Financial Oversight & Management Board for Puerto Rico

Members
Andrew G. Biggs
John E. Nixon
Betty A. Rosa

Robert F. Mujica Jr.
Executive Director

Arthur J. Gonzalez
Chair and Board Member

BY ELECTRONIC MAIL

January 30, 2026

The Honorable Thomas Rivera Schatz
President
Senate of Puerto Rico

The Honorable Carlos J. Méndez Núñez
Speaker
Puerto Rico House of Representatives

Re: Personal Income Tax Reduction Proposal, Administration Bill A-087, introduced as Senate Bill 912 and House Bill 1014

Dear President Rivera Schatz and Speaker Méndez Núñez:

We write in response to your letters dated January 20 and 21, 2026[1] and following up on our recent meetings in which, among other things, you requested the review and position of the Financial Oversight and Management Board for Puerto Rico (the "Oversight Board") regarding Governor Jenniffer González Colón's administrative proposal to permanently reduce personal income tax rates for Puerto Rico's individual taxpayers.[2] The letters include a request for the Oversight Board to conduct a preliminary review pursuant to PROMESA § 204(a)(6) to determine whether the Administration's proposal is consistent with the Certified Revised 2024 Fiscal Plan for Puerto Rico (the "Fiscal Plan") and PROMESA.

[1] Senate Minority Leader Hon. Luis Javier Hernández also requested the Oversight Board's position regarding Senate Bill 912 and House Bill 1014 through a letter dated January 15, 2026. We understand this letter to be responsive to Senator Hernández's request.

[2] Including the Senate President's suggestion, on his letter dated January 20, 2026, that resources from the Puerto Rico Trust be considered in the evaluation of Senate Bill 912.

This Administration's proposal was introduced on January 12, 2026, as Senate Bill 912 and House Bill 1014 (the "Bills"). The Oversight Board thanks you for the opportunity to set forth its preliminary position regarding the proposal's feasibility and adherence to the principles of PROMESA and the Fiscal Plan.

The Oversight Board is fully aware of the considerable burden Puerto Rico's current tax framework imposes on individual taxpayers and the consequent imperative need to identify sustainable alternatives to alleviate this reality. The Oversight Board has always been supportive of efforts to make Puerto Rico a competitive jurisdiction and finds related efforts a priority. However, while the Bills reduce the tax rates for many taxpayers, they do not constitute a broad, holistic or integrated tax reform that is capable of positioning Puerto Rico for long-term economic growth, as has been consistently discussed during the Government and the Oversight Board's continued collaborative efforts to enable a reform of Puerto Rico's tax-related statutory framework. Nonetheless we provide our review of the legislation as introduced.

The Puerto Rico Internal Revenue Code of 2011

Personal income tax
Currently, the personal income tax provisions of Act 1-2011, known as the Puerto Rico Internal Revenue Code (the "PRIRC"), establish five tax brackets through which the maximum tax rate of 33% applies to taxable income in excess of $61,500. The thresholds for each tax bracket are not subject to annual inflation adjustments. These provisions also establish an exemption for each dependent in the amount of $2,500. Further, the PRIRC imposes an additional 5% increase on the tax liability determined on individuals with net taxable income over $500,000.

The PRIRC also provides for a 5% or 8% discount to individual taxpayers depending on the income level prior to determining the final amount due on their annual tax returns.

Sales and use tax
Pursuant to the PRIRC, solar powered equipment and accessories, alternative fuel vehicles and promotional materials imported for conventions and events are not subject to the sales and use tax provisions. The sales and use tax provisions impose a 10.5% tax on the sale, use, consumption, and storage of taxable items, which include tangible personal property, taxable services, admission rights and certain other types of transactions covering separable and identifiable taxable items that are sold for a single price, subject to certain exceptions and limitations.

The Bills

Personal income tax
The focus of the Bills is to alleviate the tax burden of individual taxpayers. To these effects, the Bills propose amendments to the PRIRC aimed at reducing the tax burden of, mostly, middle income taxpayers through:

- an expansion of the individual income tax brackets, including an additional tax bracket, that would subject more income to the lower tax rates;

- an increase in the threshold of taxable income to reach the maximum tax rate to $150,000;
- an increase in the amount of the exemption per dependent from $2,500 to $5,000;
- an annual inflation adjustment to both the personal income tax brackets and the amount of the exemption per dependent; and
- repeal of the 5% increase on the tax determined on taxable income over $500,000.

