

**The original documents are located in Box 7, folder “Puerto Rico - Compact of Permanent Union, November 7, 1975” of the White House Special Files Unit Files at the Gerald R. Ford Presidential Library.**

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**THE WHITE HOUSE**  
**WASHINGTON**

**November 7, 1975**

**Pat McKee:**

**Here is a copy for Jim Cannon  
as requested.**

**Trudy Fry**

**cc: Jim Falk**

THE WHITE HOUSE  
WASHINGTON

November 6, 1975

Dear Marlow:



Your dedication to the successful completion of the proposed "Compact of Permanent Union Between the United States and Puerto Rico" deserves the highest commendation.

Please accept my personal thanks for your hard work and the sacrifices you and your colleagues had to make to complete this endeavor.

You have my assurance that this Compact will be given a thorough review by my Cabinet.

Please express my sincere appreciation to your fellow Commissioners from Puerto Rico and the United States.

Sincerely,



The Honorable Marlow Cook  
Ad Hoc Advisory Group on the  
Status of Puerto Rico  
1016 Sixteenth Street, NW.  
Washington, D.C. 20036

November 5, 1975

Robert Linder -

The attached was edited by Paul  
Theis. Please arrange for it to  
be prepared in final form for the  
President's signature. Thanks.

Trudy Fry



THE WHITE HOUSE  
WASHINGTON

DRAFT

*FR*

November 4, 1975

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Your dedication to the successful completion of the proposed "Compact of Permanent Union Between the United States and Puerto Rico" deserves the highest commendation.

Please accept my personal thanks for your hard work and the sacrifices ~~which all had to make to complete this endeavor.~~

*You have my, and your colleagues*  
~~Let me assure you and your colleagues that this Compact will~~  
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Please express my sincere appreciation to your fellow Commissioners from Puerto Rico and the United States.

Sincerely,

Gerald R. Ford

The Honorable Marlow Cook  
Ad Hoc Advisory Group on  
the Status of Puerto Rico  
1016 Sixteenth Street, N.W.  
Washington, D.C. 20036

THE WHITE HOUSE  
WASHINGTON

November 5, 1975

Paul Theis -

The attached letter was prepared by Jim Falk. We would appreciate your prompt review.

Thanks.

Jim Connor

P.S. Please return copy of the report that is attached.

THE WHITE HOUSE  
WASHINGTON

DRAFT

*FRF*

November 4, 1975

Dear Marlow:

Your dedication to the successful completion of the proposed "Compact of Permanent Union Between the United States and Puerto Rico" deserves the highest commendation.

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*You have my* ~~Let me assure you and your colleagues~~ *ance* ~~you and your colleagues~~  
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The Honorable Marlow Cook  
Ad Hoc Advisory Group on  
the Status of Puerto Rico  
1016 Sixteenth Street, N.W.  
Washington, D.C. 20036

**November 7, 1975**

**Jim Falk:**

**Attached are additional reports from the Departments  
on the Puerto Rico report:**

**Department of the Interior  
HUD**

**Trudy Fry**





THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D. C. 20410

NOV 6 1975

MEMORANDUM FOR: James E. Connor  
Secretary to the Cabinet  
The White House

Subject: Report of the Ad Hoc Advisory Group on Puerto Rico

The report entitled "Compact of Permanent Union Between Puerto Rico and the United States" has been circulated for review within this Department. Since the document does not deal directly with issues which fall under this Department's purview, it would be inappropriate for us to make recommendations.

  
Carla A. Hills



# United States Department of the Interior

OFFICE OF THE SECRETARY  
WASHINGTON, D.C. 20240

NOV 7 1975

Dear Mr. Connor:

This responds to your memorandum of October 23, 1975, in which you have requested my comments and recommendations concerning the Report of the Ad Hoc Advisory Group on Puerto Rico.

This Report, which in essence is a draft "Compact of Permanent Union Between Puerto Rico and the United States," represents an important step toward a new relationship between the United States Federal Government and the Commonwealth of Puerto Rico. As noted in the Letter of Transmittal to the President and the Governor of the Commonwealth of Puerto Rico, the Compact represents the consensus of the Ad Hoc Advisory Group, and as such is subject to several reservations by members of both the United States and Puerto Rican Delegations. I, too, have certain reservations on the Draft Compact as enumerated below.

In general, the Compact bestows all the benefits on Puerto Rico of a permanent union with the United States without imposing the attendant obligations and responsibilities. It appears to weaken the sovereign relationship of the United States to Puerto Rico by granting Puerto Rico certain exceptions that do not apply to the several states or territories.

Specifically, Section 2 of the draft Compact would permit the Free Associated State of Puerto Rico to participate in international organizations and conclude agreements with foreign countries covering a wide range of subjects. This is contrary to the stand the Federal Government has taken with other U.S. territories such as Guam where they have been denied permission to participate in international organizations. Granting Puerto Rico this privilege could redound to the detriment of the Federal Government in future discussions with other U.S. territories regarding their relationship with the Federal Government.



Section 9, Common Market, expands on the international, sovereign aspect of Puerto Rico under the Compact by having the "Free Associated State of Puerto Rico" accepted as an associated developing state which can participate in all the benefits from any regional or worldwide system of preferences for developing countries. This is contrary to the fact of U.S. sovereignty and responsibility with respect to the conduct of foreign affairs and should not be approved. Also in this section, Puerto Rico would, while remaining in the U.S. customs territory, permit duty free imports of material for processing, provided that not less than 35% in value is added in Puerto Rico before shipment to the United States market. While this value added provision applies in Guam and the Virgin Islands, both of these territories are outside the U.S. customs territory. Granting this privilege to Puerto Rico would affect adversely the income Guam and the Virgin Islands now receive from this value added benefit.

