The Earned Income Tax Credit under Scrutiny by the Fiscal Oversight Board

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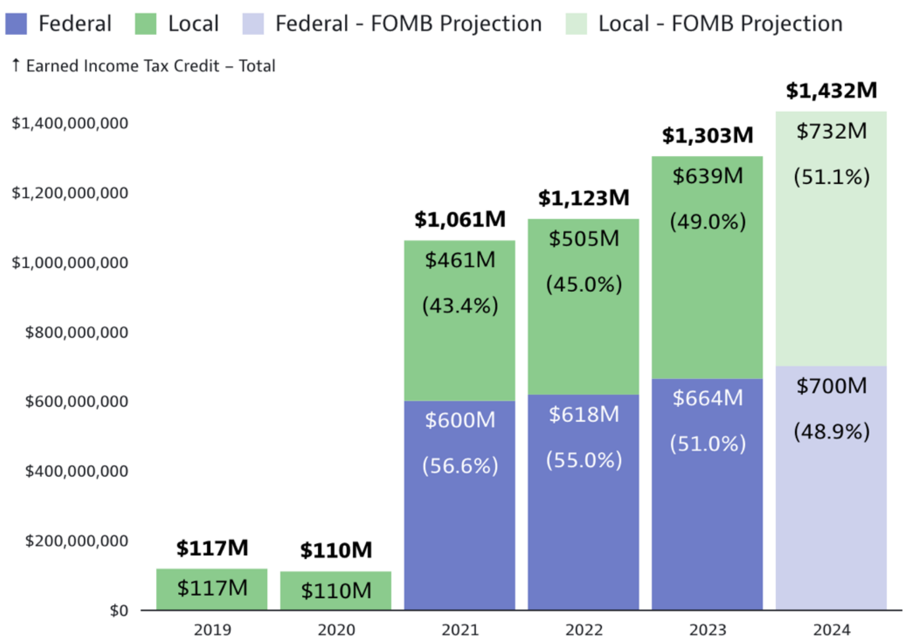
THE EARNED INCOME TAX CREDIT UNDER SCRUTINY BY THE FISCAL OVERSIGHT BOARD

This study was conducted by Espacios Abiertos' (EA) Co-Executive Director Daniel Santamaría Ots and Data Analyst José Miguel Zavala González. We owe a special thank you to The Rockefeller Foundation for its support and commitment to EA's work, as well as to the Economic Opportunity Funders (EOF), Open Society Foundations, and The Annie E. Casey Foundation for their support of our research and analysis. We extend our thanks to Javier Balmaceda of the Center on Budget and Policy Priorities (CBPP) for his observations. We also thank the Puerto Rico Treasury Department's Office of Economic and Financial Affairs, especially its Assistant Secretary, Aixa Cruz Pol, and Economic and Financial Affairs Specialist, Waheed Murad, for their close collaboration in gathering the necessary information for the analysis. Espacios Abiertos aspires to a more open and democratic society, which will, in turn, result in a more just and equitable Puerto Rico. To that end, Espacios Abiertos strives to hold the government and its instrumentalities accountable for their work with the citizens of Puerto Rico, especially regarding transparency in the use of public funds.

INTRODUCTION

Considering anticipated reductions in federal funding for the island, the threat of potential cuts to essential services looms even larger. Programs as necessary and successful as the Earned Income Tax Credit (EITC) have already been flagged by the Financial Oversight and Management Board (FOMB). In its latest certified fiscal plan, the FOMB proposed that the government consider adjusting the eligibility criteria[1] to reduce the cost of the EITC program in Puerto Rico, which, according to the latest data from the Department of the Treasury, amounted to $1.303 billion for tax year 2023.



Sources: Fiscal Oversight Board and analysis by Espacios Abiertos

The fiscal plan specifically targets two vulnerable groups: retirees[2] and young individuals under 26 years old without dependents. In its effort to disqualify both groups from EITC eligibility, the Board argues that, first, because pensions do not derive from direct employment, they do not advance the public policy objective of the EITC; therefore, the credit

[1] Financial Oversight and Management Board (FOMB). June 5, 2024. "Fiscal Plan for Commonwealth of Puerto Rico". https://drive.google.com/file/d/1XBItaK-cYs4cKZv8VvUm2Oi6jP6S25Vc/view?usp=sharing

