

ARTICLES

U.S. TAX IMPERIALISM IN PUERTO RICO

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This Article uses historical and legal analysis to demonstrate how U.S. domination over Puerto Rico's tax and fiscal policies has been the centerpiece of a colonial system and an especially destructive form of economic imperialism. Specifically, this Article develops a novel theory of U.S. tax imperialism in Puerto Rico, chronicling the sundry ways in which the United States has used tax laws to exert economic dominance over its less developed island colony. During the colonial period, U.S. officials wrote and revised Puerto Rican tax laws to serve U.S. economic interests. In more recent years, U.S. tax laws have disadvantaged Puerto Ricans, who still lack voting rights and full democratic representation in Congress. A theory of tax imperialism may also have application far beyond the U.S.-Puerto Rican experience. For instance, it may help us understand the relationships between the United States and its other possessions and territories throughout history, and between the United Kingdom and its British Crown dependencies, overseas territories, and newly-independent colonies.

* Associate Professor of Law, Seattle University School of Law. This Article was selected for presentation at the Sixteenth Annual Yale/Stanford/Harvard Junior Faculty Forum, held at Harvard Law School in June 2015. I owe a debt of gratitude to Matt Autio, Steven A. Bank, Steven Bender, Rosa Carrasquillo, Brooke Coleman, Keith Demirjian, Lourdes Dick, Sam Erman, Rafael Gely, Carmen Gonzalez, Lily Kahng, Yair Listokin, Charlene Luke, Pedro Malavet, Omri Marian, Ajay Mehrotra, Elizabeth Porter, Diane Ring, Victor Rodriguez, Darien Shanske, and Joseph Thorndike for their helpful comments on earlier drafts. This Work has also benefited tremendously from faculty workshop presentations at my home institution as well as at the University of Utah S.J. Quinney College of Law, and from comments received at the 2015 Northwest Junior Faculty Forum and the History and Fiscal Policy Panel at the 2015 Annual Meeting of the Law and Society Association. This Article was written in loving memory of my grandparents, Joaquin and Gloria Barros.

TABLE OF CONTENTS

Introduction.....	2
I. A Theory of U.S. Tax Imperialism.....	12
II. Three Historical Stages of U.S. Tax Imperialism in Puerto Rico... ..	16
A. Stage One of U.S. Tax Imperialism in Puerto Rico, 1898–1919	20
1. U.S. evaluation of Puerto Rico’s extant system of taxation.....	21
2. U.S. adjustments to Puerto Rico’s extant system of taxation.....	25
a. U.S. enforcement of tax laws in Puerto Rico.....	36
3. Further U.S. refinements to Puerto Rican tax laws: Property taxation	37
4. Further U.S. refinements to Puerto Rican tax laws: Income taxation	42
5. Assessing the U.S. fiscal restructuring of Puerto Rico	50
B. Stage Two of U.S. Tax Imperialism in Puerto Rico, 1920–1974.....	53
C. Stage Three of U.S. Tax Imperialism in Puerto Rico, 1975–Present.....	68
D. Recent Fiscal Developments in Puerto Rico	78
III. A Broader Theory of Tax Imperialism: Possible Future Applications, Points for Further Study.....	83
Conclusion	84

INTRODUCTION

Today, Estado Libre Asociado de Puerto Rico (the Commonwealth of Puerto Rico)¹ is financially and economically distressed; this much

1. See P.R. CONST. art. 1, § 2 (establishing a republican form of government for the U.S. territory); see also Act of July 3, 1952, Pub. L. No. 447, 66 Stat. 327 (approving the island’s constitution, thereby giving it effect under federal law). Puerto Rico is composed of three separate inhabited islands; however, it is consistently referred to as “the island.” See, e.g., CÉSAR J. AYALA & RAFAEL BERNABE, PUERTO RICO IN THE AMERICAN CENTURY: A HISTORY SINCE 1898 1 (2007) (using the term “the island” to refer to Puerto Rico in a comprehensive account of the island’s relations with the United States); see also 48 U.S.C. § 731 (2012) (applying “[t]he provisions of this chapter . . . to the island of Puerto Rico and to the adjacent islands belonging to the United States and waters of those islands” and declaring that “the name Puerto Rico . . . shall be held to include not only the island of that name, but

is painfully clear. The Commonwealth struggles with weak economic growth² while shouldering a heavy debt load.³ In recent years, prominent U.S. investment rating firms have repeatedly lowered Puerto Rico's bond ratings to below junk status, signaling that the Commonwealth may be unable to satisfy its obligations.⁴ Defaults⁵ are not just harmful to Puerto Rico itself; Puerto Rican government bonds have been traded widely in U.S. capital markets for years. Meanwhile, a legal fight is brewing regarding the island's right to restructure its obligations. Although a federal court has thrown out a new debt restructuring law⁶ passed by the Legislative Assembly of Puerto Rico in June 2014,⁷ the island continues to push for an out-of-

all the adjacent islands").

2. See D. ANDREW AUSTIN, CONG. RESEARCH SERV., R44095, PUERTO RICO'S CURRENT FISCAL CHALLENGES 1–2 (2015), <https://www.fas.org/sgp/crs/row/R44095.pdf>.

3. See, e.g., Michelle Kaske, *Puerto Rico Lawmakers Pass \$2.9 Billion Bonding Measure*, BLOOMBERGBUSINESS (Dec. 9, 2014, 10:06 AM), <http://www.bloomberg.com/news/articles/2014-12-09/puerto-rico-lawmakers-pass-2-9-billion-debt-plan-with-rate-cap> (reporting that Puerto Rico's debt had reached approximately \$73 billion in December 2014).

4. See, e.g., Josh Beckerman, *Standard & Poor's Downgrades Puerto Rico: S&P Cuts Puerto Rico's General Obligation Rating to Two Notches Below Investment Grade*, WALL STREET J. (July 11, 2014, 6:37 PM), <http://www.wsj.com/articles/standard-poors-downgrades-puerto-rico-1405117331> (explaining that Puerto Rico's lower general obligation rating could indicate "mounting economic and fiscal challenges for the commonwealth as a whole"); Irina Baron & Xian Li, *Puerto Rico's Credit Risk Measures Reach a Five-Year High*, MOODY'S ANALYTICS (June 30, 2014), https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_172396 (reporting a one-year measure of Puerto Rico's "credit risk" as higher than that of Argentina, Venezuela, and Ukraine).

5. The island defaulted for the first time in August 2015. Mary Williams Walsh, *Puerto Rico Defaults on Bond Payment*, N.Y. TIMES (Aug. 3, 2015), <http://www.nytimes.com/2015/08/04/business/dealbook/puerto-rico-decides-to-skip-bond-payment.html>.

6. 2014 P.R. Leyes 71.

7. See Franklin Cal. Tax-Free Tr. v. Puerto Rico, Nos. 15-1218, 15-1221, 15-1271, 15-1272, 2015 WL 4079422, at *1 (1st Cir. July 6, 2015) (affirming the constitutionality of 2014 P.R. Leyes 71 because the U.S. Bankruptcy Code pre-empts Puerto Rico's law, and Puerto Rico lacks authority to authorize its municipalities to pursue bankruptcy relief), *petition for cert. filed*, No. 15-233 (Aug. 24, 2015); see also Michael Corkery, *Judge Strikes Down Puerto Rico's Debt Restructuring Law*, N.Y. TIMES (Feb. 8, 2015, 1:52 PM), <http://dealbook.nytimes.com/2015/02/08/judge-strikes-down-puerto-ricos-debt-restructuring-law> (explaining that "[i]nvestors in billions of dollars of Puerto Rico bonds secured a major legal victory" as a result of the decision invalidating Puerto Rico's debt restructuring law).

court restructuring⁸ or, in the alternative, access to federal bankruptcy protections that are normally granted to municipalities.⁹

Scholars and journalists have compared the situation in Puerto Rico to other emerging market financial shocks, such as the 1980s Latin American debt crisis and the City of Detroit's downward economic spiral.¹⁰ But the Puerto Rican experience is exceptional in a number of ways. Puerto Rico is not a U.S. state or a political subdivision thereof.¹¹ However, other nation-states do not recognize Puerto Rico as being independent from the United States.¹² In actuality, Puerto Rico is the largest unincorporated U.S. territory and is, therefore, subject to U.S. federal laws and the plenary power of Congress.¹³ Puerto Rican citizens are U.S. citizens,¹⁴ although they lack

8. See, e.g., Michelle Kaske, *Puerto Rico Faces Higher Hurdles in Debt Restructuring Plan*, BLOOMBERG BUSINESS (Sept. 10, 2015, 3:00 AM), <http://www.bloomberg.com/news/articles/2015-09-10/puerto-rico-confronts-higher-hurdles-in-debt-restructuring-plan>.

9. See Clayton P. Gillette & David A. Skeel Jr., *How Congress Can Help Puerto Rico*, N.Y. TIMES (Sept. 14, 2015), <http://www.nytimes.com/2015/09/14/opinion/how-congress-can-help-puerto-rico.html> (discussing Puerto Rico's recent efforts to obtain access to Chapter 9 bankruptcy protection).

10. See, e.g., FRANCISCO E. GONZÁLEZ, *CREATIVE DESTRUCTION?* 1–4 (2012) (discussing the relationship between economic collapse and regime change from observations of various Latin American countries); Errol Louis, *Puerto Rico: Detroit of the Caribbean*, N.Y. DAILY NEWS (July 17, 2014, 4:30 AM), <http://www.nydailynews.com/opinion/puerto-rico-detroit-caribbean-article-1.1869561> (noting that Puerto Rico, "the next Detroit," holds \$73 billion in debt, far surpassing its \$9.6 billion annual budget).

11. However, Puerto Ricans have been debating the island's political future (whether it will remain a U.S. territory, become a U.S. state, or gain full independence) for several decades. See, e.g., Maryellen Tighe & Ellie Ismailidou, *Wall Street Waits While Statehood Debate Handcuffs Puerto Rico Decision Makers*, FORBES (July 7, 2014, 3:00 PM), <http://www.forbes.com/sites/mergermarket/2014/07/07/wall-street-waits-while-statehood-debate-handcuffs-puerto-rico-decision-makers> (explaining that dealing with the Commonwealth's massive debt will affect the outcome of the debate over Puerto Rico's statehood). See generally EDGARDO MELÉNDEZ, *PUERTO RICO'S STATEHOOD MOVEMENT* 1–10 (1988) (discussing the history of the statehood movement in Puerto Rico, and its connection to national identity, politics, and sociopolitical conflicts).

12. That said, the island's unique history and ethnic background have contributed to Puerto Rico's adoption of its own distinct national identity. See JORGE DUANY, *THE PUERTO RICAN NATION ON THE MOVE: IDENTITIES ON THE ISLAND AND IN THE UNITED STATES* 9–11 (2002) (considering the multiple social actors that contribute to the definition of Puerto Rico's national identity).

13. See U.S. CONST. art. IV, § 3, cl. 2 ("The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States . . .").

14. See Jones-Shafroth Act, ch. 145, 39 Stat. 951, 953 (1917) (extending U.S. citizenship to Puerto Ricans); see also 8 U.S.C. § 1402 (2012) (codifying and clarifying the extension of U.S. citizenship). However, Puerto Ricans do not enjoy all of the

voting rights at the federal level and are represented in the U.S. House of Representatives only by a non-voting Resident Commissioner.¹⁵

Puerto Rico's ambiguous political status and historic lack of a formal legal process for restructuring its public debts¹⁶ are partly responsible for a mounting crisis, which has inspired hand-wringing and speculation on Wall Street.¹⁷ For years, U.S. mainstream media outlets have warned of a Puerto Rican default, which would cause ripple effects for all U.S. investors.¹⁸ Journalists have editorialized the Commonwealth's struggles from a variety of angles, such as by recounting crime statistics in San Juan's urban center¹⁹ and citing the

rights and protections of the U.S. Constitution unless and until they set foot on the mainland. *See* *Balzac v. Porto Rico*, 258 U.S. 298, 304–05 (1922) (holding that certain provisions of the U.S. Constitution do not apply to territories not incorporated into the union).

15. *See* 48 U.S.C. § 891 (2012) (outlining the election procedures and responsibilities of the Puerto Rican Resident Commissioner); RULES OF THE HOUSE OF REPRESENTATIVES, R. III, 114th Cong. (2015), <http://clerk.house.gov/legislative/house-rules.pdf> (noting that the Resident Commissioner may not vote, but is permitted to serve on committees and speak from the House floor).

16. Congress has the authority to enact “uniform Laws on the subject of Bankruptcies throughout the United States.” U.S. CONST. art. I, § 8, cl. 4. Most recently, Congress adopted the Bankruptcy Reform Act of 1978, as amended, codified in title 11 of the U.S. Code (the “U.S. Bankruptcy Code”). However, bankruptcy relief under the U.S. Bankruptcy Code does not apply to the Commonwealth of Puerto Rico or its public corporations. Puerto Rico attempted to fill this void with a restructuring law, which was recently invalidated by a U.S. federal court of appeals. *See* Corkery, *supra* note 7 and accompanying text (discussing the law suit striking down Puerto Rico’s restructuring law); *see also* Stephen J. Lubben, *Puerto Rico and the Bankruptcy Clause*, 88 AM. BANKR. L.J. 553, 553–55, 578 (2014) (thoughtfully critiquing the constitutional challenges to Puerto Rico’s attempts to restructure its public debts).

17. *See, e.g.*, Mary Childs & Michelle Kaske, *Puerto Rico Distress Spells Wall Street Opportunity: Muni Credit*, BLOOMBERG BUSINESS (Nov. 12, 2013, 12:01 AM), <http://www.bloomberg.com/news/articles/2013-11-12/puerto-rico-distress-spells-wall-street-opportunity-muni-credit>.

18. *See, e.g.*, Michelle Kaske, *Puerto Rico Debt Crisis: A Bond Guide as Potential Defaults Loom*, BLOOMBERG BUSINESS (Sept. 11, 2015, 4:35 PM), <http://www.bloomberg.com/news/articles/2015-09-11/puerto-rico-debt-crisis-a-bond-guide-as-potential-defaults-loom>; Jordan Weissmann, *Here It Comes: Puerto Rico Is Headed for a Debt Default*, SLATE (July 31, 2015, 7:07 PM), http://www.slate.com/blogs/moneybox/2015/07/31/puerto_rico_is_about_to_default_on_some_of_its_debt.what_happens.next.html.

19. *See, e.g.*, Lizette Alvarez, *Economy and Crime Spur New Puerto Rican Exodus*, N.Y. TIMES (Feb. 8, 2014), <http://www.nytimes.com/2014/02/09/us/economy-and-crime-spur-new-puerto-rican-exodus.html> (stating the primary reason Puerto Ricans are migrating to the mainland is because of the high rate of violent crime); David Greene, *Don’t Give Up On Us’: Puerto Ricans Wrestle with High Crime*, NPR (Feb. 7,

migration of highly educated young people to the mainland.²⁰ Analysts have searched for someone or something to blame. Some criticize Puerto Rico's governmental inefficiencies and crumbling infrastructure.²¹ Others suggest that public sector workers receive overly generous retirement benefits and that Puerto Rico should reform its pension system.²²

Other analysts focus on narrow aspects of U.S.-Puerto Rican relations. For instance, some observers argue that highly technical U.S. tax policies—such as the now-repealed possessions tax credit that had encouraged U.S. corporations to invest in Puerto Rico²³—have

2013, 3:27 AM), <http://www.npr.org/2013/02/07/171071473/-don-t-give-up-on-us-puerto-ricans-wrestle-with-high-crime> (stating that Puerto Rico's murder rate is six times that of the entire United States); Andrew O'Reilly, *Plagued By Violence, Bad Economy, Puerto Rico Rings in 2014 with Bang; 13 Murders in 5 Days*, FOX NEWS LATINO (Jan. 8, 2014), <http://latino.foxnews.com/latino/news/2014/01/08/plagued-by-violence-bad-economy-puerto-rico-rings-in-2014-with-bang-13-murders> ("The burst of murders in the first few days of the New Year indicates that Puerto Rico's homicide rate, which reached a record high in 2011 of 1,130, remains high above the level of the rest of the United States.").

21. See, e.g., Cindy Y. Rodriguez, *Why More Puerto Ricans Are Living in Mainland U.S. Than in Puerto Rico*, CNN (Mar. 24, 2014), <http://www.cnn.com/2014/03/22/us/puerto-rico-migration-economy> (explaining that many of the individuals migrating from Puerto Rico are young, educated professionals who come to the mainland in search of work); see also, D'Vera Cohn et al., *Puerto Rican Population Declines on Island, Grows on U.S. Mainland*, PEW RES. CTR. (Aug. 11, 2014), www.pewhispanic.org/2014/08/11/puerto-rican-population-declines-on-island-grows-on-u-s-mainland (stating that as of 2006, more Puerto Ricans reside on the U.S. mainland than on the island).

22. See, e.g., Simone Baribeau, *Puerto Rico's Public Relations Headache*, FORBES (July 28, 2014, 12:13 PM), <http://www.forbes.com/sites/mergermarket/2014/07/28/puerto-ricos-public-relations-headache> (critiquing Puerto Rico's management of investor relations during the debt crisis); Tighe & Ismailidou, *supra* note 11 (claiming that Puerto Rican officials have been so distracted by the statehood debate that they have failed to institute sound economic policies).

23. See, e.g., Lisa Lambert, *Puerto Rico Court Strikes Down Teacher Pension Overhaul*, REUTERS (Apr. 11, 2014, 8:05 PM), <http://www.reuters.com/article/2014/04/12/puertorico-pensions-idUSL2N0N325N20140412> ("Wall Street rating agencies had said Puerto Rico's pension reforms were essential to improving the territory's deteriorating credit quality."); see also Ted Dabrowski, *Lessons from Puerto Rico: The Problem with Big Pension Debts and Little Solutions*, ILL. POL'Y (Mar. 31, 2013), <https://www.illinoispolicy.org/lessons-from-puerto-rico-the-problem-with-big-pension-debts-and-little-solutions> (arguing that Puerto Rico's fiscal crisis demonstrates why public employers must move away from defined benefit pension plans, in favor of defined contribution pension plans).

24. See *infra* Section II.C (outlining the history of tax benefits received by corporations doing business in Puerto Rico and the effects they had on the Commonwealth's economy).

propelled up the island's economy for decades. According to these observers, the United States attempted to stimulate American investment in Puerto Rico and improve economic opportunity on the island.²⁴ Then, as the U.S. government scaled back these initiatives—most notably by phasing out the possessions tax credit between 1996 and 2006—Puerto Rico increasingly turned to the debt markets to fund general obligations.²⁵ Most accounts like these further note that Puerto Rico has been able to borrow heavily at below-market interest rates because its bonds are exempt from U.S. federal, state, and local taxes.²⁶ And, of course, some commentators are quick to point out that Puerto Rican residents do not have to pay federal income tax, although they benefit from many federal aid programs.²⁷

These narratives consistently portray U.S. policies as generous and benevolent compared to Puerto Rican tax and economic policies, which are portrayed as grasping and even guileful. Some observers suggest that, in recent years, Puerto Rico has refused to institute necessary austerity measures, instead choosing to reinvent itself as a tax haven for wealthy mainland residents in an attempt to lure American capital to the island and deprive Uncle Sam of his rightful due.²⁸

24. See, e.g., Mark Nestmann, *Is Puerto Rico the Perfect Tax Haven for US Citizens?*, ECON. POL'Y J. (May 7, 2014), <http://www.economicpolicyjournal.com/2014/05/is-puerto-rico-perfect-tax-haven-for-us.html> (writing that Congress had tried “direct aid, industrial incentives, and tax breaks to revive Puerto Rico’s economy” over the course of three decades).

25. See, e.g., Louis, *supra* note 10 (explaining that “[t]he economic storm now engulfing the island began in 1996, when the Clinton administration began a 10-year phaseout of [s]ection 936, a tax program that had allowed companies to take tax-free profits from operations based in Puerto Rico”).

26. See *infra* note 273 and accompanying text (discussing the Jones-Shafroth Act and noting that Puerto Rican government bonds are exempted from federal, state, and county taxes).

27. See, e.g., ALEXANDER ODISHELIDZE & ARTHUR LAFFER, PAY TO THE ORDER OF PUERTO RICO 61 (2004) (“The heart of the imbalance consists in this: while, for the purposes of most programs that tap the federal Treasury, Puerto Ricans operate like other American citizens and receive benefits, the people of the island do not pay federal income tax.”). For an example of a federal aid program, see FEMA, *President Declares Major Disaster for the Commonwealth of Puerto Rico*, HQ-10-209 (2010), <https://www.fema.gov/news-release/2010/10/26/president-declares-major-disaster-commonwealth-puerto-rico>.

28. See, e.g., Katherine Burton, *Puerto Rico: Tropical Tax Haven for America’s Super-Rich*, BUSINESSWEEK (June 26, 2014), <http://www.bloomberg.com/bw/articles/2014-06-26/puerto-rico-tax-haven-for-americas-super-rich> (describing a law that allows Americans to pay minimal or no local or federal capital gains taxes as long as they live in Puerto Rico for at least 183 days a year, and no local taxes on dividend or interest income for twenty years).

Indeed, a recent highly-publicized report by a U.S. tax expert accused Puerto Rico of helping itself to a seemingly back-door bailout from the U.S. Treasury in the form of ever-increasing corporate taxes that can be credited by U.S. firms against their federal income tax liabilities.²⁹ In response, some analysts wonder when the United States will finally grow tired of supporting its ne'er-do-well stepchild in the Caribbean.³⁰

The dominant account of Puerto Rico's contemporary economic condition strongly implies that the island has never been able to stand on its own, even with ample support from the U.S. Treasury and American capital markets.³¹ In essence, Puerto Rico is characterized as an undisciplined and highly dependent island economy that has made little use of generous U.S. tax and economic incentives to become self-sufficient. Critics accuse the Puerto Rican government of taking the easy way out, mostly by accepting large federal transfers and racking up cheap debt from U.S. creditors to fund a bloated public sector that enjoys a lavish tropical lifestyle.³² By

29. Martin A. Sullivan, *Economic Analysis: The Treasury Bailout of Puerto Rico*, TAXANALYSTS (Jan. 27, 2014), <http://www.taxanalysts.com/www/features.nsf/Features/1F974381895173AC85257C6D005F0128?OpenDocument>.

30. See Jim McTague, *Puerto Rico's Bleak Options*, BARRONS (July 12, 2014, 2:37 AM), <http://www.barrons.com/articles/SB50001424053111903684104580015233972245568> (describing any potential U.S. government bailout of Puerto Rico as "tossing greenbacks at fiscally irresponsible communities" and comparing the situation in Puerto Rico to the Mexican-American border crisis, cynically suggesting that "residents move en masse to the mainland—producing the type of humanitarian crisis Obama would toss money at"); Louis, *supra* note 10 (noting the "irresponsibility of the island's political leaders and their Wall Street enablers" as an important factor in the current economic crisis).

31. See, e.g., Lisa Lerer, *Obama Economic Advisory Team Said to Aid Puerto Rico*, BLOOMBERG (Nov. 20, 2013, 6:26 PM), <http://www.bloomberg.com/news/articles/2013-11-20/obama-economic-advisory-team-said-to-aid-puerto-rico-on-f> (describing a U.S. government dispatch of financial advisors to provide fiscal management advice and suggesting that ongoing U.S. assistance has taken many forms).

32. See, e.g., *Buying on Credit Is So Nice*, ECONOMIST (Nov. 23, 2013), <http://www.economist.com/node/21590501> (referencing a song from *West Side Story*—a Broadway musical portraying Puerto Ricans in New York City—in the title, and beginning with a description of Puerto Rico's bustling Plaza Las Americas mall, suggesting that Puerto Ricans spend freely while the government slides deeper into insolvency); see also Mary Anastasia O'Grady, *Puerto Rico's Borrowing Bubble Pops*, WALL STREET J. (July 6, 2014, 6:04 PM), <http://www.wsj.com/articles/mary-ogrady-puerto-ricos-borrowing-bubble-pops-1404684277> (describing Puerto Rico as a "big-government paradise . . . running out of other people's money" and comparable to a drug addict: "high on cheap money from American creditors").

Such accounts implicitly and even explicitly adopt tired stereotypes of Latinos: shopping excessively on credit, anxious to maintain a sensual image, with little ambition to build and sustain successful enterprises. See generally, e.g., CHARLES

pursuing an unwise and unsustainable course, critics argue, the island has brought fiscal ruin unto itself; by holding itself out as a tax haven, Puerto Rico has now turned against its most generous benefactor.

Notwithstanding these enduring discourses on U.S. goodwill and patriarchy, history suggests a very different explanation. Puerto Rico has not simply chosen to shirk in the face of steadfast U.S. assistance; rather, the Commonwealth's present difficulties are the result of more than a century of expansionary fiscal and monetary U.S. policies. Early in U.S.-Puerto Rican relations, U.S. officials rewrote Puerto Rican tax laws to serve U.S. economic interests. In more recent years, U.S. tax laws reflecting mainland economic interests have been imposed on Puerto Ricans, who lack voting rights and full, democratic representation in the U.S. Congress.³³ In essence, the United States has, for more than one hundred years, practiced an understudied form of economic imperialism in Puerto Rico. The United States has used tax laws to advance U.S. corporate interests, deny Puerto Rico's economic and political self-determination, and cripple Puerto Rican enterprise. Consequently, the island still has difficulty raising revenue through taxation; it has generated significant operating deficits and has borrowed heavily to perform critical government functions.

To be sure, not all of the harmful tax and economic policies imposed by the United States reflect deliberate attempts to promote mainland economic interests at the expense of Puerto Rican growth. The story of U.S. involvement in Puerto Rico is far more nuanced. Some laws and policies were motivated, in whole or in part, by white paternalism and other forms of racism.³⁴ At other times, the United

RAMÍREZ BERG, LATINO IMAGES IN FILM: STEREOTYPES, SUBVERSION, AND RESISTANCE 81–82 (2002) (addressing the highly offensive and persistent stereotype of the “lazy Latino”); STEPHANIE GRECO LARSON, MEDIA & MINORITIES: THE POLITICS OF RACE IN NEWS AND ENTERTAINMENT 60–62 (2006) (discussing common stereotypes of Latina women in mainstream film and media); Cynthia Kwei Yung Lee, *Race and Self-Defense: Toward a Normative Conception of Reasonableness*, in CRITICAL RACE THEORY: THE CUTTING EDGE (Jean Stefancic, ed., 2d ed. 2000) (discussing Latino stereotypes broadly, and their undertreatment in legal scholarship). But see generally Dania Alexandrino, *Study: Puerto Rico’s Children Mired in Poverty That Dwarfs Rest of U.S.*, CNN (Aug. 1, 2012), <http://www.cnn.com/2012/08/01/us/puerto-rico-child-poverty> (reporting that, contrary to the assumption of a lavish lifestyle on the island, many Puerto Ricans, including eighty percent of Puerto Rican children, live in poverty).

33. See *supra* note 15 and accompanying text (describing the island’s limited right to participate in Congress via its Resident Commissioner).

34. See *infra* notes 273–82 and accompanying text (providing specific examples of Senator Vardaman’s racist commentary regarding U.S. citizenship for Puerto Ricans and a triple tax exemption for Puerto Rican government bonds).

States simply acted with indifference, paying little attention to the economic effects of its laws and policies on Puerto Rican development.³⁵ But regardless of the specific motivations, the primarily self-interested tax laws put into place by the United States with respect to the captive and disenfranchised island territory have had the cumulative effect of leaving Puerto Rico financially and economically crippled. Considering that the Founding Fathers' chief grievance with Great Britain concerned the imposition of tax laws that were detrimental to the interests of the American colonies,³⁶ our subsequent interventions in Puerto Rico—whether driven by malice, greed, neglect, or indifference—are especially disquieting. In this way, this Article joins a chorus of scholars,³⁷ literary figures,³⁸ political

35. See *infra* notes 329–32 and accompanying text (noting other motivating factors behind U.S. policy decisions unrelated to Puerto Rico).

36. See generally CHARLES ADAMS, FOR GOOD AND EVIL: THE IMPACT OF TAXES ON THE COURSE OF CIVILIZATION 297–306 (1st ed. 1993) (outlining colonial America's view on taxes from 1765 to 1778); HENRY M. GLADNEY, NO TAXATION WITHOUT REPRESENTATION: 1768 PETITION, MEMORIAL, AND REMONSTRANCE 1–4 (2014).

37. See generally LAURA BRIGGS, REPRODUCING EMPIRE: RACE, SEX, SCIENCE, AND U.S. IMPERIALISM IN PUERTO RICO (2002) (exploring U.S. imperialism in Puerto Rico through racial as well as sex-related discourses, including sexuality, reproductive patterns, and family arrangements); COLONIAL DILEMMA: CRITICAL PERSPECTIVES ON CONTEMPORARY PUERTO RICO (Edwin Meléndez & Edgardo Meléndez eds., 1993) (situating modern political and economic conflicts in Puerto Rico within a broader neocolonial context); PEDRO A. MALAVET, AMERICA'S COLONY: THE POLITICAL AND CULTURAL CONFLICT BETWEEN THE UNITED STATES AND PUERTO RICO (2004) (critiquing U.S. imperialism in Puerto Rico and thoughtfully analyzing alternatives to its present colonial status); JOSÉ TRÍAS MONGE, PUERTO RICO: THE TRIALS OF THE OLDEST COLONY IN THE WORLD (1999) (arguing for liberation of the island colony from American oversight based on his experiences as Puerto Rico's Attorney General and its Supreme Court Chief Justice); EFRÉN RIVERA RAMOS, THE LEGAL CONSTRUCTION OF IDENTITY: THE JUDICIAL AND SOCIAL LEGACY OF AMERICAN COLONIALISM IN PUERTO RICO (2001) (detailing the role of the American judicial system in advancing U.S. imperial goals in Puerto Rico); José Julián Alvarez-González, *Law, Language and Statehood: The Role of English in the Great State of Puerto Rico*, 17 LAW & INEQ. 359, 360–61 (1999) (considering the role of language in restraining Puerto Rico's right to self-determination); Ediberto Román, *Empire Forgotten: The United States's Colonization of Puerto Rico*, 42 VILL. L. REV. 1119, 1120–26 (1997) (contrasting purported U.S. commitments to human rights and self-governance, on the one hand, with its colonization of Puerto Rico, on the other).