The following table shows the Oversight Board's estimated cost of each of these proposals for the current fiscal year 2026 plus four additional fiscal years.

Summary of the revenue impact of proposed changes to the PIT *(millions, dollars $)*

	FY 2026	FY 2027	FY 2028	FY 2029	FY 2030	5-year
New PIT schedule	-$462.8m	-$462.8m	-$462.8m	-$462.8m	-$462.8m	-$2,314.0m
Increases in dependent exemption from $2.5k to $5K	-$94.6m	-$94.6m	-$94.6m	-$94.6m	-$94.6m	-$473.0m
Phase out of the 5% increase on the tax determined on net income over $500k	-$5.2m					
Impact of Inflation adjustment to the PIT schedule and the dependent exemption amount	No impact in FY2026	-$45.7m	-$99.3m	-$153.0m	-$208.0m	-$506.0m
Total	**-$563.0m**	**-$603.1m**	**-$656.7m**	**-$710.4m**	**-$765.4m**	**-$3,293.0m**

The Bills provide that the proposals impacting the individual income tax provisions of the PRIRC would be effective for calendar year 2025 (fiscal year 2026). Further, the Bills do not contemplate any substantive provisions regarding corporate income taxation.

Revenue provisions

As offsets to, partially, cover the cost of the above tax reducing provisions to individual taxpayers, the Bills propose the repeal of the following:

- 5% or 8% discount to individual taxpayers; and
- sales and use tax exemption on: (i) solar powered equipment and accessories; (ii) alternative fuel vehicles; and (iii) promotional materials imported for conventions and events.

The Oversight Board's estimated annual revenue gains from these proposals are as follows:

Proposed amendment	Estimated annual revenue
5% or 8% discount to individual taxpayers	$115-$280M
Repeal of sales and use tax exemption on solar powered equipment and accessories	$77M
Repeal of sales and use tax exemption on alternative fuel vehicles	$0.6M

Repeal of sales and use tax exemption on promotional materials imported for conventions and events	$0.4M
Total	**$193M**

Net impact on revenues

Based on the foregoing, the net impact of the Bills on the revenue collections for the fiscal year ending June 30, 2026, would be a reduction in tax collections of approximately **$370M** ($563M cost vs. $193M offsets).

The Oversight Board's analysis and position

The Oversight Board recognizes the value of the Bills' intention to reduce the tax burden of individual taxpayers in Puerto Rico. However, in considering legislation that affects its financial position, the Government must evaluate the legislation's impact on the current year budget and the 5-year financial plan period. Legislation with significant budget impact in the current and future years should be considered along with deliberations on budget priorities and risks to the financial plan. Passing ad hoc legislation with no long-term financial plan considerations would signal a return to failed practices of the past. Only by considering legislation within the overall context of the financial plan can we ensure that it does not threaten the fiscal stability we have worked together to achieve.

During the last three fiscal years, the Government's tax collections have remained relatively flat and are projected to decrease in FY2026, which could be interpreted as suggesting a slight decline in the local economy's growth. It is clear the Bills would significantly reduce Commonwealth revenues without having identified recurring mechanisms to fully replace the permanent revenue loss.

Historical General Fund Tax Collections and Year-over-Year Growth (FY2020–FY2025)

Fiscal Year	FY2020	FY2021	FY2022	FY2023	FY2024	FY2025	FY2026
Actual Receipts ($M)	$10,745	$12,378	$13,927	$13,553	$14,018	$14,067	$13,642
YoY Change (%)	-10.27%	15.20%	12.51%	-2.69%	3.43%	0.35%	-3.02%

Furthermore, the fiscal impact of tax-related legislation should be evaluated within the broader context of multiple tax measures enacted or currently under consideration, many of which carry material fiscal implications for Commonwealth and municipal revenues and affect the taxation of income streams such as capital gains, dividends, interest, and other taxable income.