[2] Although pension payments do not qualify as earned income for the Earned Income Tax Credit (EITC) in other U.S. jurisdictions, the Puerto Rico Legislative Assembly chose to include pensioners under the local EITC law. This decision aimed to compensate for the benefit cuts established under Act No. 60 of 2013, which reduced the Christmas bonus from $600 to $200, eliminated the $100 annual Summer bonus, eliminated the $100 yearly Medication bonus, and eliminated Health Plan contributions of up to $100 per month. In addition to these cuts, pensions have been frozen until 2032, with no cost-of-living adjustments (COLAs), as stipulated in the Central Government's Plan of Adjustment (PoA).

could be eliminated for pensioners. Second, concerning young taxpayers under 26 without dependents, the Board supports their potential disqualification on the grounds that their income is already exempt under Act No. 135 of 2014[3], which exempts the first $40,000[4] in income from taxation.

At Espacios Abiertos, we set out to calculate the overall impact of a reduction in the EITC, and specifically examining how such a change would affect our older adults and young workers.

However, conducting this analysis without contextualizing the effects of this credit in comparison to other tax expenditures would yield only limited results and recommendations. For this reason, we will also briefly comment on the status of the incentive established under Act No. 22 of 2012[5], as well as the implicit acknowledgment in a recent report by the Budget Office of the Legislative Assembly (OPAL) that the incentive, as currently designed, has left several million dollars in forgone revenue for Puerto Rico since its inception.

THE EITC: RETIREES, YOUNG ADULTS, AND CHILDLESS HOUSEHOLDS

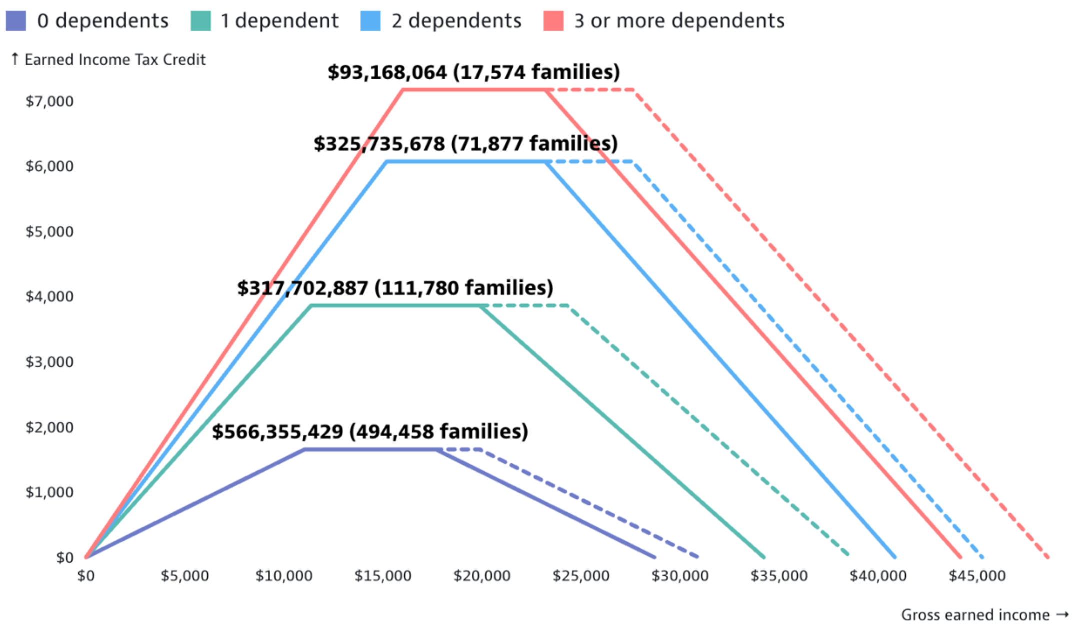
EARNED INCOME TAX CREDIT

In the most recent year with available data, the EITC disbursed $1.303 billion across 695,689 households. The chart below breaks down the monetary amounts received, and the number of households benefited according to the number of dependents.