38. See, e.g., JESÚS COLÓN, THE WAY IT WAS AND OTHER WRITINGS 71 (1993) (decrying U.S. imperialism in Puerto Rico and its accompanying “agricultural slavery, monoculture, absenteeism and rank human exploitation”); LUIS RAFAEL SÁNCHEZ, LA GUARACHA DEL MACHO CAMACHO (1976) (confronting U.S. cultural imperialism); ESMERALDA SANTIAGO, WHEN I WAS PUERTO RICAN 63–83 (1993) (offering a subtle critique of the U.S. colonization of the island nation through public health and educational outreach initiatives).

activists,³⁹ and other Puerto Rican and mainland critics⁴⁰ who have denounced the indefensible and unjust nature of U.S. interventions in Puerto Rico. To this rich body of work, this Article contributes historical and legal analysis, demonstrating precisely how U.S. domination over the island's tax and fiscal policies has been the centerpiece of a colonial system and an especially destructive form of economic imperialism.⁴¹

As a case study, the Puerto Rican story demonstrates how systems of taxation can facilitate a more complex, broader pattern of economic subordination. It reveals how more powerful governments are able to use tax laws to not only redistribute wealth within their own boundaries, but to also redirect the flow of capital globally in order to help large corporations fulfill their manifest destiny. Such policies have the effect of enriching corporate and financial interests at the expense of developing economies. The implications are not only relevant to the study of U.S.-Puerto Rican relations; they shed new light upon the dealings of more powerful governments and the taxing jurisdictions they have been able to dominate—whether by political right, or by cultural, military, or socio-economic fiat. In particular, the analysis may help us to understand the relationships between the United States and its other possessions and territories throughout history,⁴² and between other imperial rulers and their colonies, such as the United Kingdom and its British Crown

39. See, e.g., ALFREDO LÓPEZ, DOÑA LICHA'S ISLAND: MODERN COLONIALISM IN PUERTO RICO 1–7 (1987) (exploring the negative effects of U.S. colonialism in Puerto Rico and on the mainland); see also, e.g., JOSÉ DE DIEGO, NUEVAS CAMPAÑAS: INDEPENDENCIA DE PUERTO RICO UNIÓN ANTILLANA SOLIDARIDAD IBERO-AMERICANA (1916) (urging the Puerto Rican people to resist the influence of the United States and preserve their national identity); VICENTE BALBÁS CAPÓ, PUERTO RICO A LOS DIEZ AÑOS DE AMERICANIZACION (1910) (opposing U.S. political and economic control in Puerto Rico).

40. For example, the legendary Puerto Rican composer, Rafael Hernández Marín, lamented the “tyrant” who rules Puerto Rico in his 1937 song, *Preciosa*. See *Precious*, LYRICS TRANSLATE, <http://lyricstranslate.com/en/preciosa-precious.html> (last visited Oct. 26, 2015); see also José Luis Gonzalez, *The “Lamento Borincano”*, in BORICUAS: INFLUENTIAL PUERTO RICAN WRITINGS—AN ANTHOLOGY 48–49 (Roberto Santiago ed., 1995) [hereinafter BORICUAS] (describing the messages of political protest that are reflected in Hernández Marín’s work).

41. See Victor M. Rodriguez, *Puerto Rico and Wall Street’s 21st Century Debt Peonage Imperialism*, COUNTERPUNCH (Feb. 19, 2014), <http://www.counterpunch.org/2014/02/19/puerto-rico-and-wall-streets-21st-century-debt-peonage-imperialism> (arguing similarly, that U.S. tax policies in Puerto Rico have had damaging long-term effects on the local economy).

42. See generally Bruce Leiserowitz, *Coordination of Taxation between the United States and Guam*, 1 INT'L TAX & BUS. LAW 218 (1983) (observing similar patterns with respect to U.S. tax policies in Guam). Such a theory might also be relevant to states that were initially annexed as territories.

dependencies, overseas territories, and newly-independent colonies. Of course, tax imperialism and other forms of economic subordination are by no means creatures of the past or limited to situations of quasi-colonial territorial control: they are features of North-South relations that remain ubiquitous.⁴³ Thus, there is much to learn from the Puerto Rican experience.

This Article proceeds in three parts. Part I introduces the concept of tax imperialism and situates it within the broader literature on economic imperialism. Part II engages in a robust historical and legal analysis to construct a detailed account of U.S.-Puerto Rican political and economic relations. Specifically, this Part focuses on the major U.S. tax and economic policies that have impacted Puerto Rican development, identifying in the process three distinct stages of U.S. tax imperialism with respect to the island. Part III considers the ways in which a more broadly applicable theory of tax imperialism might help us to understand the complex relationships between more and less powerful taxing authorities. This Article concludes by stressing the need for Puerto Rican economic self-sufficiency in the future.

I. A THEORY OF U.S. TAX IMPERIALISM

Imperialism is generally defined as an ongoing process of aggressive state action to exert control over another nation.⁴⁴ Throughout history, states have used military intervention to achieve such control. But in the modern age of neocolonialism, states have used less formal, but nonetheless invasive, mechanisms to gain influence over target nations' cultural, economic, and legal affairs.⁴⁵ As dependency theory underscores in its rejection of modernization theory,⁴⁶

43. For a detailed discussion of economic policies that have negatively impacted the global South, see generally JOSEPH E. STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* (2002).

44. See generally, e.g., J.A. HOBSON, *IMPERIALISM: A STUDY* (5th ed. Ann Arbor ed., 1978) (explaining in detail imperialism and its history); VLADIMIR I. LENIN, *IMPERIALISM, THE HIGHEST STAGE OF CAPITALISM* (1917) (critiquing imperialism).

45. See, e.g., JEAN-PAUL SARTRE, *COLONIALISM AND NEOCOLONIALISM* 1–15 (Azzedine Haddour et al. trans., 2001) (setting forth Sartre's analysis of colonialism and neocolonialism, and arguments for decolonization).

46. See DAVID E. APTER, *RETHINKING DEVELOPMENT: MODERNIZATION, DEPENDENCY, AND POSTMODERN POLITICS* 7–11 (1987) (explaining modernization theory, and arguing that it is important despite being a confusing and constantly changing concept); see also Rumu Sarkar, *Critical Essay: Theoretical Foundations in Development Law: A Reconciliation of Opposites?*, 33 DENV. J. INT'L L. & POL'Y 367, 367–68 (2005) (acknowledging the historical tensions between modernization theory and dependency theory); Jane Kaufman Winn, Book Review, *How to Make Poor Countries*

blame for the plight of developing nations ought to be assigned to the powerful states, whose imperialist interventions create dependencies.⁴⁷

Classic works in the social sciences reveal how powerful states, such as the United States, exert control over weaker states in order to extract resources and advance their own economic interests. Scholarship has focused on economic imperialism's negative effects on labor and infrastructure within developing regions,⁴⁸ and on the role of states, multinational corporations, nongovernmental organizations, and other actors in advancing the interests of powerful regimes.⁴⁹ Drawing upon the closely-related world systems theory,⁵⁰ these works tend to show that imperialism by its very nature poorly integrates developing nations into the global market, leaving them suspended in a state of dependency, with only a peripheral role to play in the world economy.⁵¹

Rich and How to Enrich Our Poor, 77 IOWA L. REV. 899, 908 (1992) (reviewing HERNANDO DE SOTO, THE OTHER PATH (1987)) (explaining that dependency theory reasons that Latin American nations' economies have failed because development has been "twisted toward the interests of a small number of local businesses and the multinational corporations with whom they cooperate" instead of toward the common good of the nation).

47. See, e.g., FERNANDO HENRIQUE CARDOSO & ENZO FALETTO, DEPENDENCY AND DEVELOPMENT IN LATIN AMERICA 1–7 (1979) (arguing that Northern pressures toward "modernization" caused several South American countries' economies to fail during the mid-twentieth century).

48. See, e.g., Andre Gunder Frank, *The Development of Underdevelopment*, MONTHLY REV., Sept. 1966, at 17 (arguing that the expansion of capitalism has generated underdevelopment in some parts of the world while spurring economic development in others); Arno Tausch, *Social Cohesion, Sustainable Development and Turkey's Accession to the European Union: Implications from a Global Model*, 2 TURKISH J. INT'L REL. 1, 1–3 (2003) (highlighting that income distribution around the world has worsened with globalization); see also Tayyab Mahmud, *Migration, Identity, & the Colonial Encounter*, 76 OR. L. REV. 633, 634–35 (1997) (categorizing migration as one collateral consequence of imperial rule).

49. See generally MORAL IMPERIALISM: A CRITICAL ANTHOLOGY (Berta Esperanza Hernández-Truyol ed., 2002) (containing numerous essays that explore these themes).

50. See Immanuel Wallerstein, *The Rise and Future Demise of the World Capitalist System: Concepts for Comparative Analysis*, 16 COMP. STUD. SOC'Y & HIST. 387, 390 (1974) (describing world systems "as . . . unit[s] with a single division of labor and multiple cultural systems," and reasoning that there can be two types: world systems with a common political system, and those without); Winn, *supra* note 46, at 908 (explaining that world systems theory "divides the world into core and peripheral areas" and argues that economic relations between core and peripheral areas are formed on terms that favor only the core areas).

51. See generally Francis G. Snyder, *Law and Development in the Light of Dependency Theory*, 14 LAW & SOC'Y REV. 723 (1980) (suggesting, tentatively, that research on law in undeveloped countries should elaborate on Marxist theories of law); Winn, *supra* note

At the same time, a fundamental limitation of dependency theory has been its general unwillingness to seriously consider laws as the primary method of achieving imperialist ends.⁵² Dependency theory has also attracted a number of other criticisms. Some argue that the theory neglects to explain the ostensible economic growth and industrial development that has taken place throughout much of the developing world, including within regions that were once colonized.⁵³ Others assert that, in assigning blame to the dominant state, the theory also fails to take into account the role of factors unique to the subordinated one, such as quality and quantity of natural resources, the nature of the prevailing political and economic culture, and levels of education.⁵⁴ In essence, critics argue that the theory focuses too much upon the “dyadic relations between nations.”⁵⁵

While modern works in economics, history, sociology, political science, and law increasingly blend dependency theory with a more thoughtful critique of factors specific to each developing nation, there continues to be a relative dearth of scholarship identifying the precise legal mechanisms that create and regulate economic dependencies.⁵⁶ Even less attention has been given to the use of *tax* laws—of both the dominant state and the target nation—to achieve economic imperialistic ends.⁵⁷ Nevertheless, as evidenced by the so-

46, at 908 (explaining the linkages between dependency theory and world systems theory).

52. See Sarkar, *supra* note 46, at 373 (stating that dependency theorists consider law secondary to economics because of Marx’s theory “that law constitutes the superstructure to the underlying structure of economics”). But see generally ASSAF LIKHOVSKI, LAW AND IDENTITY IN MANDATE PALESTINE (2006) (exploring laws as instruments of British power in mandate Palestine).

53. Snyder, *supra* note 51, at 734.

54. See, e.g., James Thuo Gathii, *Retelling Good Governance Narratives on Africa’s Economic and Political Predicaments: Continuities and Discontinuities in Legal Outcomes Between Markets and States*, 45 VILL. L. REV. 971, 996 (2000) (critiquing traditional dependency theory by pointing out the flaw that “the influence of outside control as the source of problems in Africa was unduly overstated, while internal issues were unduly trivialized”).

55. Harriet Friedmann & Jack Wayne, *Dependency Theory: A Critique*, 2 CAN. J. SOC. 399, 402 (1977).

56. But see Carmen G. Gonzalez, *An Environmental Justice Critique of Comparative Advantage: Indigenous Peoples, Trade Policy, and the Mexican Neoliberal Economic Reforms*, 32 U. PA. J. INT’L L. 723, 746–55 (2011) (examining the impact of the North American Free Trade Agreement, and of International Monetary Fund and World Bank structural adjustment policies, on Mexico).

57. Notable recent exceptions include LEIGH A. GARDNER, TAXING COLONIAL AFRICA: THE POLITICAL ECONOMY OF BRITISH IMPERIALISM (2012), ALVIN RABUSHKA, TAXATION IN COLONIAL AMERICA (2008), and Assaf Likhovski, *Is Tax Law Culturally Specific? Lessons from the History of Income Tax Law in Mandatory Palestine*, 11 THEORETICAL INQUIRIES L. 725 (2010).

called “Shoup missions” to reconstruct tax laws in—among other places—France, Cuba, and post-World War II Japan, U.S. representatives have directly participated in drafting internal revenue codes around the globe.⁵⁸ Meanwhile, the U.S. Tax Code⁵⁹ itself continues to exert undeniable influence over the investment decisions of U.S. firms and their counterparts in developing nations.⁶⁰ Further compounding matters, the United States wields considerable power over the international tax coordination activities of prominent nongovernmental organizations.⁶¹ Yet, scholars still do not completely understand the nature and extent of U.S. influence over other taxing jurisdictions; nor do we fully comprehend the collateral and direct consequences of the countless historical and ongoing intrusions. By focusing on a particularly rich case study, this Article helps to fill this void in the social science and legal literature, tackling questions that demand equal parts rigorous tax analysis and deep understanding of U.S. and Puerto Rican history.

The following sections develop a theory of U.S. “tax imperialism,”⁶² using U.S.-Puerto Rican relations throughout history to demonstrate

58. See generally THE POLITICAL ECONOMY OF TRANSNATIONAL TAX REFORM: THE SHOUP MISSION TO JAPAN IN HISTORICAL CONTEXT (W. Elliot Brownlee et al. eds., 2013) (discussing the development of the U.S. tax reform initiative); W. Elliot Brownlee, *The Shoup Mission to Japan: Two Political Economies Intersect*, in THE NEW FISCAL SOCIOLOGY: TAXATION IN COMPARATIVE AND HISTORICAL PERSPECTIVE 237, 240–43 (Isaac William Martin et al. eds., 2009).

59. All references herein to the U.S. Tax Code are to the Internal Revenue Code of 1986 (codified as amended at 26 U.S.C. (2012)).

60. Robert Hellawell, *United States Income Taxation and Less Developed Countries: A Critical Appraisal*, 66 COLUM. L. REV. 1393, 1423 (1966) (discussing U.S. Tax Code provisions that reward businesses for investing in less-developed countries, while doing little to help those countries).

61. See, e.g., Yariv Brauner & Miranda Stewart, *Introduction: Tax, Law and Development*, in TAX, LAW AND DEVELOPMENT 3, 9 (Yariv Brauner & Miranda Stewart eds., 2013) (cautioning that international tax coordination often leads to tragic economic and tax policy choices by developing nations); Allison Christians, *Sovereignty, Taxation and Social Contract*, 18 MINN. J. INT'L L. 99, 99 (2009) (considering the rising influence of non-governmental organizations, such as the Organization for Economic Cooperation and Development, in coordinating tax policies across international jurisdictions).

62. The phrase “tax imperialism” has been used in recent years by academics and journalists to critique taxation of citizens’ worldwide income. See, e.g., Bernard Schneider, *The End of Taxation Without End: A New Tax Regime for U.S. Expatriates*, 32 VA. TAX REV. 1, 53 (2012) (defining tax imperialism as the “worldwide taxation of nonresidents”); Jeffrey Goldfarb, *U.S. Should Scale Back Tax Imperialism*, CNN (Oct. 7, 2009, 12:28 PM), http://money.cnn.com/2009/10/07/pf/taxes/obama_international_taxes_breakingviews. However, this Article uses the phrase to refer to a much more specific historical phenomenon.

how the United States has used tax laws to exert economic dominance over the island. The United States engaged in three distinct stages of tax imperialism in Puerto Rico. In stage one, which lasted from 1898 through 1919, the United States evaluated—and ultimately dismantled—Puerto Rico's extant system of taxation, which was itself an instrument of Spanish colonial rule, constructing in its place an entirely new system. This fiscal reconstruction was not carried out simply to remedy injustices, increase revenues, and stimulate Puerto Rican enterprise; rather, the changes were calculated to provide an ideal environment for large U.S. corporations doing business on the island. In stage two, which extended from 1920 through 1974, the United States promulgated, maintained, and encouraged tax and economic policies that designated the island as a lower-cost provider of manufacturing inputs used to improve the global competitiveness of U.S. corporations. In stage three, which commenced in 1975 and continues to the present day, the United States has struggled to defend its corporate tax base and regain control over large accumulations of American capital in Puerto Rico. As international capital markets have rapidly developed and expanded, and as corporate tax planning methods have grown more sophisticated, tax policies have abruptly shifted. Current U.S. policies reflect a new emphasis on facilitating the free flow of U.S. corporate wealth from Puerto Rico back into the United States, and on impeding large-scale outflow of capital from Puerto Rico to burgeoning international tax haven countries. The following Part provides a detailed account of each of these stages, constructing in the process a model of tax imperialism that is potentially applicable far beyond the U.S.-Puerto Rican experience.

II. THREE HISTORICAL STAGES OF U.S. TAX IMPERIALISM IN PUERTO RICO

The analysis necessarily begins with a review of the earliest days of U.S. dominance over Puerto Rico. Spain possessed Puerto Rico from the early-sixteenth century until the conclusion of the Spanish-American War in 1898.⁶³ For the United States, the acquisition of Puerto Rico was economically and strategically valuable, particularly in light of the then increasing interest in tropical goods.⁶⁴ The island had

63. See LÓPEZ, *supra* note 39, at 9–28 (describing Puerto Rico's Spanish colonial history); Treaty of Peace, U.S.-Spain, art. II, Dec. 10, 1898, 30 Stat. 1754 [hereinafter Treaty of Paris] (transferring Puerto Rico from Spain to the United States).

64. O. P. Austin, *Our Trade with Hawaii and Porto Rico*, 19 ANNALS AM. ACAD. POL. & SOC. SCI. 377, 377 (1902).

the potential to serve as both a lower-cost provider of raw materials and as a site for future U.S. naval ports. As one observer explained:

The United States buys from abroad every day of the year a million dollars' worth of tropical products, and if it can buy these or any considerable part of them in its own territory, it will benefit not only the population of that territory, but incidentally the people of the United States, whose capital is or may be invested in the new fields, as well as the great manufacturing and producing elements of our community[,] by opening an increased market for our products.⁶⁵

In the late-nineteenth and early-twentieth centuries, the sugar industry was an especially important global business that relied upon access to tropical products.⁶⁶ Those who owned the means of growing, refining, and trading in cane sugar were some of the wealthiest and most politically powerful persons of the day.⁶⁷ However, because U.S. refineries imported large amounts of raw and partially refined cane sugar from foreign countries, their businesses were extremely sensitive to tariff laws.⁶⁸ Thus, the acquisition of Puerto Rico was a pivotal moment for American refineries, dramatically expanding access to lower-cost and tariff-free raw sugar.⁶⁹

For Puerto Ricans, however, the timing of the acquisition could not have been worse. After a long struggle, Puerto Ricans had finally secured some autonomy from Spanish rule in 1897.⁷⁰ *La Carta Autonómica*⁷¹ promised suffrage to all male Puerto Ricans and authorized the island to participate in trade negotiations and to

65. *Id.*

66. See F. R. Rutter, *The Sugar Question in the United States*, 17 Q. J. ECON. 44, 44 (1903) (stating that at the time the article was written, the U.S. sugar industry was divided into three separate factions: the cane sugar growers in the Deep South, the beet sugar factories in the West and the North, and the sugar refiners, mostly based in the Northeast).

67. See, e.g., ANDREA STUART, SUGAR IN THE BLOOD: A FAMILY'S STORY OF SLAVERY AND EMPIRE 151–54 (2012) (exploring the history of sugar trade in Barbados through the lens of one family's story). See generally MATTHEW PARKER, THE SUGAR BARONS: FAMILY, CORRUPTION, EMPIRE, AND WAR IN THE WEST INDIES (2011) (providing an historical account of sugar trade in the West Indies and its broader role in the global economy).

68. JAMES L. DIETZ, ECONOMIC HISTORY OF PUERTO RICO: INSTITUTIONAL CHANGE AND CAPITALIST DEVELOPMENT 103–05 (1986).

69. *Id.*

70. See José Trías Monge, *La Carta Autonómica de 1897: Cien Años Después*, 67 REVISTA JURIDICA UNIVERSIDAD DE PUERTO RICO (REV. JUR. U. P.R.) 973 (1998) (reflecting upon the promised autonomous regime).

71. Not even a year before the U.S. invasion, Spain had finally relaxed its colonial grip on Puerto Rico pursuant to an autonomous constitution, *La Carta Autonómica* (the Autonomic Charter), which authorized a new insular government to rule on matters of local concern. See *id.*

stipulate tariffs.⁷² Before Puerto Ricans could develop an autonomous regime, however, Spain transferred the island to another colonial power, the United States.

Pursuant to the Treaty of Peace between the United States and Spain (Treaty of Paris), through which the United States acquired Puerto Rico, and in accordance with its constitutional power to oversee any “Territory or other Property belonging to the United States,”⁷³ Congress assumed direct control over Puerto Rico.⁷⁴ Initially, the United States placed Puerto Rico and its inhabitants under military rule.⁷⁵ Throughout the early part of the twentieth century, the United States not only dictated political relations with Puerto Rico, but also orchestrated a full-scale fiscal restructuring by instituting a series of military orders, legislative enactments, judicial decisions, and executive actions. Although often accompanied by humanitarian rhetoric, these refinements primarily reflected a desire to maintain the competitiveness of U.S. corporations in an increasingly global economy.⁷⁶

From the beginning, the United States portrayed itself to the Puerto Rican people as a benevolent patriarch. For instance, in his proclamation to the island’s inhabitants after leading the U.S. invasion in the Spanish-American War, Major General Nelson Miles of the U.S. Army articulated the “noble purpose” of the U.S. government to “give the people of [the] beautiful island the largest measure of liberty.”⁷⁷ General Miles further explained that the United States would bring protection to person and property, while promoting prosperity.⁷⁸ He wrote, “It is not our purpose to interfere with any existing laws and customs that are wholesome and beneficial to your people[,] so long as they conform to the rules of military administration of order and justice.”⁷⁹ Rather, the U.S. military

72. *Id.* The concession may have been nothing more than a desperate move by Spain, which could have been revoked at a later date; thus, Puerto Ricans were certainly not insulated from future Spanish repression.

73. U.S. CONST. art. IV, § 3, cl. 2.

74. Treaty of Paris, *supra* note 63, art. IX, 30 Stat. at 1759.

75. JUAN CRUZ-RICART, A BRIEF HISTORY OF PUERTO RICO 1800–2008, at 67 (2013) (reprinting portions of Military Governor of Puerto Rico John B. Brooke’s Executive Order, which established military rule over Puerto Rico).

76. See *infra* Part II.A–B (describing the first two stages of U.S. tax imperialism in Puerto Rico).

77. THE SPANISH-AMERICAN WAR: THE EVENTS OF THE WAR DESCRIBED BY EYE WITNESSES 192 (Herbert S. Stone & Co. 1899) [hereinafter THE SPANISH-AMERICAN WAR].

78. *Id.*

79. *Id.*

would confer upon the island nation “the advantages and blessings of enlightened civilization.”⁸⁰ Back at home, Republican Congressman Marriott Brosius explained, “[O]ur duty in respect to [the Puerto Ricans] is so clear as to be free from difficulty. We must take care of them until they can take care of themselves.”⁸¹

But, after centuries of Spanish rule that exacted a heavy toll on the island’s natural resources⁸² and had an especially devastating impact on Puerto Rican society,⁸³ the American takeover had almost immediate negative economic consequences. Prior to the cession, Puerto Rico traded heavily on a tariff-free basis with Spain and Cuba. Following the war, Puerto Rico found itself shut off from these markets,⁸⁴ leading Brigadier-General George W. Davis to acknowledge in 1899 that “American sovereignty for Puerto Rico has so far been disastrous to its commerce, for it has deprived the island of [the] markets where[in] [] nearly one-half of its total output”⁸⁵ was sold. Further compounding matters, the island initially faced high tariffs for trade with the United States, effectively shutting it off from U.S. markets as well.⁸⁶ For these and related reasons, writers for the

80. *Id.*

81. Marriott Brosius, *The Ethics of Expansion*, reprinted in MEN AND ISSUES OF 1900: THE VITAL QUESTIONS OF THE DAY 76 (James P. Boyd ed., 1900).

82. See, e.g., Thomas E. Benner, *American Difficulties in Porto Rico*, 8 FOREIGN AFF. 609, 609 (1930) (highlighting that the Spanish “exhausted” the island’s gold mines and the United States did not discover any further mineral resources).

83. Of course, the social, political, and economic impacts of centuries of Spanish colonial rule cannot be reduced to any one or several legacies. But among the countless negative consequences of colonial rule, the introduction of slavery stands as a particularly noteworthy one. See, e.g., ENCYCLOPEDIA OF THE AFRICAN DIASPORA: ORIGINS, EXPERIENCES, AND CULTURE 773–74 (Carole Boyce Davies ed., 2008) (explaining the history of slavery in Puerto Rico); Alejandro Tapia y Rivera, *African Slavery*, in THE INTELLECTUAL ROOTS OF INDEPENDENCE: AN ANTHOLOGY OF PUERTO RICAN POLITICAL ESSAYS 54–61 (Iris M. Zavala & Rafael Rodríguez eds., 1980) (highlighting Spain’s introduction of slavery, which caused particularly damaging and persisting racial tensions and injustices on the island); see also RUBY ROHRLICH LEAVITT, THE PUERTO RICANS: CULTURE CHANGE AND LANGUAGE DEVIANC 42 (1974) (describing how Spanish colonial rule nearly destroyed Puerto Rico’s native population through enslaving them and forcing them to assimilate to Spanish culture).

84. See THE INSULAR CASES, COMPRISING THE RECORDS, BRIEFS, AND ARGUMENTS OF COUNSEL IN THE INSULAR CASES OF THE OCTOBER TERM, 1900, IN THE SUPREME COURT OF THE UNITED STATES, INCLUDING THE APPENDICES THERETO, H.R. DOC. NO. 509, at 737 (2d Sess. 1901) (explaining how Spain erected its tariff wall immediately, even before ratifying the Treaty of Paris).

85. REPORT OF BRIGADIER-GENERAL GEORGE W. DAVIS ON CIVIL AFFAIRS OF PUERTO RICO 34 (1899).

86. See LAIRD W. BERGAD, COFFEE AND THE GROWTH OF AGRARIAN CAPITALISM IN NINETEENTH-CENTURY PUERTO RICO 204 (1983) (explaining how the sudden lack of

New York Times would remark in 1903 that Puerto Rico “has not prospered under the rule of the United States,” and that “[i]t was far better off when Spain governed it.”⁸⁷ As the following section reveals, the island’s economic struggles were further amplified by a U.S.-imposed fiscal reconstruction.

A. Stage One of U.S. Tax Imperialism in Puerto Rico, 1898–1919

Notwithstanding General Miles’ assurance that the United States would not unnecessarily interfere with Puerto Rican laws and customs,⁸⁸ “[t]he American commanding general . . . at once exercised his power of legislation, and statute after statute was abrogated. These were generally tax laws . . .”⁸⁹ The regime later explained that it “found in force a system of taxes and public duties unlike any that had existed in the United States.”⁹⁰ Although the economic preferences of the previous Spanish colonial regime and the new U.S. imperial power were similar in many respects, the island’s extant tax system would require numerous adjustments before it could serve U.S. economic interests. In going about this fiscal reconstruction, American policymakers strived to align Puerto Rico’s tax laws with prevailing U.S. theories of taxation⁹¹ and to provide the ideal economic setting for U.S. corporations doing business in Puerto Rico. Meanwhile, in public debate and promotional materials, policymakers relied upon moral preaching to justify changes, establishing a pattern for public discourse on U.S.-Puerto Rican fiscal relations that continues to the present day.⁹²

access to foreign markets was especially devastating to the island’s coffee industry).

87. *Porto Rico Not Prospering Under United States Rule*, N.Y. TIMES, Oct. 4, 1903.

88. THE SPANISH-AMERICAN WAR, *supra* note 77, at 192.

89. ANNUAL REPORTS OF THE WAR DEPARTMENT FOR THE FISCAL YEAR ENDED JUNE 30, 1900: REPORT OF THE MILITARY GOVERNOR OF PORTO RICO ON CIVIL AFFAIRS, at 41 (1902).

90. *Report of the Treasurer of Porto Rico*, reprinted in ANNUAL REPORT OF THE GOVERNOR OF PORTO RICO FOR THE FISCAL YEAR ENDING JUNE 30, 1907, at 62 (1907) [hereinafter *Report of the Treasurer* (1907)].

91. See Paul Salamone, *Constitutional Separation and the Foraker Act: How They Influenced Puerto Rico’s Tax Reform from 1898–1901 and Led to the Adoption of the Import Excise and Property Tax*, 64 REVISTA DEL COLEGIO DE ABOGADOS DE PUERTO RICO (REV. COL. ABOG. P.R.) 34, 36 (2003) (describing Puerto Rico’s tax system as a “modified version of the federal import excise”).

92. See discussion *infra* Part III.C (providing a discussion of U.S. tax imperialism in Puerto Rico from 1975 to the present).

