

C O N F I D E N T I A L

September 22, 1955

M E M O R A N D U M*

Subject: Tax Burden in Relation to Social and Economic Conditions--
A Comparative Study.

Conclusions of previous studies in this project (relating to Federal grants and to Federal-Commonwealth Tax Relations) suggest the desirability of the Commonwealth making annual financial contributions to the United States when a certain level of income or other measurable standard of living is reached. This assumes that it is quite proper for the people of Puerto Rico to accept direct and indirect financial aid from the United States without making special contributions to the United States as long as conditions of living and public services in Puerto Rico are below acceptable levels, e.g. below the level of any state, and as long as the tax burden on the individual in relation to his income in Puerto Rico is roughly comparable to that in the States.

This memorandum presents relevant comparisons of levels of living conditions, of public services, and of tax burdens which, it is hoped, may assist those responsible for policy formulation. It is based largely on a study made by Miss Carmen Alcaráz of the Bureau of Economics and Statistics, Planning Board, whose manuscript contains the data used in preparing the charts included herein.

* Prepared by Emil J. Sady, with the collaboration of Carmen Alcaraz and David Ladin of the Bureau of Economics and Statistics, Planning Board.

The stenciled charts compare certain living conditions and public services in Puerto Rico with those in Mississippi (the State having the lowest individual income payments), in the States having the best and poorest record in the item compared, and in the United States as a whole (average). To the extent that data were available, comparisons are also made with Latin American countries--showing the countries with the best and the poorest record in the item compared. The charts indicate that by almost every available measure of standard of living and coverage of social services, Puerto Rico compares favorably with the more advanced countries in Latin America but is worse off than any State of the Union.

A chart is also presented at the end of this memorandum which indicates that, general speaking the tax burden in relation to income in Puerto Rico is heavier than in most states. All types of taxes paid in 1953 to all levels of government (Federal, State, Commonwealth, and local) which could be allocated to the States and Puerto Rico were included. The only major tax excluded was the tax on corporate income and the reason for this is explained below.

Federal excise taxes and Federal individual income taxes were prorated among the States on the basis of the total Federal individual income and employment taxes reported for each State. All State and local taxes (except corporate income taxes) were included. Customs and other minor sources of Federal revenue which could not be readily allocated among the States were excluded from the tax burden for States.

An estimate of Federal income taxes paid by Federal employees in Puerto Rico, the Federal tax paid on sugar refined and consumed in Puerto Rico and the gross customs receipts on imports into Puerto Rico, were

included along with Commonwealth and municipal tax receipts in calculating the debt burden in Puerto Rico. However, Commonwealth receipts from Federal grants-in-aid and from Federal excise taxes on rum and tobacco shipped to the States were excluded. The total tax burden allocable to persons in Puerto Rico, as shown in the table below, was estimated to be \$117,000,000.

Tax Payments by Persons in Puerto Rico--1953
(in millions of dollars)

<u>Commonwealth</u>		<u>Total</u>
Property taxes	5.5	
Income Taxes (less corporate income tax)	18.9	
Inheritance and gift taxes	.9	
Excise taxes	57.9	
Licenses, permits fees and business charges	6.5	
Lottery proceeds	<u>4.4</u>	94.1
<u>Municipal</u>		
Property taxes	8.7	
Excise taxes, cigarettes	1.2	
Excise taxes, admissions	.013	
Automobile licenses	.2	
Lottery proceeds	1.3	
Municipal "patentes"	<u>1.3</u>	<u>12.713</u>
Total		106.813
Federal Individual Income Tax*	5.0	
Tax on sugar refined and consumed in Puerto Rico	1.08	
Customs Duties on Imports into Puerto Rico	<u>4.2</u>	<u>10.28</u>
Grand Total		<u>117.093</u>

*Federal taxes estimated as follows:

359 continental military personnel at \$240	\$ 86,160
17,585 Puerto Rican military personnel at \$150 after Puerto Rican taxes	2,637,750
8,260 Civilian employees at \$275 after Puerto Rican taxes paid	<u>2,271,500</u>
Total	\$4,995,410

Corporate income taxes--Federal, State, and Commonwealth--were excluded from consideration because of the absence of any valid means of allocating the burden of such taxes between the States, Puerto Rico, the territories, and foreign countries. Part of these taxes are borne by corporate employees in the form of lower wages and salaries, part by consumers everywhere in the form of higher prices for corporate services and products, and part by dividend recipients and other shareholders wherever they be in the form of lower corporate profits. Since the proportion of corporate taxes which each group bears cannot be determined with any degree of accuracy, their allocation among the States and Puerto Rico would be arbitrary and therefore possibly misleading. Moreover, a reasonable distribution of these taxes would be according to individual income payments and if done on that basis the conclusions reached in this analysis would not have been altered.

On the final chart the location of each State and Puerto Rico is determined by plotting on the vertical scale the ratio of taxes to income payments while the corresponding average per capita income payments for the States are plotted on the horizontal scale. The line of relationship shown on the chart was computed by the method of least squares without reference to the data for Puerto Rico.^{1/} The position of Puerto Rico with reference to the line of relationship suggests that, relative to per capita income, the tax burden in Puerto Rico is higher than it is in most states.

^{1/} Data for 5 states were not available but the line of regression as computed passes very close to the U. S. average.

The Commonwealth of Puerto Rico had an average per capita income payment of \$420. The state having the lowest per capita income was Mississippi with \$834. Taxes constituted 13 percent of income payments in Puerto Rico and 15 percent in Mississippi. Per capita income payments in 1953 for the entire United States was \$1,714 and allocable taxes as percent of income payments was 22 percent. Adding non-allocable taxes other than corporate income taxes would raise the latter figure to 23 percent.

While the tax burden in relation to income in Puerto Rico is generally heavier than that in the States, the tax burden on individuals at certain income levels in Puerto Rico may be lighter than that in the States. This tentative conclusion has been drawn from the following comparison made by the Commonwealth Treasury Department of the income tax liability of persons at selected income levels in Puerto Rico under Commonwealth law and those in the United States under Federal law:^{1/}

"A taxpayer--like Mr. J. D. Smith...--with military service, married, having two dependents and entitled to itemized deductions amounting to 10 percent of adjusted gross income would pay the following tax:

On Gross Income of	In Puerto Rico*	In Continental United States**	Difference
\$ 4,000	\$ 37.80	\$ 240	\$ 202.20
6,000	267.75	600	332.25
10,000	906.15	1,372	465.85
16,000	2,320.50	2,720	399.50
25,000	5,388.60	5,318	-70.60
50,000	17,678.85	15,976	-1,702.85
100,000	49,466.55	44,724	-4,742.55

* Income splitting not allowed in Puerto Rico.

