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Resolving the Great Inventory Tax Debate

By María Soledad Dávila Calero on October 18, 2018



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For many years, the government and business organizations have supported the repeal of Puerto Rico's inventory tax, but the change has never materialized. The latest attempt seems to be on a better track than previous efforts.

The business community argues that lifting this tax will open possibilities for economic growth that go beyond increasing inventories because some prominent commercial and professional organizations argue that there are industries that could be developed, such as establishing Puerto Rico as a storage hub for other countries.

A major hurdle has been the fact that the inventory tax is a key source of revenue for municipalities, so mayors have traditionally been reluctant to eliminate this tax.

The situation had to change. Mayors from the New Progressive (NPP) and Popular Democratic (PDP) parties are on board, as well as Gov. Ricardo Rosselló Nevares, the Legislature and the Financial Oversight & Management Board. Nonetheless, some mayors and members of the business community remain concerned that replacing the inventory tax with a slot machine tax provides insufficient funds.

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by its Spanish acronym), Chamber of Commerce, Asociación de Comercio al Detal de P.R. (ACDET, or Retailers Association), among other organizations, the representative and House Treasury & Budget Committee chairman, Antonio “Tony” Soto, confirmed plans to repeal the inventory tax and replace it with a new tax formula on slot machines not in casinos.

Soto mentioned that various NPP mayors assured the press during a roundtable discussion that they were on board with the tax changes.



Presidents from several professional organizations during a round table with House Treasury and Budget Committee chairman, Antonio “Tony” Soto

Rolando Ortiz, president of the PDP-affiliated Mayors Association, explained that he spoke with several peers, who said they are in favor of eliminating the yearly inventory tax, especially after Hurricane Maria, because the tax represents a hindrance to Puerto Rico’s recovery, particularly because island conditions reduce the number of ways products can reach the island.

Iván Báez, director of public & government affairs for Walmart and ACDET president, presented a similar argument but added that Puerto Rico businesses’ need to have a robust inventory arises not just from a *force majeure* event happening in Puerto Rico.

“[Hurricane] Michael will create a disruption to Puerto Rico’s supply chain. A storm doesn’t have to hit us directly for the island to be impacted because if Texas, Florida or an important port that ships to Puerto Rico is hit by a hurricane, the island is left exposed,” Báez said.

He added that some ACDET members have pledged to increase their stock to up to 21, 45 or 60 days if the inventory tax is repealed. Nonetheless, Báez explained that some businesses are buying more inventory but are keeping it in the state of Florida or in the Dominican Republic, where they don’t have to pay an inventory tax.

The ACDET president argued that the elimination of the inventory tax could result in increased business inventories on the island but could even turn Puerto Rico into “the great warehouse of the Caribbean.”

Chamber of Commerce President Kenneth Rivera agreed with the assertion that Puerto Rico could become a storage and distribution hub, especially if the Jones Act and other elements are addressed.

“It is a natural progression for Puerto Rico to become a distribution center for the Caribbean and South America. [On the island,] we have good facilities and people can have confidence that the inventory and operations are still in the United States [when stored in Puerto Rico],” Rivera said.

Rivera also argued that just from internal growth alone, Puerto Rico could see big changes. The prospect of increasing and diversifying business inventories could result in \$400 million in additional sales. Although he explained that the ultimate tax revenue these additional sales could bring is more complicated to estimate because items have various sales-tax rates.



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The measure to eliminate the inventory tax is expected to be approved before the end of October, along with a new tax code, but will be processed in a different bill. Treasury & Budget Committee Chairman Soto explained that there is no need to present new legislation because they will amend or substitute the text in House Bill 1411, which is about the revenue tax.

A good exchange?

The proposal to eliminate the inventory tax is not new. For example, in 2012, then-Gov. Luis Fortuño had announced he wanted to change the inventory tax to a tax at the point of sale. The ongoing challenge has been to find a good source of revenue for the municipalities, which are the sole recipients of the inventory-tax revenue.

Soto is confident the Legislature has found the answer to replace municipalities' inventory-tax funding by modifying the tax formula on slot machines not located in casinos.

Slot machines pay either \$300 or \$3,000, depending on the type of machine, for a registration ticket, but most operators get the \$300 registration sticker. The new version, according to Soto, leaves the funding from the \$300 registration sticker for Treasury's Gambling Division. The funds from the \$3,000 licenses will go to the Municipal Revenue Collections Center (CRIM by its Spanish acronym). Finally, in the revenue collecting chain, the slot machines will be connected to a government system and a portion of the machines' gains—after handing out the prizes—will be “divided” between the government and machine operators.

The measure also includes a cap on the number of slot machines on the island and requires background checks on the slot machine operation and businessowner housing the slot machines.