1. U.S. evaluation of Puerto Rico's extant system of taxation

In 1899, Dr. Henry K. Carroll, a U.S. Special Commissioner to Puerto Rico sent by President William McKinley to examine civil affairs on the island and, in particular, to evaluate the system of taxation,⁹³ opined that while Puerto Rico had no public debts and had even been in a position to lend money to Spain to support the war in Cuba,⁹⁴ its tax laws were quite different from those in place on the mainland.⁹⁵ Under Spanish rule, insular revenues were obtained primarily through indirect taxes⁹⁶ in the form of customs duties and stamp taxes. The municipal governments similarly relied upon indirect taxes, largely in the form of excise taxes⁹⁷ on food stuffs, fuel, and other articles of consumption,⁹⁸ called *consumo*⁹⁹ taxes. Additionally, the government relied on lotteries and some direct taxes,¹⁰⁰ including fees for the issuance of personal identification

93. *Reforms in Puerto Rico: Commissioner Carroll Returns and Tells of Conditions There*, N.Y. TIMES, Mar. 31, 1899.

94. H. K. Carroll, *What Has Been Done for Porto Rico Under Military Rule*, AM. MONTHLY REV. REV., July-Dec. 1899, at 705; see also *Report of the Treasurer of Porto Rico*, reprinted in WAR DEP'T, ANNUAL REPORTS, 1919, VOL. III, at 360–61 (1919) [hereinafter *Report of the Treasurer* (1919)] (reporting that although the Spanish Crown extended numerous tax breaks to European settlers in Puerto Rico, the island itself was financially self-sufficient for most of the nineteenth century).

95. Carroll, *supra* note 94, at 705.

96. In an economic sense, an “indirect tax” is one that is collected indirectly—such as through a merchant—rather than through a direct assessment upon the person who ultimately bears the economic burden of the tax. Generally speaking, indirect taxes are applied to particular *transactions*, such as purchases or sales, or imports and exports. Indirect taxes are generally believed to be more regressive, with the burden falling more heavily upon persons with fewer economic resources. See generally BENT HANSEN, THE ECONOMIC THEORY OF FISCAL POLICY 260–78 (P.E. Burke trans., 1958) (explaining direct versus indirect taxation).

97. Excise taxes are taxes “laid upon the manufacture, sale, or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges.” Flint v. Stone Tracy Co., 220 U.S. 107, 110 (1911).

98. The system of taxation in place in Puerto Rico at the time of the U.S. takeover is described in J.H. Hollander, *Excise Taxation in Porto Rico*, 16 Q. J. ECON. 187 (1902) [hereinafter Hollander, *Excise Taxation*]. See also J.H. Hollander, *The Finances of Porto Rico*, 16 POL. SCI. Q. 553 (1901) [hereinafter Hollander, *Finances of Porto Rico*]; *Report of the Treasurer* (1907), *supra* note 90, at 62–63 (describing Puerto Rico’s existing system of taxation).

99. See Robert W. Turner, *Consumo Taxes in Spain*, Sept. 12, 1889, in REPORTS FROM THE CONSULS OF THE UNITED STATES, H.R. MISC. DOC. NO. 232, at 338–39 (1st Sess. 1889) (explaining that “consumo” taxes are levied upon articles of consumption).

100. See *supra* note 96 and accompanying text (explaining that direct taxes are imposed upon each person, who remits the amount owed directly to the government).

papers and licenses on industrial and professional occupations.¹⁰¹ Finally, Puerto Ricans were subjected to a percentage tax upon net income derived from agricultural, forest, and pasture land, from the increase of livestock, and from rentals of urban property.¹⁰² This “territorial” tax was based on the net *income* of property, in comparison to property taxes on the mainland, which were based on assessed *value* of the property. In this way, the territorial tax was especially threatening to U.S. sugar corporations: it essentially functioned as an income tax on agricultural operations in Puerto Rico at a time in history when the federal government did not even have a comprehensive individual or corporate income tax.¹⁰³

In public comments, U.S. policymakers claimed that the Spanish system of taxation fell unfairly on Puerto Rico’s lower classes. Carroll critiqued the system as downright oppressive, commenting that “[t]he rule in Porto Rico¹⁰⁴ seems to have been to ‘pay as you go’ and to collect everything collectible. The wonder is that the people had anything left after paying the demands of the government.”¹⁰⁵ Carroll also suggested that the government’s policies were designed “to benefit [Spanish] manufacturers and producers” rather than the Puerto Rican people.¹⁰⁶ Similarly, Johns Hopkins University economist and Treasurer of Puerto Rico, Jacob Hollander, later noted that the “general policy of the Spanish administration in Porto Rico [was] economic exploitation,”¹⁰⁷ complaining that the Spanish system imposed a lighter burden upon the “financial, banking,

101. See *Annual Report of the Governor of Puerto Rico for the Fiscal Year Ending June 30, 1907* 62–63 (describing these and other components of Puerto Rico’s extant system of taxation).

102. See *Report of the Treasurer* (1907), *supra* note 90, at 62–63 (listing these and other miscellaneous sources of revenue, and describing the tax overall as a “territorial tax”); see also ROSA E. CARRASQUILLO, OUR LANDLESS PATRIA: MARGINAL CITIZENSHIP AND RACE IN CAGUAS, PUERTO RICO, 1880–1910, at 48 (2006) (describing the mechanisms for imposing the territorial tax in that area).

103. See *infra* notes 179–84; 254–56 and accompanying text (describing the eventual adoption of a comprehensive U.S. corporate excise tax in 1909 and the U.S. income tax in 1913); see also *infra* note 156 and accompanying text (explaining the more specific excise tax imposed upon the gross receipts of companies engaged in the sugar refining business).

104. Most American mainlanders misspelled the island’s name until the original Castilian spelling was officially recognized by the United States in Joint Resolution of May 17, 1932, 47 Stat. 158.

105. Carroll, *supra* note 94, at 705.

106. *Id.* at 706.

107. *Report of the Treasurer of Porto Rico, reprinted in FIRST ANNUAL REPORT OF CHARLES H. ALLEN, GOVERNOR OF PORTO RICO, COVERING THE PERIOD FROM MAY 1, 1900, TO MAY 1, 1901*, at 150 (1901) [hereinafter *Report of the Treasurer* (1901)].

exporting, importing, and distributive interests[, which] were almost exclusively in the hands of Spanish merchants," while imposing a higher burden upon "small retail and manufacturing activities[, which] were generally in the hands of Porto Ricans."¹⁰⁸ In a 1901 interview, Dr. José Celso Barbosa, a Puerto Rican physician and statehood activist, raised similar criticisms of the Spanish system: "the burden fell upon the poor people, who were in no position to make their protests heard."¹⁰⁹ With respect to the territorial tax on property, historian Rosa Carrasquillo recently identified similar failings through archival research in Caguas, Puerto Rico. Citing a number of documented injustices, she concluded that the "system was subject to manipulation, abuses, and discriminatory practices against people of the lower classes."¹¹⁰

To be sure, reproaches of this sort would resonate strongly with the U.S. public. Throughout the late-nineteenth and early-twentieth centuries, a growing populist movement¹¹¹ decried the U.S. government's heavy reliance upon indirect taxes.¹¹² Critics characterized tariffs and excise taxes on consumer products as regressive in nature, alleging that the burden fell primarily upon the lower classes.¹¹³ U.S. mainlanders had also widely protested the nineteenth century general property tax, which was "a highly politicized and polarizing levy... [as well as] extremely arbitrary in practice."¹¹⁴ Thus, the criticisms articulated by U.S. policymakers and Puerto Rican activists with respect to the island's Spanish colonial system of taxation were familiar and deeply sympathetic to mainland observers.

But, comments by Thomas Adams, a prominent tax scholar who consulted with the military government on Puerto Rican fiscal policy, reveal other, less-publicized U.S. trepidations over the then extant system of taxation. Lawmakers were not merely concerned with the plight of island workers and consumers. Appearing before the

108. *Id.*

109. *Porto Rican Conditions: Secretary Hunt Declares that the Outlook Is Encouraging*, N.Y. TIMES, June 4, 1901.

110. CARRASQUILLO, *supra* note 102, at 43.

111. See AYALA & BERNABE, *supra* note 1, at 25 (explaining the emergence of the populist movement); ROBERT C. McMATH, JR., AMERICAN POPULISM: A SOCIAL HISTORY 1877-1898, at 50-65 (1993) (same).

112. See AJAY K. MEHROTRA, MAKING THE MODERN AMERICAN FISCAL STATE: LAW, POLITICS, AND THE RISE OF PROGRESSIVE TAXATION, 1877-1929, at 2-3 (2013) (noting that the revenue system consisted mainly of indirect taxes on alcohol and tobacco and that the working class "bore the brunt" of these taxes).

113. *Id.* at 1-3.

114. *Id.* at 4.

American Economic Association in 1901, Adams discussed *consumo* taxes on sugar and other agricultural products shipped out of Puerto Rico and on coal brought into the island, which, he argued, using anecdotal evidence, were too high.¹¹⁵ He also suggested that Puerto Rico imposed higher licensing taxes on foreign importers than on Puerto Rican entrepreneurs.¹¹⁶ Finally, he criticized Puerto Rico's failure to levy excises on goods that were considered socially undesirable by U.S. standards, such as alcohol and tobacco.¹¹⁷ He expressed hope that under a U.S. system of taxation "the peon will get a little more codfish and a little less rum."¹¹⁸

Thus, the military government acted quickly to reconfigure Puerto Rico's system of taxation. It dismantled the previous bureaucratic structure and designated an office within the civil secretary's office to administer and collect taxes, which would be directed by Puerto Rican writer and historian, Dr. Cayetano Coll y Toste.¹¹⁹ American officials discontinued the government lottery, the *consumo* taxes, the stamp taxes, and many of the customs duties.¹²⁰

In 1907, Professor Hollander questioned the military government's sweeping changes, particularly its abolishment of successful Puerto Rican stamp taxes that had "yield[ed] considerable revenues without imposing an onerous burden on any particular class, and were actually less extensive than existent internal revenue taxes on similar transactions in the United States."¹²¹ He remarked that the government's eradication of the *consumo* taxes, in particular, was far from "the benevolent end contemplated."¹²² He explained,

In Porto Rico the economic relations of retail trade are determined by custom rather than by competition; and the sudden removal of *octrois* simply resulted in increased profit to the retailer rather than

115. Thomas S. Adams, *Porto Rican Finance Under the Spanish and American Governments*, in PAPERS AND PROCEEDINGS OF THE FOURTEENTH ANNUAL MEETING [OF THE AMERICAN ECONOMIC ASSOCIATION], 3 AM. ECON. ASS'N Q. 314, 325–28 (1902).

116. *Id.* at 325.

117. *Id.* at 341.

118. *Id.*

119. *Report of the Treasurer* (1901), *supra* note 107, at 149–51.

120. See L.S. ROWE, THE UNITED STATES AND PORTO RICO: WITH SPECIAL REFERENCE TO THE PROBLEMS ARISING OUT OF OUR CONTACT WITH THE SPANISH-AMERICAN CIVILIZATION 190 (1904); see also *Report of the Treasurer* (1907), *supra* note 90, at 63 (suggesting that the military government abolished the stamp tax, also known as the "derechos reales," out of a mistaken belief that it was a form of royal dues to the Spanish crown inconsistent with American principles).

121. Hollander, *Excise Taxation*, *supra* note 98, at 188.

122. *Id.*

in reduced cost to the purchaser. The municipal treasuries were depleted, and a minimum benefit was derived by the consumer.¹²³

He remained highly critical of the license taxes that were retained, as they seemed to favor Spanish entrepreneurs while disproportionately burdening others:

The financial and commercial interests were almost exclusively in the hands of Spanish merchants, and upon these classes the rates of taxation were relatively low. The small retail and manufacturing activities were generally in the hands of Porto Ricans, and upon these the taxes were comparatively high.¹²⁴

Notwithstanding these reflective criticisms, the U.S.-led fiscal restructuring of Puerto Rico would continue unabated.

2. *U.S. adjustments to Puerto Rico's extant system of taxation*

In search of new revenue sources and eager to abolish the Spanish territorial tax, the military government in 1899 directed Dr. Cayetano Coll y Toste to develop a new system of property taxation. In response, Coll y Toste proposed a law that would no longer assess the tax based upon income derived from agricultural property. Instead, assessments would be based on the use and quality of the land, as determined by a classification scheme.¹²⁵ In this way, Coll y Toste's new tax was responsive to the needs of U.S. sugar corporations. But, while the proposal reflected some aspects of U.S. mainland property taxation, it continued to imitate Spanish modes of property taxation. For instance, with respect to urban property, assessments would still be based upon net rental value.¹²⁶ The tax also imposed a higher burden on non-resident owners of both urban and agricultural land, subjecting them to an additional surcharge equal to fifty percent of the usual rate.¹²⁷

The military government made Coll y Toste's property tax effective July 1, 1899.¹²⁸ The new law "was debated among Puerto Ricans who favored and condemned it,"¹²⁹ with at least one Puerto Rican

123. *Id.*

124. Hollander, *Finances of Porto Rico*, *supra* note 98, at 556.

125. See *Report of the Treasurer* (1901), *supra* note 107, at 151–52 (explaining that agricultural lands were classified by use—for example, cane, coffee, and tobacco—and further sub-classified by quality—first, second, and third—and that taxes were imposed based on the quality classification of each use, meaning that lands of the first class for any given use would pay a certain tax, lands of the second class would pay a lesser tax, and so on).

126. *Id.* at 152.

127. *Id.*

128. Hollander, *Finances of Porto Rico*, *supra* note 98, at 556.

129. CARRASQUILLO, *supra* note 102, at 47.

newspaper declaring it to be “patriotic” and “fair,” despite its inherent flaws.¹³⁰ For his part, Professor Hollander, appointed in February 1900 to conduct another evaluation of Puerto Rican tax laws,¹³¹ severely criticized the new law.¹³² At the time, property taxes were a primary source of public financing on the U.S. mainland,¹³³ and policymakers naturally had strong views regarding the proper structure of such a tax.

Hollander did not censor his condemnations, even declaring that Coll y Toste’s new land classification scheme was “crude” and “primitive,” stating that the scheme was based upon theories of taxation that had been “discarded by every civilized country on its emergence from financial infancy.”¹³⁴ He primarily argued that the new property tax failed to properly incentivize more productive uses of land, a flaw apparent in the tax exemptions given to “uncultivated agricultural and unimproved city property.”¹³⁵ He further referred to the law’s two-year exemption for new houses and nonresident surcharge on agricultural lands as “unfortunate innovations.”¹³⁶ Hollander’s distaste for the nonresident surcharge may have stemmed from the fact that it ran afoul of tax provisions in the Northwest Ordinance, which many viewed as a highly persuasive precedent for new U.S. territories.¹³⁷

130. *See id.* (explaining that the new tax would force small producers and owners of large farms to pay the same tax percentage).

131. *Puerto Rican Taxation Laws: Prof. Hollander Appointed Special Commissioner to Revise Them*, N.Y. TIMES, Feb. 23, 1900.

132. *See infra* notes 134–37.

133. *See generally* John Joseph Wallis, *A History of the Property Tax in America*, in PROPERTY TAXATION AND LOCAL GOVERNMENT FINANCE 131–39 (Wallace E. Oates ed., 2001) (explaining the role of property taxes in funding the U.S. government).

134. Hollander, *Finances of Porto Rico*, *supra* note 98, at 557.

135. *Report of the Treasurer* (1901), *supra* note 107, at 152.

136. *Id.*

137. *See* BARTHOLOMEW H. SPARROW, THE INSULAR CASES AND THE EMERGENCE OF AMERICAN EMPIRE 27 (2006) (stating that the Northwest Ordinance and all subsequent similar legislation prevented territorial and state legislatures from taxing nonresidents’ land higher than residents’ land). The Northwest Ordinance was enacted in 1787 and served as the fundamental governing instrument for the Northwest Territory. 16 AM. JUR. 2d *Constitutional Law* § 7 Westlaw (database updated Aug. 2015). Among its provisions, the Northwest Ordinance provided that nonresident proprietors may not be taxed higher than residents. An Ordinance for the Government of the Territory of the United States north-west of the river Ohio, art. IV, 1 Stat. 50, 52 n.(a) (1789).

Following a devastating hurricane in August 1899,¹³⁸ the military government found itself in severe financial distress. In response to pressure from large landowners—particularly corporate agricultural interests¹³⁹—the government halted the collection of most taxes, as well as all enforcement activities, even allowing for remittance of some taxes already paid.¹⁴⁰ The insular government attempted to raise revenue by establishing, via military orders, new consumer excise taxes on liquor, matches, oleomargarine, and playing cards.¹⁴¹ The new taxes, which essentially copied the so-called “sin taxes” that were becoming increasingly common on the U.S. mainland,¹⁴² were extremely unpopular among islanders. Residents expressed their disapproval through a variety of evasion techniques, including outright fraud and illicit trade.¹⁴³ Dealers and merchants—who were generally native Puerto Ricans—also protested the new laws, complaining of a lack of clarity as to which articles were covered and whether the taxes applied to existing inventories imported under much higher tariff regimes.¹⁴⁴

138. See generally Stuart B. Schwartz, *The Hurricane of San Ciriaco: Disaster, Politics, and Society in Puerto Rico, 1899–1901*, 72 HISP. AM. HIST. REV. 303, 304 (1992) (detailing the hurricane’s social implications and “horrendous” devastation to Puerto Rico).

139. *Id.* at 310–12 (explaining how landowners’ petitions for tax relief for everyone—not just people who could document a loss after the hurricane—spurred the grant of the tax holiday).

140. General Orders, No. 125, Aug. 22, 1899, in REPORT OF BRIG. GEN. GEO. W. DAVIS ON CIVIL AFFAIRS IN PUERTO RICO, at 144 (1899).

141. See LAWS, ORDINANCES, DECREES, AND MILITARY ORDERS HAVING THE FORCE OF LAW, EFFECTIVE IN PORTO RICO, MAY 1, 1900, H.R. DOC. NO. 1484, at 1977–78 (2d Sess. 1909) (summarizing the excises and other miscellaneous taxes established by general orders of the U.S. military); see also *Report of the Treasurer* (1901), *supra* note 107, at 154 (explaining that the military government also established a poll tax in 1899 to support schools, although this tax was largely uncollected and essentially discontinued in 1900).

142. See generally Rachelle Holmes Perkins, *Salience and Sin: Designing Taxes in the New Sin Era*, 2014 BYU L. REV. 143, 150–52 (explaining that before the U.S. government reinstated the income tax on the mainland in 1913, it raised the majority of its revenue through tobacco and alcohol taxes, also referred to as “sin taxes”). For example, with respect to Puerto Rico’s tax on oleomargarine, a similar tax was initially imposed upon the food product on the U.S. mainland in 1886. Act of Aug. 2, 1886, ch. 840, 24 Stat. 209, 209–13; see *McCray v. United States*, 195 U.S. 27, 27 (1904) (upholding the federal tax on oleomargarine).

143. Hollander, *Excise Taxation*, *supra* note 98, at 189–90.

144. See *Porto Rican Tax Troubles: Protest Against Impost on German Beer and Other Articles*, N.Y. TIMES, June 16, 1900 (discussing the discrepancies and confusion regarding the Foraker Act’s taxation of alcoholic beverages).

But the most sweeping changes came in Congress's first major legislative act with respect to Puerto Rico, the Foraker Act of 1900.¹⁴⁵ The Foraker Act, which went into effect in the spring of that same year, ended military rule and installed a civilian colonial government. The Act placed the island within the U.S. common market¹⁴⁶ but also established a peculiar brand of "Puerto Rican citizenship," which would be recognized only by the United States.¹⁴⁷

The Foraker Act did not, however, establish a fully democratic government. The U.S. President retained the right to appoint the Governor, all heads of administrative departments, and all members of the highest branch of the legislature—the majority of which would be U.S. citizens rather than native Puerto Ricans.¹⁴⁸ Moreover, any acts by the lower branch of the legislature were subject to veto by the upper branch, the Governor, or the U.S. Congress.¹⁴⁹ Puerto Rican journalist and politician Vincente Balbás Capó complained that, under this system, Puerto Rican political parties were meaningless: they had "no power to act. They do what the governing power and [U.S.-controlled upper branch of the legislature] want them to do . . ."¹⁵⁰ In his view, the notion of a republican form of government in Puerto Rico was a sham, pursuant to which "the president's representative use[d] the parties as instruments, to pretend that he [was] vesting in the country faculties [that] the governing power and the [upper branch of the legislature] reserve

145. Organic Act of 1900, ch. 191, § 17, 31 Stat. 77, 81 (codified as amended at 48 U.S.C. §§ 733, 736, 738–40, 744, 866).

146. See *infra* notes 174, 176 and accompanying text (explaining that the Foraker Act provided for a maximum of two years of reduced tariffs on certain goods, then fully free trade, between the United States and Puerto Rico).

147. See Juan Manuel Carrión, *Puerto Rican Nationalism and the Struggle for Independence*, in BERCH BERBEROGLU, THE NATIONAL QUESTION: NATIONALISM, ETHNIC CONFLICT & SELF-DETERMINATION IN THE 20TH CENTURY 138 (1995) (exploring the oddities of "Puerto Rican citizenship" extended under the Foraker Act); see also *No Citizenship for Porto Rico*, CHI. TRIB., Dec. 21, 1906, at 1 ("The condition of the people of Porto Rico is anomalous. They have no real citizenship anywhere.").

148. § 17, 31 Stat. at 81 (addressing the appointment of the Governor); § 18, 31 Stat. at 81 (addressing the appointment of members of the highest branch of the legislature, known as the Executive Council); §§ 29, 35, 31 Stat. at 83–84 (addressing the election of delegates to the lower branch of the legislature, known as the House of Delegates). See generally William Franklin Willoughby, *The Executive Council of Porto Rico*, 1 AM. POL. SCI. REV. 561, 561–62 (1906) (describing the inner workings of the Executive Council).

149. Willoughby, *supra* note 148, at 568.

150. Vincente Balbás Capó, *The Emigrants*, in THE INTELLECTUAL ROOTS OF INDEPENDENCE, *supra* note 83, at 127.

absolutely to themselves.”¹⁵¹ This state of affairs was intentional. In the words of William Franklin Willoughby, U.S.-appointed secretary of Puerto Rico and president of the highest branch of the legislature, in 1906, the civil government could not be fully democratic because it was not free to deal with “the dangers of misrule and inefficiency that the experience of other Latin-American countries ha[d] demonstrated to be present.”¹⁵²

Although the political provisions frustrated many Puerto Ricans, it was the Foraker Act’s tariff provisions that polarized U.S. commercial interests in the months leading up to the Act’s passage.¹⁵³ On the one hand, duty-free trade with Puerto Rico was highly threatening to U.S. sugar beet and tobacco growers, as it meant new competition from island producers in the markets for raw sugar and tobacco.¹⁵⁴ On the other hand, free trade was extremely attractive to powerful North American cane sugar refining companies who stood to benefit from the ability to purchase cheaper, tariff-free raw sugar from the islands.¹⁵⁵ And the latter companies most likely believed they had earned financial concessions after paying special excise taxes on sugar refining activities during the Spanish-American War.¹⁵⁶

Adding further fuel to the debate, many opponents of free trade feared that duty-free exchange with Puerto Rico would set a dangerous precedent for the Philippines, which was widely viewed as the United States’ troubled, yet deeply valuable gateway to

151. *Id.*

152. Willoughby, *supra* note 148, at 561.

153. George B. McClellan, *The Porto Rican Tariff*, in MEN AND ISSUES OF 1900: THE VITAL QUESTIONS OF THE DAY 140 (James P. Boyd ed., 1900) (exploring the opposing viewpoints regarding extending free trade to Puerto Rico).

154. *Id.*; see also AYALA & BERNABE, *supra* note 1, at 36 (noting the sugar beet producers’ opposition to free trade with Puerto Rico).

155. AYALA & BERNABE, *supra* note 1, at 36; see also CARL STROEVER, THE HAWAIIAN PROBLEM 2 (1898) (explaining the same benefits in relation to free trade with Hawaii); *Philippine Free Trade Would Help Sugar Trust*, AM. SUGAR INDUSTRY & BEET SUGAR GAZETTE, June 5, 1906, at 273 (noting the benefits of free trade with the Philippines to sugar refining companies); cf. *Senate Investigation: President Havemeyer of the Sugar Trust Subpoenaed*, AUBURN BULL., June 12, 1894, at 1 (describing an investigation into potential relations between U.S. senators and the American Sugar Refining company).

156. War Revenue Act of 1898, ch. 448, § 27, 30 Stat. 448, 464; see Spreckels Sugar Ref. Co. v. McClain, 192 U.S. 397, 412–13 (1904) (upholding the special excise tax as a lawful and indirect tax, even though it was based on a percentage of a refiner’s gross annual receipts above a certain amount); Roy A. Ballinger, *A History of Sugar Marketing Through 1974*, ECON. RES. SERV. 15–19 (1978), <http://www.ers.usda.gov/media/1731272/aer382a.pdf> (describing the U.S.-Puerto Rico sugar trade following the Spanish-American War).

burgeoning Asian markets.¹⁵⁷ Acknowledging the prospect of ripple effects beyond Puerto Rico, the named sponsor of the Foraker Act focused his attention on the potential costs and benefits of the proposed legislation to U.S. corporate interests. Citing the necessity of new markets for American products—and the concomitant need to carefully manage any potential spillover effects in the Philippines—Senator Foraker explained, “[w]e have reached the point in the development of our resources and the multiplication of our industries where we are not only supplying our home demands, but are producing a large surplus, constantly growing larger. Our greatest present and prospective commercial need is for markets abroad.”¹⁵⁸

President McKinley, already well-known for supporting protective tariffs that benefited U.S. commercial interests, advocated in favor of free trade between the United States and Puerto Rico.¹⁵⁹ The President publicly claimed that free access to U.S. markets would help the Puerto Rican economy, which was in dire need of assistance following the 1899 hurricane.¹⁶⁰ At least on the surface, his views seemed to reinforce those of prominent Puerto Ricans.¹⁶¹ But, just a decade earlier, as chairman of the House Ways and Means Committee, McKinley had exposed his alliance with large U.S. sugar refineries. For instance, in 1890, long before the United States acquired Puerto Rico, McKinley sponsored legislation allowing for duty-free imports of all island sugars into the United States. Many scholars believe the move was intended to benefit leading east-coast sugar refineries who were struggling to compete with western refineries that acquired duty-free raw sugar from Hawaii.¹⁶² McKinley revealed his preferences when he testified in Congress that, although he supported free trade in *raw* sugar, “[t]he refiners should have

157. AYALA & BERNABE, *supra* note 1, at 36.

158. JOSEPH BENSON FORAKER, SPEECHES OF J.B. FORAKER, 1869–1917, VOLUME 3, 64 (1917) (noting that U.S. commercial interests needed to sell surplus goods abroad after fulfilling domestic demands).

159. See generally QUENTIN R. SKRABEC, JR., WILLIAM MCKINLEY: APOSTLE OF PROTECTIONISM (2008) (exploring President McKinley’s reputation for protectionism).

160. See, e.g., President William McKinley, Third Annual Message to Congress (Dec. 5, 1899), www.presidency.ucsb.edu/ws/?pid=29540.

161. See J.J. HENNA & M. ZENO GANDÍA, THE CASE OF PUERTO RICO 14–18 (1899) (making an impassioned plea for free trade).

162. CÉSAR J. AYALA, AMERICAN SUGAR KINGDOM: THE PLANTATION ECONOMY OF THE SPANISH CARIBBEAN, 1898–1934, at 56 (1999); see also KEVIN PHILLIPS, WEALTH AND DEMOCRACY: A POLITICAL HISTORY OF THE AMERICAN RICH 242 (2002) (intimating McKinley’s tendency to align with trusts).

whatever duty will protect them against their foreign rivals in the difference of the labor cost.”¹⁶³ Then, after the largest sugar refineries on the United States’ east and west coasts merged in 1894, Congress reinstated the tariffs on imported sugar.¹⁶⁴

President McKinley was not the only politician to use humanitarian rhetoric to justify actions in Puerto Rico that would benefit a preferred corporate constituency. For instance, Congressman George B. McClellan, Jr., criticizing those who opposed free trade with Puerto Rico, asked whether the United States, “having acquired Porto Rico in the interest of humanity and in the cause of liberty, . . . shall govern it in the interest of [American beet sugar producers] and in the cause of Connecticut [tobacco producers]? ”¹⁶⁵ McClellan, reflecting a common interpretation of the Northwest Ordinance—that it prescribed the future political course of all new U.S. territories¹⁶⁶—assumed that the United States would eventually offer statehood to Puerto Rico. Accordingly, he claimed, “[t]o make her fit for self-government[,] we must first care for her material prosperity.”¹⁶⁷ Of course, free trade was also attractive to the nation’s leading sugar refineries, all located in or around New York City, which McClellan represented in Congress.¹⁶⁸ The largest of them, the American Sugar Refining Company (which controlled the so-called “Sugar Trust”),¹⁶⁹ was based in Brooklyn.¹⁷⁰

163. William McKinley, *The Duty on Sugar, Speech in the House of Representatives, Fifty-First Congress, May 20, 1890*, reprinted in WILLIAM MCKINLEY, SPEECHES AND ADDRESSES OF WILLIAM MCKINLEY 453 (1893); see, e.g., THE LOUISIANA PLANTER & SUGAR MANUFACTURER, Vol. XXI, No. 22 (1898), at 340 (noting the effects of war on consumption, supply, and demand).

164. See AYALA, *supra* note 162, at 56 (describing the merger).

165. McClellan, *supra* note 153, at 140–41.

166. See SPARROW, *supra* note 137, at 18–19 (noting that the Northwest Ordinance reflected the ideals of protecting political, civil, and economic equality); see also Shively v. Bowlby, 152 U.S. 1, 49 (1894) (holding that “the Territories acquired by Congress, whether by deed of cession from the original States, or by treaty with a foreign country, are held with the object, as soon as their population and condition justify it, of being admitted into the Union as States”).