** At 1954 Federal rates, allowing for income splitting and excluding state income taxes, if any."

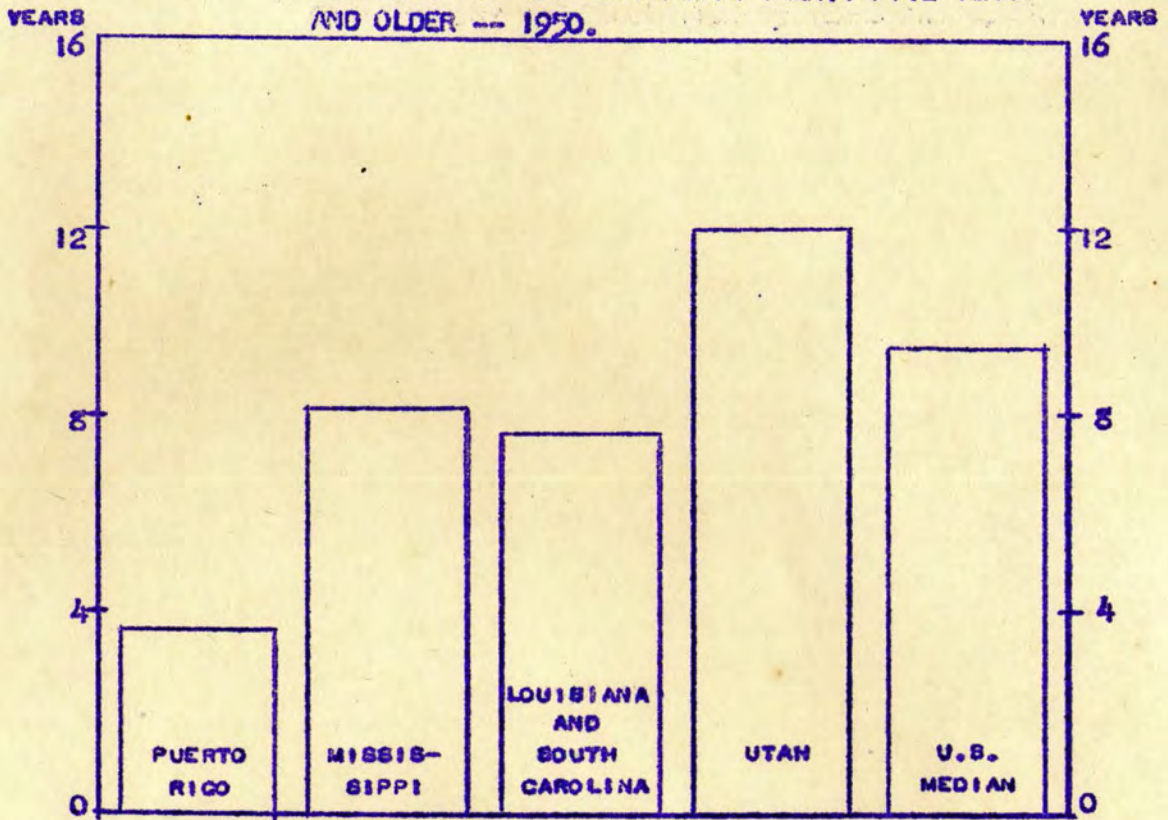
^{1/} Taxes in Puerto Rico, Office of Research and Statistics, Department of the Treasury, Commonwealth of Puerto Rico, 1955-56 Edition, pp. 16-17.

Additional study would be needed to determine whether the above differences would be narrowed or widened if account were taken of other taxes to which persons at these income levels are subject. However, considering the larger number of taxing jurisdictions in the States, it seems reasonable to assume that such a study would reveal that the total tax burden on persons at certain of the higher income levels in Puerto Rico may be lighter than that in the States. This conclusion is also implied in the 1953 Economic Report of the Planning Board to the Governor.

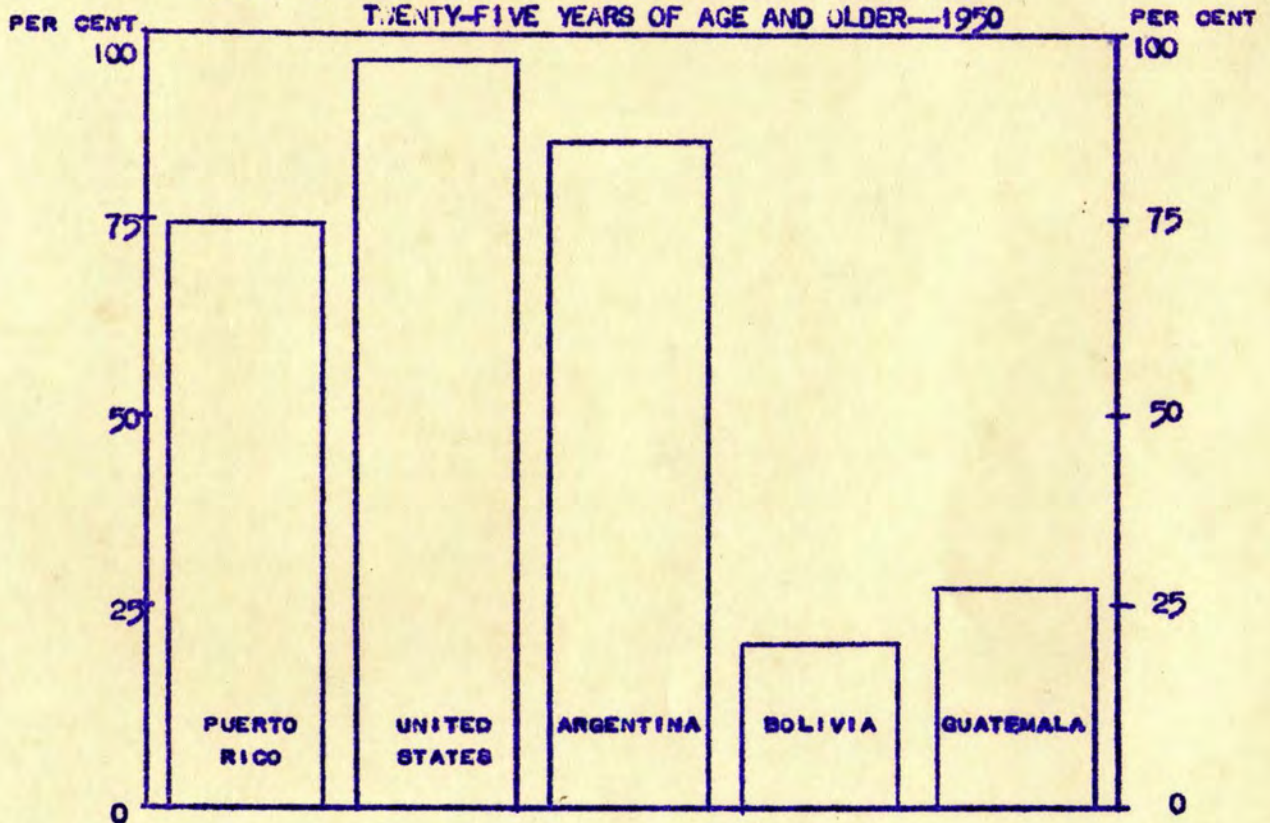
Conclusions: Since the theory of "taxation according to ability to pay" has wide acceptance in the States, Puerto Rico as a community is in a strong position to continue for some time seeking and receiving Federal grants and other assistance without making a financial contribution to the United States. The Commonwealth may be exposed to the criticism that persons in certain higher income brackets are not being taxed as heavily as in the States, but in general the tax burden of its citizenry in relation to income is higher than in most states. Moreover, although standards of living in Puerto Rico compare favorably with those in the more advanced Latin American countries, substantial expansion in public services and improvements in living conditions are required to bring Puerto Rico up to the present level of the poorest States of the Union and those most deficient in public services. In view of Puerto Rico's young and fast growing population, the Commonwealth "must run in order to stand still". And if it is to continue advancing, it must for some time utilize to the fullest its available resources, including Federal grants and services.

While Commonwealth public revenues might be increased by raising taxes (and policy considerations alone might justify increasing income taxes on certain higher incomes), revenues will be increased to the extent required to attain and maintain levels of public services comparable to those in the States only through substantial increases in per capita income.

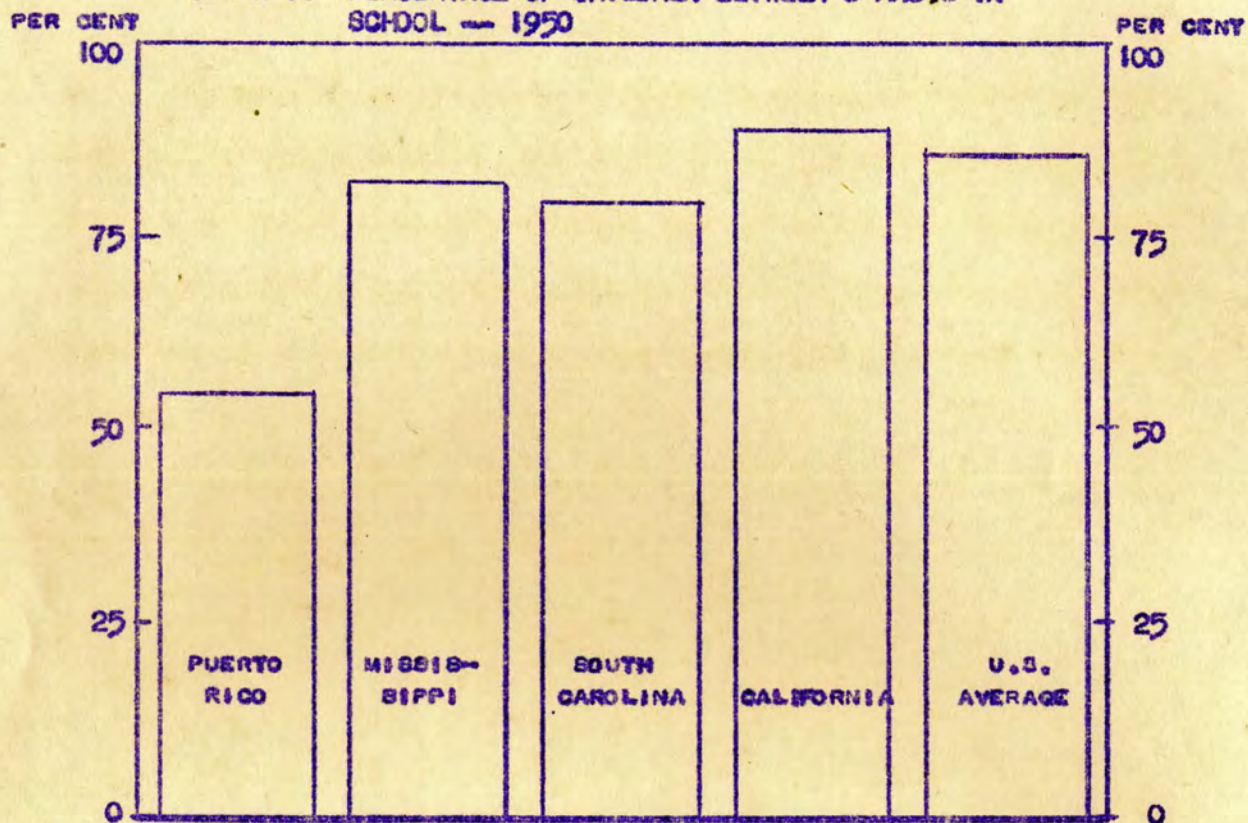
GRAPH 3: MEDIAN NUMBER OF YEARS OF FORMAL SCHOOLING COMPLETED BY THE POPULATION TWENTY-FIVE YEARS AND OLDER -- 1950.