[3] Act No. 135 of August 7, 2014. "Incentives and Financing Act for Young Entrepreneurs". https://bvirtualogp.pr.gov/ogp/Bvirtual/leyesreferencia/PDF/2/0135-2014.pdf

[4] According to the latest Tax Expenditure Report (TER), the estimated fiscal cost for 2026 is $80 million. Department of the Treasury. "Tax Expenditure Report for the Years 2020-2026". https://hacienda.pr.gov/sites/default/files/pr_tax_expenditure_report_for_tax_year_v_section_iii_d_06.28.23_f_copy_1.pdf. Recently, the Senate approved Senate Bill 184, which seeks to extend the age limit for the $40,000 exemption from 26 to 29 years of age. The Legislative Assembly's Budget Office (OPAL) estimated its impact at $20 million.
Budget Office of the Legislative Assembly (OPAL, by its acronym in Spanish). "Report 2025-047 | SB184." https://www.opal.pr.gov/informes/informe-2025-047-ps-184

[5] Act No. 22 of January 17, 2012, as amended — "Act to Promote the Relocation of Individual Investors to Puerto Rico". https://bvirtualogp.pr.gov/ogp/Bvirtual/leyesreferencia/PDF/Desarrollo Económico/22-2012/22-2012.pdf



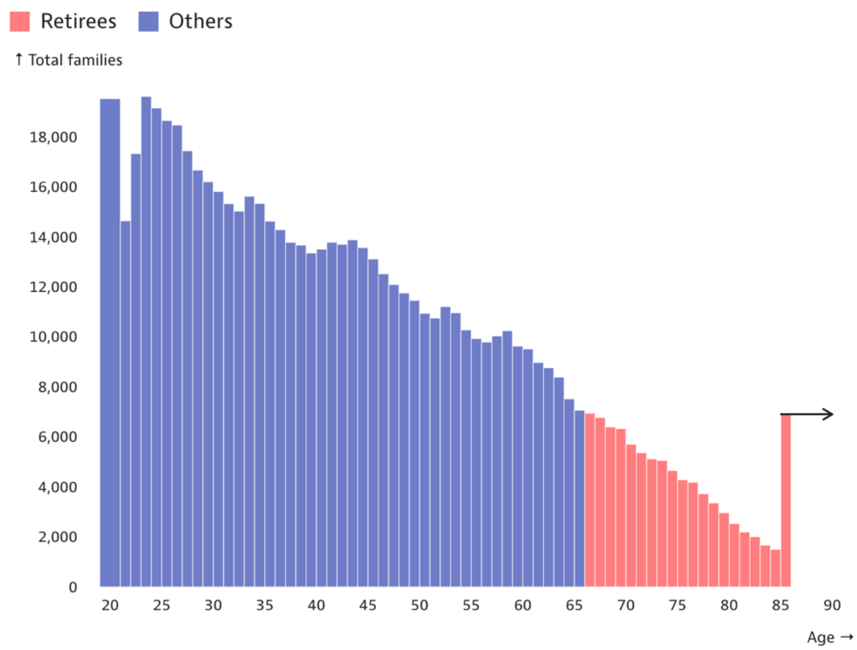
Sources: Department of the Treasury and analysis by Espacios Abiertos

The Oversight Board has already expressed the need for adjustments to the program in its fiscal plan. This would imply reducing the total current investment in the credit ($1.3 billion) up to the sum of: 1) the annual local cap imposed by the Board ($200 million); and 2) the annual federal contribution ($700 million, adjusted for inflation since 2021). Combined, this would result in a potential $400 million cut to the program—i.e., from $1.3 billion to approximately $900 million.

To quantify the potential effects on retirees and youth under age 26, Espacios Abiertos conducted an analysis to estimate the impact.

EITC FOR RETIREES

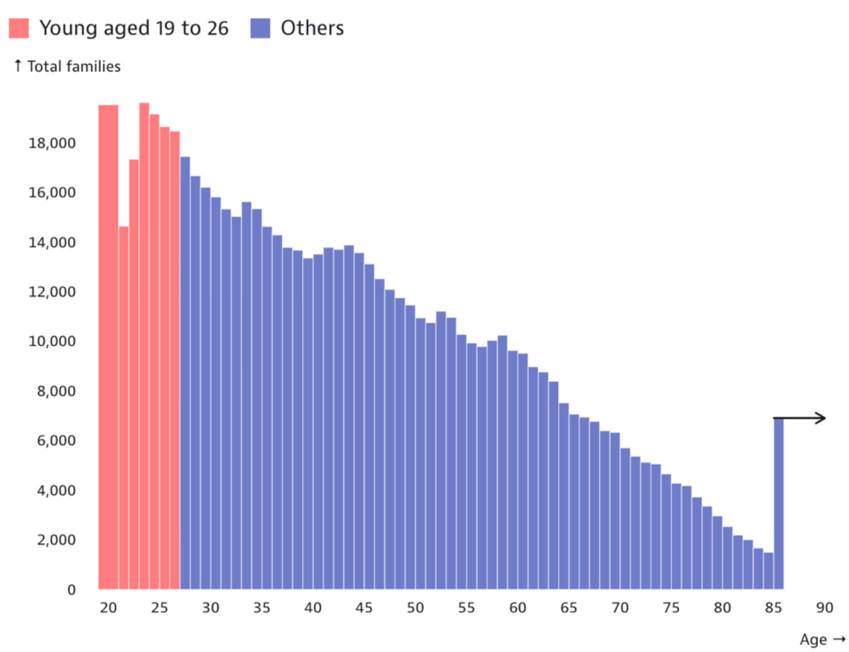
In Puerto Rico, 86,735 retirees benefited from a total of $104,783,593 in EITC disbursements, with an average credit of $1,208 per household.