167. McClellan, *supra* note 153, at 141.

168. See DEBORAH JEAN WARNER, SWEET STUFF: AN AMERICAN HISTORY OF SWEETENERS FROM SUGAR TO SUCRALOSE 5–30 (2011) (exploring the history of sugar refining in New York). See generally UNITED STATES OF AMERICA, PETITIONER, AGAINST THE AMERICAN SUGAR REFINING COMPANY, DEFENDANTS: PETITIONER’S EXHIBITS, VOLUME II (1913) (setting forth interview transcripts and other evidence detailing the extensive sugar refining business in New York City in the decades leading up to the case).

169. In 1895, the company prevailed in the Supreme Court in an antitrust action brought by the federal government after the company acquired a ninety-eight percent monopoly of the U.S. sugar refining business. *United States v. E.C. Knight*

Large American and European corporations doing business in Puerto Rico also called for free trade, even advocating against *all* forms of federal taxation on the island. For instance, a representative for the Fritze-Lundt Company, a German-owned enterprise that was then the largest shipper of sugar in Puerto Rico, stated, “[i]f the tariff had been removed at first, Porto Rico would now have double [the] crops.”¹⁷¹ Mullenhoff & Korber, a prominent German financial institution in Puerto Rico, declared that it would “be a hard blow if the internal revenues of the United States were applied here.”¹⁷² Indeed, a prominent Dutch sugar importing company¹⁷³ would later win a victory in the Supreme Court against the U.S. tariff on trade with Puerto Rico in one of the first of the so-called “Insular Tariff Cases.”¹⁷⁴

In a final compromise, the Foraker Act provided for a tariff equal to fifteen percent of the Dingley rate¹⁷⁵ on certain goods exchanged between the United States and Puerto Rico—including raw sugar—for a period not to exceed two years, after which all trade would be duty-free.¹⁷⁶ Seemingly in response to President McKinley’s stated goal of providing economic aid to the island, the reduced tariffs on Puerto Rican trade with the United States, whether collected in the United States or in Puerto Rico, and all other tariffs collected in Puerto Rico with respect to international trade, would inure to the benefit of the Puerto Rican Treasury.¹⁷⁷ During the interim period, the insular government was expected to develop alternative revenue-raising measures.¹⁷⁸ In speeches and promotional materials, sponsors of the bill focused on humanitarian aims; no mention was made of the United States’ role in dismantling most of Puerto Rico’s previous sources of revenue.

Co., 156 U.S. 1, 17–18 (1895).

170. See *Federal Attack on Sugar Trust*, N.Y. TIMES, Nov. 29, 1910; *Guide to the American Sugar Refining Company Records 2008.042*, BROOKLYN HIST. SOC’Y (Apr. 9, 2012), http://dlib.nyu.edu/findingaids/html/bhs/arms_2008_042_american_sugar.

171. *Porto Ricans Are Disappointed Over Court’s Decision*, L.A. HERALD, May 29, 1901, at 1.

172. *Id.*

173. See *Elias S. A. de Lima*, BANKERS MAGAZINE, Jan.-June 1910, at 661–62 (providing a brief biography of the firm’s principal).

174. *De Lima v. Bidwell*, 182 U.S. 1, 2, 199 (1901) (holding that Puerto Rico was no longer a foreign country for the purposes of U.S. tariff laws; accordingly, absent congressional legislation, the U.S. government could not collect customs duties on sugar shipped from Puerto Rico to other U.S. ports).

175. Dingley Tariff Act, ch. 11, 30 Stat. 151 (1897) (providing a schedule of tariff rates on sugar, salt, tobacco, petroleum, and other goods and commodities).

176. See *The President Is Right: Common-Sense View of the True Inwardness of the Puerto Rican Matter*, AM. ECON., Mar. 30, 1900, at 153 (explaining the compromise).

177. *Id.*

178. See McClellan, *supra* note 153, at 167.

Moreover, in response to the demands of large corporations doing business in Puerto Rico, the Foraker Act further provided that, with the exception of the reduced tariff for U.S. trade, the normal tariffs on international trade, and a federal equalization excise tax,¹⁷⁹ “the internal revenue laws . . . shall not have force and effect in Porto Rico.”¹⁸⁰ The provision was not a reference to any federal income tax; the Supreme Court had declared that the first peace-time federal income tax was unconstitutional in 1895,¹⁸¹ and the Sixteenth Amendment would not be ratified until 1913.¹⁸² Rather, in 1900, the United States primarily raised revenue through excise taxes on alcohol, tobacco, playing cards, certain food items, and bank capital, as well as stamp duties and inheritance taxes.¹⁸³ Additionally, the War Revenue Act of 1898 imposed a special excise tax upon the gross receipts of persons engaged in refining petroleum and sugar.¹⁸⁴

Although the Foraker Act’s tax provisions would have been clearly unconstitutional for a U.S. state,¹⁸⁵ the Supreme Court ruled that

179. Essentially, this was a protective tariff designed to safeguard U.S. manufacturers. This special excise tax applied to goods—mainly tobacco and distilled spirits—manufactured in Puerto Rico and exported to the U.S. mainland, to the extent such goods were “like articles” that, if manufactured in the United States, would have been subject to federal excise taxes. 26 U.S.C. §§ 7652–53 (2012); *see also* Puerto Rico v. Blumenthal, 642 F.2d 622, 623, 625 (D.C. Cir. 1980) (describing the scope and intent of the special excise tax); STEVEN MAGUIRE & JENNIFER TEEFY, CONG. RESEARCH SERV., R41028, THE RUM EXCISE TAX COVER-OVER: LEGISLATIVE HISTORY AND CURRENT ISSUES 1 (2010) (noting that from the tax’s inception, its proceeds were “covered-over” to the Puerto Rican treasury); David Kocieniewski, *Rum Battle in Caribbean Leaves Tax Hangover*, N.Y. TIMES (Oct. 15, 2010), <http://www.nytimes.com/2010/10/16/business/16rum.html> (reporting that the federal equalization tax on rum is still an important source of revenue for Puerto Rico).

180. Organic Act of 1900, § 14, 31 Stat. 77, 80 (codified as amended at 48 U.S.C. §§ 733, 736, 738–40, 744, 866).

181. *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429, 586 (1895) (holding that taxes upon rents and profits of real estate and upon returns from investments of personal property were in effect direct taxes upon such property and therefore unconstitutional to the extent that they were not apportioned).

182. *United States v. Sitko*, 845 F.2d 43, 47 (2d Cir. 1988); *see* discussion *infra* notes 260–67 and accompanying text.

183. 26 U.S.C. § 7652 (2012); *see* Bruce Bartlett, *Taxing Sin: A Win-Win for Everyone?*, TAXANALYSTS (Sept. 22, 2010), <http://www.taxanalysts.com/www/features.nsf/Articles/4656FF5DE09AE5D1852577A600703965?> (“Among the earliest federal taxes were those on alcohol, tobacco, and playing cards, and they remained mainstays of the federal revenue system until the creation of the corporate and individual income taxes in 1909 and 1913, respectively. In 1900, 50 percent of all federal revenue came from taxing alcohol, tobacco, and playing cards . . .”).

184. *See supra* note 156 and accompanying text.

185. U.S. CONST. art. I, § 8 (providing that “all Duties, Imposts, and Excises shall

Congress had the authority to create non-uniform revenue laws for unincorporated territories, such as Puerto Rico.¹⁸⁶ The decision would come to stand for the proposition that, although there were certain constitutional protections that “cannot be under any circumstances transcended,” matters of taxation were not as fundamental as a citizen’s rights of liberty and property.¹⁸⁷ Especially in matters of taxation, Puerto Rico would be treated as “foreign to the United States in a domestic sense.”¹⁸⁸ And so, with the Supreme Court’s blessing, Congress imposed certain permanent and temporary tariffs on trade between the United States and Puerto Rico, while also maintaining that the internal revenue laws generally had no force and effect on the island. In so doing, the United States quietly extended one of its earliest federal tax incentives to U.S. companies doing business in Puerto Rico. The key beneficiaries were the powerful Sugar Trust and other large American corporations, who could obtain raw materials from the newfound U.S. territory while receiving immediate relief from many forms of U.S. taxation and, eventually, permanent relief from U.S. tariffs on imports from and exports to the island.

Despite this result, Senator Foraker gave a very different justification for declining to fully extend U.S. internal revenue laws to Puerto Rico. Declaring that “[n]o such favor has ever been shown to any other people for whom we have legislated,”¹⁸⁹ he offered a humanitarian justification for the unprecedented move:

Are people who to-day [sic] can not buy bread to be subjected to that kind of burden? . . .

[W]hen we found the Puerto Ricans in that situation, we stopped to consider whether we could not in mercy toward these people, not in a spirit of illiberality, not lacking generosity, but practicing the most gracious generosity, find some way whereby we could exempt them

be uniform throughout the United States”).

186. *Downes v. Bidwell*, 182 U.S. 244, 287 (1901) (noting that the Foraker Act applied to Puerto Rico because Puerto Rico was a “territory appurtenant” that belonged to the United States, but that it was not considered part of the United States for purposes of the revenue clauses of the U.S. Constitution).

187. *Id.* at 295 (White, J., concurring).

188. *Id.* at 341. See generally FOREIGN IN A DOMESTIC SENSE: PUERTO RICO, AMERICAN EXPANSION, AND THE CONSTITUTION (Christina Duffy Burnett & Burke Marshall eds., 2001) (exploring the legal, social, and political consequences of the Supreme Court’s conception of Puerto Rico); Sam Erman, *Citizens of Empire: Puerto Rico, Status, and Constitutional Change*, 102 CALIF. L. REV. 1181 (2014) (discussing the insular cases and the evolution of empire under U.S. constitutional law).

189. Joseph Benson Foraker, *Porto Rico: Speech of Hon. J.B. Foraker in the Senate of the United States, reprinted in FORAKER, supra* note 158, at 43.

from this ruinous burden and raise revenues for their government in some other manner that would rest more lightly upon them.¹⁹⁰

In speeches and promotional materials pertaining to the law that would bear his name, Senator Foraker painted a picture of an island that had no ability to generate its own revenues because its people were unaccustomed to direct taxes—at least in the forms then most prevalent in the United States. For instance, he explained: “[t]he question presented to the framers of this bill was . . . whether Porto Rico should be remitted to this system of direct taxation for the raising of her revenues, or whether we would give her the revenues derived by the methods of indirect taxation already mentioned . . .”¹⁹¹ He never acknowledged the United States’ role in stripping away much of Puerto Rico’s extant system of taxation two years earlier. Rather, he referred to America’s “[u]nprecedented [g]enerosity”¹⁹² and, noting that “[m]en do not do extraordinary things without having extraordinary reasons therefor,”¹⁹³ he explained that the members of Congress were compassionate and wanted to alleviate the burden of a direct tax.¹⁹⁴

Meanwhile, Professor Hollander, who claimed credit for Congress’s refusal to fully apply the internal revenue laws to Puerto Rico, suggested that American lawmakers had been more restrained and sensitive to Puerto Rico’s culture:

The system of internal revenue taxation in the United States . . . is the result of gradual development and is adapted to the conditions prevailing in an economically advanced community. To extend this system in any degree en bloc to Porto Rico, where social and economic conditions are radically different, would be a financial error and an economic embarrassment.¹⁹⁵

Professor Hollander also emphasized the “generosity unique in the annals of our political history, and typical of the future attitude of the United States to Porto Rico.”¹⁹⁶

But on balance, any such generosity was little more than symbolic; the Foraker Act also authorized the United States to retire the Puerto Rican peso, with drafters refusing a provision that would transfer an amount equal to the nearly \$2 million of seigniorage to the local

190. *Id.* at 9.

191. Joseph Benson Foraker, *Protection’s Grave Peril*, reprinted in FORAKER, *supra* note 158, at 57.

192. *Id.* at 56.

193. *Id.*

194. *Id.* at 57.

195. Hollander, *Finances of Porto Rico*, *supra* note 98, at 558.

196. *Id.* at 559.

government.¹⁹⁷ The new civil government's first governor would later acknowledge that the currency exchange caused "the circulating medium" to contract by forty percent and imposed a hardship upon the people.¹⁹⁸ The Act further increased the costs of trade by requiring that Puerto Rican trade occur solely by American shipping lines.¹⁹⁹ These and related facets of the legislation led Professor James Dietz to conclude that "[t]he Foraker Act was not simply a political document, . . . it was also an economic instrument designed to control Puerto Rico's economic life."²⁰⁰ And, highlighting the precise economic interests that the United States sought to advance in Puerto Rico, following the passage of the Foraker Act in the spring of 1900, President McKinley appointed Charles Herbert Allen, a Massachusetts politician and founder of the American Sugar Refining Company, to serve as the first U.S.-appointed Governor of Puerto Rico.²⁰¹

a. U.S. enforcement of tax laws in Puerto Rico

Following the establishment of the first civil government on May 1, 1900, a new insular revenue agency was formed to enforce Puerto Rican taxes. The agency initially focused its attention on enforcing the excise taxes on alcohol, tobacco, playing cards, and certain food items, which Puerto Ricans had largely evaded. As Professor Hollander explained, "it became the definite policy of the civil administration to enforce rigidly the excises as then existing, [with a goal of] developing such a degree of popular respect for insular revenue laws as to insure the prompt adoption and successful operation of a rational system of excise taxation . . ."²⁰² The civil government dedicated its resources to field inspections, monitoring, and enforcement, employing an army of revenue officers, virtually all of whom had a background in military service.²⁰³ These efforts

197. See FORAKER, *supra* note 158, at 369–70 (including testimony relating to this aspect of the legislation).

198. *Report of the Treasurer*, *supra* note 108, at 65–66.

199. Organic Act of 1900, § 9, 31 Stat. 77, 79 (codified as amended 48 U.S.C. §§ 733, 736, 738–40, 744, 866); JAMES L. DIETZ, *ECONOMIC HISTORY OF PUERTO RICO: INSTITUTIONAL CHANGE AND CAPITALIST DEVELOPMENT 89–90* (1986) (noting that "the U.S. merchant fleet was more expensive than that of other countries").

200. DIETZ, *supra* note 199, at 89.

201. Henry Macfarland, *Charles H. Allen, the First Governor of Puerto Rico*, AM. MONTHLY REV. OF REVS. 563, 564 (1900) (stating that Allen initially wanted to decline the appointment, but accepted out of a sense of patriotic duty).

202. Hollander, *Excise Taxation in Porto Rico*, *supra* note 98, at 192.

203. *Id.* at 193–94; see also *Report of the Treasurer* (1907), *supra* note 90, at 177 (describing the military service background of internal revenue agents).

reflected a revenue collection trend that had been in place on the U.S. mainland since the 1880s: the increased enforcement of taxes, including through a “classic instrument of alien imposition—the bounty—to enforce their demands on the population.”²⁰⁴ Predictably, the civil government’s enhancement of its revenue collecting powers encountered significant public backlash:

Contempt for the law pervaded every class of the population. The liquor-loving peasant in the rural districts sat up at night soaking the stamps off his bottle of rum to be stuck on the next bottle he bought; and the army officer in charge of the post canteen had [to] resort to the United States District Court to test the propriety of denominating beer an alcoholic beverage. . . . In certain localities cancelled stamps indeed served as a minor circulating medium, available for re-use until worn to tatters Open defiance of the law was not unknown.

On several occasions internal revenue agents were mobbed; and in one notable instance two agents were severely clubbed and one of them put in jail.²⁰⁵

Nonetheless, the civil government persisted in its efforts to bring Puerto Ricans into compliance with the laws, ultimately leading to improved enforcement and collection of tax liabilities. The internal revenue agents successfully increased the sale of stamps, and the Treasurer brought several hundred cases of possible fraud to the district courts.²⁰⁶

3. Further U.S. refinements to Puerto Rican tax laws: Property taxation

The United States completed its initial fiscal overhaul of Puerto Rico in 1901, engineering “a clean sweep of all existing laws relative to taxation and establish[ing] an entirely new system to take its place.”²⁰⁷ As American political scientist Leo Stanton Rowe remarked several years later, “taxation in Porto Rico was made to conform to the system prevailing in the more advanced States of the Union.”²⁰⁸ Notably, policymakers instituted a direct tax on real and personal property developed by Professor Hollander, who was appointed Treasurer of the insular government in 1900.²⁰⁹ This new source of revenues made the interim tariff unnecessary and allowed for free trade between the United States and Puerto Rico.

204. NICHOLAS R. PARRILLO, AGAINST THE PROFIT MOTIVE: THE SALARY REVOLUTION IN AMERICAN GOVERNMENT, 1780–1940, at 191 (2013).

205. Hollander, *Excise Taxation in Porto Rico*, *supra* note 98, at 194–95.

206. *Id.* at 195.

207. *Report of the Treasurer* (1907), *supra* note 90, at 63.

208. ROWE, *supra* note 120, at 192.

209. Hollander, *Finances of Porto Rico*, *supra* note 98, at 557.

As its centerpiece, the new system imposed a one percent tax upon the assessed value of real and personal property, which was subsequently reduced to one-half of one percent²¹⁰ following “a wave of protests.”²¹¹ The Hollander law also continued the highly unpopular excise taxes on liquor, tobacco, matches, and other goods; license taxes on merchants selling those goods; stamp taxes upon certain documents; an inheritance tax; a tax upon insurance and surety companies; and an annual twenty-five dollar license tax upon foreign corporations doing business in Puerto Rico.²¹² Governor Allen later remarked that these changes installed “a purely American system of taxation . . . to take the place of the old Spanish system that had been in vogue for over 300 years.”²¹³

The protests did not end following the reduction in the rate of property taxation. The entire concept of taxing the *value* of property—as opposed to the income it generated—was foreign to Puerto Ricans, leading many to oppose the law.²¹⁴ Puerto Rican landowners “claimed that the rate of taxation would ruin them.”²¹⁵ The loudest objections came from the island’s elite classes, who called upon the federal government to annul the tax on the basis that it was “unfavorable to the commercial interests of the island.”²¹⁶ Puerto Ricans especially resented that property assessments were made by a staff of centralized revenue agents hired and supervised by a U.S.-appointed treasurer.²¹⁷ These revenue agents were not shy

210. *Porto Rican Legislation: Tax Rate Cut Down One-Half—Land Leased to French Railroad*, N.Y. TIMES, Jan. 27, 1901.

211. AYALA & BERNABE, *supra* note 1, at 37.

212. *Report of the Treasurer* (1907), *supra* note 90, at 63–64.

213. *Gov. Allen Not to Resign: Will Remain in Porto Rico at the President’s Request*, N.Y. TIMES, Apr. 7, 1901.

214. *Porto Rico Tax Law to Stand: Government Unlikely to Heed Plea of Commissioners from Island*, CHI. TRIB., Apr. 13, 1901 (reporting that “the landed aristocracy [did not] understand the American idea of taxing land,” and, therefore, made objections to the President).

215. ROWE, *supra* note 120, at 195.

216. *Make Appeal to Congress: Porto Ricans Want Hollander Revenue Law Nullified—Say it Is Against Their Interests*, N.Y. TIMES, Feb. 4, 1901; *see Reply to Gov. Allen: Commissioner Borda Declares Porto Rico Is Not Prosperous—The Revenue Law Condemned*, N.Y. TIMES, Apr. 11, 1901 (articulating criticisms of the Hollander law); *see also* CARRASQUILLO, *supra* note 102, at 48 (“Property owners across the island protested the bill, favoring the Spanish system as highly civilized and condemning the new one as hateful and abusive.”).

217. *See* AYALA & BERNABE, *supra* note 1, at 37 (noting how the governor appointed assessors in Puerto Rico, which sparked protests, while elected municipal officials typically had this appointment power in the United States).

about increasing assessed property values: in May 1901, assessments were increased by approximately sixty-six percent.²¹⁸

Many observers have alleged over the years that the tax was administered in a way that privileged U.S. corporate interests. For instance, island activist Pedro Albizu Campos accused the insular government of appraising Puerto Rican-owned farms at the highest possible prices in order to force owners to sell their lands, while appraising U.S. land holdings at artificially low values and tolerating U.S. landowners' nonpayment of taxes.²¹⁹ In his landmark treatise on U.S. interventions in Puerto Rico, Gordon K. Lewis detailed a number of tax evasion techniques employed by U.S. firms, who, with the tacit approval of the colonial regime, largely escaped the burden of Puerto Rican taxation while enjoying generous federal incentives.²²⁰ In 1916, even the U.S. Forest Service complained that the Hollander property tax incentivized the destruction of forests by increasing tax assessments on land with timber while decreasing assessments on land devoted to the growing of sugar cane, coffee, and tobacco.²²¹

Meanwhile, Puerto Ricans also protested the four consumer excise taxes, which some argued were especially oppressive to the island's native tobacco and rum industries.²²² Indeed, entrepreneurs warned they would be forced to close those businesses.²²³ But, in defense of the new laws, Senator Foraker explained in a *Chicago Tribune* article that the tax system was intended to improve conditions for the "200,000 [to] 300,000 persons who live in the interior and are in an extremely destitute condition, living in huts of thatched palm and with few cooking utensils or any of the other attributes of civilization and comfort."²²⁴ Once again, appealing to mainland populist

218. See *Higher Assessment in Porto Rico*, N.Y. TIMES, May 18, 1901 (noting how the San Juan property valuation increased from \$9 million to \$15 million).

219. See Pedro Albizu Campos, *Observations on the Brookings Institution Report*, in THE INTELLECTUAL ROOTS OF INDEPENDENCE, *supra* note 83, at 175 (condemning the practice of auctioning off Puerto Rican farms for two dollars); see also BAILEY W. DIFFIE & JUSTINE WHITFIELD DIFFIE, PORTO RICO: A BROKEN PLEDGE 55–56 (1931) (observing that a sugar corporation's taxes were not based on the full value, market value of stock, capital value, or physical assets of the corporation).

220. GORDON K. LEWIS, FREEDOM AND POWER IN THE CARIBBEAN 98–99 (1963).

221. See Louis S. Murphy, *Forests of Porto Rico; Past, Present, and Future, and Their Physical and Economic Environment*, U.S. DEP'T OF AGRIC. BULL. NO. 354, Oct. 20, 1916, at 14–16 (arguing the forest should be classified as a crop to encourage more favorable taxation structures to maintain forests).

222. *Porto Ricans Protest: Commissioners See the President and Present Arguments Against the Hollander Tax Bill*, N.Y. TIMES, Mar. 12, 1901.

223. ROWE, *supra* note 208, at 195.

224. *Porto Rico Tax Law to Stand*, CHI. TRIB., Apr. 13, 1901.

sentiments, the article concluded that those Puerto Ricans who protested the new taxes were “aristocra[ts].”²²⁵

Scholars have long debated whether the new property tax led to wide-scale foreclosure of small landowners’ properties and a corresponding increase in land accumulation by large, absentee U.S. corporations.²²⁶ In 2007, sociologist César J. Ayala and professor and director of the Federico de Onís Hispanic Studies Center at the University of Puerto Rico Rafael Bernabe, observed that Governor Allen “was explicit about his intentions: ‘I’d tax a little life into them. Every Portorican has a right to demand that every acre of rich sugar land should be developed, and I’d tax it until they had to put up or shut up.’”²²⁷ The authors concluded that “[h]igh assessments would force large landowners with idle lands to sell,” while at the same time forcing “small property owners to enter the market economy, either as small producers or as wageworkers, in order to obtain dollars to pay the tax.”²²⁸ In 1996, Ayala similarly explained that:

as a result of [the Hollander property tax], the peasantry polarized. The middle land owning sectors lost ground as land became concentrated into larger farms, at one extreme, and into ever smaller peasant plots on the other, as existing peasant plots were subdivided to heirs, creating a multiplication of farms too small for viable commercial exploitation.²²⁹

Moreover, through differentiation of the peasant economy and expropriation, many peasants lost their lands.²³⁰

But, in a separate empirical study, Ayala and his co-author Laird Bergad determined that the imposition of U.S.-style property taxation did not necessarily lead to more concentrated land tenure in Puerto Rico, in part because land holdings were already highly concentrated under Spanish rule.²³¹ Given that Hollander’s property tax exempted land valued at less than \$100 from taxation, it would seem that the two positions can be reconciled. The subdivision of peasant plots might have offset the increased concentration of land holdings. Meanwhile, any increased concentration of land holdings was more

225. *Id.*

226. See César J. Ayala & Laird W. Bergad, *Rural Puerto Rico in the Early Twentieth Century Reconsidered: Land and Society, 1899–1915*, 37 *LATIN AM. RES. REV.* 65, 69–72 (2002) (observing land ownership “was highly concentrated well before 1898,” and the Hollander tax actually led to the growth of small farms).

227. AYALA & BERNABE, *supra* note 1, at 37.

228. *Id.* at 37–38.

229. César J. Ayala, *The Decline of the Plantation Economy and the Puerto Rican Migration of the 1950s*, 7 *LATINO STUD.J.* 61, 62–63 (1996).

230. *Id.*

231. See Ayala & Bergad, *supra* note 226, at 72.

likely to come at the expense of middle and upper class Puerto Ricans, who held large plots of idle land that would be subject to especially burdensome tax assessments. This explanation is consistent with Carrasquillo's conclusion that the Hollander tax shifted the control of land from local elites to U.S. corporations.²³² Likewise, Ayala and Bernabe summarized their argument thusly: "[T]he tax measure promoted both the rise of capitalist agriculture based on the exploitation of a vast sea of wage laborers and the fragmentation of some existing large landholdings."²³³

Notwithstanding any lingering questions regarding the extent and nature of observable changes in land ownership, it is undeniable that Hollander's property tax exacted economic pressure on Puerto Rican landowners, strongly incentivizing them to sell property outright or use it more productively in order to pay the new taxes.²³⁴ Indeed, this is precisely what the tax was designed to accomplish. Thus, while it may be difficult to quantify the impact of the new property tax on land distribution in Puerto Rico, the tax unquestionably altered patterns of land use and ownership in ways that were intended to better align the island's resources with U.S. economic interests. As many have argued elsewhere, the net effect of virtually all U.S. tax, economic, and political policies with respect to Puerto Rico was to generate a monocrop economy centered upon the sugar industry, with economic benefits ultimately flowing almost exclusively to large U.S. corporations.²³⁵

232. CARRASQUILLO, *supra* note 102, at 48.

233. AYALA & BERNABE, *supra* note 1, at 38.

234. Ayala, *supra* note 229, at 71; see CARRASQUILLO, *supra* note 102, at 40–89 (noting that the tax system created a restructuring of property ownership based on the quality of the land, where blacks disproportionately lost title to their land and the Mestizo and blacks were only able to afford the poor, steep mountainside properties).

235. See, e.g., DIFFIE & DIFFIE, *supra* note 219, at 88 (providing the landmark critique of U.S. policies contributing to a monocrop sugar economy); see also, e.g., BENJAMIN KEEN & KEITH HAYNES, A HISTORY OF LATIN AMERICA 585 (2013) (explaining that U.S. policies created a monocrop sugar economy where title to land was predominately concentrated in foreign corporations); IRIS LÓPEZ, MATTERS OF CHOICE: PUERTO RICAN WOMEN'S STRUGGLE FOR REPRODUCTIVE FREEDOM 21 (2008) (remarking how Puerto Rico in the 1920s and 1930s was transitioning economically under colonial rule, from a subsistence to a monocrop economy, resulting in rural displacement and impoverishment); CARMEN TERESA WHALEN, FROM PUERTO RICO TO PHILADELPHIA: PUERTO RICAN WORKERS AND POSTWAR ECONOMIES 22 (2001) (noting that U.S. occupation led to sugar's domination of the economy, and it was grown on all four corners of the island); SANDRA L. SUÁREZ, DOES BUSINESS LEARN?: TAX BREAKS, UNCERTAINTY, AND POLITICAL STRATEGIES 23 (2000) ("By the early 1900s, the island had become a monocrop economy based on sugar, with absentee U.S. investors reaping the profits.").

4. *Further U.S. refinements to Puerto Rican tax laws: Income taxation*

Congressman Albert Douglas of Ohio expressed frustration toward Puerto Ricans in a 1909 speech in the House of Representatives: “why is it nevertheless true that when, upon the plaza at San Juan, the band of the Porto Rican regiment plays our Star-Spangled Banner and every American present rises and stands uncovered, the natives all sit in sullen silence?”²³⁶ He surmised: “[t]hey certainly have shown in many respects a lack of appreciation of what has already been accomplished in [sic] their behalf.”²³⁷ But instead of recommending expressions of gratitude, prolific writer and activist José de Diego urged members of the lower branch of the Puerto Rican legislature to “arch the lips, relax the chest, tense up all the vocal muscles and powers of will, and shout out that O of the NO!”²³⁸ to further intrusions by U.S. officials.

Yet any such attempts by Puerto Ricans to exercise what little political power they had only brought further opposition and chastisement. For example, Puerto Rican members of the lower branch of the legislature proposed reforming the property tax, authorizing municipal representatives and local landowners (mostly native Puerto Ricans) to conduct local property assessments.²³⁹ They believed this would be preferable to Hollander’s system,²⁴⁰ in which the office of the U.S.-appointed treasurer made centralized assessments, and appeals were allowed to be made to a board consisting primarily of U.S.-appointed officials.²⁴¹ However, the Treasurer lobbied strongly against the Puerto Rican legislature’s proposal in his annual report, citing the wisdom of U.S. tax scholars and claiming that local assessments would be “clumsy, complex, expensive, and inefficient.”²⁴² Unsurprisingly, the proposed measure failed to pass. As disagreements of this sort between native elected

236. 43 Cong. Rec. 994 (1909) (statement of Rep. Douglas).

237. *Id.*

238. José de Diego, *No, in INTELLECTUAL ROOTS OF INDEPENDENCE*, *supra* note 83, at 133.

239. *Report of the Treasurer, in U.S. WAR DEP’T, REPORT OF THE GOVERNOR OF PORTO RICO TO THE SECRETARY OF WAR*, 92 (1909) [hereinafter *Report of the Treasurer* (1909)].