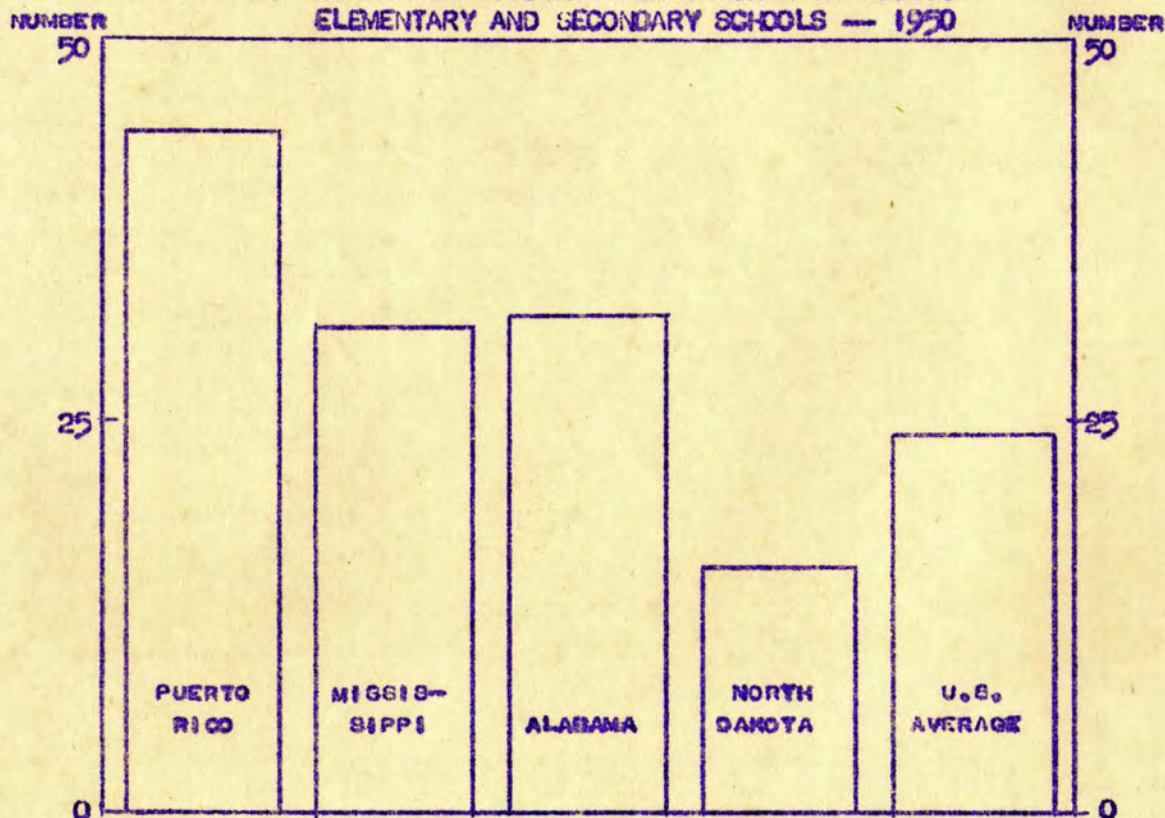
GRAPH 4: PERCENTAGE OF LITERACY AMONG POPULATION TWENTY-FIVE YEARS OF AGE AND OLDER--1950



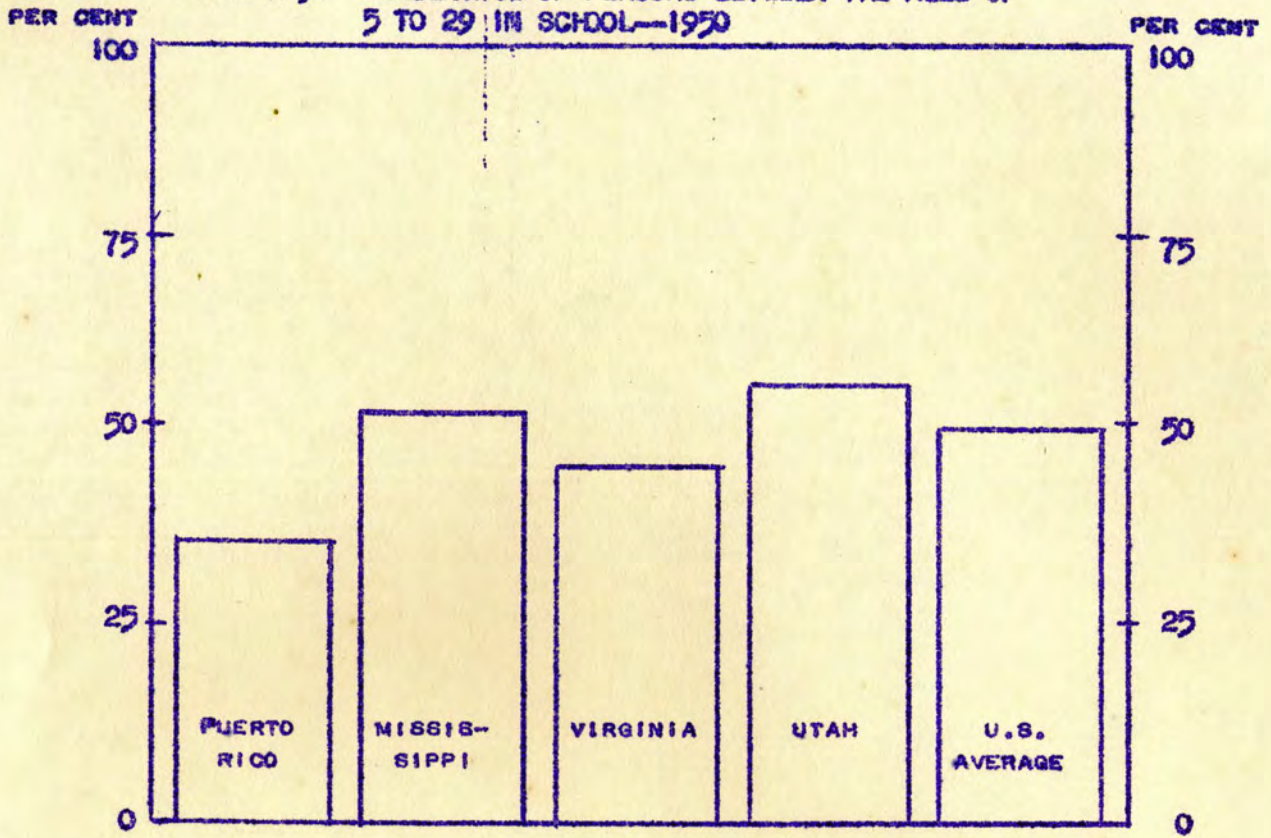
GRAPH 1: PERCENTAGE OF CHILDREN BETWEEN 6 AND 18 IN SCHOOL — 1950



