

Businesses point to pain from patente

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A growing chorus in Puerto Rico's private sector is calling for the elimination of a new islandwide business tax, known as the national patente, arguing that it threatens to sink thousands of businesses amid a deepening economic downturn.

The latest call kicked off a gathering of business and government leaders in San Juan on Thursday that was convened by the Chamber of Commerce to discuss ways to kick-start the economy and boost the private sector.

"We want the *patente* totally eliminated as quickly as possible under a full overhaul of the tax system," said Angel Morales, who heads the CofC's tax committee.

The administration of Gov. Aeljandro García Padilla is betting on the islandwide *patente* to raise roughly \$500 million or more than one-third of \$1.4 billion in new tax revenue for the \$9.77 billion fiscal 2014 general fund budget.

The *patente* is being applied to gross sales on businesses generating at least \$1 million a year. The tax rate will be applied on a sliding scale, depending on sales volume. Businesses are on the hook to pay the new levy with their estimated income tax filings this month, but the Treasury Department has yet to establish guidelines for exemption.

Treasury Secretary Melba Acosta signaled sympathy toward the pleadings from private sector representatives during the CofC forum, but closed the door to changes that would undercut the administration's budget goals.

Acosta noted that the *patente* was pushed by the private sector to scale-back the García Padilla administration's plan to broadly expand the sales & use tax (IVU) to business-to-business (B2B) transactions.

"We know that this is the hot issue in Law 40," Acosta said. "The *patente* wasn't the administration's idea."

Law 40 is the package of new taxes passed by the administration that also includes limited IVU collections on B2B transactions that are expected to bring in \$237 million. A hike in the corporate tax scales is expected to

glean another \$270 million. The increase brings corporate tax rates back up to 1994 levels, pushing the top rate to 39 percent. Rates were slashed by 30 percent under a tax reform enacted in 2011.

Other revenue measures being implemented to fund the budget include increasing cigarette taxes, which is expected to generate \$334 million.

Small and midsize businesses are feeling the biggest blow from the *patente*.

“We listened to the private sector and scaled back the IVU plan while accepting the *patente* with the understanding that it would have a big impact on some businesses,” Acosta said.

Investors and economists praised the passage of the fiscal 2014 Puerto Rico government budget but expressed concerns over the commonwealth’s economy.

While hailing the tax increases they said would help stave off a downgrade of Puerto Rico’s credit to a junk-bond rating, they said it would also do some immediate economic damage.

On the positive side, significant sources of revenue, such as the sales & use tax (IVU by its Spanish acronym), have continued to grow through past recessionary periods, while the Law 154 excise tax on multinational manufacturers isn’t affected by local economic conditions.

The problem is that if the economy continues to contract, revenue may wind up not meeting estimates because Treasury Department estimates are based on a projected economic growth rate of 0.2 percent. It declined the previous year by 0.4 percent.

Most economists are predicting continued contraction during fiscal 2014, which began July 1.

Economist Gustavo Vélez, chairman of Inteligencia Económica, is predicting a decline of nearly 1 percent; Joaquín Villamil, chairman of Estudios Técnicos, is predicting a contraction of at least 1 percent; and Vicente Feliciano, president of Advantage Business Consulting, is expecting an even larger shrinkage of about 2 percent.

Puerto Rico’s economy fell for a ninth straight month in July, plunging by 5 percent compared to the same month in 2012, according to the latest GDB-EAI.

The report said that the average cumulative value for calendar year 2013 (January-July) showed a reduction of 3.5 percent with respect to the same seven-month period in calendar year 2012.

The index fell across the board in July and was down in all four categories measured for the fiscal year: total nonfarm payroll employment, electric power generation, gasoline consumption and cement sales.

Not only does the GDB-EAI show a continuous decline in economic activity, but the extent of the decline has been growing throughout 2013.

The GDB-EAI had returned to growth in December 2011 for the first time since Puerto Rico's recession began in 2006. It showed small but consistent year-over-year gains for nearly a year before beginning to retreat again last October. Since then, it has been on a steadily steepening decline: falling 0.7 percent in November, 2012, 1.3 percent in December, 2012, 1.8 percent in January, 3.1 percent in February, 3.1 percent in March, 3.5 percent in April and 3.4 percent in May and 4.5 percent in June.

All three credit rating agencies – Standard & Poor's, Moody's and Fitch – rate Puerto Rico credit one notch above investment grade and have warned of potential downgrades to a junk rating.

Most analysts say preserving its investment-grade rating will depend on hitting revenue targets during fiscal 2014 and an improvement in the economy.