240. See CARL C. PLEHN, *REVENUE SYSTEMS OF STATE AND LOCAL GOVERNMENTS* 827 (1907) (noting how in its first year of operation, the Hollander property tax relied upon locally generated property assessments, but commencing in 1902, assessments were centralized under the office of the treasurer).

241. *Report of the Treasurer* (1909), *supra* note 239, at 92.

242. *Id.*; see also WILLIAM FRANKLIN WILLOUGHBY, *TERRITORIES AND DEPENDENCIES OF THE UNITED STATES: THEIR GOVERNMENT AND ADMINISTRATION* 150 (1905) (justifying centralized administration of taxes by arguing that it would keep the process efficient and prevent corrupt local officials from abusing the system).

members and mainland appointees to the legislature mounted, President William Taft publicly reprimanded the islanders for their political immaturity: “Porto Ricans have forgotten the generosity of the United States . . . and the present situation indicates that the United States has gone too fast in the extension of political power to them.”²⁴³

Indeed, in light of the early history described in the previous section, it is not surprising that many Puerto Ricans were skeptical of U.S. involvement in the island’s affairs. While prominent Puerto Rican literary figures grieved the island’s loss of its formal ties to the Spanish language,²⁴⁴ influential political theorists highlighted the hypocrisy of U.S. imperialism, and, echoing the same populist sentiments that U.S. officials repeatedly used to justify their actions, argued that America’s colonial relationship with Puerto Rico was intended to benefit U.S. corporate interests. For instance, in a poignant 1910 essay, journalist and activist Vincente Balbás Capó wondered why “[i]mportant Americans are so insistent on Puerto Rico’s unpreparedness to govern herself.”²⁴⁵ Differentiating islanders from the “peasant colonists from Great Britain who took up arms to win independence,” he reproached U.S. mainlanders for allowing Puerto Rico to be “exploited by the ‘trusts’ who corner what wealth remains . . . and take out most of the wealth it produces.”²⁴⁶ Balbás also warned that American capital would destroy Puerto Rico’s economy, and that even “in Congress itself, the trusts govern.”²⁴⁷ Reflecting on the conditions of Puerto Rican society on the island and in New York, Jesús Colón—widely regarded as the Father of the Nuyorican Movement—would later remark, “[t]he same American

243. *Porto Ricans Unfit to Rule, Says Taft: Tells Congress That Power Over Appropriations Should Be Taken from Them*, N.Y. TIMES, May 11, 1909.

244. See, e.g., José Mercado, *The Castilian Language*, in BORINQUEN: AN ANTHOLOGY OF PUERTO RICAN LITERATURE 99 (María Teresa Babín & Stan Steiner eds., 1974) [hereinafter BORINQUEN] (“This knot, which force yesterday broke asunder, tie it, my Castilian tongue. Eternal messenger of harmony, cross the immense sea that separates us . . . for a flag can be changed, but never sentiments!”); Manuel Zeno Gandía, *The Redeemers*, in BORINQUEN: AN ANTHOLOGY OF PUERTO RICAN LITERATURE 107 (María Teresa Babín & Stan Steiner eds., 1974) (remarking, with respect to American attempts to mandate the English language in Puerto Rican schools, “[t]hey spend our millions, so necessary for the fields and industries, in the teaching of a language that is for our people . . . a dead tongue.’ . . . ‘Never among us, can our intimate thoughts be expressed in the English language’”).

245. Vincente Balbás Capó, *Aren’t We Capable of Governing Ourselves?*, in THE INTELLECTUAL ROOTS OF INDEPENDENCE, *supra* note 83, at 123.

246. *Id.* at 123–25.

247. SUGARLANDIA REVISITED: SUGAR AND COLONIALISM IN ASIA AND THE AMERICAS, 1800 TO 1940, at 163–64 (Ulbe Bosma et al. eds., 2007).

trusts that milked us in Puerto Rico were in control in New York.”²⁴⁸ And in 1911, lawyer and defender of independence, Rosendo Matienzo Cintrón, argued that, to the extent Puerto Ricans had been granted “citizenship with colonialism’, . . . [and] without sovereignty,” it would be a “third citizenship, as degrading for Americans as Puerto Ricans, . . . a citizenship granted for convenience, a concession calculated by and for ‘business.’”²⁴⁹ Cintrón further warned that, “[a]s long as you who mystify freedom and your own country’s precepts continue to govern, Puerto Rico will be governed by [] lie[s], by dirty business deals, and by the trusts.”²⁵⁰

To be sure, with Puerto Rico within the U.S. tariff wall, American corporations thrived on the island. The largest U.S. sugar refining companies vertically integrated their Puerto Rican operations into their corporate structure, allowing them to extract considerable economic rents from their monopoly control.²⁵¹ Meanwhile, the insular government continued to struggle. The island was heavily dependent upon tariffs on international trade at a time in history when sovereign states were systematically negotiating to reduce and even eradicate these duties.²⁵² In comments that were more broadly focused on the evolution of trade policy, French economist Thomas Piketty cogently described how “[t]rade liberalization is not necessarily a bad thing” if the lost revenue can be replaced by other substitute sources, and so long as “it is not peremptorily imposed from without.”²⁵³ Lacking the autonomy to establish its own tariffs or alternative systems of taxation, the island remained at the mercy of U.S.-led negotiations. Moreover, although the federal government began to replace shrinking tariff revenues by, among other things,

248. COLÓN, *supra* note 38, at 71.

249. Rosendo Matienzo Cintrón, *The Guachafita Fá, in THE INTELLECTUAL ROOTS OF INDEPENDENCE*, *supra* note 83, at 116. For a thoughtful debate concerning U.S. citizenship for Puerto Ricans, see José A. Cabranes, *Citizenship and the American Empire—Notes on the Legislative History of the United States Citizenship of Puerto Ricans*, 127 U. PA. L. REV. 391, 397–98 (1978) (describing how Puerto Ricans were given a “second-class citizenship” without the same rights as other Americans).

250. Cintrón, *supra* note 249, at 117.

251. See generally AYALA, *supra* note 162, at 108–11 (noting how through vertical integration, U.S. sugar companies were able to escape taxation by keeping profits out of Puerto Rico).

252. For an historical snapshot of the revenue problems faced by Puerto Rico, see U.S. DEP’T OF COMMERCE & LABOR, COMMERCIAL PORTO RICO IN 1906: SHOWING COMMERCE, PRODUCTION, TRANSPORTATION, FINANCES, AREA, POPULATION, AND DETAILS OF TRADE WITH THE UNITED STATES AND FOREIGN COUNTRIES DURING A TERM OF YEARS 42 (1907) [hereinafter COMMERCIAL PORTO RICO IN 1906].

253. THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 492 (2014).

imposing a new federal excise tax on corporate income beginning in 1909,²⁵⁴ it did not initially extend this corporate income tax to Puerto Rico.²⁵⁵ For these and other reasons, the Puerto Rican government began in the early 1900s to rely upon debt financing as an alternative revenue-raising device; these early bond issuances would represent the insular government's first indebtedness in more than three decades.²⁵⁶

The final nail in the coffin with respect to Puerto Rico's tariff revenues came in 1913. After powerful lobbyists representing the sugar refining industry persuaded Congress to do away with tariffs on sugar traded beyond the U.S. common market,²⁵⁷ Congress passed the Underwood-Simmons Tariff Act,²⁵⁸ a law that provided for duty-free international trade in sugar after May 1, 1916.²⁵⁹

After the tariffs on sugar exports were eradicated, the insular government experienced a severe revenue shortfall.²⁶⁰ The federal government faced a similar loss of revenue, but it was able to protect its public fisc by reinstating the income tax following the ratification of the Sixteenth Amendment²⁶¹ and by imposing a new federal tax on estates and gifts in 1916. In an effort to similarly replace lost revenues on the island, Congress applied the corporate excise tax of 1909,²⁶² as well as the federal income tax laws of 1913²⁶³ and 1916,²⁶⁴

254. Tariff Act of 1909, Pub. L. No. 5, § 38, 36 Stat. 11, 112 (1909) (providing for a one percent excise tax on corporations' net yearly income above \$5,000). See generally Steven A. Bank, *Entity Theory as a Myth in the US Corporate Excise Tax of 1909*, in 2 STUDIES IN THE HISTORY OF TAX LAW (John Tiley ed., 2007) (exploring the history and significance of this first tax on corporate income).

255. See HENRY CAMPBELL BLACK, A TREATISE ON THE LAW OF INCOME TAXATION UNDER FEDERAL AND STATE LAWS § 74 (1913) (noting that the Treasury Department ruled that Porto Rican companies were exempt from the tax if they did not conduct business in the United States).

256. COMMERCIAL PORTO RICO IN 1906, *supra* note 252, at 42–44.

257. See E.P. Miller, *Bourbon Inconsistency: How a Democratic Candidate for President Looks at the Cuban Reciprocity Treaty*, AM. ECON., Dec. 4, 1903, at 273–74 (explaining the Sugar Trust's desire to abolish sugar tariffs).

258. Underwood-Simmons Tariff Act, Pub. L. No. 16, 38 Stat. 114 (1913).

259. § 177, 38 Stat. at 131.

260. See *Report of the Treasurer*, in U.S. WAR DEP'T, REPORT OF THE GOVERNOR OF PORTO RICO TO THE SECRETARY OF WAR, FISCAL YEAR ENDED JUNE 30, 1915, 240 (1915) [hereinafter *Report of the Treasurer* (1915)] (remarking that revenues in Puerto Rico were about \$1,000,000 below expectations as a result of the changes in tariff laws).

261. See U.S. CONST. amend. XVI (paving the way for the adoption of a federal income tax); see also Revenue Act of 1913, Pub. L. No. 16, 38 Stat. 114, 166–81 (providing for an income tax).

262. See BLACK, *supra* note 255, § 74 (amending the Tax Code to extend the corporate excise tax to Puerto Rico, providing that any revenues collected on the island would flow to the insular government).

to Puerto Rico, and, consistent with its previous laws, provided that any such taxes collected on the island would be transferred to the Puerto Rican treasury. As Judge Learned Hand later opined, Congress “probably was acting merely as local sovereign”²⁶⁵ when it extended federal revenue laws to the island in this manner, as Puerto Rico at the time lacked the statutory power to enact a local income tax of its own. In any case, actual collections in Puerto Rico were extremely poor in the early years of the income tax; the insular government collected approximately \$67,000 in 1913 and \$78,000 in 1914.²⁶⁶ While collections would increase dramatically in the ensuing years, eventually surpassing \$500,000 in both 1916 and 1917, initial receipts were insufficient to replace lost tariff revenues.²⁶⁷

Meanwhile, another U.S.-led fiscal restructuring of Puerto Rico was on the horizon. In March of 1917, Congress enacted the Jones-Shafroth Act, extending U.S. citizenship²⁶⁸ and a bill of rights to Puerto Ricans,²⁶⁹ and also granting general legislative powers to the island government.²⁷⁰ With respect to fiscal policy, the Jones-Shafroth Act purported to expand the island’s taxing powers. It provided that:

[N]o export duties shall be levied or collected on exports from Porto Rico, but taxes and assessments on property, internal revenue, and license fees, and royalties for franchises, privileges, and concessions may be imposed for the purposes of the insular and municipal governments, respectively, as may be provided and defined by the Legislature of Porto Rico . . .²⁷¹

But much like the general grant of legislative authority, this provision was in large part symbolic; all Puerto Rican legislative enactments—including tax laws—were required to be reported to Congress, which reserved the right to annul them.²⁷²

263. Revenue Act of 1913, Pub. L. No. 16, § 3176M, 38 Stat. 180.

264. Revenue Act of 1916, Pub. L. No. 271, § 23, 39 Stat. 756, 776.

265. *Porto Rico Coal Co. v. Edwards*, 275 F. 104, 107 (S.D.N.Y. 1921).

266. *Report of the Treasurer* (1919), *supra* note 94, at 353.

267. *See id.* at 353–54 (anticipating that, in the future, the income tax would be Puerto Rico’s main source of revenue).

268. Jones Act of 1917, Pub. L. No. 368, § 5, 39 Stat. 951, 953.

269. *Id.* § 2, 39 Stat. at 951.

270. *See id.* § 26, 39 Stat. at 958 (authorizing the formation of a popularly elected Senate); *see also supra* note 14 (listing other acts and case law regarding Puerto Rican citizenship and rights).

271. § 3, 39 Stat. at 953; *see Benedicto v. Porto Rican Am. Tobacco Co.* 256 F. 422, 425 (1st Cir. 1919) (noting that the Puerto Rican legislature had “no powers except those granted expressly or by necessary implication by Congress”).

272. *See Organic Act of 1900*, ch. 191, §§ 23, 34, 31 Stat. 77, 82, 84 (codified as amended 48 U.S.C. §§ 733, 736, 738–40, 744, 866).

At the same time, the Jones-Shafroth Act implicitly recognized that the island's cash flow requirements were unlikely to be satisfied through insular taxation. Thus, the Act exempted Puerto Rican government bonds from federal, state, and local taxes.²⁷³ This triple tax exemption made Puerto Rican government bonds highly attractive to mainland financial interests, thereby giving the island ample access to the debt markets to fund its general obligations. Legislative history concerning the provision focused upon the humanitarian benefits that would presumably flow to Puerto Ricans. For instance, Senator James K. Vardaman explained that "it is for the purpose of enabling [the Puerto Rican people] to develop their country [and] to make the securities attractive by extending that exemption. It was thought by the committee that it would probably be better for those people."²⁷⁴

But Senator Vardaman's humanitarian concern was out of character for him, given that the Mississippi politician was not known to display compassion for his fellow man: he is remembered mostly for his racist commentary and advocacy of white supremacy.²⁷⁵ On the topic of U.S. citizenship for Puerto Ricans, for example, he remarked: "it is a misfortune for the United States to take that class of people into the body politic. They will never, no, not in a thousand years, understand the genius of our government . . . [W]e have enough of that element in the body politic already to menace the Nation with mongrelization . . ."²⁷⁶ Although he preferred independence for the island, he acknowledged another reason for continued colonial relations: "the investments that have been made there by American white men."²⁷⁷

273. 48 U.S.C. § 745 (1917) ("[A]ll bonds issued by the Government of Puerto Rico, or by its authority, shall be exempt from taxation by the Government of the United States, or by the government of Puerto Rico or of any political or municipal subdivision thereof, or by any State, Territory, or possession, or by any county, municipality, or other municipal subdivision of any State, Territory or possession of the United States . . .").

274. 54 Cong. Rec. 2250 (1917) (statement of Sen. Vardaman).

275. See, e.g., *Vardaman and the Fight of the Seven for the Vacant Senatorship in Mississippi: Unique Career of the Man Who Surprised His Friends*, N.Y. TIMES, Jan. 9, 1910 ("Vardaman simply says that the negro is not qualified to be a voter, and that political and social equality with the whites is not to be thought of.").

276. 54 Cong. Rec. 2250 (statement of Sen. Vardaman).

277. *Id.* (acknowledging that the current proposal was the most convenient and practical).

More likely, Senator Vardaman was motivated by his awareness²⁷⁸ of the nearly insatiable U.S. demand for municipal bonds at a time when supply was less than normal. For instance, writers for the periodical *American Municipalities* observed in 1916 that municipal bonds were the premier investment security because they were exempt from increasingly higher income tax rates.²⁷⁹ However, the supply of municipal bonds was very low.²⁸⁰ By ensuring, through federal law, that Puerto Rican public debt would receive the most preferential tax treatment available to municipal bonds, Congress deflected attention away from the fact that the United States had installed an ineffective system of taxation in Puerto Rico, which did not generate sufficient governmental revenue. It also capitalized on the island's plight by expanding the municipal bond supply for U.S. investors.²⁸¹

In essence, through these legislative enactments, Congress once again dramatically restructured Puerto Rico's system of taxation and public finance. The island was forced to relinquish a large portion of its tariff revenues. Then, to replace these revenues, Puerto Ricans were subjected to a new and foreign form of direct taxation.

In late 1917, because collections from the federal income tax were insufficient, the Puerto Rican legislature enacted a second, separate income tax on the island.²⁸² Although, as states began to enact their own income taxes,²⁸³ the situation in Puerto Rico was similar to that which was becoming increasingly common on the mainland,

278. Such awareness may have come via his son. *See Memphis Banker Will Face Court*, ATLANTA CONST., Feb. 9, 1921, at 10 (noting that Senator Vardaman's son, an assistant manager of the bond department at a Memphis bank, was being investigated for potentially selling stolen liberty bonds).

279. *Municipal Financing in 1916*, AM. MUNICIPALITIES, Jan. 1917, at 107.

280. *Id.*

281. Economically speaking, access to relatively inexpensive credit can be a good thing. However, debt ratios must be carefully managed so that they do not inhibit economic growth, leading to a vicious borrowing cycle. For Puerto Rico, excessive borrowing—necessitated by an inadequate system of taxation—has ultimately led to higher financing costs, which have further constrained access to much-needed credit. *See* Sonia Colón et al., *Puerto Rico: Still in the Spotlight*, AM. BANKR. INST. J. 14 (2015) (noting Puerto Rico's recent financial struggle as exacerbated by bonds). *See generally* PUERTO RICO POLITICAL STATUS REFERENDUM 1989–1991, REPORTS AND STUDIES ON THE PUERTO RICO POLITICAL STATUS AND RELATED ISSUES 43 (1992) (discussing mounting economic challenges for the island).

282. *Report of the Treasurer* (1919), *supra* note 94, at 346.

283. *See generally* Harley L. Lutz, *The Progress of State Income Taxation Since 1911*, 10 AM. ECON. REV. 66, 66 (1920) (noting that after the successful implementation of an income tax in Wisconsin, the measure has grown in popularity).

Congress reacted to the new insular income tax as a potential source of double taxation, rather than as an additional local tax.

Thus, in October 1917, Congress clarified its desire for a more streamlined system of income taxation in Puerto Rico. It did so by encouraging the Puerto Rican legislature to “amend, alter, modify, or *repeal* the [federal] income tax laws in force in Porto Rico.”²⁸⁴ Congress further emphasized the government’s view of Puerto Rico as a foreign nation through the Revenue Act of 1918, which included a provision granting U.S. taxpayers a credit in an amount equal to any income taxes paid to foreign countries, as well as any of the possessions.²⁸⁵ The credit mechanism was much more generous to U.S. taxpayers than the deduction mechanism generally applied with respect to state income taxes.²⁸⁶ In essence, the federal law strived to maintain Puerto Rico’s status as a tax haven for U.S. companies, notwithstanding the island’s own efforts to exercise its growing—albeit still limited—taxing powers.

In 1919, Congress sought to consolidate Puerto Rican income taxes by encouraging the island to enact a comprehensive insular income tax, which was a blend of the previously enforced federal and local income tax mechanisms.²⁸⁷ The new Puerto Rican law imposed a three percent tax on the income of resident individuals and Puerto Rican corporations, and a six percent tax on the income of nonresidents and foreign corporations.²⁸⁸ Any such taxes paid by U.S. domestic corporations doing business on the island remained creditable against federal tax liabilities.²⁸⁹

By the 1919–20 fiscal year, the fiscal restructuring of Puerto Rico was complete. Evidencing the extent and nature of the changes, the War Department published a chart comparing insular revenues for the periods 1898 to 1899 and 1919 to 1920.²⁹⁰ In the earlier period, the government relied almost exclusively upon indirect taxes, with less than ten percent of total revenues generated through direct taxes on income from property.²⁹¹ More than two-thirds of the island’s

284. Revenue Act of 1918, ch. 18, § 261, 40 Stat. 1057, 1087–88 (1919) (emphasis added).

285. *Id.* § 222(a).

286. *See id.* § 214(a)(3) (providing the domestic tax deduction).

287. 1919 P.R. Laws 613; *Report of the Treasurer* (1919), *supra* note 94, at 363.

288. 1919 P.R. Laws 616, 634.

289. *Id.* at 622.

290. *Report of the Treasurer* (1919), *supra* note 94, at 363.

291. *Id.*

revenues came from customs duties,²⁹² and the remainder of revenues came from sundry excise and transfer taxes.²⁹³

By 1919 and 1920, however, more than half of the island's revenues came from direct taxes on personal and corporate income and on the assessed value of property.²⁹⁴ Approximately thirty percent of total revenues came from the new property tax,²⁹⁵ with the income tax providing an additional twenty-five percent of revenues.²⁹⁶ Meanwhile, although indirect taxes were no longer the chief revenue source, excise taxes continued to generate more than one third of Puerto Rico's total revenues.²⁹⁷ Notably, unlike the *consumo* taxes they replaced, the new excises were much more limited in scope, applying only to certain articles of consumption that were deemed to be leisure items and/or socially undesirable.²⁹⁸ In essence, the U.S.-led fiscal reorganization lessened the island's reliance on some forms of indirect taxation, such as tariffs and stamp duties, while dramatically increasing reliance on other forms of indirect taxation, such as sumptuary excise taxes. At the same time, the restructuring introduced new forms of direct taxation of income and property.

5. Assessing the U.S. fiscal restructuring of Puerto Rico

At least on the surface, the U.S.-led fiscal restructuring of Puerto Rico appeared to mirror a much broader fiscal transformation that was taking place on the U.S. mainland during roughly the same period. In the late-nineteenth and early-twentieth centuries, the emergence of income taxes gradually reduced reliance on indirect levies, such as customs duties and excise taxes.²⁹⁹ At the same time, systems of taxation on the mainland were increasingly centralized and professionally administered.³⁰⁰

Tax reforms in Puerto Rico superficially resembled those in the states, but differed in many key respects. The gradual tax policy changes on the U.S. mainland were accomplished through a legitimate law making process and reflected an emerging consensus

292. *Id.*

293. *Id.*

294. *Id.*

295. *Id.* However, virtually all of the proceeds flowed to the municipal governments.

296. *Id.*

297. *Id.*

298. See *supra* notes 141–44 and accompanying text.

299. MEHROTRA, *supra* note 112, at 6–7.

300. *Id.* at 8–11.

in support of the fiscal and social state.³⁰¹ However, like the previous Spanish system of taxation, the new system in Puerto Rico was constructed by foreign interlopers through an opaque, illegitimate political process. And, while the transformation on the mainland was primarily motivated by broad social justice concerns,³⁰² the restructuring of the Puerto Rican system of taxation was intended to advance U.S. strategic and economic interests. In other words, as a matter of political decision making, the changes made in Puerto Rico were the byproducts of coercive power, rather than democratic deliberation.

The changes made in Puerto Rico were *substantively* different as well. For instance, while on balance the professionalization and centralization of tax administration on the U.S. mainland was a good thing because it reduced reliance on potentially corrupt local officials and encouraged uniformity and consistency in the application of increasingly complex tax laws, the same transformation in Puerto Rico was overwhelmingly destructive. Notably, it extinguished the local population's remaining power over taxation. Thus, although U.S. lawmakers in Puerto Rico cited the same social justice concerns as they did on the mainland, the fiscal restructuring of the island had profoundly different effects.

The historical account provided here sharply contrasts with the prevailing U.S. and Puerto Rican narrative of a legitimate fiscal foundation for the island, constructed through a representative political process that was nurtured and facilitated by American democratic ideals.³⁰³ And, predictably, such a flawed political decision making process generated poor substantive tax policy. From the earliest days of military rule, the U.S. regime established a pattern of rewriting laws to reduce taxation of U.S. corporations doing business on the island and to increase direct and indirect taxation of Puerto Rican consumers, landowners, and native enterprises. Rather

301. See generally PIKETTY, *supra* note 253 (exploring the historical relationship between increased progressive taxation and the emergent social state).

302. MEHROTRA, *supra* note 112, at 9–10 (suggesting that those with the “ability to pay” have a greater social obligation to contribute to the public good).

303. See generally Carlos E. Díaz Olivo, *The Fiscal Relationship Between Puerto Rico and the United States: A Historical Analysis*, REV. COL. ABOG. P.R. Apr.-Sept. 1990, at 32 (reflecting the dominant account of a legitimate tax system constructed through a representative political process, and explaining that a local tax system, under which the legislature levied taxes for real and personal property, inheritance, tobacco, alcoholic beverages, and other products, “defray[ed] the expenses of the Government”); Felipe Rodríguez Lafontaine, *Puerto Rico Act 154: The Beginning of the End? Effects of Act 154 on Future Economic Development*, 2 U. P.R. BUS. L.J. 216, 218–21 (2011) (describing the prevailing modern view of the history of Puerto Rico’s strong taxing powers).

than incentivizing local entrepreneurship and capital growth, the tax laws encouraged almost exclusive reliance upon mainland financing and managerial expertise.³⁰⁴ Meanwhile, the new system of property taxation reconfigured access to land in real and consequential ways, causing local landholding elites to lose power. The system also facilitated U.S. sugar corporations' dominance in a monocrop economy with correspondingly high levels of dependence on wage labor.³⁰⁵ And, across the island, U.S. officials' aggressive tax collection and enforcement led to Puerto Ricans' widespread mistrust of revenue collection activities, poor compliance, and low tax morale.³⁰⁶ Even to this day, the island struggles with the social and economic consequences of these policies.³⁰⁷ Tax compliance rates on the island remain relatively low.³⁰⁸ At the same time, Puerto Rico's relatively large underground and informal economy, estimated at twenty-three percent of the island's gross national product, avoids taxation.³⁰⁹ These behaviors have fueled a vicious cycle in which the island must "levy high [taxes] on narrow bases," worsening tax morale and creating further incentives for tax evasion.³¹⁰ In essence, the U.S.-imposed system of taxation badly distorted the economy at a critical point in history, cultivating negative habits and attitudes with

304. This critique echoes observations made by economist James Dietz in a 2003 work. See JAMES L. DIETZ, PUERTO RICO: NEGOTIATING DEVELOPMENT AND CHANGE 45–48 (2003) (stating that Puerto Rico relied on mainland U.S. financing and entrepreneurial expertise instead of attempting to promote the development of local sources of such knowledge). However, while Dietz attributed these conditions to the Puerto Rican government's decision to initiate Operation Bootstrap in the late 1940s, I argue that the groundwork was actually laid much earlier, by the U.S. tax and economic policies put into place during stage one of U.S. tax imperialism in Puerto Rico.

305. At the same time, the economic shifts privileged Puerto Ricans who held managerial roles in large U.S. corporations or professional service positions.

306. See generally Marjorie E. Kornhauser, *A Tax Morale Approach to Compliance: Recommendations for the IRS*, 8 FLA. TAX REV. 599 (2007) (defining "tax morale" generally as the intrinsic motivation to pay taxes).

307. See generally James Alm, *Assessing Puerto Rico's Fiscal Policies*, in THE ECONOMY OF PUERTO RICO: RESTORING GROWTH 319 (Susan M. Collins et al. eds., 2006) (highlighting the weaknesses of Puerto Rico's modern fiscal infrastructure).

308. See Michelle Kaske, *Puerto Rico Seen Collecting Up to \$6.7 Billion From Proposed Tax*, BLOOMBERG BUSINESS (Feb. 4, 2015), <http://www.bloomberg.com/news/articles/2015-02-04/puerto-rico-seen-collecting-up-to-6-7-billion-from-proposed-tax> [hereinafter Kaske, *Puerto Rico Seen Collecting Up to \$6.7 Billion From Proposed Tax*] (citing a report by the consulting firm KPMG which estimated that the rate of compliance with the new sales tax in Puerto Rico is fifty-six percent).

309. FEDERAL RESERVE BANK OF NEW YORK, AN UPDATE ON THE COMPETITIVENESS OF PUERTO RICO'S ECONOMY 24 (2014).

310. *Id.* at 24.

respect to revenue collection activities and leaving the island's economy extremely fragile and dependent.

Indeed, the cumulative effects of Spanish and American colonial policies meant that future growth was unlikely to develop organically from the island's own entrepreneurial efforts. At the same time, colonial history left a legacy of stunted taxing powers and impaired revenue-raising abilities. If it is true that the Spanish system extended preferences to peninsular interests, then the U.S.-led fiscal reconstruction appears to have simply traded these external preferences for new ones. These troubling consequences would be of little immediate import to the island; in the subsequent years, the United States would carve a very specific role for the colony that did not require a thriving local economy or a strong local consensus with respect to the importance of revenue collection. This role would become more apparent in the second stage of U.S. tax imperialism.

B. Stage Two of U.S. Tax Imperialism in Puerto Rico, 1920–1974

For Puerto Rico, the 1920s were characterized by economic crisis, political violence, and instability.³¹¹ The tax and economic policies that steered the island toward a monocrop economy left it incapable of weathering a post-WWI global collapse in sugar prices.³¹² Against this backdrop, newly-appointed Governor E. Mont Reily instituted an “Americanism” campaign on the island, promoting the use of the English language and the flying of only the U.S. flag.³¹³ Naturally, native politicians and U.S.-born appointed members of the insular government sparred frequently, leading the extremely unpopular Governor to declare that Puerto Rican party leaders were “dictators or plotters seeking to undermine the authority of the Federal Government.”³¹⁴ Puerto Rican officials retorted that the Governor

311. See generally José O. Solá, *Partisanship, Power Contenders, and Colonial Politics in Puerto Rico, 1920s*, 38 CARIBBEAN STUD. 3 (2010) (exploring the political and economic landscape of Puerto Rico in the 1920s).

312. See DEREK H. ALDCROFT, FROM VERSAILLES TO WALL STREET, 1919–1929, at 227 (1981) (describing the worldwide fall in sugar prices); MARK S. LECLAIR, INTERNATIONAL COMMODITY MARKETS AND THE ROLE OF CARTELS 72 (2000) (same).