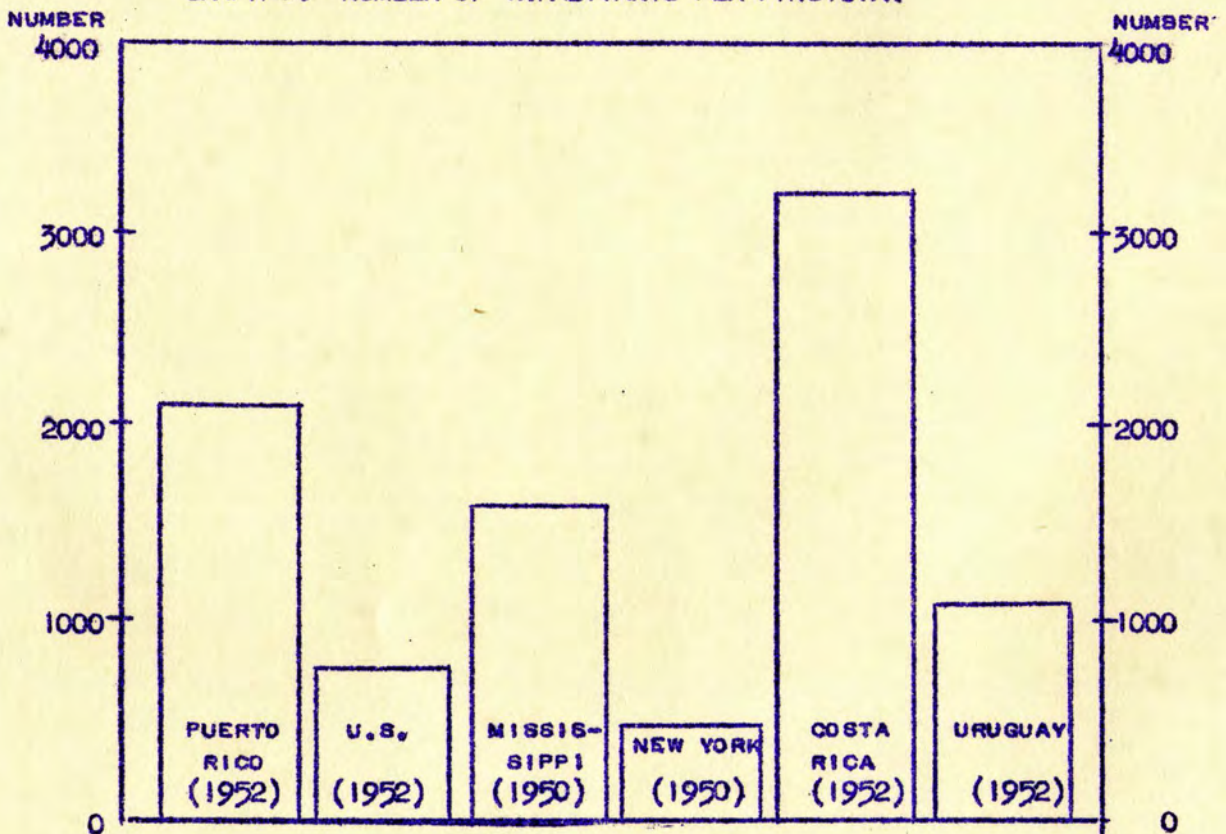
GRAPH 2: NUMBER OF STUDENTS PER TEACHER IN PUBLIC ELEMENTARY AND SECONDARY SCHOOLS — 1950



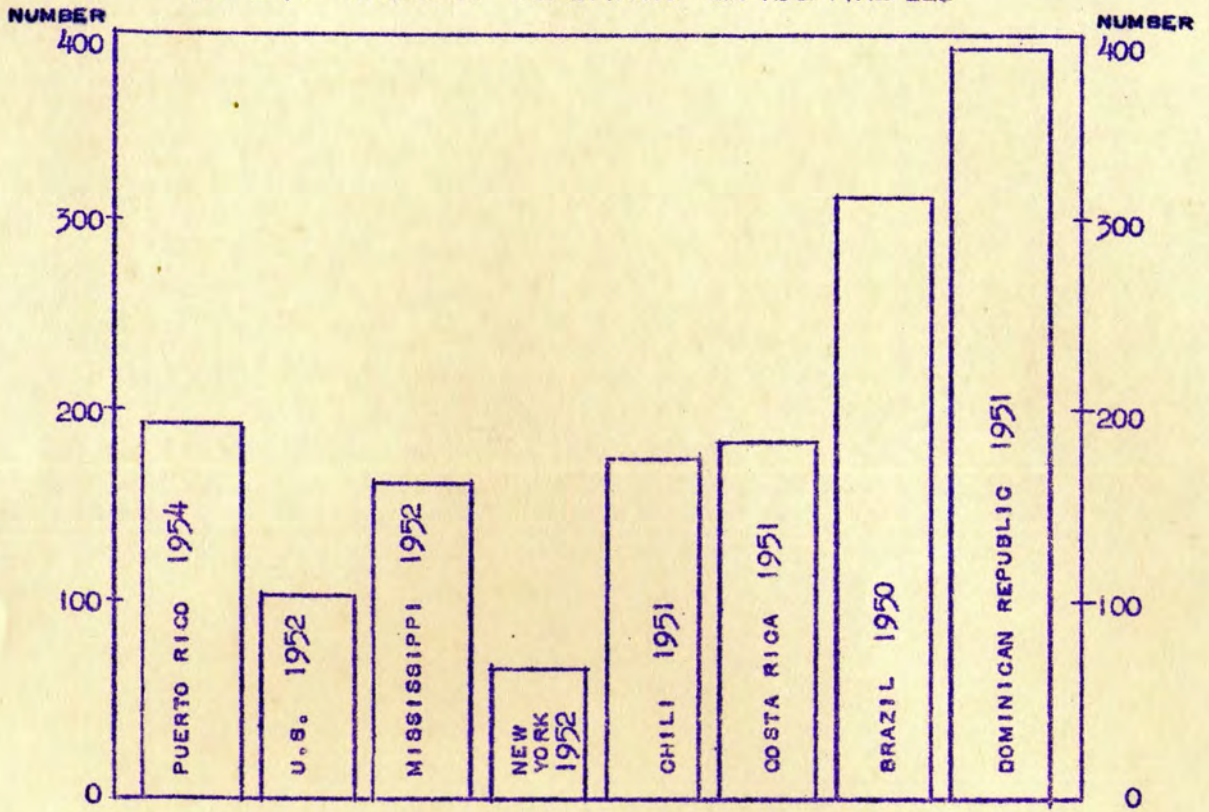
GRAPH 5: PERCENTAGE OF PERSONS BETWEEN THE AGES OF 5 TO 29 IN SCHOOL—1950



