Loan Margin pledged up to ten percent.

Section 8.—Essential Principles and Parameters that Should Govern the Fiscal Reform.—

The fiscal system shall incorporate effective mechanisms to control and reduce public spending at a short and medium term. To address the fiscal difficulties of the Government of Puerto Rico and without it being construed as a limitation, the following principles and parameters to rehabilitate the current state of government finances are hereby established:

(a) To ensure discipline in government spending, a new public policy shall be adopted, to establish a distinction between unnecessary expenses and indispensable expenses.

(b) A sustainable expense reduction plan shall be implemented in government agencies through the adoption of a seven (7)-year Strategic Plan.

(c) A sustainable limitation on the publicity expenses of the Government of Puerto Rico shall be immediately implemented, authorizing only those that generate additional economic activity or which result in additional revenues to the agency or to the General Fund, those required by law, and those that address a public purpose.

(d) As long as there is a structural deficit, the issue of notices to recruit personnel shall be prohibited and Government positions shall be

frozen, except in essential areas such as security, health and education, or due to a compelling need, which shall be duly justified and certified by the Office of Management and Budget. For said areas and under such circumstances, notices for applicants for new jobs or to cover vacancies shall be authorized only when the aforementioned Office so certifies and justifies financially, through a documented analysis that reflects that it is less costly to recruit new employees than to promote the re-training of personnel for transferring them from functions that are no longer necessary or that will be eliminated.

(e) Early retirement programs with incentives shall only be established when actuarial studies guarantee that the financial condition of the Retirement Systems of the Government of the Commonwealth of Puerto Rico will not be affected.

(f) A financial boost shall be provided to the Commonwealth Retirement Systems Administration through the transfer of assets and additional collections resulting from the Tax Reform that exceed indispensable resources for the operation of the government.

(g) The provisions of Act No. 183 of July 23, 1974, as amended, and Act No. 164 of December 17, 2001, are hereby amended to provide that the capital notes to balance government expenses budgets issued by the Secretary of the Treasury, shall be approved by the Legislature, except those issued and repaid in the same fiscal year.

(h) The balancing of the budget shall be provided only through the certification of recurring revenues by the Secretary of the Treasury, duly certified by certified public accountants.

(i) New legislation shall be approved to establish controls on the use of the Budgetary Fund.

(j) Executive Branch agencies shall be restructured and consolidated and nongovernmental entities and programs shall be eliminated.

(k) The use of e-mails shall be adopted as public policy as the main means of messaging, and vehicle fleets and related expenses shall be reduced.

(l) The purchase of vehicles shall be regulated so that the cost does not exceed thirty thousand (30,000) dollars, including excise taxes, and the main criterion for selection shall be the economy factor in fuel consumption. These criteria shall not apply to vehicles purchased to incorporate them into the fleet identified with the name and logo of each agency or dependency.

(m) Public funds shall not be used for the purchase of first class airline tickets, nor for suites or luxury rooms, including the heads of agencies, except as authorized by law.

(n) Legislation shall be adopted to require that the Secretaries of Departments, Heads of Agencies and Directors of Programs of the Executive Branch be under the obligation to use the appropriations of funds provided in budget joint resolutions in combination with other funds, when applicable, to cover, as a top priority, payroll expenses, fringe benefits and related expenses, and then to cover all other operating expenses of the dependencies.

(o) Any other measures that contribute to the reduction of government expenses that do not entail the dismissal of public employees or the decrease of essential services provided to the People, shall be adopted.

Section 9.—Enforcement of the Fiscal Reform.—

Pursuant to the public policy, principles and parameters established in this Joint Resolution, and recognizing the importance of swiftly establishing

a Fiscal Reform that provides for the reduction of excessive spending by the Government of Puerto Rico, the Executive Branch shall begin to implement the mechanisms necessary for such purposes as of the date of effectiveness of this Resolution and before the closing of the Third Regular Session of the Fifteenth Legislature.

The Office of Management and Budget shall render quarterly reports to each of the Legislative Houses. These shall contain specific figures and data on the public expenses incurred as compared to the budget. These reports shall be presented in the form, through the means and as detailed as required by the Legislature and shall include the specific measures adopted to reduce expenses in agencies, the savings generated or projected for each and every one and any other additional data required. The reports shall include the official documents which sustain their contents. In addition, the Secretary of the Treasury and the Director of the Office of Management and Budget shall designate the officials who shall be members of the permanent liaison groups in representation of their agencies to provide the details and analysis that the technicians and advisors of the Legislature may require concerning these Reports.

The reports required by virtue of this Section shall be filed with the Office of the Secretary of the Senate and the Office of the Clerk of the House, duly certified by the Director of the Office of Management and Budget, beginning on January 2006. Within the term of five (5) days as of the date of filing with the Secretary and the Clerk, an external audit thereof shall be conducted by certified public accountants. The result of said audits shall be reported at a public hearing.

Section 10.—Effectiveness.—

This Joint Resolution shall take effect immediately after its approval.