These measures include: Act 66-2025 (rental income tax exemption extension); Act 76-2025 (hospital tax exemption extension); Act 78-2025 (exemption on prescription drug inventories); Act 179-2025 (retirement savings deduction aligned with federal limits); Act 178-2025 (education savings account contribution limits); Act 177-2025 (ABLE savings accounts); and House Bill 501, which proposes a reduction in the tax rate applicable to capital gains, dividends, and interest for certain taxpayers. Based on estimates provided by the Budget Office of the Legislative Assembly of Puerto Rico and the Oversight Board, when considered collectively and using comparable multi-year estimates, these enacted and pending tax measures are projected to result in an aggregate revenue impact of approximately $340M over the FY2026–FY2028 period for the Commonwealth and municipalities.

In addition, other tax-related proposals, such as HB 505, which would amend Act 60 to impose a 4% tax on certain resident investors and extend existing decrees, are projected to generate additional revenues; however, such impacts are scenario-dependent and not directly comparable on a uniform FY2026–FY2028 basis. Accordingly, tax-related proposals should be assessed as part of coordinated tax and budget reforms and in light of the Government's multi-year financial plan and the availability of resources to meet its obligations.

The Governor's desire for a comprehensive tax reform is welcomed and encouraged. Nonetheless, a commitment to responsible budget management is equally important. Any tax and revenue measures that may impact government tax collections must be addressed as part of the budget process and must be consistent with the Fiscal Plan, which projects revenues and spending over a five-year period so the Government can plan and determine its spending priorities, and which mandates that any tax measure be revenue neutral or otherwise fiscally responsible over the long-term.[3] Any factual discussion regarding long-term needs, obligations, or resource availability necessarily includes expiration of current levels of Medicaid funding in fiscal year 2028 and recurring government budget priorities, requests to increase salaries, and funding municipal governments and services, among others.[4] The Government has publicly recognized the importance of identifying the necessary sources of funding to ensure that the Bills meet the principle of fiscal neutrality.

The Oversight Board has consistently opposed efforts to enact *ad hoc* tax legislation that materially impacts the Commonwealth budget outside of a disciplined budget process. An economic impact analysis is also an important element of these deliberations. By discussing these initiatives within the formal budget development process, we can ensure that any decisions are fully aligned with Puerto Rico's financial situation, long-term fiscal objectives, statutory requirements, and the Island's overall policy priorities. Any such efforts outside of the budget process are inconsistent with the Fiscal Plan – particularly when pursued without thorough fiscal impact analysis.

[3] Fiscal Plan at 133 ("[T]ax policy changes must be made in a manner that is revenue neutral or otherwise fiscally responsible over the long-term over the long-term as determined by the Oversight Board. That is, all tax reductions must be accompanied by specific offsetting revenue measures identified in the enabling legislation of at least the same amount, or by offsetting reductions in government spending identified in the enabling legislation.").

[4] As discussed in our Quarterly Report for Q4 of FY2025, [b]eginning in FY2028, unless Congress and the Administration act, the Commonwealth will face a "Medicaid fiscal cliff" where Puerto Rico would become responsible for a significantly higher portion of Medicaid costs than in previous years. CBO estimates that in October 2027, the federal Medicaid annual funding cap for Puerto Rico will fall from $4 billion to approximately $500 million. Assuming no change in program eligibility or expenditures, this would increase the share of program costs to be covered by the Commonwealth to over 90%. This state-federal spending ratio would be triple that of the average U.S. state.

https://drive.google.com/file/d/1hUXJvMD_c0irLj74NCOzc4nKKi96JhZo/view.

Conclusion

Given the substantial recurring reductions in revenue without an identified recurring mechanism to fully replace the funds lost permanently, the Bills, as introduced and currently drafted, appear to be significantly inconsistent with the Fiscal Plan, the fiscal year 2026 Budget, and PROMESA.

The Fiscal Plan requires that any tax reform or tax law initiative that the Government undertakes or pursues must be revenue neutral or otherwise fiscally responsible over the long term. Specifically, the Fiscal Plan provides that "all tax reductions must be accompanied by specific offsetting revenue measures… of at least the same amount or by offsetting reductions in government spending identified in the enabling legislation."[5]

As stated, the Bills revise Puerto Rico's individual income tax bracket structure and lower the tax rates resulting in a revenue reduction of $370M without identifying comparable recurrent revenue or budgetary offsets. Revenues included are preliminarily valued at $193M.