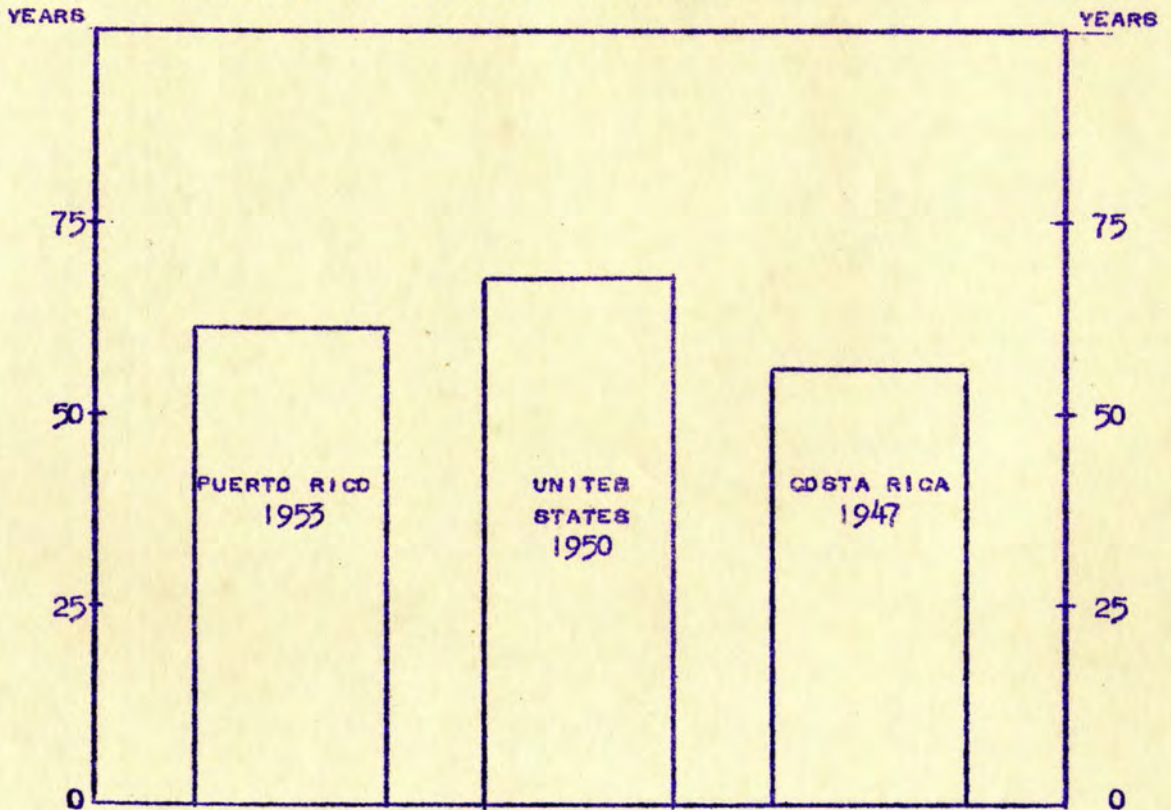
GRAPH 6: NUMBER OF INHABITANTS PER PHYSICIAN



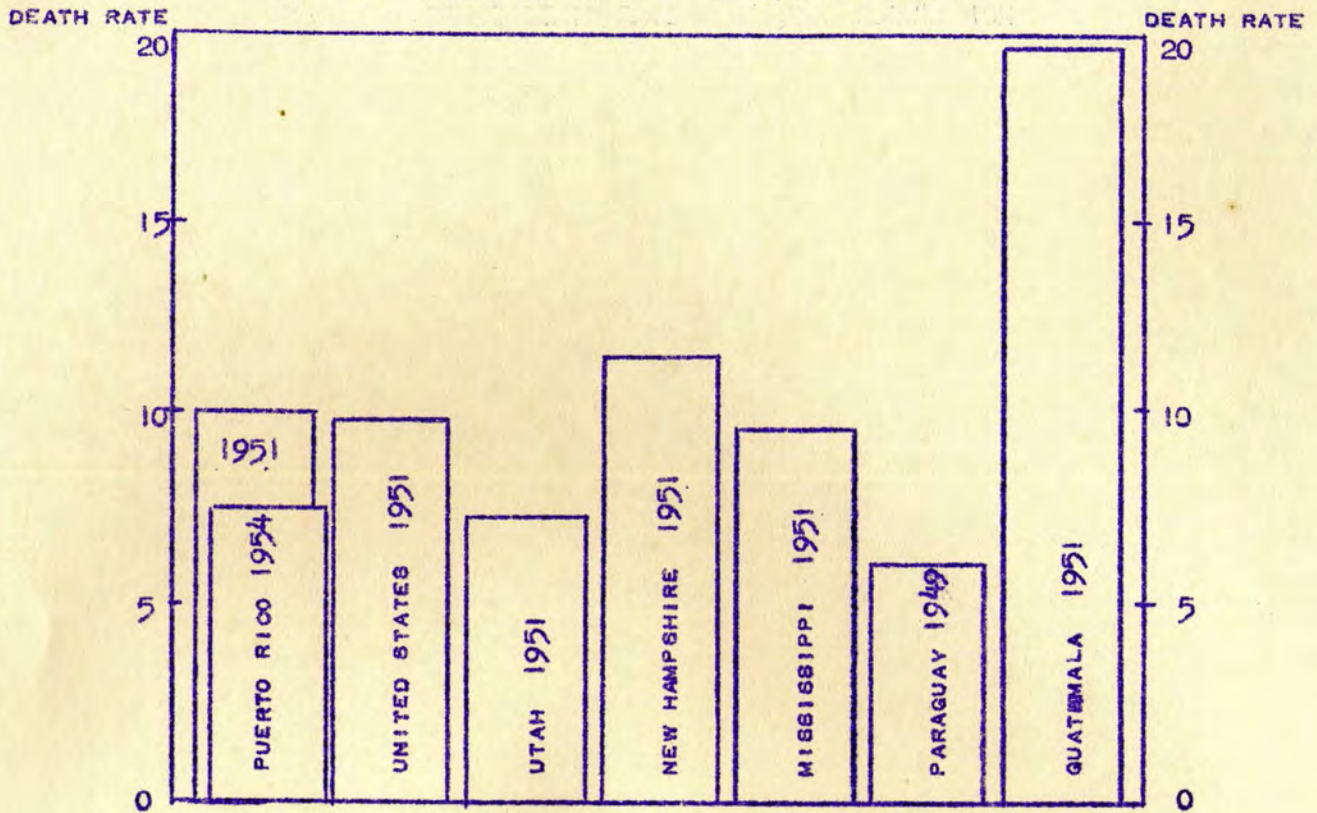
GRAPH 7: NUMBER OF INHABITANTS PER HOSPITAL BED



GRAPH 8: LIFE EXPECTATION AT BIRTH



GRAPH 9: CRUDE DEATH RATE PER 1,000 POPULATION



GRAPH 10: INFANT MORTALITY PER 1,000 CHILDREN UNDER ONE YEAR OF AGE.