313. See, e.g., J.R. Hull, *Letter to the Editor, English in Porto Rico*, N.Y. TIMES, Sept. 27, 1921 (quoting the Governor’s inaugural address: “I hope to see the language of Washington, Lincoln and Harding taught equally with that of Spanish in our public schools, and that all other languages shall be secondary”); *New Governor Takes Office in Porto Rico*, N.Y. TIMES, July 31, 1921 (reporting that Governor Riley’s statement that “there was no room in Porto Rico for any flag other than Old Glory” was met with great applause).

314. *Denies Porto Rico Plans to ‘Secede’: President of the Island Senate Declares the Unionist Party Is a Patriotic League*, N.Y. TIMES, Dec. 19, 1921.

was “an irresponsible despot, who wraps himself in the folds of the Star Spangled Banner and then attempts to rule our people after the fashion of a Roman proconsul.”³¹⁵ As Puerto Ricans began to relocate in large numbers to the U.S. mainland, a politically active and vocal community developed in New York City and demanded improvements for the island.³¹⁶

Meanwhile, with the U.S.-led fiscal reconstruction completed, history ushered in the second stage of U.S. tax imperialism in Puerto Rico. During this period, which extended from 1920 through 1974, the United States promulgated, maintained and encouraged tax and economic policies that situated Puerto Rico as a lower-cost provider of manufacturing inputs, thereby improving the global competitiveness of U.S. corporations and lessening their dependence upon international labor and materials. It is important to note that, because of the tax and economic policy groundwork laid by the United States in stage one, this was the *only* development option for Puerto Rico; the island would suffer profoundly until it accepted and embraced this role.

One of this period’s earliest tax laws³¹⁷ was designed to respond to a perceived threat of double taxation for American corporations doing business in the possessions: they were technically subject to income taxes imposed by the possessions themselves, and to federal income taxes imposed on all worldwide income.³¹⁸ Of course, Congress had already eliminated any actual threat of double taxation in earlier legislation, granting a foreign tax credit in an amount equal to any taxes paid to the possessions.³¹⁹ Moreover, not all observers were certain that insular taxation ought to be viewed as a source of “double taxation,” which generally refers to the levying of taxes by two separate sovereign states.

For instance, U.S. corporations doing business in states that had enacted their own income taxes, beginning with Wisconsin in 1911,³²⁰

315. *Davila Asks House for Reily Inquiry*, N.Y. TIMES, Apr. 5, 1922.

316. Angelo Falcon, *A History of Puerto Rican Politics in New York City: 1860s to 1945*, in PUERTO RICAN POLITICS IN URBAN AMERICA 24–27 (James Jennings & Monte Rivera eds., 1984) (discussing how Puerto Ricans relocated to New York and formed organizations to advocate on behalf of the island).

317. Revenue Act of 1921, ch. 136, § 262, 42 Stat. 227, 271.

318. See *Medchem (P.R.) Inc. v. Comm'r of Internal Revenue*, 116 T.C. 308, 333–34 (2001) (explaining this history), *aff'd*, 295 F.3d 118 (1st Cir. 2007); see also Revenue Act of 1918, ch. 18, 230, 40 Stat. 1057, 1077; Tariff Act of 1913, ch. 16, § II, 38 Stat. 144, 166.

319. Revenue Act of 1918, ch. 18, §§ 214, 222, 40 Stat. 1057, 1066–67, 1073.

320. See Harley L. Lutz, *The Progress of State Income Taxation Since 1911*, 10 AM. ECON. REV. 66, 66 (1920) (noting after the successful implementation of an income tax in Wisconsin, the measure grew in popularity).

also encountered multiple tiers of taxation, and yet this was not viewed by lawmakers in the same way. Indeed, Judge Learned Hand made this very observation in 1921. In *Porto Rico Coal Co. v. Edwards*,³²¹ a New York corporation that derived substantially all of its income from activities in Puerto Rico in the years 1917 and 1918 made a claim of unlawful double taxation.³²² In his opinion, Judge Hand explained that “[t]he situation [wa]s . . . no different [than] if [the plaintiff] had drawn its income from New York, or Massachusetts, or any other state of the Union having an income tax. It would have been subject to two taxes on the same property—one for local, and one for general, purposes.”³²³ But, rather than adopt Judge Hand’s view of the possessions as members of a federal system that may have multiple tiers of income taxation, Congress chose to continue viewing them as foreign participants in a global taxing regime that strongly disfavored double taxation. This likely reflected a deeply held, biased view of the possessions as global playing fields for U.S. corporations in their battle to compete with foreign counterparts.

Thus, Congress included section 262 in the Revenue Act of 1921, citing concern that the “double tax burden [had] placed American businesses at a competitive disadvantage when compared with their British and French counterparts, which were not subject to taxation upon the profits they earned abroad unless paid back to the home company.”³²⁴ But, section 262 went much further than the previously enacted legislation extending the foreign tax credit to the possessions; rather than offering a credit against federal taxes, it outright exempted from federal income taxation all foreign-sourced income of qualifying U.S. citizens and corporations to the extent that at least eighty percent of such person’s earnings from the three preceding years derived from U.S. possessions (including, but not limited to, Puerto Rico), and at least fifty percent of such person’s earnings from the three previous years derived from active income earned in U.S. possessions.³²⁵ For these purposes, income from

321. 275 F. 104, 106–08 (S.D.N.Y. 1921).

322. *Id.*

323. *Id.* at 107.

324. Medchem (P.R.), Inc. v. Comm’r of Internal Revenue, 116 T.C. 308, 333–34 (2001); see H.R. REP. NO. 350, at 8 (1921); 61 CONG. REC. 6997 (1921) (remarks of Senator Smoot); see also U.S. GOV’T ACCOUNTABILITY OFF., GAO-93-109, TAX POLICY: PUERTO RICO AND THE SECTION 936 TAX CREDIT 2 (1993) (clarifying that section 262 was intended “to help U.S. corporations compete with foreign firms in the Philippines (then a U.S. possession)”).

325. Revenue Act of 1921, ch. 136, § 262(a), 42 Stat. 227, 271.

sources within a U.S. possession was treated as foreign-sourced income. As tax analyst David A. Buckley, Jr., explained in a 1921 monograph, “[i]n substance[,] therefore[,] citizens or domestic corporations conducting a trade or business in a possession . . . are taxed by this Act only on the income from within the United States and not on the income from the possessions if they comply with the [eighty percent] and [fifty percent] provisions.”³²⁶

This provision essentially continued—at least for U.S. persons doing business on the island—the federal government’s earlier tradition of declining to extend the federal tax laws to Puerto Rico. In this respect, while not a “tax sparing mechanism”³²⁷ per se, but rather an exception to the normal tax on worldwide income,³²⁸ the provision would ultimately have the same effect. By declining to impose the tax that the United States would normally impose on certain foreign income earned by U.S. persons, it encouraged the possessions to extend generous tax incentives to attract capital. This is because the exemption fully preserved the economic benefits to investors of any tax incentives offered by the possessions; in contrast, under a more customary foreign tax credit mechanism, these benefits would have been merely offset by larger U.S. tax liabilities.

It is important to note, however, that section 262 was not targeted at Puerto Rico, but rather at the Philippines. In fact, as the U.S. Treasury later conceded, “Puerto Rico was virtually ignored in the public debate.”³²⁹ Because the island’s economy was contracting rather than expanding in the first half of the twentieth century, the new law would have little impact on the Puerto Rican economy until decades later, when the U.S. and Puerto Rican governments would

326. DAVID A. BUCKLEY, JR., FEDERAL TAXATION: AN INTERPRETATION AND ANALYSIS WITH THE TEXT OF THE REVENUE ACT OF 1921, at 35 (1921).

327. In tax policy literature, the phrase “tax sparing” is reserved for tax laws that offer foreign tax credits equal to—or even greater than—the tax that would have been collected by a developing nation, even if that nation does not actually impose the tax. In other words, if the tax credit were not provided, the developing nation’s tax incentives would not be as attractive because the investor would still pay the full (and presumably higher) rate of taxation imposed by the more developed nation. See generally Damian Laurey, Note, *Reexamining U.S. Tax Sparing Policy with Developing Countries: The Merits of Falling in Line with International Norms*, 20 VA. TAX REV. 467 (2000) (exploring U.S. policy with respect to tax sparing mechanisms).

328. See 26 U.S.C. § 61(a) (2012) (defining gross income as “all income from whatever source derived”).

329. U.S. TREASURY DEPARTMENT, THE OPERATION AND EFFECT OF THE POSSESSIONS CORPORATION SYSTEM OF TAXATION: FIRST ANNUAL REPORT, GOVERNMENT PRINTING OFFICE 10 (1978).

make additional refinements to the patchwork of federal and insular tax provisions impacting U.S. investors on the island.

So, for the immediate time being, Puerto Rico's economic troubles worsened as problems mounted in the island's major agricultural industries. In response to a global decrease in sugar prices during the Great Depression, the U.S. government allowed U.S. sugar producers to enter into a voluntary marketing agreement to control production.³³⁰ Each sugar producing region, including Puerto Rico, was assigned a quota restricting its sale of sugar.³³¹ These restrictions were a major setback to Puerto Rican workers in the sugar industry. The new sugar production quotas caused the previously expanding sugar producers to decrease wages in response to increased labor competition and in an effort to protect their profit margins.³³²

Meanwhile, the already-struggling Puerto Rican tobacco industry "began a calamitous decline" during the 1930s, mostly due to increased global competition and declining world prices.³³³ To add further insult to injury, as islanders attempted to rejuvenate a once-burgeoning coffee industry, another powerful hurricane struck Puerto Rico in September 1928, causing substantial damage to the island's coffee plantations.³³⁴ In the wake of the storm, although it lacked power to levy customs duties, the Puerto Rican legislature imposed an emergency import duty on all foreign coffee brought into Puerto Rico.³³⁵ Given the exigency of the situation, Congress legalized and ratified the measure pursuant to the Tariff Act of 1930, retroactively empowering the island to levy customs duties on imported coffee.³³⁶ But, this measure was not enough; the Puerto Rican coffee industry would continue to suffer, with sales to the

330. RONALD FERNANDEZ, THE DISENCHANTED ISLAND: PUERTO RICO AND THE UNITED STATES IN THE TWENTIETH CENTURY 116 (1992) (describing early attempts to stabilize the sugar industry by allowing voluntary control of sugar production by setting sugar-production quotas).

331. *See id.* (stating that states like Louisiana or Hawaii had seen their production quotas rise, while Puerto Rico's sugar production quota was cut by a full twenty percent).

332. *See* GERALD MEYER, VITO MARCANTONIO: RADICAL POLITICIAN 1902–1954, at 155–56 (1989) (exploring the economic and political consequences of the sugar quotas); *see also* FERNANDEZ, *supra* note 330, at 116.

333. Teresita A. Levy, *Tobacco Growers and Resistance to American Domination in Puerto Rico, 1899–1940*, at 6 (Commodities of Empire, Working Paper No. 17, 2010).

334. *See* ROBERT MYKLE, KILLER 'CAKE: THE DEADLY HURRICANE OF 1928, at 4–7 (2002) (illustrating the importance of the recently thriving plantations for the audience to understand the impact of the 1928 hurricane).

335. *Porto Rico to Tax Imported Coffee*, N.Y. TIMES, May 6, 1930, at 47; *see* 1930 P.R. Laws 742, quoted in Porto Rico Brokerage Co. v. United States, 76 F.2d 605, 606 (C.C.P.A. 1935).

336. *See* 19 U.S.C. §§ 1319, 1319a (2012).

United States stalled for nearly eight years.³³⁷ When productivity finally normalized more than a decade later, the industry would encounter further diminished prices on the world market.³³⁸

In an effort to draw attention to the plight of the island's rural population—and in response to increasing political attacks on indigenous island culture—Puerto Rican writers, poets and songwriters in the 1930s frequently wrote allegories, with the main character being the authentic Puerto Rican rural villager, *el jíbaro*.³³⁹ These depictions were intended to protest colonial rule and its attendant economic exploitation. Take, for instance, music by legendary Puerto Rican songwriter Rafael Hernández. Pro-independence writer José Luis Gonzalez acknowledged Hernandez's 1929 composition *Lamento Borincano* as "Latin America's first 'protest song,'" in that it captured "[t]he tragedy of the Puerto Rican *jíbaro*, [which,] in the 1930s[, was] a helpless victim of poverty and spiritual malaise."³⁴⁰ Antonio Pedreira, Professor of Spanish Literature at both the University of Puerto Rico and Columbia University during the 1930s, wrote extensively about Puerto Rican cultural identity and, in particular, rural peasant culture.³⁴¹ These works challenged the prevailing "image of the rural worker, the *jíbaro*, as a lazy, violent, uneducated, and taciturn mestizo[, which] was widely diffused in government circles and among the landed and commercial elite."³⁴²

As deepening economic woes contributed to growing discontent with American colonial rule, the highly contentious Puerto Rican Nationalist Party gained considerable ground.³⁴³ The Nationalist Party's chief complaint was that Puerto Rico was not seen as a nation, but rather

337. *Shipment of Coffee Here by Puerto Rico Resumed*, N.Y. TIMES, July 15, 1936, at 27.

338. *Puerto Rico Asks U.S. Aid: Policy to Help Rehabilitate Coffee Industry Is Urged*, N.Y. TIMES, Oct. 28, 1939, at 6.

339. As a central character intended to represent Puerto Rican peasant culture, *el jíbaro* first began to appear in literature more than a century earlier. See, e.g., Manuel A. Alonso, *A Jíbaro Wedding*, in BORINQUEN, *supra* note 244, at 40–43.

340. *Gonzalez*, *supra* note 40, at 49.

341. See, e.g., Antonio S. Pedreira, *La Actualidad del Jíbaro*, in ENRIQUE A. LAGUERRE & ESTHER M. MELÓN, *EL JÍBARO DE PUERTO RICO: SÍMBOLO Y FIGURA 7–13* (1968) (demonstrating tales of the *jíbaro*).

342. Schwartz, *supra* note 138, at 313. See generally ILEANA M. RODRÍGUEZ-SILVA, *SILENCING RACE: DISENTANGLING BLACKNESS, COLONIALISM, AND NATIONAL IDENTITIES IN PUERTO RICO* (2012) (illustrating the complex racial and class hierarchies within Puerto Rican society).

343. See Arnold Leibowitz, *The Commonwealth of Puerto Rico: Trying to Gain Dignity and Maintain Culture*, 11 GA. J. INT'L & COMP. L. 211, 227–29 (1981) (chronicling the growth of the Nationalist Party during the 1930s).

as an island property that was taken through military intervention.³⁴⁴ In a 1936 speech, party leader Pedro Albizu Campos took precise aim at the unjust concentrations of economic power on the island:

We stand as a nation surrounded by industry, but with little of it belonging to our people. The business development in Puerto Rico since the United States intervention should have made the island one of the most prosperous islands in the world, but that is not the case. The United States controls our economy, our commerce. Puerto Rico must determine a price for its products that is acceptable to the United States, while the United States issues their products to Puerto Rico at a rate that is comfortable to its own manufacturers and not the Puerto Rican consumer. The result is exploitation and abuses perpetrated at will, resulting in poverty for our people and wealth for the United States. Seventy-six percent of the wealth is in the hands of United States corporations, and their stability is ensured by the United States military.³⁴⁵

While most Puerto Ricans declined to embrace Albizu's confrontational style and violent methods of protest—indeed, his followers would later attempt, among other things, to assassinate President Harry Truman³⁴⁶—his social and political commentary would be far more influential than his call to arms. As a result, other less radical, but equally impassioned, socialist, independence, and nationalist movements gained considerable steam during the 1930s and 1940s, both on the island and among mainland Puerto Ricans.³⁴⁷ Large-scale labor strikes, marches, and demonstrations occurred throughout the 1930s, to which the colonial regime responded with a "campaign of repression."³⁴⁸ In one of the bloodiest clashes, the

344. Pedro Albizu Campos, *Puerto Rican Nationalism*, in BORICUAS: INFLUENTIAL PUERTO RICAN WRITINGS—AN ANTHOLOGY, *supra* note 40, at 27.

345. *Id.* at 28.

346. See generally STEPHEN HUNTER & JOHN BAINBRIDGE, JR., AMERICAN GUNFIGHT: THE PLOT TO KILL PRESIDENT TRUMAN—AND THE SHOOT-OUT THAT STOPPED IT (2005) (highlighting the linkage between Truman's assassination attempt and Albizo's nationalist movement). Nationalist party followers were also linked to other violent acts and conspiracies, including an attack on members of Congress and plots to assassinate prominent mainland and Puerto Rican politicians. See *10 Puerto Ricans Guilty of Plots*, N.Y. TIMES, Mar. 11, 1955, at 16.

347. See, e.g., ROBERT W. ANDERSON, PARTY POLITICS IN PUERTO RICO 32–42 (1965) (describing the emergence of new parties and realignments of old ones during this period); see also Falcon, *supra* note 316, at 37 (noting that the Puerto Rican independence movement received widespread support in New York City throughout the 1930s and 1940s).

348. This period is thoughtfully considered in Carrión, *supra* note 147, at 141–42. Many of the violent clashes were reported by mainland newspapers. See, e.g., 2 in

Ponce massacre in March of 1937, the colonial regime killed nineteen Puerto Rican nationalists and wounded many others.³⁴⁹ The United States would struggle to contain dissident elements of Puerto Rican civil society for decades to come, ultimately leading the colonial power to lessen its grip on the island's economic and political affairs.

In his September 1941 inaugural address, Rexford Tugwell, the last U.S.-born appointed Governor of Puerto Rico,³⁵⁰ attempted to respond to widespread discontent within the island population. As a devoted New Deal liberal, he vowed to tackle the overwhelming poverty on the island and called upon Puerto Ricans to support his vision of agricultural and industrial diversification.³⁵¹ Expressing hope that the island would attract "the other kind of capital—investment," he explained that "[t]he time is past when absentee capitalists can expect to extract extravagant percentages of gain, using the people's need and their own monopoly to force the acceptance of [unfair] terms."³⁵²

Governor Tugwell, with the support of President Franklin Roosevelt and working in conjunction with legendary reformer Luis Muñoz Marín, who was then presiding over the Puerto Rican Senate, initiated a number of populist reforms to remedy economic imbalances on the island and restore social justice. Notably, his government passed a land reform measure that promised strict local enforcement of a previously ignored farm size restriction codified in the Foraker Act.³⁵³ The new law established a public Land Authority ("Authority") that would purchase any corporate farms that exceeded five hundred acres. The Authority was financed through the insular government's lucrative returns from tariffs on sales of rum to the

Puerto Rico Kill Police Head and Are Shot Dead: Nationalist Youths Murder Col. E.F. Riggs in Revenge for University 'Massacre', N.Y. TIMES, Feb. 24, 1936, at 1; *Four Killed in Clash in Puerto Rico Town*, N.Y. TIMES, Oct. 25, 1935, at 15.

349. J. MICHAEL MARTINEZ, TERRORIST ATTACKS ON AMERICAN SOIL: FROM THE CIVIL WAR ERA TO THE PRESENT 156 (2012) (writing that police officials opened fire on the unruly crowd and a hostile struggle followed).

350. See generally MICHAEL NAMORATO, REXFORD G. TUGWELL: A BIOGRAPHY (1988).

351. *Inaugural Address*, in PUERTO RICAN PUBLIC PAPERS: R.G. TUGWELL 5–11 (1945).

352. *Id.* at 8.

353. See, e.g., *Sugar Acreage Limit Hailed in Puerto Rico*, N.Y. TIMES, Mar. 27, 1940, at 9. The Foraker Act included a provision making it unlawful for corporations to own farms greater than 500 acres, but this law was never enforced by the federal government—indeed, the federal provision lacked any enforcement mechanism. TRUMAN R. CLARK, PUERTO RICO AND THE UNITED STATES, 1917–1933, 110 (1975) (describing the legislative history of the 500 acre restriction, and the lack of enforcement measures).

mainland.³⁵⁴ The government also instituted a number of laws that gave preference to small farmers. For instance, it permitted any farmer access to a small portion of the island's overall quota, essentially allocating the quota with a preference for small farmers.³⁵⁵ Similarly, the government required sugar factories to process cane delivered by small farmers.³⁵⁶

Historians largely view the Puerto Rican economic initiatives of the early 1940s as unsuccessful. As Muñoz Marín would later explain, "social justice attained at low levels of production may be honorable, but it is inefficient for achieving true well-being."³⁵⁷ Without sufficient local enterprise to grow the economy, island policies would need to specifically target foreign direct investment. Thus, priorities shifted once again, coinciding with the Puerto Rican legislature's passage of the Industrial Incentives Act of 1948 (the "Act"),³⁵⁸ and the popular election of Muñoz Marín as the first elected governor in 1948.³⁵⁹ Muñoz Marín was a candidate of the Popular Democratic Party, which favored maintenance of Puerto Rico's status as a U.S. territory.³⁶⁰ Specifically, Muñoz Marín felt that Puerto Rico should capitalize on the "exceptional advantage" of Puerto Rico's "fundamental economic asset": free trade with the United States.³⁶¹ Muñoz Marín hoped that increased U.S. investment in Puerto Rico

354. The Bacardi rum company, originally founded in Cuba by Spanish entrepreneurs, relocated production facilities to Puerto Rico in 1936. Tariff advantages made it more attractive to produce in Puerto Rico and sell to the U.S. mainland. *Bacardi Runs Puerto Rico Plant*, N.Y. TIMES, Apr. 18, 1937, at 59. Then, because the U.S. government requisitioned whiskey for industrial uses during World War II, rum manufacturers who were unaffected by the government order enjoyed a Roman holiday of sorts, leading to sharp increases in Puerto Rican exports of rum to the mainland and a dramatic rise in tariff collections. *Puerto Rico Asks to Build Up Trade*, N.Y. TIMES, Jan. 3, 1949, at 70; see also *supra* note 179 and accompanying text (describing the federal tariff cover-over program).

355. 28 L.P.R.A. § 247 (1941).

356. BENJAMIN BRIDGMAN ET AL., FED. RES. BANK OF MINN., WHAT EVER HAPPENED TO THE PUERTO RICAN SUGAR MANUFACTURING INDUSTRY? 19 (2012), <https://www.minneapolisfed.org/research/sr/sr477.pdf>.

357. DIETZ, *supra* note 304, at 52.

358. P.R. LAWS ANN. TIT. 13, §§ 221–38 (1948).

359. *Puerto Rico Elects Munoz its Governor*, N.Y. TIMES, Nov. 3, 1948, at 5 (declaring a landslide victory in Puerto Rico's first direct election). In 1947, at Muñoz Marín's urging, Congress passed the Elective Governor Act, allowing Puerto Ricans to choose their Governor by popular ballot. See Pub. L. No. 362, 61 Stat. 700, 770–71 (1947), repealed by Act of July 3, 1950, ch. 446, 64 Stat. 319, 319–20 (providing for the organization of a constitutional government by the people of Puerto Rico).

360. *Puerto Rico Elects Munoz its Governor*, N.Y. TIMES, Nov. 3, 1948.

361. *Puerto Rico Asks to Build Up Trade*, N.Y. TIMES, Jan. 3, 1949, at 70.

would enhance economic conditions for all Puerto Ricans. Working closely with the federal government and the Puerto Rican legislature, Muñoz Marín spearheaded the Industrial Tax Exemption Act, which included generous tax and economic incentives and launched what would come to be known as *Operación Manos a la Obra* (“Operation Bootstrap”).³⁶² The program was intended to transform the island from “a declining agrarian economy into an expanding industrial structure.”³⁶³

As its centerpiece, Operation Bootstrap offered U.S. corporations at least ten years of exemption from Puerto Rican income and property taxes, as well as from most excise taxes, municipal taxes, and license fees.³⁶⁴ When combined with section 262 of the U.S. Tax Code,³⁶⁵ these tax incentives amounted to a total holiday from virtually all forms of taxation. Operation Bootstrap included a number of other economic subsidies to corporations investing in the island. Muñoz Marín engaged directly with Wall Street, traveling to the mainland to make presentations that urged direct investment on the island.³⁶⁶ Finally, he recognized the value of tourism as a prospective revenue source, calling upon the island’s development company to expand tourist facilities.³⁶⁷

Pleased with the direction of economic policy on the island, and under increasing global pressure to relax its imperial grip on its colonies, Congress in 1950 passed a law authorizing Puerto Rico to draft its own constitution, subject to approval by the people of Puerto Rico and by Congress.³⁶⁸ The law also repealed sections of the Jones-Shafroth Act, renaming the remaining sections the Puerto Rican

362. See Act of May 13, 1948, P.R. LAWS ANN. TIT. 13, §§ 221–38; see also LEWIS, *supra* note 220, at 167–70 (explaining that Operation Bootstrap would combat the “battle for production” with a planned industrialization program to create new income production, and that it transformed Puerto Rico’s economy from being reliant on agriculture to being driven mainly by industrial and manufacturing jobs).

363. LEWIS, *supra* note 220, at 167.

364. DIETZ, *supra* note 68, at 300–01 (describing a legal construct that allowed for tax free income on all non-expatriated assets to U.S. companies operating within Puerto Rico).

365. See *supra* notes 324–26 and accompanying text (explaining that section 262 completely exempted U.S. persons from federal income tax on all foreign-sourced income if they complied with the eighty percent and fifty percent provisions).

366. *Puerto Rico Plea Put to Investors*, N.Y. TIMES, July 29, 1949, at 25.

367. *Island for Tourists: Puerto Rico Launches Drive for Visitors with Opening of a Fine New Hotel*, N.Y. TIMES, Dec. 18, 1949, at X17 (detailing the grand opening of the Caribe Hilton and contrasting it with the relative dearth of hotels for tourism). See generally DENNIS MERRILL, NEGOTIATING PARADISE: U.S. TOURISM AND EMPIRE IN TWENTIETH-CENTURY LATIN AMERICA (2009) (discussing in detail the early development of the Puerto Rican tourist industry).

368. Act of July 3, 1950, ch. 446, 64 Stat. 319 (codified at 48 U.S.C. §§ 731–916 (2012)).

Federal Relations Act.³⁶⁹ In preambles to the Act, the federal government acknowledged the island's need to self-govern, and authorized the Puerto Rican people to call a constitutional convention to draft a governing instrument for the island.³⁷⁰ The Puerto Rican Constitution, which established the island as a Commonwealth of the United States, was overwhelmingly approved by a popular referendum held on March 3, 1952.³⁷¹ As a commonwealth, the island would be "self-governing under a constitution of its adoption," possessing a "right of self-government [that] will not be unilaterally withdrawn by Congress."³⁷² The Supreme Court further clarified in 1976 that Congress intended "to accord to Puerto Rico the degree of autonomy and independence normally associated with States of the Union."³⁷³

In 1954, the federal government further signaled its approval of Puerto Rican tax and economic policy by expanding the possessions tax exemption so that it applied not only to the possessions, but also to the remaining U.S. territories. The resulting amended and restated law was codified as section 931 of the U.S. Tax Code.³⁷⁴ That same year, the Puerto Rican legislature expanded the Industrial Tax Incentives Act, making it even more generous to U.S. corporations doing business on the island.³⁷⁵ The combined effect of the federal and local tax laws meant that Puerto Rico was finally meeting its full potential as a tax haven to U.S. corporations striving to compete internationally.

Over the years, scholars and commentators have debated whether Muñoz Marín was a mere "puppet" serving the interests of U.S. imperialism in Puerto Rico. Without question, Pedro Albizu Campos—the controversial leader of the Puerto Rican Nationalist Party—held this view, referring to the governor as the "puppet that is called Muñoz Marín" while also remarking on "all the 'yanquis' that surround him."³⁷⁶ Meanwhile, Juan Gonzalez, a leading member of the Young Lords Organization—a Puerto Rican nationalist group formed on the

369. *Id.* §§ 4–5, 64 Stat. at 319–20.

370. *Id.* 64 Stat. at 319.

371. *Puerto Rico's Constitution*, N.Y. TIMES, Mar. 5, 1952, at 28.

372. U.S. DEP'T OF STATE, 7 FOREIGN AFFAIRS MANUAL 1121.2-1 (2013).

373. Examining Bd. of Eng'rs, Architects & Surveyors v. Flores de Otero, 426 U.S. 572, 594 (1976).

374. Internal Revenue Code of 1954, 26 U.S.C. § 931, *repealed* by Internal Revenue Code of 1986, 100 Stat. 2593 (1986).

375. Industrial Tax Incentives Act of Puerto Rico of 1954, 1953 P.R. Laws 12, 16.

376. A. W. MALDONADO, LUIS MUÑOZ MARÍN: PUERTO RICO'S DEMOCRATIC REVOLUTION 300 (2006). "Yanqui" is an alternative spelling of "Yankee."

mainland in the 1960s—had a more detailed list of grievances: “[Muñoz Marín] . . . made a deal with the Gringo: he would become the first Puerto Rican governor if he would agree not to push for independence and accept his puppet role.”³⁷⁷ Referring to Muñoz Marín as the “biggest traitor in Puerto Rican history,” “the apostle of non-violence for profit,” and a “lackey,” he complained that the Governor

shipped [Puerto Ricans] by the hundreds of thousands to New York because he could not provide jobs for them; . . . taught our people to be white middle class americanos, when they were poor, oppressed boricuas; . . . destroyed the jibaro with operation bootstrap, moving thousands off the land into the slums of San Juan, and Ponce, and let all our money go to [U.S.] capitalists.³⁷⁸

Gumersindo Vidot, a Puerto Rican boxer who grew up impoverished in Spanish Harlem, made a similar indictment in his memoirs: “Puerto Ricans were brought here with lies and promises. New York Mayor Robert F. Wagner, Jr., with the help of Luis Muñoz Marín (who was . . . [a] puppet governor for the USA), had begun a campaign to recruit . . . laborers from Puerto Rico to work in the city’s factories.”³⁷⁹ He further opined that “[t]his campaign was called ‘Operation Bootstrap’ and was a big joke that only gave false hope.”³⁸⁰ Indeed, many Puerto Ricans who resettled on the mainland not only continued to struggle economically, but also faced discrimination.³⁸¹

In a 2001 work, Professor Carmen Teresa Whalen struggled to detail these and similar criticisms of Muñoz Marín and his political party. Reflecting upon the work of other political theorists and historians, she thoughtfully concluded, “[t]here is no question that the politicians and policy makers of the [Popular Democratic Party] developed strategies and made decisions within the confines of the colonial relationship.”³⁸² In other words, the Governor declined to really challenge the broader political and economic construct. It seems that, from the depths of Puerto Rico’s economic despair, he acknowledged and embraced the only development path that was left

377. Juan Gonzalez, *The Vote or the Gun*, in THE YOUNG LORDS: A READER 82 (Darrel Enck-Wanzer ed., 2010).

378. *Id.*

379. GUMERSINDO VIDOT, YOU ONLY LIVE TWICE: MY STORY, FROM BOOT STRAPS TO SUCCESS 29–30 (2010).

380. *Id.* at 30.