The general idea is to replace the inventory tax with slots tax, but there are discrepancies in revenue projections. Soto explained that CRIM's original revenue figure was \$261 million but the House Treasury Committee's analysis said this calculation was incorrect because it includes companies with decrees that exempt them from paying the inventory tax. A second calculation reduces the new estimated tax revenue to \$219 million. However, even this second figure is still dozens of millions higher than the revenue projections from the slot machines tax, which is projected to be more than \$160 million.

Regardless of current slot machine-tax projections, the president of the Mayors Association is concerned the revenue source is too unstable to serve as a viable substitute for the inventory tax.

“The slot machines tax is dramatically affected by economic activity. Gambling, in many cases, is not the priority and any change in that consumption pattern will affect municipal revenue, which needs certain stability because the services citizens request are continuous,” Ortiz said.

Members from various business-sector associations, including Cecilia Colón, president of El Colegio de CPAs de Puerto Rico (Society of CPAs), argued that the elimination of the inventory tax is going to bring economic growth that needs to be considered when assessing whether the slot machines tax will be a sufficient replacement.

“Every additional item that is bought because the inventory tax was eliminated will generate municipal *patentes* through the sale of that item, which will also generate municipal sales tax that goes directly to the municipalities, and that has to be considered in the formula because it is new revenue for the municipality,” Colón argued.

Walmart's Báez explained that retailers are focused on eliminating the inventory tax—not on endorsing or disavowing a particular revenue-replacement measure.

“We have focused on the elimination of the inventory tax and have not delved into how it is going to be replaced. I think it's a responsibility of the Legislative powers to look for alternatives, and we as citizens, as taxpayers, will analyze them and endorse them or reject them,” Báez said.

With fiscal control board approval

The reform of the Puerto Rico Tax Code has come with difficulties to get the fiscal control board and government to work out all the details, with the board citing the requirement for taxes and incentives to be “revenue-neutral” as the main source of contention.

This situation led Treasury Secretary Teresita Fuentes to state during her confirmation hearing, “We are in the best disposition to discuss alternatives. Certainly, we have a mandate from the fiscal

control board that is requesting that the [tax] reform be neutral. That, obviously, is a straitjacket with which the tax reform was conceived.”

However, the repeal of the inventory tax, which will be completed in a separate bill from the tax code, appears to have the fiscal control board, executive branch and Legislature on the same page.

“We understand the negative effect of the inventory tax on businesses on the island. Such a repeal would require an alternate source of revenue for municipalities,” said Natalie Jaresko, executive director of the fiscal control board, through the board’s press spokesperson.

The board’s position toward eliminating the inventory tax comes as no surprise to its proponents from both the business and government sectors.

“If [the fiscal control board] is committed to activating Puerto Rico’s economy, it needs to support the repeal of the inventory tax. We are asking for it; the private sector is asking for it,” the ACDET president said prior to Jaresko’s statement.

As for the municipalities, the Mayors Association president said, “The reality is that that decision needs to be backed by the fiscal control board. Even though we are not happy it is like that, but we have to recognize that the board needs to back the measure. But I have to highlight that the fiscal control board has repeatedly said that the municipalities are a key piece and fundamental in the recovery process of the country’s economic development.”

This is not to say that the board has yet to take a position on the measure involving the slot machines tax, which is the frontrunner to substitute the revenue for the municipalities. Although the inventory tax has gone directly to the municipalities, the new revenue source needs to be sufficient enough that it doesn’t affect the budget of the Government of Puerto Rico.

“The board will evaluate any proposal from the Government or the Legislature to pay for a possible inventory tax repeal, which would need to be revenue-neutral and not affect commonwealth revenues,” Jaresko added.

When analyzing the final proposal, the House Treasury & Budget Committee chairman argued that the fiscal control board needs to evaluate not only the raw numbers but also “the economic impact and need to give us an economic value related to the elimination of the [inventory] tax.”



If [the fiscal control board] is committed to activating Puerto Rico’s economy, it needs to support the repeal of the inventory tax. We are asking for it; the private sector is asking for it.



— Iván Báez, director of public & government affairs for Walmart and ACDET president

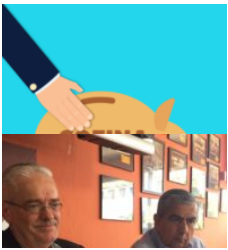


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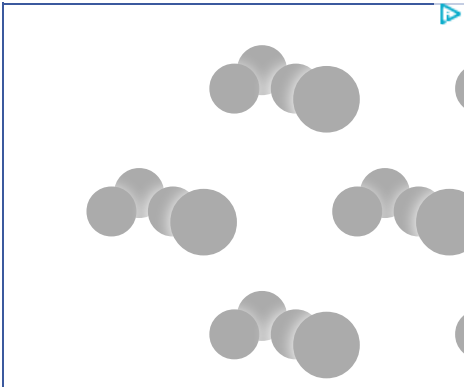
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