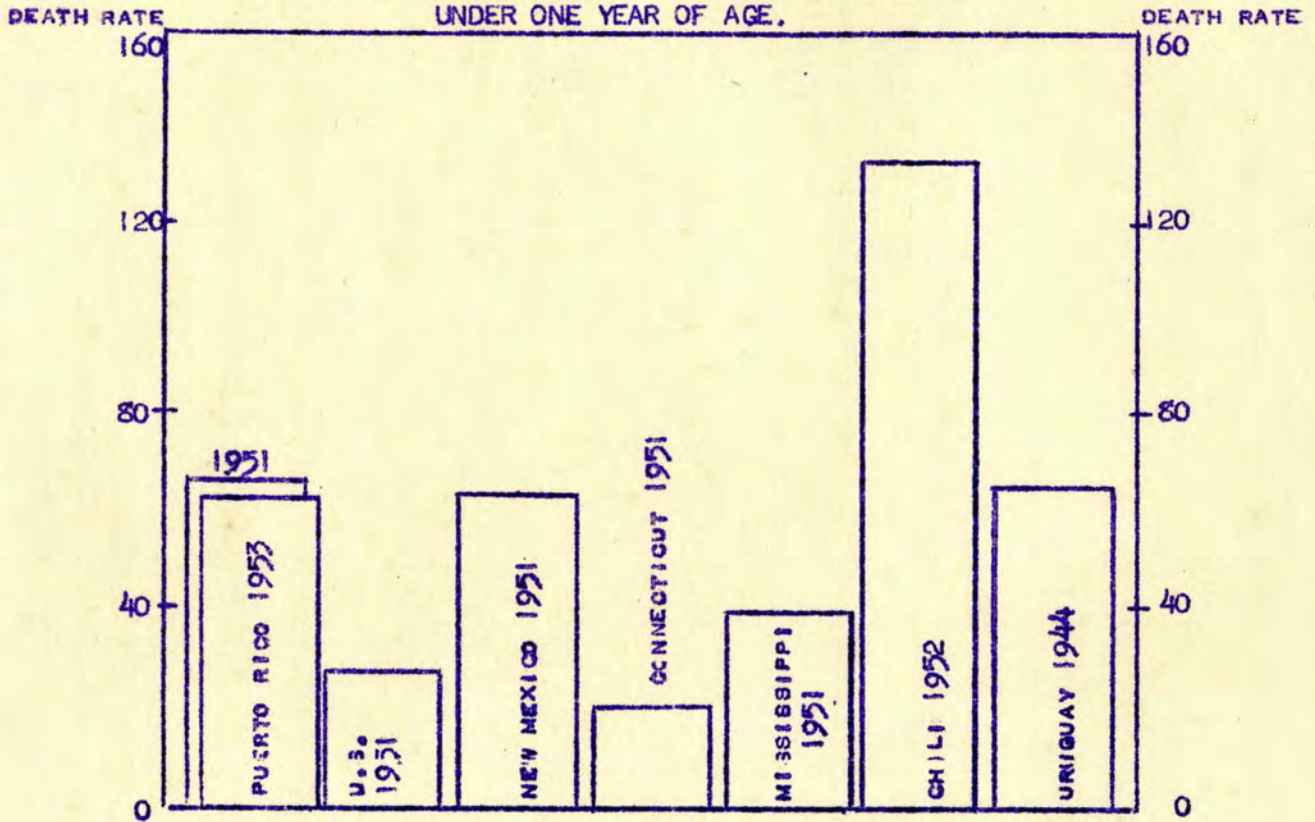
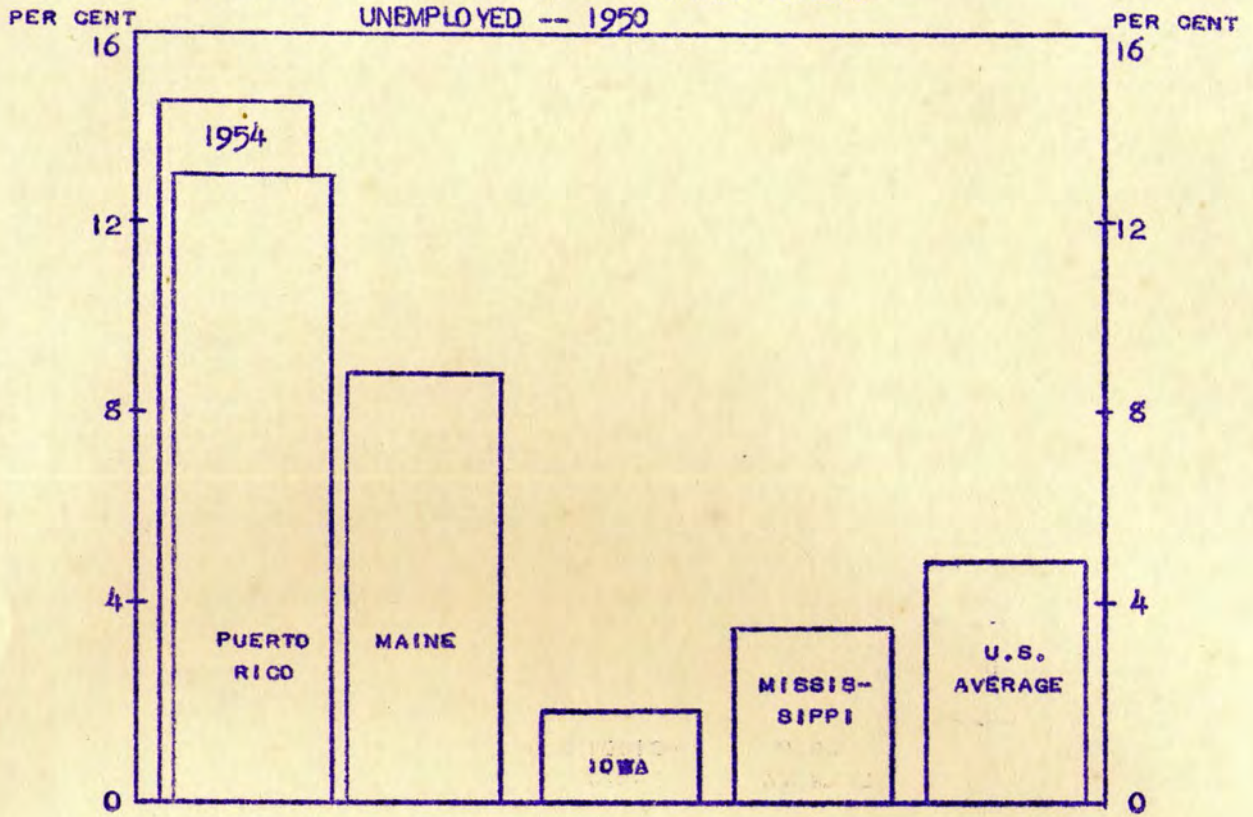
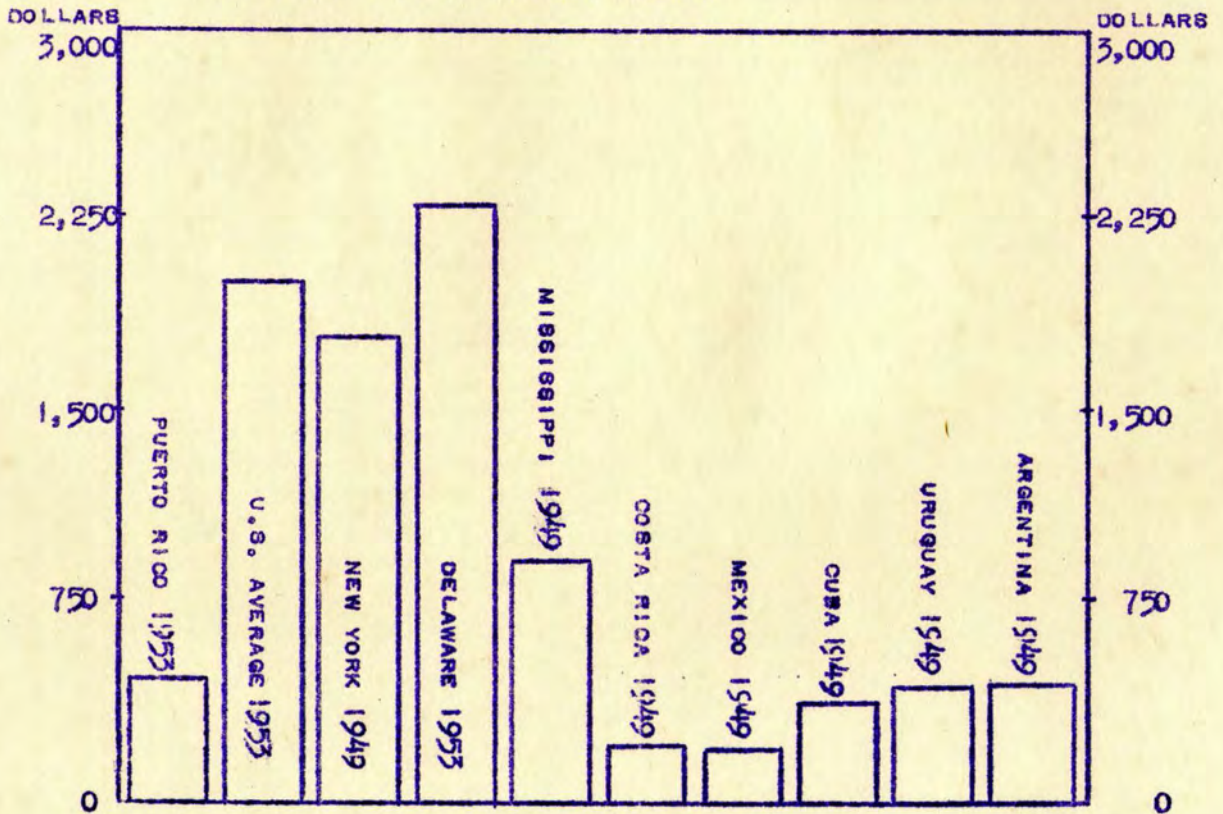