381. See, e.g., GINA M. PÉREZ, THE NEAR NORTHWEST SIDE STORY: MIGRATION, DISPLACEMENT, AND PUERTO RICAN FAMILIES 78–79 (2004); see also *infra* notes 395–98 and accompanying text.

382. WHALEN, *supra* note 235, at 11.

available to the island: serving as a tax haven and as a lower-cost provider of manufacturing inputs to American corporations.

This was not simply an act of submission; rather, Muñoz Marín and other leaders of the Popular Democratic Party were most likely deeply influenced by prevailing U.S. political and economic theories, having witnessed through New Deal policies how American capital could be redistributed to the less fortunate members of society.³⁸³ Moreover, Muñoz Marín deeply admired his father, a legendary pro-independence activist dedicated to improving conditions for the long-suffering *jíbaro*.³⁸⁴ Indeed, it was precisely his desire to improve the island's economy for its most impoverished members that caused him to question whether Puerto Rican independence was the right course, at least in the short-term.³⁸⁵ Thus, the argument that he and his fellow partisans were mere "puppets" of U.S. corporate interests seems an oversimplification of history; they most likely believed, authentically, that the island could make substantial gains from trade with the United States, which would then lift the tides for all.

To be sure, Operation Bootstrap was quickly hailed as a success. A 1949 article in the *New York Times* called the program "one of the most spectacular economic achievements of the post-war era."³⁸⁶ American companies entered the island in droves and established manufacturing facilities that hired great numbers of Puerto Ricans. Throughout the 1960s, even as the rest of the United States slipped into a business slump, Puerto Ricans enjoyed staggering growth in all major economic sectors.³⁸⁷ Puerto Rico's successes would continue well into the 1970s, with a reporter for the *Chicago Tribune* declaring in 1972 that per capita income on the island was "now among the world's highest, comparable with the West European countries."³⁸⁸

383. *Id.* at 11–12; see also AYALA & BERNABE, *supra* note 1, at 223–26 (thoughtfully exploring the political conflicts concerning Puerto Rico's growing reliance on U.S. capital during this and subsequent decades).

384. For instance, Muñoz Marín penned the following as a young man: "I would like to be a giant . . . / to complete the work of [my father] Luis Muñoz Rivera, / the giant of Borinquén." CARMEN T. BERNIER-GRAND, POET AND POLITICIAN OF PUERTO RICO: DON LUIS MUÑOZ MARÍN 25 (1995); see also *id.* at 57–60 (describing his father's dedication to the *jíbaro*); MALDONADO, *supra* note 376, at 27–54 (exploring his father's legacy and its impact on him as a young politician).

385. MALDONADO, *supra* note 376, at 193–95.

386. *Puerto Rico Plan Called a Success*, N.Y. TIMES, Oct. 2, 1949, at F9.

387. See *Puerto Rico Reports Boom in All Lines*, CHI. TRIB., Jan. 8, 1961 at B38 (celebrating a ten percent gain in GDP in 1960 and a sixteen percent rise in manufacturing).

388. Joseph Egelhof, *Refugee Family Builds Fortune in Puerto Rico*, CHI. TRIB., Apr. 24, 1972, at C9.

Operation Bootstrap succeeded because it was the natural and obvious response to U.S. tax and economic policies, and indeed, the only possible path forward for the island following centuries of colonial policies that arrested the development of local enterprise. In essence, it was an example of a phenomenon cynically acknowledged by Professor Frank Bonilla: “[a] Puerto Rican solution is one in which what looks inevitable is transformed into a national project.”³⁸⁹

Despite the early and remarkable successes, not everyone celebrated Operation Bootstrap. Soon after the program commenced, mainland politicians and commentators began to take notice of the extremely preferential tax treatment afforded to companies doing business in Puerto Rico. Writers for the *New York Times* declared in 1956 that the island was nothing more than a “tax haven,” listing it alongside other notorious low-tax regimes.³⁹⁰ To such accusations, Muñoz Marín responded that the program was intended to be an “example of ‘self help,’” and that “[t]ax exemption is not the lure.”³⁹¹ Rather, he argued that Puerto Rico’s “reasonably low production costs, cheap transportation for raw materials from the entire Western Hemisphere, [and] an abundance of [skilled] labor” were drawing U.S. corporations to the island.³⁹²

These explanations did little to quell mainland criticisms, however. Increased importation of foreign products and materials in the 1950s—along with a corresponding rise in offshoring of U.S. business processes—further amplified concerns that U.S. workers were being displaced and that Puerto Rico’s successes came at the expense of mainland productivity.³⁹³ Although the U.S. government seemed to be turning a blind eye to aggressive tax planning maneuvers by U.S.

389. Frank Bonilla, *Beyond Survival: Por Qué Seguimos Siendo Puertorriqueños*, in IRIS M. ZAVALA & RAFAEL RODRÍGUEZ, THE INTELLECTUAL ROOTS OF INDEPENDENCE: AN ANTHOLOGY OF PUERTO RICAN POLITICAL ESSAYS 360 (1980).

390. See Burton Crane, *Tax Havens Draw Many Companies: U.S. Corporations and Some Individuals Rush to Set Up Concerns Abroad*, N.Y. TIMES, Aug. 19, 1956, at 135 (comparing Puerto Rico’s tax policies with other countries like Liberia that have no currency of their own and provide extraordinary tax preferences for U.S. corporations).

391. *Puerto Rico Plan Called a Success*, N.Y. TIMES, Oct. 2, 1949, at F9.

392. *Id.*

393. See Many ‘Ghost Town’ Residents Have Moved to Other Jobs or Returned to Farming, N.Y. TIMES, Nov. 1, 1953, at F1 (describing job losses and generalized economic plight in Park City, Utah, as the domestic lead-zinc mining industry collapsed under the pressure of cheaper metal imports); *Industries Oppose Imports Program*, N.Y. TIMES, Apr. 14, 1950, at 16 (reporting protests against increased imports of products manufactured in Marshall Plan nations).

corporations doing business in Puerto Rico,³⁹⁴ the American public was growing increasingly sensitive to the economic distortions created by generous tax incentives on the island. In 1964, a writer of an opinion editorial in the *Chicago Tribune* complained that Operation Bootstrap was “not only a giveaway,” but also that “it d[id] violent injury to us at home . . . [took] away jobs of our people, . . . [and] subsidize[d] the flight of factories out of this country.”³⁹⁵ Moreover, as Puerto Rican migration to the mainland reached its peak in the 1950s and 1960s, mounting ethnic and racial tensions in urban America only amplified existing prejudices toward Puerto Ricans.³⁹⁶ Protests against excessive tax breaks in Puerto Rico continued well into the 1970s, culminating in a series of official complaints launched by the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO).³⁹⁷ In 1973, the House Ways and Means Committee responded by conducting a series of hearings on potential revisions to the U.S. Tax Code.³⁹⁸

Meanwhile, an emergent international awareness of the dangers of unfair tax competition³⁹⁹—and a corresponding growth in abusive tax planning practices—led U.S. officials to turn a more skeptical eye toward corporations claiming the benefits of section 931. The Internal Revenue Service became concerned that U.S. corporations were increasingly shifting expenses to Puerto Rican affiliates in order to reduce their U.S. tax liabilities.⁴⁰⁰ The Internal Revenue Service

394. See Rev. Proc. 63-10, 1963-1 C.B. 490 (providing that, if under all facts and circumstances, intangible assets “belong” to a possessions corporation, then the possessions corporation is entitled to the income attributable to such intangible assets).

395. M.R.F., *Puerto Rico’s ‘Bootstrap’*, CHI. TRIB., Sept. 21, 1964, at 20.

396. See generally CLARA A. RODRÍGUEZ, PUERTO RICANS: BORN IN THE U.S.A. (1989) (exploring the effect of U.S. colonialism on Puerto Rican immigration); JOSÉ RAMÓN SÁNCHEZ, BORICUA POWER: A POLITICAL HISTORY OF PUERTO RICANS IN THE UNITED STATES (2007) (questioning why the increase of the Puerto Rican and Hispanic populations in the United States has not granted commensurate power).

397. See Adam H. Rosenzweig, *Why Are There Tax Havens?*, 52 WM. & MARY L. REV. 923, 923–25 (2010) (detailing the public outrage and attempts by Congress to curtail tax havens).

398. STAFF OF J. COMM. ON INTERNAL REVENUE TAXATION, 93RD CONG., SUMMARY OF TESTIMONY OF PANELISTS ON TAX REFORM TOPICS 1-2 (Comm. Print 1973) (receiving proposals for alternative methods of dealing with tax avoidance and tax havens).

399. See Rosenzweig, *supra* note 397, at 923 (describing how legislative and political efforts to combat tax havens have exacerbated the problem).

400. Zoltan M. Mihaly, *Tax Advantages of Doing Business in Puerto Rico*, 16 STAN. L. REV. 75, 75 (1964) (suggesting strategic tax avoidance through Puerto Rican law can yield zero tax liability).

commenced a series of investigations, but called off the initiative in response to pleadings from Puerto Rican officials.⁴⁰¹

Nonetheless, by the mid-1970s, the second stage of U.S. tax imperialism in Puerto Rico came to an inevitable end. The economic successes of Operation Bootstrap began to taper off in the early 1970s, and by 1976, one journalist declared that “the Commonwealth [wa]s in serious economic trouble.”⁴⁰² History had demonstrated that the role the United States carved for Puerto Rico—to be a domestic tax haven and lower-cost provider of manufacturing inputs for U.S. corporations—was short-lived. Globalization, along with increasing sophistication and competition in corporate tax planning, meant that U.S. companies desiring to remain competitive would need to look beyond the U.S. flag altogether to locate their operations and source lower-cost inputs.⁴⁰³ And, although Puerto Rico would continue to serve capital-intensive U.S. industries for several more decades, it was clear by the 1970s that the manifest destiny of more labor-intensive U.S. industries was to march further across the globe, where wages were more depressed and regulations less constricting.⁴⁰⁴ As the following section explains, U.S. policies once again shifted, introducing the third stage of U.S. tax imperialism in Puerto Rico.

C. Stage Three of U.S. Tax Imperialism in Puerto Rico, 1975–Present

In the third stage of U.S. tax imperialism in Puerto Rico, which commenced in 1975 and continues to the present day, the United States has struggled to prevent further accumulation of U.S. capital in Puerto Rico. As international capital markets have rapidly developed and expanded, and as methods of corporate tax planning have grown more sophisticated, U.S. tax policies have abruptly shifted. The current policies try to facilitate corporate wealth’s free flow from Puerto Rico back to the mainland, in an effort to prevent further erosion of the U.S. tax base. Unfortunately, this means that the United States and its island colony have been engaged in a struggle over capital—the very resource that Puerto Rico needs most, but for which it is left wholly reliant on the United States to obtain.

401. SUÁREZ, *supra* note 235, at 31.

402. David Vidal, *Deepening Troubles in Puerto Rico: Operation Bootstrap’s Gains Are Shrinking*, N.Y. TIMES, Feb. 15, 1976, at F1.

403. *See id.* (detailing how Puerto Rico’s relatively high minimum wage put it in direct competition with the Eastern Caribbean, Africa, and Asia—countries with much cheaper labor).

404. *See id.* (“Factories keep coming, especially in drugs and electronics, but not as fast and they aren’t the labor intensive plants of the past.”).

Initially, the struggle centered upon a perceived loophole in the federal tax treatment of corporations engaged in business in U.S. possessions. Under the U.S. Tax Code, corporate dividends that related to income excluded from gross income under section 931 were not eligible for the intercorporate dividends received deduction.⁴⁰⁵ But, because section 931 corporations were considered domestic corporations for the purposes of the U.S. Tax Code's subsidiary liquidation provisions, the eventual liquidation of the possession corporation was treated as a nonrecognition event.⁴⁰⁶

This legal milieu basically incentivized U.S. corporations to accumulate their profits, either in the possessions or in other foreign jurisdictions, until they were ready to liquidate the section 931 corporation. For Puerto Rico, the accumulation of capital "was a win-win for everyone," as one trade consultant explained.⁴⁰⁷ "All of the billions of dollars stayed in Puerto Rico, and the banks lent out the profits."⁴⁰⁸ But as the mainland economy faltered, the United States came to view "repatriation of . . . corporate earnings [accumulated in the possessions or abroad because of section 931] as a possible stimulus to the mainland economy," even though the possessions had come to rely upon these "badly needed investment funds."⁴⁰⁹ In a 1975 report to Congress, the staff of the Joint Committee on Internal Revenue Taxation summarized the problem thusly:

Because no current U.S. tax is imposed on the earnings if they are not repatriated, the amount of income [that] accumulates over the years from [business activities in the possessions] can be substantial. The amounts [that] may be allowed to accumulate are often beyond what can be profitably invested within the possession where the business is conducted. As a result, corporations generally invest this income in other possessions or in foreign countries either directly or through possessions banks or other financial institutions.⁴¹⁰

405. See 26 U.S.C. § 246(a)(2)(B) (1974).

406. 26 U.S.C. § 332; see 26 U.S.C. § 1504(b)(4) (prohibiting corporations receiving benefits under section 931 from inclusion in the consolidated return of an affiliated group of corporations). Nonrecognition means that no gain or loss is recognized to the parent as a result of the subsidiary liquidation.

407. *Can Puerto Rico Reinvent Itself as a Global Competitor?*, KNOWLEDGE@WHARTON (Aug. 22, 2012), <http://knowledge.wharton.upenn.edu/article/can-puerto-rico-reinvent-itself-as-a-global-competitor>.

408. *Id.*

409. *Vidal*, *supra* note 402.

410. STAFF OF JT. COMM. ON INTERNAL REVENUE TAXATION, U.S. TAXATION OF FOREIGN SOURCE INCOME OF INDIVIDUALS AND CORPORATIONS AND THE DOMESTIC INTERNATIONAL SALES CORPORATION PROVISIONS, PREPARED FOR THE USE OF THE

Pursuant to the Tax Reform Act of 1976,⁴¹¹ Congress revised the U.S. Tax Code, purportedly to provide for a more efficient system of exempting possessions corporations from income taxation.⁴¹² In place of the exemption mechanism previously codified, Congress enacted a new provision (codified as section 936) enabling U.S. corporations to elect to receive a tax credit equal to the portion of U.S. tax liabilities attributable to taxable income from sources outside the United States that relate to the active conduct of a trade or business within a U.S. possession and from qualified possession-source investment income.⁴¹³ Qualified possession-source income was defined to mean income derived from the investment of accumulated trade or business profits in the same possession as the trade or business is conducted. To receive the tax credit under the initial formulation of section 936, a U.S. corporation must have earned at least eighty percent of its gross income for the three-year period immediately preceding the close of its taxable year from sources within a U.S. possession, with at least fifty percent of such earnings from the three previous years derived from active income earned in U.S. possessions.⁴¹⁴ In this way, section 936 was “in the nature of a tax sparing mechanism, since it allow[ed] a tax credit regardless of the amount, if any, that the 936 corporation pa[id] in possession income taxes.”⁴¹⁵ In other words, the new provision was similar in effect to its predecessor, section 931.⁴¹⁶ Because the credit was not contingent upon actual foreign taxes paid, it preserved the economic effect to the corporation of any tax incentives offered by the possession.

Finally, to encourage repatriation of accumulated earnings, Congress also amended the U.S. Tax Code to allow parent companies to claim a 100% dividends-received deduction with respect to income

COMMITTEE ON WAYS AND MEANS 14 (Comm. Print 1975).

411. Pub. L. No. 94-455, § 1051, 90 Stat. 1643 (1976).

412. See *Coca-Cola Co. v. Comm'r of Internal Revenue*, 106 T.C. 1, 21–23 (1996), *abrogated by Sunoco, Inc. v. Comm'r of Internal Revenue*, 118 T.C. 181 (2002) (providing background regarding the purposes of revising the U.S. Tax Code and the subsequent benefits for corporations).

413. § 1051(c), 90 Stat. 1520, 1643–47.

414. *Id.*; see *BUCKLEY, JR.*, *supra* note 326, at 35, and accompanying text (discussing the eighty and fifty percent provisions carried over from the predecessor statute).

415. Juan C. Mendez-Torres, *The Internal Revenue Code's Role in Puerto Rico's Economic Development*, J. INT'L TAX'N, Feb. 2004, at 29; see Andrew E. Gerow, Comment, *Shooting for the Stars (and Stripes): How Decades of Failed Corporate Tax Policy Contributed to Puerto Rico's Historic Vote in Favor of Statehood*, 88 TUL. L. REV. 627, 640–41 (2014) (providing a thorough explanation of tax sparing, along with an example).

416. See *supra* notes 323–24; 374–75 and accompanying text (demonstrating the similar tax preferences that corporations could receive under section 931).

earned in a U.S. possession.⁴¹⁷ At least in the short-term, the change in federal law achieved its intended effect. The U.S. Treasury reported that “there ha[d] been a clear response in the repatriation of earnings.”⁴¹⁸ “Before 1977, possession corporations paid virtually no dividends to their U.S. parents. In tax years 1978 to 1980, however, possession corporations in manufacturing distributed dividends of \$885 million, \$905 million, and \$1,215 million, respectively.”⁴¹⁹ Nonetheless, the federal government remained concerned about the many more billions of retained earnings still in the possessions.⁴²⁰

Because this latter amendment encouraged the outflow of badly-needed investment capital, the Puerto Rican government responded defensively in 1976 with significant updates to a decades-old provision of the island’s own revenue code.⁴²¹ Under existing law, when a possessions corporation paid a dividend to its U.S. parent corporation from earnings and profits derived from hotel, manufacturing, or shipping activities, it was required to withhold fifteen percent of the dividend and pay this amount as a tax to the Puerto Rican government.⁴²² But dividends paid out of industrial incentives income to nonresident shareholders were exempt from the tax to the extent such shareholder was not required to pay income tax in any other jurisdiction on income from activities in Puerto Rico, or to the extent such shareholder was unable to claim a deduction or credit for any taxes paid in Puerto Rico.⁴²³ All other dividends were subject to twenty-five percent withholding.⁴²⁴

These exclusions meant that most dividends paid to U.S. companies by section 931 corporations would not be subject to the so-called “tollgate tax.” But, even without these exclusions, until 1976, the Puerto Rican tax would have been wholly irrelevant to U.S. firms. Under prior federal tax law, U.S. firms had far greater reasons to avoid repatriation of their earnings: these intracompany dividends would be subject to federal income taxes. However, the 1976 revision to the federal dividends-received deduction removed the tax

417. § 1051, 90 Stat. 1520, 1643.

418. U.S. Treasury Dep’t., *Impact of Changing From Section 931 to Section 936 and of Changes in the Puerto Rican Tollgate Tax and Industrial Incentives Program*, 9 INT’L TAX J. 445, 445 (1983).

419. *Id.*

420. *Id.* at 446.

421. See 1956 P.R. Laws 474, 796, 858.

422. See Ralph J. Sierra, Jr., *The Puerto Rico Tollgate Tax*, 4 INT’L TAX J. 824, 825 (1978).

423. See 1963 Industrial Incentive Act, 1963 P.R. Laws 120–22, 142–43.

424. Sierra, *supra* note 422, at 825.

disincentive. By extending the Puerto Rican tollgate tax to apply to the repatriated earnings of section 936 corporations, Puerto Rico ensured that there would still be a major tax disincentive for U.S. firms desiring to repatriate earnings.⁴²⁵ Put simply, the Puerto Rican tollgate tax was irrelevant before, because federal tax law gave firms all the reason they needed to keep their money in Puerto Rico. But, once the federal government amended its laws to allow for tax-free dividends, there was a real threat that companies would transfer the wealth back to the U.S. mainland in the form of intracompany dividends. The Puerto Rican tollgate tax was an attempt to put back up some sort of barrier—a tax that would incentivize firms to leave their money in Puerto Rico.

Although the move clearly had the potential to alienate U.S. investors, Puerto Rican officials were encouraged by a growing economic nationalism movement in Latin America, pursuant to which Latin American nations attempted to restrict the repatriation of profits earned within their borders by foreign investors.⁴²⁶ Thus, in 1976 legislation, the Puerto Rican government expanded the tollgate tax by repealing the exclusion for industrial incentives income. At the same time, the Puerto Rican government lowered the rate of the tollgate tax from fifteen to ten percent for dividends relating to hotel, manufacturing, or shipping activities, or from industrial development income.⁴²⁷ Special provisions allowed for reduced rates of taxation to the extent that the company made corresponding investments in designated Puerto Rican assets, which included deposits in Puerto Rican banks and investments in Puerto Rican bonds and mortgages.⁴²⁸

Meanwhile, the 1976 revisions to the U.S. Tax Code were not enough to quell concerns on the mainland. The federal government became increasingly wary that section 936 encouraged the shifting of high-value intangible assets to the possessions, allowing large portions of corporate profits to be artificially attributed to section 936 corporations⁴²⁹ and leading to deferral of federal income taxes.⁴³⁰

425. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1051, 90 Stat. 1520, 1643 (1976).

426. See Joseph J. Jova et al., *Private Investment in Latin America: Renegotiating the Bargain*, 19 TEX. INT'L L.J. 3, 11–22 (1984) (describing how Latin America shifted from “a passive to an active posture at the investment bargaining table”).

427. P.R. LAWS ANN. tit. 13, § 3231 (1977).

428. See U.S. GEN. ACCOUNTING OFFICE, GAO-97-101, TAX POLICY: PUERTO RICAN ECONOMIC TRENDS 3 (1997) (describing the tollgate tax).

429. The U.S. parent corporation could simply transfer its intangible property to the section 936 corporation in a tax-free transfer under 26 U.S.C. § 351 (2012). See, e.g., Eli Lilly & Co. v. Comm'r of Internal Revenue, 856 F.2d 855, 858 & n.2 (7th Cir.

Congress also remained concerned that companies could reduce their U.S. tax liabilities by artificially inflating the sale price for finished products transferred from section 936 corporations to affiliates for distribution in the United States and elsewhere. The Internal Revenue Service began to more aggressively police transactions that violated the spirit of federal tax laws.⁴³¹ Over the next few decades, Congress made a number of technical revisions to the U.S. Tax Code to make these practices more difficult.⁴³² But, these changes did little to appease critics of section 936. Moreover, contrary to the preliminary data, reporting by the U.S. Treasury in the early 1980s revealed that U.S. firms were in fact continuing to retain billions of dollars in Puerto Rico, rather than repatriating to the mainland—likely due to the new incentive effects of the Puerto Rican tollgate tax.⁴³³

1988), *aff'd in part and rev'd in part*, 856 F.2d 855 (7th Cir. 1988) (describing a transaction of this sort under 26 U.S.C. § 351 where a parent corporation claimed nonrecognition treatment after transferring two patents and proprietary information to its section 936 subsidiary in exchange for stock in that subsidiary). Similarly, the U.S. parent corporation could transfer cash to the section 936 corporation and then direct it to acquire potentially valuable intangible property from unrelated third parties. Alternatively, the U.S. parent corporation could enter into a license agreement granting the section 936 corporation the exclusive or nonexclusive right to use its intangibles in exchange for royalty payments. Of course, intercompany transactions of this sort remained subject to the arm's length standard codified in 26 U.S.C. § 482, but enforcement of this provision required aggressive policing and contentious audits. See, e.g., Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 95–104 (2008) (examining the arm's length standard for transfer valuation).

430. See Merck & Co. v. United States, 24 Cl. Ct. 73, 91 (1991) (explaining such concerns in the specific context of finding that Merck & Co. had retained earnings of “98.82 percent of all reported taxable income” and that such profits were due to the disparity between cost of production and the supply price).

431. See, e.g., I.R.S. Priv. Ltr. 80-40-019 (July 7, 1979), reprinted in 2 WILLIAM C. GIFFORD & ELISABETH A. OWENS, INTERNATIONAL ASPECTS OF U.S. INCOME TAXATION: CASES AND MATERIALS 346–51 (1982) (finding that the transfer of income-producing intangibles should not allow for the shifting of income between parent and subsidiary corporations).

432. Changes included, among other things, increasing the percentage of a section 936 corporation’s gross income that must be derived from the active conduct of business, and introducing mechanisms to allocate to the mainland parent corporation the income from intangibles developed by the parent but used by the section 936 subsidiary. See Eduardo Jose Fernandez, Note, *La Isla del Escape: America’s Escape from Corporate Taxes & Puerto Rico’s Taxed Future*, 19 FLA. J. INT’L L. 311, 318–22 (2007) (reviewing the various amendments and modifications to section 936); BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS & SHAREHOLDERS ¶ 15.22 (2015) (referencing the historical changes). See generally Lorraine Eden, *Puerto Rican Transfers and Section 936*, 9 TAX NOTES INT’L 37 (1994) (detailing changes made to section 936 through 1993).

433. U.S. DEP’T OF THE TREASURY, THE OPERATION AND EFFECT OF THE POSSESSIONS

Puerto Rico remained highly dependent on this large accumulation of U.S. investment capital. A report by the Reserve Bank of New York would later explain that accumulated earnings from section 936 corporations “provided key support to bank liquidity from the late 1970s to the late 1990s, representing almost [thirty-five] percent of total bank liabilities in 1995.”⁴³⁴ As Congress searched for ways to close the loopholes in federal law, and as mainland politicians repeatedly threatened to repeal section 936 altogether,⁴³⁵ the Puerto Rican government and U.S. firms alike struggled to retain federal tax incentives and U.S. direct investments in Puerto Rico.⁴³⁶

It was in the context of this policy debate that a new explanation for federal tax policies toward Puerto Rico was born. U.S. lawmakers began to assert that federal tax incentives for corporations doing business in the possessions were intended to provide economic stimulus in the possessions.⁴³⁷ Federal reports evaluating section 936 classified potential beneficiaries of the tax expenditure as belonging to either capital-intensive or labor-intensive industries, suggesting that the legislative intent had been to encourage labor-intensive industries to relocate to Puerto Rico to create jobs and stimulate the island economy. However, the benefits were primarily flowing to capital-intensive industries, such as pharmaceutical and electronics companies, meaning that the policy initiative had failed. But, this account stands in direct contrast to the historical reality, which is that the federal government had initially set out to create domestic tax havens in the possessions to benefit U.S. corporations, without regard to the capital- or labor-intensive nature of the industry. Of course, the fictional account better served the immediate needs of mainland politicians; by characterizing federal tax policies as charitable and beneficent, lawmakers could convince each other and the American public that the tax benefits ought to be rescinded to the extent they presently fail to satisfy those aims. Further, by implying that the United States had been historically motivated by altruistic goals, lawmakers could essentially blame Puerto Rico itself for becoming a tax haven.

CORPORATION SYSTEM OF TAXATION, FOURTH REPORT 155 (1983).

434. FED. RES. BANK OF N.Y., REPORT ON THE COMPETITIVENESS OF PUERTO RICO’S ECONOMY 15 (2012).

435. See generally SUÁREZ, *supra* note 235, at 41–129 (providing an historical overview of, and describing the various legislative threats to, section 936).

436. *Id.*

437. See U.S. GEN. ACCOUNTING OFFICE, GAO-97-101, TAX POLICY: PUERTO RICAN ECONOMIC TRENDS 1 (1997) (articulating the changed explanation of the federal tax incentives).

Nonetheless, some observers recognized that the struggle was really over large accumulations of capital and a dwindling U.S. corporate tax base, rather than failed attempts to provide economic stimulus to less developed colonial possessions. A 1985 *New York Times* opinion criticized lawmakers for essentially pitting U.S. economic interests against those of its colony.⁴³⁸ The column further derided U.S. lawmakers for failing to acknowledge the degree of capital mobility in the modern economy: “[t]he Treasury seems to assume that those businesses would remain in its jurisdiction. Experience argues they will move elsewhere, probably Asia.”⁴³⁹

Indeed, these warnings were based on more than mere conjecture. A leading tax attorney suggested in a 1995 article that U.S. corporations concerned about the potential repeal of section 936 should consider expatriating their operations entirely by conducting business in Puerto Rico through controlled foreign corporations.⁴⁴⁰ Operating through a controlled foreign corporation was and continues to be particularly attractive because it allows for deferral of federal income tax liabilities to the extent a company qualifies for the manufacturing exception to anti-deferral laws codified in subpart F of title 26 of the U.S. Code.⁴⁴¹ The U.S. Treasury initially assumed that firms that previously enjoyed the benefits of section 936 would be unwilling to transfer highly valuable intangible assets to controlled foreign corporations because of the high current tax costs associated with this move; instead, the U.S. Treasury believed most firms would enter into arm’s length licensing arrangements, pursuant to which the controlled foreign corporation would make fully taxable payments to the parent in exchange for the right to use its intangible property.⁴⁴²

438. Opinion, *Tax Reform's Sting in Puerto Rico*, N.Y. TIMES, July 20, 1985.

439. *Id.*; see also Anne Swardson, *Puerto Rico Supports Tax Credit*, WASH. POST (May 1, 1985), <http://www.washingtonpost.com/archive/business/1985/05/01/puerto-rico-supports-tax-credit/979afb82-74c6-450a-aaa8-dfa47b48be38/> (making a similar observation, warning that “[m]any U.S. companies would pack up and leave, relocating principally to cheap-labor regions such as the Pacific Basin”).