The Bills also violate Section 204(c) of PROMESA by creating a revenue deficiency that would likely necessitate a budget reprogramming. Section 204(c) precludes the Government from "adopting a reprogramming . . . until the Oversight Board has provided the Legislature with an analysis that certifies such reprogramming will not be inconsistent with the Fiscal Plan and Budget." In line with this, court precedent has established that "a revenue deficiency in the budget that the Government would likely have to remedy through reprogramming" is a reprogramming governed by Section 204(c).[6] As such, the passage of the Bills by the Legislature would violate PROMESA Section 204(c), and Section 204(c) bars any effort to implement the same.[7]

[5] Fiscal Plan at 133.

[6] Further, Judge Swain has rejected the approach of addressing financial shortfalls *after* enacting laws, noting that "[t]he Government may not avoid the bar on implementation of statutes calling for unauthorized reprogramming by holding onto its cards and waiting until a post-implementation date to request reprogramming if the law as written is likely to require reprogramming due to insufficiency of budgeted funds." *In re Fin. Oversight and Mgt. Bd. for P.R.*, 511 F. Supp. 3d 90, 134 (D.P.R. 2020); *In re Fin. Oversight and Mgt. Bd. for P.R.*, 616 B.R. at 249 ("Section 204(c)(2) incorporates no temporal limitations; it prohibits both the adoption and the carrying out of unapproved reprogramming legislation.").

[7] Finally, the Bills also violate the Commonwealth Plan of Adjustment and undermine the Commonwealth's ability to fulfill its obligations under the Plan of Adjustment. The Confirmation Order prohibits any "party, individual, official, or officer (elected or appointed), agency, or Entity" from "enact[ing], adopt[ing], or implement[ing] any law, rule, regulation, or policy that . . . creates any inconsistency in any manner, amount, or event between the terms and provisions of the Plan [of Adjustment] or a Fiscal Plan certified by the Oversight Board, each of which actions has been determined by the Oversight Board to impair or defeat the purposes of PROMESA." This section of the Confirmation Order permits the District Court to retain jurisdiction in cases where the "Confirmation Order is cited as a basis for jurisdiction and, in the context of the factual allegations of the Complaint, it is properly such on its face." *In re Fin. Oversight and Mgt. Bd. for Puerto Rico*, 650 B.R. 334, 352 (D.P.R. 2023), *aff'd*, 77 F.4th 49 (1st Cir. 2023).

Please note the Oversight Board reserves the right to take such actions as it deems necessary, consistent with PROMESA §§ 104(k), 108(a), and 204, including seeking remedies to prevent implementation and enforcement of the Bills. We hope such action will not be necessary.

The Oversight Board believes there is an opportunity to collaborate on a broad-based tax reform. This should be done with a focus on addressing Puerto Rico's current economic and demographic challenges by using tax reform as a mechanism that makes Puerto Rico a much more competitive jurisdiction that is capable of long-term economic growth. However, any tax law changes that the Government pursues must be fiscally responsible; that is, all tax reductions must be accompanied by specific recurring revenue or reductions in government spending that would offset the revenue impact of proposed legislation.

While the Oversight Board cannot support the tax reduction proposal of the Bills for the reasons stated above, we concur with the Government's position that individual taxpayers in Puerto Rico should be afforded some degree of relief within available resources. As a result, one potential source of assistance to individual taxpayers could be a non-recurring reimbursable incentive or rebate in an amount consistent with the rate changes offset by the elimination of the discount to taxpayers to be distributed among the group of individual taxpayers that would have benefited from the proposal of the Bills.

We recognize the Bills as an opportunity to provide tax relief. Nonetheless, any legislation establishing new obligations or modifications to existing obligations should be discussed during the upcoming Commonwealth General Fund budget process for fiscal year 2027, and as a part of the broader efforts to reform the Commonwealth's budgetary and financial statutory framework. By discussing these initiatives within the formal budget development process, we can ensure that any decisions consider Puerto Rico's overall financial situation, and are fully aligned with long-term fiscal objectives, statutory requirements, and policy priorities.

Sincerely,

Robert F. Mujica, Jr.
Executive Director

CC. The Honorable Luis Javier Hernández Ortiz
The Honorable Héctor E. Ferrer Santiago