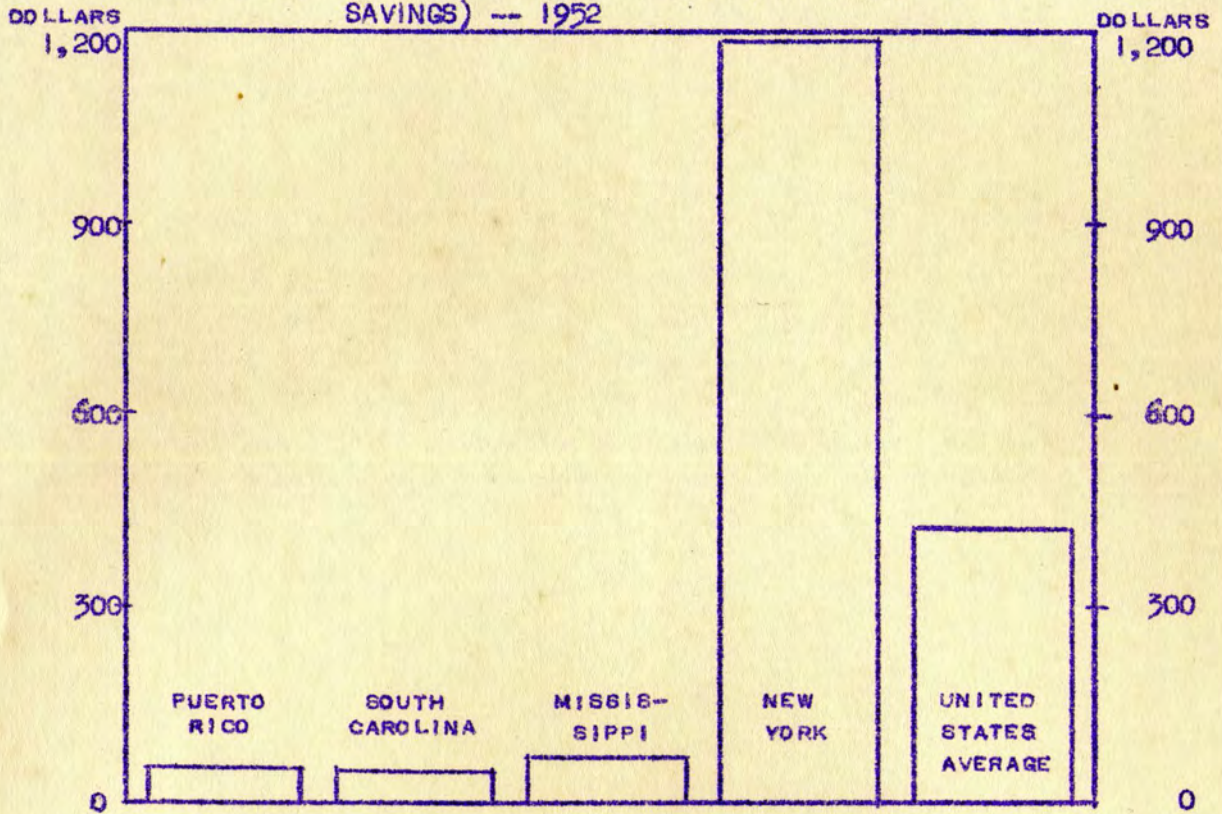
CHART 11: PERCENTAGE OF EMPLOYABLE PERSONS UNEMPLOYED -- 1950



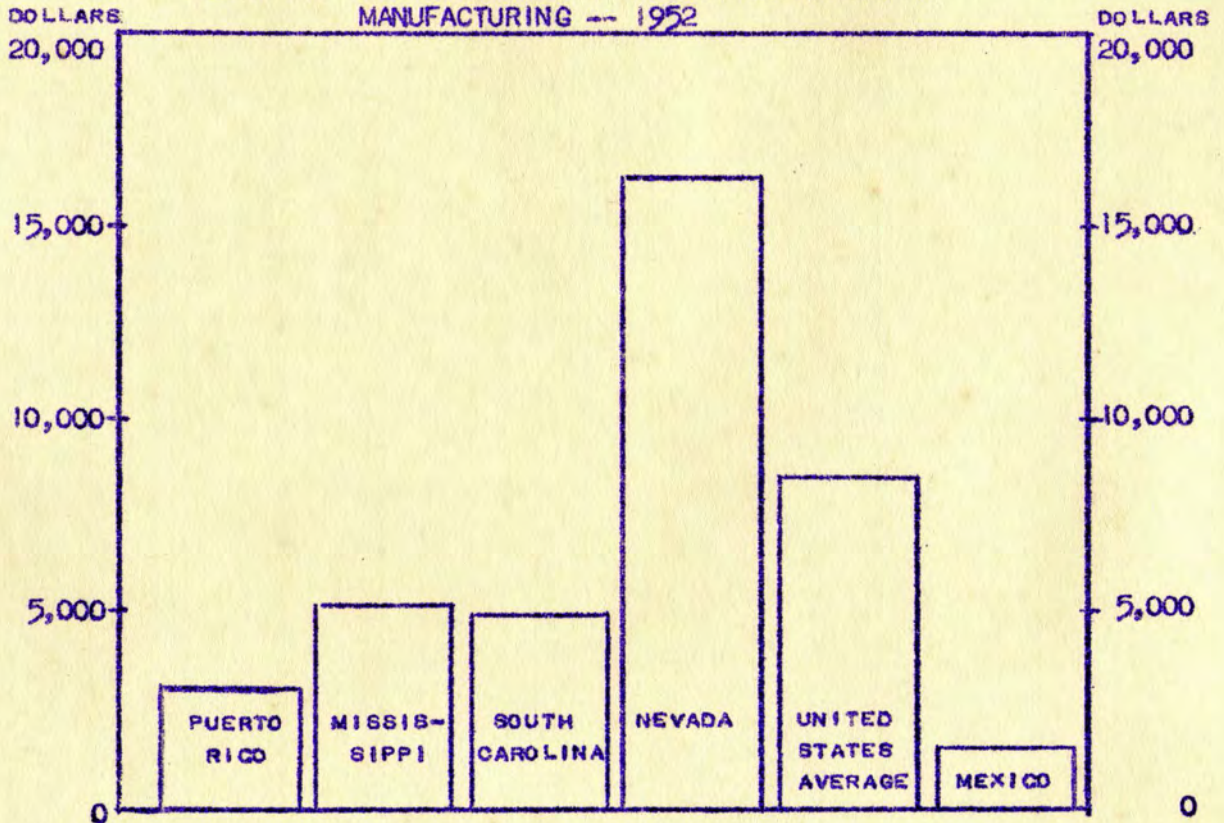
GRAPH 12: PER CAPITA NET INCOME



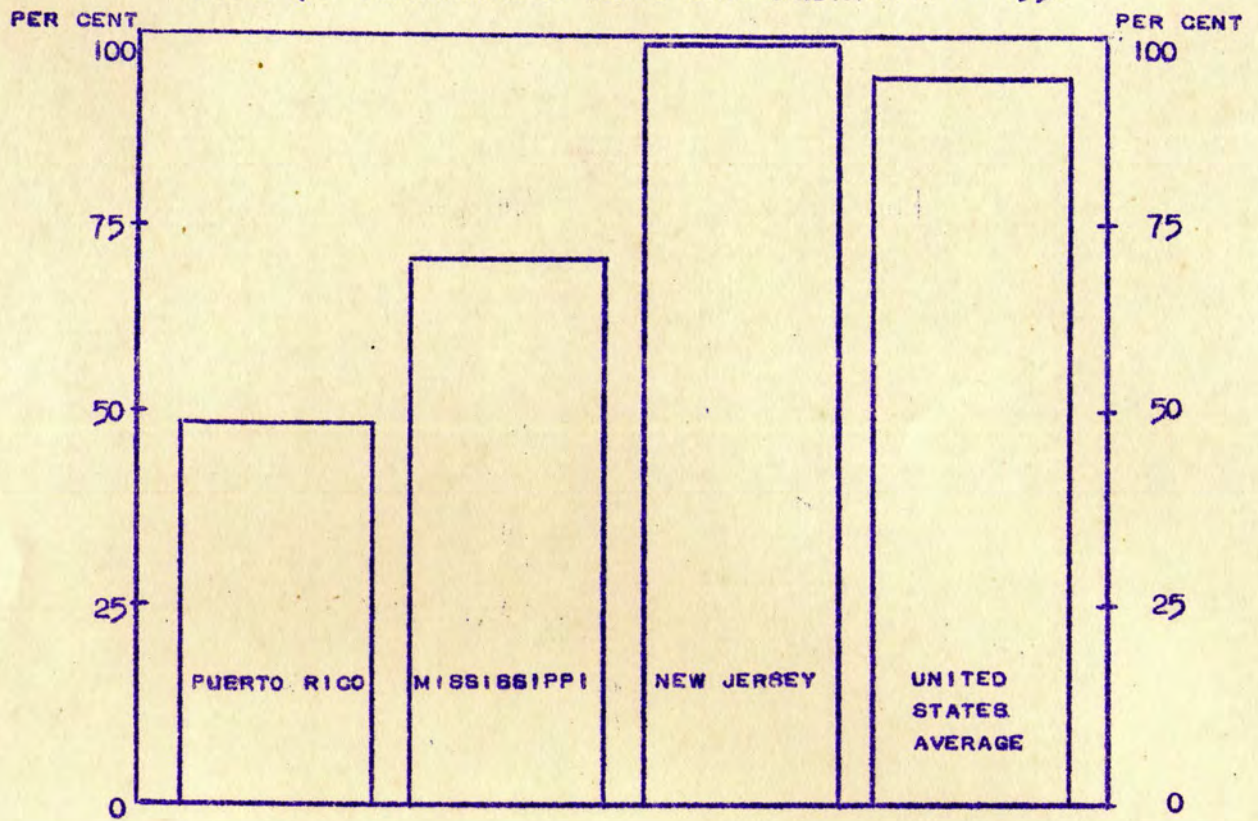
GRAPH 13: TIME DEPOSITS PER CAPITA (INCLUDING POSTAL SAVINGS) -- 1952