Sources: Department of the Treasury and analysis by Espacios Abiertos

EITC FOR YOUTH AGES 19–26

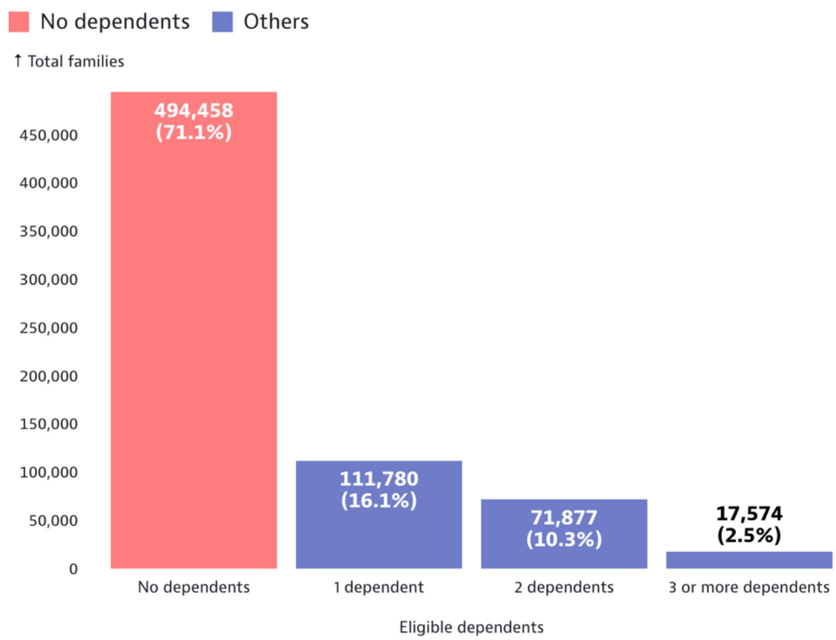
In Puerto Rico, 127,399 young individuals aged 19 to 26 benefited from a total of $191,517,540 in EITC disbursements, with an average credit of $1,503 per household.



Sources: Department of the Treasury and analysis by Espacios Abiertos

EITC for Childless Families

In Puerto Rico, 494,458 childless households received a total of $566,355,429 through the EITC, with an average credit of $1,145 per household.