440. G. Marshall Abbey, *Expatriation' as an Alternative to Operating Under Section 936*, 6 J. INT'L TAX’N 493, 493 (1995). A “controlled foreign corporation” is any foreign corporation to the extent that more than fifty percent of the total combined voting power of classes of stock entitled to vote, or of the total value of the stock, is owned by U.S. shareholders on any day during such corporation’s taxable year. 26 U.S.C. § 957(a) (2012).

441. See 26 U.S.C. § 954(e)(2) (describing the manufacturing exception).

442. JOINT COMM. ON TAXATION, JCX-24-06, AN OVERVIEW OF THE SPECIAL TAX RULES RELATED TO PUERTO RICO AND AN ANALYSIS OF THE TAX AND ECONOMIC POLICY IMPLICATIONS OF RECENT LEGISLATIVE OPTIONS, 9–10, 83, 92 (2006), <http://www.jct.gov/x-24-06.pdf>.

In the end, American lawmakers prevailed in the battle against Puerto Rico, although it does not appear that the spoils of victory ever actually passed to the United States (not to suggest, of course, that they remained with Puerto Rico). In 1996, Congress enacted section 30A, repealing section 936 and establishing a ten-year transitional period, during which the section 936 credit remained available only for taxpayers who had claimed it in previous years.⁴⁴³ In the years following the repeal, many section 936 corporations doing business in the pharmaceutical sector—which controlled the largest amount of accumulated capital in Puerto Rico—converted to controlled foreign corporations, thereby maintaining preferential positions under federal and Puerto Rican tax law.⁴⁴⁴ For instance, in 1998, the large U.S. pharmaceutical firm OMJ Pharmaceuticals transferred three of its wholly-owned subsidiaries doing business in Puerto Rico to an Irish corporation also owned by OMJ.⁴⁴⁵ Much to the U.S. Treasury's frustration, companies avoided the substantial federal tax liabilities associated with deemed asset sales not by entering into arm's length licensing agreements, but by entering into pre-conversion cost-sharing and research partnership arrangements.⁴⁴⁶ As a result, conversions to controlled foreign corporations were not only achieved on an almost entirely tax-free basis, but they also succeeded in placing large capital accumulations further beyond the U.S. Treasury's reach.⁴⁴⁷ Finally, as evidenced by the U.S. Treasury's newest battle

443. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1601, 110 Stat. 1755, 1827. Certain additional restrictions were imposed, including placing a cap on the profits that could be sheltered by the tax-sparing credit accorded by section 936 and placing a restriction on bringing new products under the coverage of that credit. *See id.* 110 Stat. at 1827, 1830 (implementing restrictions on existing credit claimants).

444. *See* A.W. Maldonado, *The Loss of 936: Good or Bad for Puerto Rico?*, PHARM. INDUS. ASS'N OF P.R. (Nov. 17, 2002), <http://www.piapr.org/index.php?src=gendocs&ref=lossof936&> (stating that forty-one percent of the industry converted from section 936 corporations to controlled foreign corporations).

445. OMJ Pharm., Inc. v. United States, 753 F.3d 333, 335–36 (1st Cir. 2014).

446. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-06-541, PUERTO RICO: FISCAL RELATIONS WITH THE FEDERAL GOVERNMENT AND ECONOMIC TRENDS DURING THE PHASEOUT OF THE POSSESSIONS TAX CREDIT 89–90 (2006), <http://www.gao.gov/new.items/d06541.pdf> (describing how controlled foreign corporations avoided tax liability after the phasing out of 25 U.S.C. § 936 through cost-sharing and research agreements); *see also* Treas. Reg. § 1.482-2(d)(4) (1969) (allowing for cost-sharing arrangements to jointly develop intangible property). To the extent the possession corporation substantially contributed to the creation of intangible property in connection with its trade or business in the possession, it would be the “developer” of the intangible property under section 1.482-2(d)(1)(c).

447. Maldonado, *supra* note 444.

against these so-called “tax inversions”—the process of changing a corporation’s legal address to avoid taxes—the fight to retain large accumulations of capital and to preserve the U.S. corporate tax base now extends far beyond the shores of Puerto Rico.⁴⁴⁸

Meanwhile, commentators have spilled much ink on the effects of section 936’s repeal on the Puerto Rican economy. With many manufacturing firms choosing to withdraw entirely from the island, Puerto Rico had registered double-digit unemployment by the early 2000s.⁴⁴⁹ A 2012 report by the Federal Reserve Bank of New York cited a sixteen percent unemployment rate, an extremely low labor participation rate, and a shrinking real GNP—a measure that tracks the amount of income actually accruing to island residents, as opposed to the numerous large foreign corporations still doing business there.⁴⁵⁰ In essence, the repeal of section 936 exposed the structural problems introduced by centuries of colonial rule, which had been etched into Puerto Rico’s fiscal and economic foundation through the groundwork laid in the first two stages of U.S. tax imperialism.⁴⁵¹ Namely, the island suffered from a dearth of local enterprise and investment capital, leaving it wholly reliant on external investment.⁴⁵²

Although many large corporations in the pharmaceutical sector continue to do business on the island through controlled foreign corporations, these are not labor-intensive businesses, and thus they have not had a meaningful impact on employment for the island’s population.⁴⁵³ Moreover, these operations no longer amass large amounts of investment capital in Puerto Rico. Owing to the emergence of more sophisticated tax planning strategies, corporations are able to shift capital for use by mainland affiliates

448. See, e.g., Jesse Drucker, *Inversions Are Often Last Stop for Avoiding U.S. Taxes*, BLOOMBERG BUSINESS (Dec. 18, 2014, 7:15 AM), <http://www.bloomberg.com/news/articles/2014-12-12/inversions-are-often-last-stop-for-companies-avoiding-u-s-taxes> (examining ongoing litigation between the IRS and large pharmaceutical companies such as Medtronic, Inc., Covidien Plc, Eaton Corp., Abbott Laboratories, and Ingersoll-Rand Plc over tax credits applied to subsidiaries in low-tax jurisdictions including the Cayman Islands, Luxembourg, and Bermuda).

449. See Ivan Roman, *Island Asks Congress for Help*, ORLANDO SENTINEL (May 28, 2001), http://articles.orlandosentinel.com/2001-05-28/news/0105280087_1_puerto-rico-calderon-tax-incentive (citing Puerto Rico’s 11.2% unemployment rate in April 2001).

450. FED. RES. BANK OF N.Y., *supra* note 434, at 4–5.

451. See *supra* Parts II.A–B (examining the first two stages of U.S. tax imperialism).

452. See *supra* notes 433–36 and accompanying text.

453. See *supra* notes 433–36 and accompanying text (finding that pharmaceuticals remain the island’s largest manufacturing industry, though the industry and employment opportunities are shrinking).

without exposing the principal to immediate U.S. income taxation.⁴⁵⁴ In essence, the assets and gains that today's multinational firms attribute to their subsidiaries doing business in Puerto Rico are mere accounting entries. For reasons such as these, the authors of the Federal Reserve Bank of New York report warned that the island should lessen its dependence on the pharmaceutical industry that continues to operate there: "[g]oing forward, there appears to be only a limited prospect for the [pharmaceutical] sector to be a driver of growth."⁴⁵⁵

D. Recent Fiscal Developments in Puerto Rico

In recent years, the Commonwealth has struggled not only to attract new business and much-needed capital, but also to collect sufficient tax revenues to support government operations, leading to heavy borrowing to fund government operations. But, even in the midst of this economic crisis, there have been some promising new developments, which offer some hope for the island's economic future.

Most notably, the government appears to be using normal political processes to restore legitimacy to its tax laws. In 2006, the government exercised its constitutional authority to "impose and collect taxes"⁴⁵⁶ by enacting a sales and use tax,⁴⁵⁷ with the proceeds shared between the central and municipal governments. In 2014, a writer for *BusinessWire* reported promising results, finding that sales tax collections were up and had increased "[t]otal sales tax revenue [by] 6.5% year-over-year through May 2014."⁴⁵⁸ Nonetheless, the government still struggles with low rates of overall compliance with the sales and use tax,⁴⁵⁹ reflecting the challenges of introducing new taxes on the island. In a recent and highly publicized move, the Puerto Rican government announced that it will abandon the sales

454. For instance, large corporations use intercompany investment and loan techniques to shift capital without exposing the principal to current U.S. income taxation. See, e.g., Maxwell Murphy, *Hasbro Weighing Repatriation Tax Strategies*, WALL ST. J. (Apr. 22, 2013), <http://blogs.wsj.com/cfo/2013/04/22/hasbro-weighing-repatiation-tax-strategies> (discussing the tax implications for Hasbro's potential repatriation of \$1.1 billion in overseas cash).

455. FED. RES. BANK OF N.Y., *supra* note 434, at iii.

456. P.R. CONST. art. VI, § 2.

457. 2006 P.R. Laws 1231.

458. *Fitch Downgrades Puerto Rico GO, Sales Tax, Retirement System & Water Revenue Bonds*, BUSINESSWIRE (July 9, 2014, 7:06 PM), <http://www.businesswire.com/news/home/20140709006332/en/Fitch-Downgrades-Puerto-Rico-Sales-Tax-Retirement>.

459. See Kaske, *Puerto Rico Seen Collecting Up to \$6.7 Billion From Proposed Tax*, *supra* note 308 and source cited therein (citing a KPMG report that found the Puerto Rican tax system overly burdensome with a tax compliance rate of only fifty-six percent).

and use tax in 2016, replacing it with a value added tax regime.⁴⁶⁰ Many Puerto Ricans objected to this proposal even in its earliest stages,⁴⁶¹ suggesting that it, too, will be a challenge to implement. But, at the very least, the Puerto Rican government's experimentation with new and additional forms of taxation suggests that it has the power to make fiscal choices and the autonomy to look beyond U.S. modes of taxation, even exploring value added tax regimes that have been used by other governments across the globe.

Meanwhile, the way that certain taxes left over from the U.S. military regime are presently imposed suggests that these vestiges of colonial rule continue to inflict the effects of political illegitimacy. For instance, although the government continues to collect property taxes, it has not conducted a real property assessment since 1958. Accordingly, the tax is imposed on the assessed values of real property as recorded in the 1957–1958 fiscal year. When coupled with rather generous principal residence exemptions, this means that the effective rate of taxation is much lower when compared to property taxes imposed on the mainland, with many owners having zero tax liability.⁴⁶² However, in times of financial exigency, such as during the recent economic recession, the government has imposed special property tax assessments to increase revenues.⁴⁶³ In such cases, the government simply imposes an additional percentage tax beyond the regular property tax.⁴⁶⁴

460. 2015 P.R. Laws No. 72, <http://www.oslpr.org/2013-2016/leyes/pdf/ley-72-29-May-2015.pdf> (providing for, among other things, a temporary, increased rate of sales and use taxation, and a new value-added tax regime to take its place in 2016); *see also* Kaske, *Puerto Rico Seen Collecting Up to \$6.7 Billion From Proposed Tax*, *supra* note 308 and accompanying text (discussing the value-added tax proposal prior to its legislative adoption); Michael Oleaga, *Puerto Rico Economy News: Governor Alejandro Garcia Padilla Proposes Tax Overhaul, Potential Billion Dollar Revenue Projected*, LATIN POST (Feb. 13, 2015, 1:09 PM), <http://www.latimpot.com/articles/37481/20150213/puerto-rico-economy-news-governor-alejandro-garcia-padilla-proposes-tax.htm> (presenting Governor Garcia Padilla's February 2015 proposal of a value-added tax).

461. *See, e.g.*, AP, *Puerto Rico Prepares to Debate Value-Added Tax Proposal*, DAILY MAIL (Feb. 11, 2015, 6:46 PM), <http://www.dailymail.co.uk/wires/ap/article-2950006/Puerto-Rico-prepares-debate-value-added-tax-proposal.html> (articulating the major arguments made by Puerto Rican economic stakeholders for and against the proposal).

462. *See* Alm, *supra* note 307, at 380–82.

463. Special property taxes are authorized pursuant to Puerto Rico Act 83 of 1991. *See* 1991 P.R. Laws 702. A special assessment of this sort was imposed in 2009. *See* 2009 P.R. Laws 77 (implementing the “Special Act to Declare a State of Fiscal Emergency and to Establish a Comprehensive Fiscal Stabilization Plan—Creation” to salvage the credit of Puerto Rico).

464. *See* 2009 P.R. Laws 77 (imposing a special tax on real property used for

The lack of regular assessments, along with the occasional imposition of special assessments, suggests that the island still struggles to fully integrate U.S. modes of property taxation. At the same time, in light of the government's ongoing fiscal crisis, Puerto Rico has not been able to abandon the tax altogether. It may be beneficial for the government to engage in a systematic review of the property tax and determine whether to maintain or repeal the law, and, if the former, whether and how to modernize it. By subjecting this tax to the island's normal political process, the government may be able to legitimize and improve upon its legal foundation. Then, regular assessments and rate adjustments can be made in accordance with economic and fiscal needs.

While using the normal political process to make gradual changes to the tax laws will help advance the popular legitimacy of the island's overall system of taxation—and thus improve tax morale and increase collections over time—such changes are unlikely to fully address the island's more immediate revenue needs. Accordingly, the Commonwealth passed Act 154 in 2010, imposing an excise tax on products manufactured on the island by companies headquartered elsewhere.⁴⁶⁵ This tax became effective in January 2011 and was originally designed to be phased out over six years.⁴⁶⁶ However, in 2013, the Commonwealth amended the law, imposing the highest rate for the years 2013 through 2017.⁴⁶⁷ Of course, the new excise tax has been severely criticized by mainland media⁴⁶⁸ and by Puerto Rican professionals working for large multinational corporations on the island.⁴⁶⁹ Moreover, U.S. tax experts have declared it to be the cornerstone of a back-door bailout by the U.S. Treasury, as firms paying the excise tax will simply offset their U.S. tax liabilities by obtaining a foreign tax credit in an amount equal to the tax paid.⁴⁷⁰ Of

residential purposes, in an amount equal to 100% of the amount of tax already imposed pursuant to the regular property tax).

465. 2010 P.R. Laws No. 154, <http://www.oslpr.org/download/en/2010/A-0154-2010.pdf>.

466. *Id.*

467. See Sullivan, *supra* note 29 (describing the extension of the excise tax to 2017).

468. See, e.g., Julio Fuentes, *New Excise Tax Undercuts Puerto Rican Business*, ORLANDO SENTINEL (Nov. 12, 2010), http://articles.orlandosentinel.com/2010-11-12/news/os-ed-law-154-puerto-rico-111210-20101111_1_excise-tax-new-tax-new-law (arguing that the new excise tax "is an added cost to doing business on the island and will create a hostile tax environment").

469. See, e.g., Lafontaine, *supra* note 303, at 240–41 (criticizing Act 154 as a threat to the island's economic development).

470. See Sullivan, *supra* note 29 (explaining how a delay by the U.S. Treasury in

course, the fact that Puerto Rican taxes are potentially creditable against U.S. tax liabilities, rather than merely deductible, reflects an historical and deliberate choice by the U.S. government to treat the possessions as foreign nations rather than U.S. states for tax purposes. In any case, the island has maintained the excise tax in the face of these criticisms, thereby demonstrating that its tax laws are capable of withstanding pressure from U.S. corporate interests and mainland journalists.

Finally, the Puerto Rican government has made it a priority to build a solid foundation of local, Puerto Rican investment capital through organic growth of the island's business, real estate, and employment markets. In 2009, in an effort to rekindle the economy, the government passed a comprehensive economic stimulus package, funding the establishment of, among other things, a program to secure loans for small and medium-sized businesses,⁴⁷¹ worker retraining,⁴⁷² and homebuyer stimulus programs.⁴⁷³ More recently, the Commonwealth passed new tax legislation designed to attract much-needed foreign capital to the island.⁴⁷⁴ Puerto Rico Act 20 of 2012 offers a four percent corporate tax rate for Puerto Rican businesses engaged in the exportation of services, 100% tax-exempt dividends from earnings and profits relating to eligible export services income, and generous permanent and temporary exemptions from certain municipal taxes.⁴⁷⁵

Under the companion Puerto Rico Act 22 of 2012, which was intended to attract new investments in real estate and services while obtaining much-needed capital infusions into Puerto Rican banks, new bona fide residents of Puerto Rico are exempt from taxation on dividends and interest income and on short- and long-term capital gains.⁴⁷⁶ To receive the tax benefits, individuals must be physically present in Puerto Rico for at least 183 days of the year, and must not have been a resident of the island for the fifteen years prior to the Act's effective date.⁴⁷⁷ Finally, Puerto Rico Act 273 of 2012 was passed in the

evaluating the excise tax has allowed corporations to claim it as a credit).

471. P.R. LAWS ANN. tit. 13, § 148 (2013).

472. *Id.* § 149.

473. *Id.* § 145.

474. P.R. LAWS ANN. tit. 13, §§ 10831–44 (2012).

475. *Id.* §§ 10832–34.

476. 2012 P.R. Laws No. 22, <http://www.oslpr.org/download/en/2012/A-0022-2012.pdf>.

477. *Id.*; see also Philip DeMuth & Lauren Gensler, *Treasure Island: Puerto Rico Bids to Become New Age Tax Haven*, FORBES, (Feb. 11, 2015), <http://www.forbes.com/sites/laurengensler/2015/02/11/puerto-rico-new-age-tax-haven>.

hopes of making Puerto Rico an international banking and financial center by extending tax incentives for new banking and financial operations on the island that serve clients outside of Puerto Rico.⁴⁷⁸ The new law offers a four percent income tax rate for any such qualifying businesses.⁴⁷⁹ To be sure, these incentives have been highly publicized in U.S. mainstream media, with most such accounts declaring that the island is choosing to become a tax haven for the wealthy.⁴⁸⁰ While the tax incentives are certainly very generous, the legislation appears to be much more narrowly targeted than previous tax incentives, with the more limited goal of increasing investment capital on the island.

As evidenced by the critical reactions of mainland commentators, it often seems that Puerto Rico simply cannot win. When the government reduces the taxes it imposes upon American investors, it is accused of courting U.S. wealth by offering itself as a tax haven; when it imposes new taxes upon the gains derived from foreign direct investments on the island, it is accused of helping itself to a back-door bailout, compliments of the U.S. Treasury. Both criticisms cast the island as a danger to mainland economic interests. But history reveals that allegations of this sort cannot be any farther from the truth; in fact, Puerto Rico has spent more than one hundred years catering to U.S. economic interests. Now the island must craft its own economic path forward; this means that difficult tax and economic decisions must be made, which will necessarily involve trade-offs. As Puerto Rican lawmakers strive to use the political process to construct a legitimate system of taxation, boost local enterprise, and grow much-needed capital, Puerto Rico takes important strides toward economic self-sufficiency. Through this

478. 2012 P.R. Laws No. 273, <http://www.oslpr.org/download/en/2012/A-0273-2012.pdf>.

479. *Id.*

480. See, e.g., Lynnley Browning & Julie Creswell, *Puerto Rico Creates Tax Shelters in Appeal to the Rich*, N.Y. TIMES (Mar. 25, 2013), <http://dealbook.nytimes.com/2013/03/25/puerto-rico-creates-tax-shelters-in-appeal-to-the-rich> (“Known for its white-sand beaches and killer rums, Puerto Rico hopes to stake a new claim: tax haven for the wealthy.”); Elizabeth MacBride, *The Billionaire Tax Move That Could Be for You: Puerto Rico*, FORBES (May 23, 2014), <http://www.forbes.com/sites/elizabethmacbride/2014/05/23/the-billionaire-tax-move-that-could-be-for-you-puerto-rico> (quoting a billionaire hedge fund manager who called Puerto Rico “the Singapore of the Caribbean”); Julie Satow, *Puerto Rico Luring Buyers with Tax Breaks*, N.Y. TIMES (Sept. 5, 2014), <http://www.nytimes.com/2014/09/07/realestate/puerto-rico-luring-buyers-with-tax-breaks.html> (“After a slow start, Puerto Rico’s status as a tax haven is beginning to catch on . . . ”).

process of rebuilding, Puerto Ricans might also come closer to resolving unsettled questions regarding the island's political destiny.

III. A BROADER THEORY OF TAX IMPERIALISM: POSSIBLE FUTURE APPLICATIONS, POINTS FOR FURTHER STUDY

This Article advances a theory of U.S. tax imperialism in Puerto Rico, chronicling how the United States has used tax laws to advance its own economic and political interests at the expense of its island territory. To this end, this Article proffers an explanatory model that breaks down the process of U.S. tax imperialism into three distinct and readily identifiable historical stages. A detailed case study of U.S.-Puerto Rican relations demonstrates how each of these stages should be analyzed to better understand the ways in which historical fiscal relations contribute to modern economic conditions.

While the theory of U.S. tax imperialism in Puerto Rico is key to understanding the island's economic struggles, a more general theory of tax imperialism is needed to understand other modern and historical relationships between powerful nations and the taxing jurisdictions they have dominated. Such a theory is likely to have application far beyond the Caribbean.

A broader theory of tax imperialism would also make an important contribution to the growing body of literature on tax havens and the economic effects of tax competition among less developed nations.⁴⁸¹ As a case study, the U.S.-Puerto Rican story challenges the prevailing view that tax havens are a "distinct developmental strategy that could have evolved only in the context of a robust international system of statehood, respectful of the sovereign right of states to write their own laws"⁴⁸² To the contrary, modern tax havens may signal the longstanding domination of more developed countries over the taxing powers of less developed nations, territories, and possessions.

481. See generally RONEN PALAN ET AL., TAX HAVENS: HOW GLOBALIZATION REALLY WORKS (2010). Interestingly, the authors identify three stages in the development of tax havens, which correspond almost exactly to the three stages of U.S. tax imperialism in Puerto Rico. *Id.* at 108. However, the authors focus upon the role of corporate and financial laws rather than upon tax laws and colonial relations. *Id.* at 107–17.

482. Ronen Palan, Policy Paper, HISTORY OF TAX HAVENS (2009), <http://www.historyandpolicy.org/policy-papers/papers/history-of-tax-havens>; see also Rosenzweig, *supra* note 397, at 980–81 (acknowledging that more developed nations unintentionally incentivized the establishment of tax havens, but also assuming that tax haven countries made the independent choice to compete on the basis of tax laws: specifically, they "sell" their jurisdictional sovereignty as a place to engage in . . . transactions in exchange for minimal tax revenues").

Of course, additional case studies are needed to determine whether other alleged tax havens have experienced similar historical interactions with more powerful taxing authorities.

Finally, a theory of tax imperialism is likely to engage in fascinating ways with the so-called “Lucas paradox,” or the observation that capital does not flow to less developed nations, as economic theory suggests that it should.⁴⁸³ In particular, while the initial stages of tax imperialism might pave the way for capital to flow to developing nations, the U.S.-Puerto Rico case study reveals that, ultimately, more developed nations may have incentives in the modern global arena to prevent large accumulations of capital in the very tax havens they have created. Thus, a theory of tax imperialism is likely to reinforce the idea that tax laws play a critical role in redirecting the flow of capital globally, but they do so in ways that often privilege more immediate political and strategic ends over longer-term economic efficiency goals.

CONCLUSION

In an influential essay entitled, *How to Know the Puerto Ricans*, Jesús Colón explained: “[t]he first thing we must realize is that the Puerto Ricans have been exploited for hundreds of years. That strangers have been knocking at the door of the Puerto Rican nation for centuries[,] always in search of something, to get something[,] or to take away something from Puerto Ricans.”⁴⁸⁴ Because of this, “when you come to knock at the door of a Puerto Rican home you will be encountered by this feeling in the Puerto Rican—sometimes unconscious in himself—of having been taken for a ride for centuries.”⁴⁸⁵

Noted playwright René Marqués delved even deeper into the national consciousness in his controversial book, *The Docile Puerto Rican*.⁴⁸⁶ After thoroughly indicting American imperial policies, he turned his criticism inward, challenging the notion that Puerto Ricans insulate themselves through their distrust of others: “On confronting the North American, the Puerto Rican for his part sets in motion his colonial guilt complex. In order to tolerate his humiliating condition he has to find an excuse for it and admit that

483. See Robert E. Lucas, Jr., *Why Doesn't Capital Flow from Rich to Poor Countries?*, 80 AM. ECON. REV. 92, 92–96 (1990) (hypothesizing that human capital reasons and political risk lead to the paradox where there is limited investment by rich economies in poor economies).

484. Jesús Colón, *How to Know the Puerto Ricans*, in A PUERTO RICAN IN NEW YORK AND OTHER SKETCHES 147 (2002).

485. *Id.* at 148.

486. RENÉ MARQUÉS, THE DOCILE PUERTO RICAN (1976).

he is *inferior* to the North American.”⁴⁸⁷ This inferiority, he argues, manifests in surrender and servility to American interests.⁴⁸⁸ Distinguished author Esmeralda Santiago situated any such national complex within centuries of military conquest:

We are told that our island doesn’t have the rich heritage of bloody struggles for independence that other countries do. The truth is, we do have a history of struggle for independence, but the opposition has always won. The failure of our best hopes for independence . . . has caused many Puerto Ricans to simply give up.⁴⁸⁹

These conceptions of weakness, subordination, and defeat have been explored through more than a century of Puerto Rican political philosophy,⁴⁹⁰ poetry,⁴⁹¹ and other literary works,⁴⁹² as writers strive to integrate past assaults and move forward as a stronger and more unified nation. But there is also good reason to be optimistic. As Justice Sonia Sotomayor recently explained with respect to her Puerto Rican heritage, “[t]here are strengths in our collective psyche that account for our resilience and that equally hold the potential for our renewal, if properly nourished and cultivated.”⁴⁹³

The same struggles—and thus the same opportunities for nourishment and renewal—exist in the fiscal and economic decisions that Puerto Ricans must make today. History reveals that the original architects of the island’s system of taxation, as well as the proponents of many federal tax policies that have shaped the Puerto Rican economy, never had the island’s best interests in mind. Rather, these interlopers knocked on the door—indeed, knocked *down* the door—of the Puerto Rican nation to extract economic opportunities. They left behind an ineffective fiscal foundation that has suspended the

487. *Id.* at 54.

488. *Id.* at 53.

489. Esmeralda Santiago, *Island of Lost Causes*, in BORICUAS, *supra* note 40, at 22–24.

490. See, e.g., Bonilla, *supra* note 389, at 358–61 (exploring Puerto Rican feelings of defeat and inferiority).

491. See, e.g., *Puerto Rican Obituary*, in PEDRO PIETRI, PUERTO RICAN OBITUARY 1–11 (1973).

492. One writer captured the shame and humiliation of colonial rule through a moving account of a young adolescent boy whose father passionately encourages him to question U.S. imperial policies in their native Puerto Rico. When the boy later refuses to salute the American flag at school, his father, in front of school officials, sheepishly urges him to behave and respect authorities. ABRAHAM RODRIGUEZ, JR., THE BOY WITHOUT A FLAG: TALES OF THE SOUTH BRONX 11–30 (1992). Boxing champion and sports writer José Torres penned a heartfelt letter to Puerto Rican youth, encouraging them to overcome their fears and not be “ruled by other people’s low expectations of [them].” José Torres, *A Letter to a Child Like Me*, in BORICUAS, *supra* note 40, at 14.

493. SONIA SOTOMAYOR, MY BELOVED WORLD 151 (2013).

island in a perpetual state of dependence, ensuring that it remains docile and subservient to corporate interests that would exact an overwhelming toll on the island's economic development.

The Commonwealth has made important strides in recent years. Nevertheless, the most immediate and pressing issue facing the island continues to be that of economic self-determination and, in particular, fiscal self-sufficiency. A strong fiscal foundation is essential because, as French economist Thomas Piketty observed in his landmark work on wealth inequality, “[w]ithout taxes, society has no common destiny, and collective action is impossible. . . . At the heart of every major political upheaval lies a fiscal revolution.”⁴⁹⁴ Thus, the broader question remains: what is the path forward for Puerto Rico? In light of the history recounted here, answers are unlikely to be found in treatises narrowly focused on technical matters of tax policy and municipal finance. Nor will they be discovered through myopic fixation on the perennial question of statehood, independence, or preservation of the political status quo.⁴⁹⁵ In striving to overcome its past, Puerto Rico must dig deeply within its national consciousness and continue to identify its social, political, and economic priorities, thereby constructing a fiscal architecture that best serves these ends.

This is no easy task, but the enduring works of the Puerto Rican writers, philosophers, poets, and other cherished public figures who have been cited throughout this Article—those who have carried and nurtured the island's heritage in the face of continual imperialist assaults—offer valuable words of wisdom. As poet José de Diego—widely regarded as the Father of the Puerto Rican Independence Movement—penned, “[d]o as the bull in the face of adversity: charge with confident power.”⁴⁹⁶ This advice applies with equal force to the decisions Puerto Rico must make in regards to its fiscal policies going forward. There is much work to be done, but the future is hopeful.

494. PIKETTY, *supra* note 253, at 493.

495. Of course, there are important reasons for this “status-driven mindset.” As one author recently explained, “[t]o speak of Puerto Rican political discourse is to speak about the question of status. No other topic comes close to its importance.” Juan Pablo Carro, *Deconstructing Sovereignty: The Validity of the Status-Driven Mindset as Seen Through Soberanías Exitosas: Seis Modelos Para el Desarrollo Económico de Puerto Rico* by Ángel Collado Schwarz, 80 REV. JUR. U. P.R. 439, 439 (2011) (footnote omitted).

496. José de Diego, *To the Persecuted*, in BORICUAS, *supra* note 40, at 7.