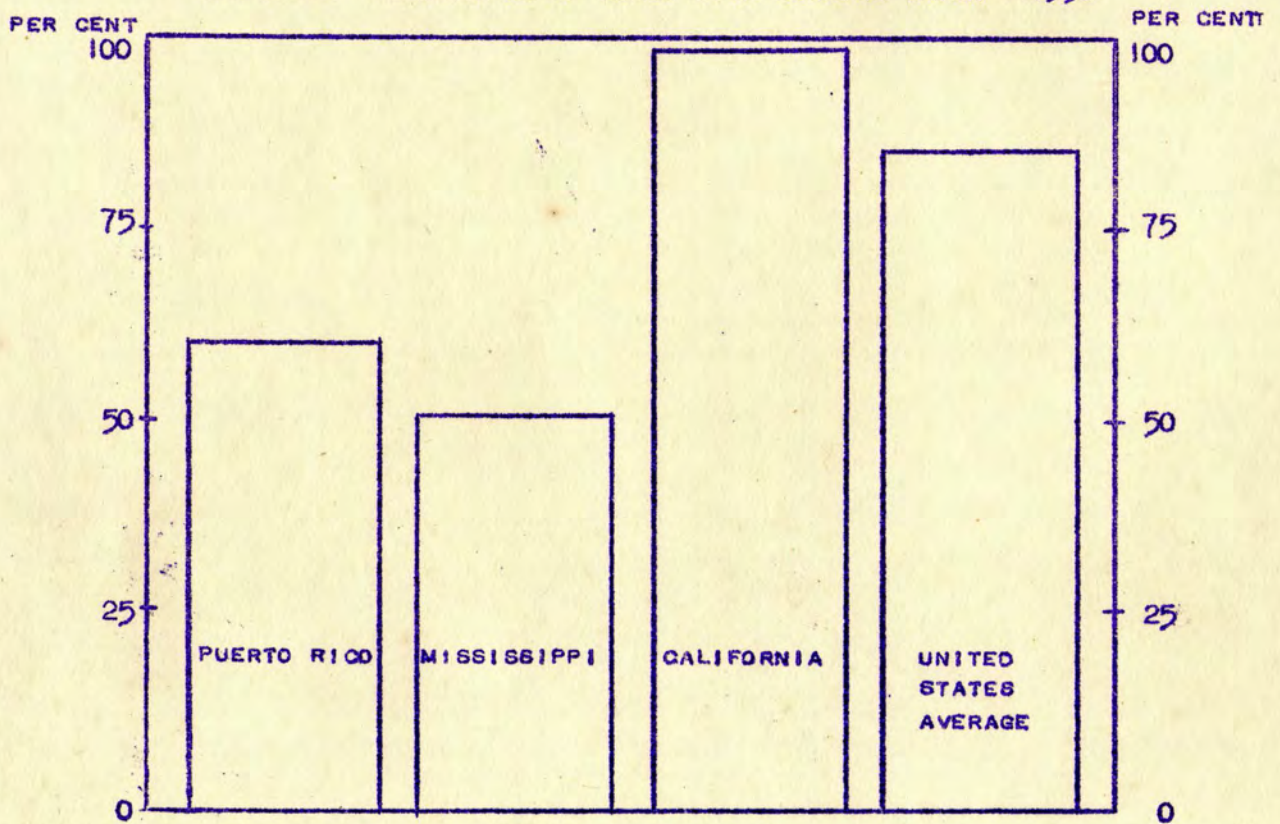
GRAPH 14: VALUE ADDED PER PRODUCTION WORKER IN MANUFACTURING -- 1952



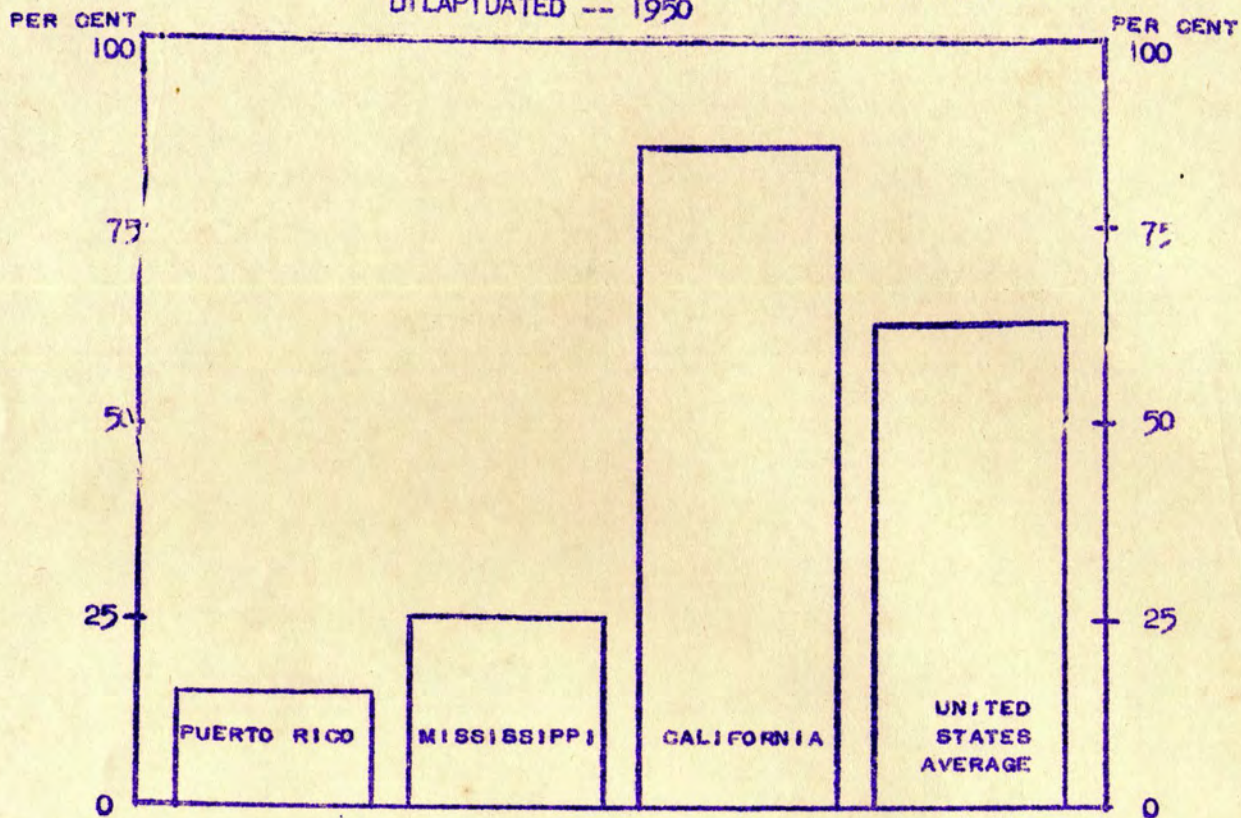
GRAPH 15: PERCENTAGE OF HOMES WITH ELECTRICITY -- 1950



GRAPH 16: PERCENTAGE OF HOMES WITH RUNNING WATER -- 1950



GRAPH 17: PERCENTAGE OF DWELLING UNITS WITH HOT RUNNING WATER, PRIVATE TOILET AND BATH NOT DILAPIDATED -- 1950



TAXES IN RELATION TO INDIVIDUAL INCOME PAYMENTS IN PUERTO RICO, THE UNITED STATES AND FORTY-THREE STATES ★

TAX AS PERCENTAGE OF INCOME PAYMENTS

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