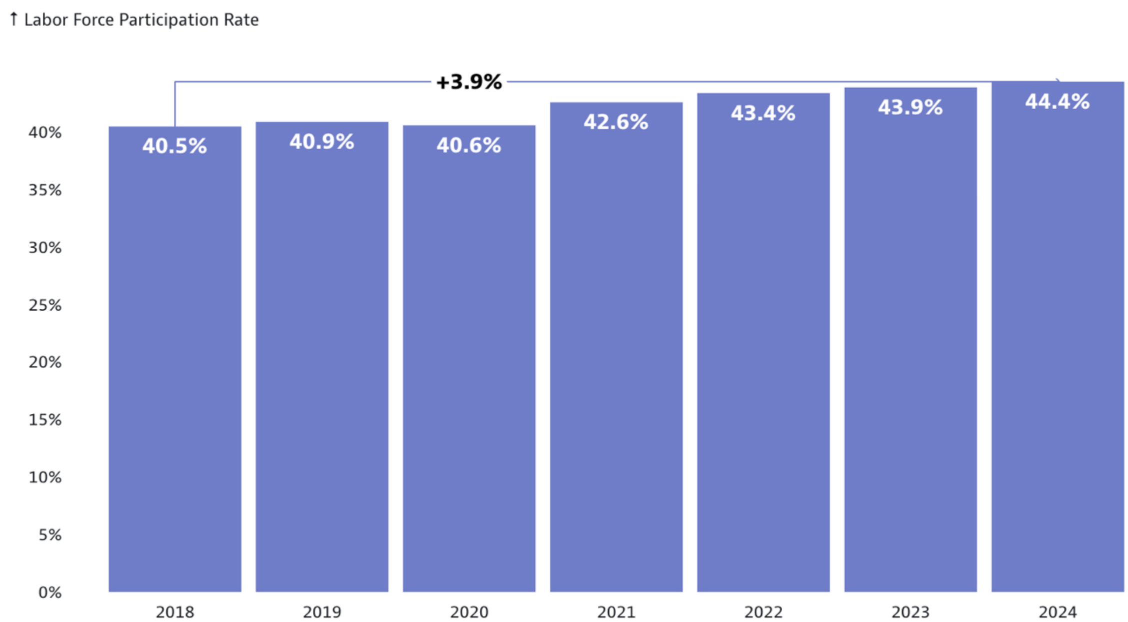


Sources: Department of the Treasury and analysis by Espacios Abiertos

The Economic Impact of the EITC

In an economic context where Puerto Rico is experiencing a clear slowdown—and in which key sectors, such as construction, are struggling to find workers—cuts to the EITC would discourage formal labor participation, thereby undermining economic growth.

If federal funding inflows are slowing down and local austerity also affects programs like the EITC, we are likely to see not only a decline in the labor force participation rate, but also an increased burden on the local business sector. To maintain the incentive to work in the formal economy, employers might have to absorb the cut in EITC benefits themselves—otherwise risking a return of part of their workforce to informality.



Sources: Department of Labor and analysis by Espacios Abiertos

ACT 22: EFFECTS AND RECENT ADJUSTMENTS

Act No. 22 of 2012 (now incorporated into Act No. 60 of 2019, the Puerto Rico Incentives Code) has already benefited approximately 4,000 individuals and is projected by the Department of the Treasury to represent a tax expenditure of $683 million in 2026[6]. Although long overdue, the recent proposal to increase the tax rate on capital gains, interest, and dividends from 0% to 4%—while still insufficient—constitutes a step in the right direction.

A recent study[7] by the Legislative Assembly's Office of Budget (OPAL) concludes that, if the proposed legislation were adopted, Puerto Rico could increase General Fund revenues by between $27.8 million and $60.6 million in fiscal year 2027. Furthermore, the OPAL report estimates that extending the current tax decrees under Act 22 beyond 2037 could generate an additional $271 million per year. This revenue increase would more than offset the potential $400 million reduction to the current Earned Income Tax Credit (EITC).

It is telling that OPAL tacitly acknowledges that raising the rate from 0% to 4% would yield between $27.8 million and $60.6 million from newly issued Act 22 decrees going forward—

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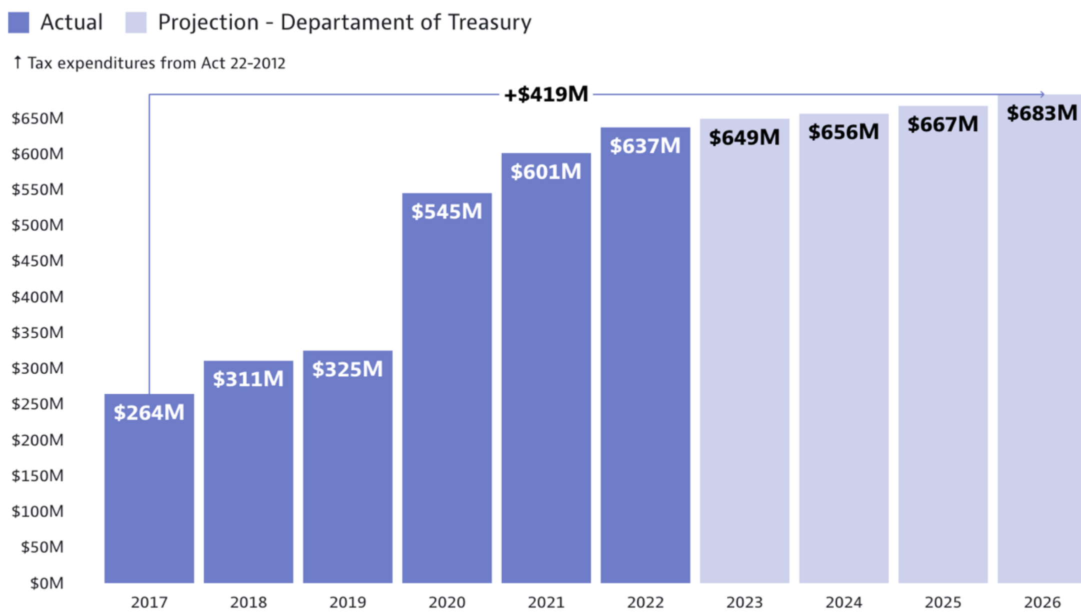
[6] Department of the Treasury. "Tax Expenditure Report for the Years 2020-2026". https://hacienda.pr.gov/sites/default/files/pr_tax_expenditure_report_for_tax_year_v_section_iii_d_06.28.23_f_copy_1.pdf.

[7] Legislative Assembly's Office of Budget (OPAL). Report 2025-091| HB 505 and SB 489. "Report on the Fiscal Impact of House Bill 505 and Senate Bill 489". https://www.opal.pr.gov/informes/informe-2025-091-pc-505-y-ps-489

without deterring investors from coming to the island. This finding undermines the core argument made by staunch defenders of the earlier version of the law, who had unfoundedly questioned its fiscal cost and erroneously claimed that without the 0% tax rate, such individuals would never have relocated to Puerto Rico. As demonstrated by OPAL's analysis of the proposed 4% tax increase—still pending Senate approval—time has proven them wrong.



Sources: Department of the Treasury and analysis by Espacios Abiertos

Conclusion

While protecting our pensioners and individuals under the age of 26 is important, it is equally essential to advance arguments grounded in fiscal responsibility. Puerto Rico must respond to the federal funding cuts enacted under the Trump administration with revenue-neutral proposals if it wishes to maintain balanced budgets. This requires not only asking how much is needed to offset the loss of federal aid, but also who will bear the fiscal burden.

This is where our elected bodies will have the opportunity to propose measures that advance tax justice for our local small business owners and working-class population. Any proposal should address the asymmetry of power embedded in the current tax system. While tax decrees shield large multinational corporations and high-income individuals—such as the beneficiaries of Act No. 22 of 2012 (now Act No. 60, the Puerto Rico Incentives Code)—our local small and medium-sized enterprises and working families are left unprotected. As some sectors remain untouchable, it is invariably the less affluent who are left to bear the brunt of the cost.

Therefore, the forthcoming tax reform—likely to be debated in the next legislative session—should include initiatives[8] aimed at offsetting or mitigating fiscally regressive[9] measures such as Act 22 and the potential $400 million cut to the Earned Income Tax Credit.

RECOMMENDATIONS

1) DEMAND TRANSPARENCY.

Between 2019 and 2023, the Treasury published four tax expenditure reports showing an annual cost of approximately $25 billion in tax incentives. Unfortunately, since last year, the Treasury has stopped publishing this essential document. It is crucial that the Treasury resume this practice for the benefit of the Legislative Assembly and all economic stakeholders.

2) DEVELOP OPEN MICROSIMULATION TOOLS.

The government should develop public microsimulation platforms to project the effects of tax policy changes. These tools should be accessible to the legislature, academia, civil society, and the general public. In 2022, the Treasury signed a $750,000 agreement with the Legislative Assembly's Office of Budget Analysis (OPAL) to create such a platform by January 2025. The consultant completed the work, and the project was paid for—but the platform has yet to be released.

3) BEGIN WORKING ON REVENUE-NEUTRAL PROGRESSIVE TAX PROPOSALS.

Ahead of a potential tax reform in the second legislative session of 2025, the Legislative Assembly should collaborate with OPAL to simulate fiscally progressive[10] measures that can demonstrate to the Board an increase in revenues, a reduction in expenditures, or a redistribution of spending. This would allow for a tax reform that is revenue-neutral, fiscally responsible, and capable of offsetting the likely up to $400 million cut to the EITC.

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[8] Evaluating and quantifying such measures lies beyond the scope of this report. However, several options that the Legislative Assembly could consider include, but are not limited to: the implementation of minimum effective tax rates of 10% on corporate profits for firms with revenues exceeding $100 million; increases in marginal tax rates on luxury real estate and luxury goods; the introduction of inheritance and gift taxes (with exemptions for amounts below $1 million); a net wealth tax applicable to assets exceeding $1 million; the elimination of sales tax refunds for high-income taxpayers; etc.

[9] A tax policy is considered regressive when it imposes proportionally higher tax burdens on low-income taxpayers than on high-income taxpayers.

[10] Fiscally progressive measures are tax or public spending policies that contribute to reducing inequality by requiring individuals with higher incomes or greater wealth to contribute a larger proportion of their resources to the public treasury than those with lower incomes or assets.

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¡ea!