There is a need, as set forth in Section 10, for Puerto Rico to control to some degree the flow of immigration to the Island. The influx of large numbers of poor, uneducated and untrained aliens into an already economically depressed area makes a difficult situation even more untenable. However, application of the provisions of this section would have to be monitored carefully by the United States Immigration and Naturalization Service to insure that the provisions of Section 10 were not abused or misused.

In the last analysis, this Report and recommended draft Compact proposing a new relationship between the United States Federal Government and its territory, Puerto Rico, should go forward to the United States Congress, but with the clear understanding that it is not a definitive document and is subject to debate, change and many compromises before it finally postulates a "permanent" relationship.

Sincerely yours,



Secretary of the Interior

Mr. James E. Connor  
Secretary to the Cabinet  
The White House  
Washington, D. C. 20006



**November 6, 1975**

**JIM FALK -**

**Attached are the comments received from the  
Cabinet on the Puerto Rico Report:**

**As others are received I will send them to you.**

**Attached are the comments of:**

**Agriculture**

**Treasury**

**HEW**

**Commerce**

**Defense**

**Trudy Fry**

THE WHITE HOUSE

WASHINGTON

October 23, 1975

MEMORANDUM FOR

THE CABINET

SUBJECT: Report of the Ad Hoc Advisory Group  
on Puerto Rico

Attached is the report of the Ad Hoc Advisory Group on Puerto Rico entitled "Compact of Permanent Union Between Puerto Rico and the United States." Prior to submitting the report to the President, it would be appreciated if we could have the comments and recommendations of the Departments concerned.

It would be further appreciated if your comments could be received by this office by close of business Thursday, October 30, 1975.



JAMES E. CONNOR  
SECRETARY TO THE CABINET

Attachment

*cc Jim Falk  
on 10/30/75.*



OFFICE OF THE SECRETARY OF DEFENSE  
WASHINGTON, D.C. 20301

30 October 1975

MEMORANDUM FOR Mr. James E. Connor  
Secretary to the Cabinet  
The White House

THROUGH: Captain Leland S. Kollmorgen, USN  
Military Assistant to the President

A handwritten signature in black ink, appearing to read "L. S. Kollmorgen", written over the typed name.

The report of the Ad Hoc Advisory Group on the Compact of Permanent Union between Puerto Rico and the United States has been reviewed, and the Department of Defense has no objection to the section pertaining to security and common defense.

FOR THE SPECIAL ASSISTANT:

A handwritten signature in black ink, appearing to read "Elmer T. Brooks", written over the typed name.

Elmer T. Brooks  
Lt Col, USAF  
Military Assistant





THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE  
WASHINGTON, D. C. 20201

NOV 4 1975

MEMORANDUM FOR THE HONORABLE JAMES E. CONNOR

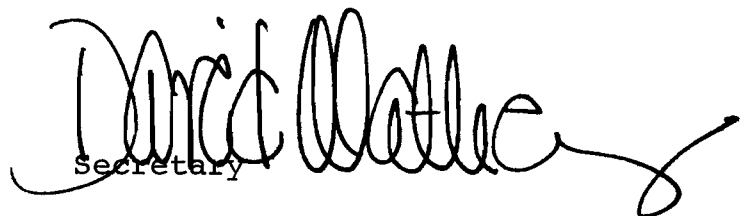
SUBJECT: Report of the Ad Hoc Advisory Group on  
Puerto Rico: Response to your memorandum  
of October 23

The Ad Hoc Advisory Group on Puerto Rico has proposed for consideration of the President of the United States and the Governor of Puerto Rico a Compact of Permanent Union Between Puerto Rico and the United States that, if adopted, would substantially alter the relationship between the two governments. Several provisions of the Compact may be expected to bear directly on the manner in which Puerto Rico participates in programs that our Department administers.

For present purposes, we would respectfully invite the President's attention to sections 6 and 11. The Advisory Committee explains section 6 as founded on a belief, "that United States citizens, notwithstanding their place of residence within the jurisdiction of the Federal Government, should participate equally in the benefits provided by laws of the United States relating to social and economic aid, such as loans and other assistance for the benefit of health, education, housing, opportunities for employment and social welfare." A number of the Department's major programs, such as welfare assistance to the adult categories under the Social Security Act, support programs in Puerto Rico on terms quite different from those that apply within the fifty States and the District of Columbia.

Section 12 of the Compact, on the applicability of Federal laws, would provide a procedure under which Puerto Rico could delay the application to it of regulations implementing any statute and ultimately obtain judicial review on the question of whether the regulation was "essential to the interests of the United States".

The implications of these provisions, as well as others that would bear on the programmatic concerns of other agencies of the Executive Branch (such as the provision allowing Puerto Rico to impose external tariffs different from those imposed on goods entering other portions of the United States), require intensive evaluation. Accordingly, I would recommend that you forward the report of the Ad Hoc Advisory Group to the President with the recommendation that he designate a suitable group, perhaps a task force of the Domestic Council, to study the report in consultation with affected departments and agencies of the Executive Branch, and to advise him whether to accept the recommendation of the Advisory Group "that the Compact be referred to both Houses by the President of the United States with his endorsement, for Congressional action."

  
Secretary







THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE  
WASHINGTON, D. C. 20201

NOV 4 1975

MEMORANDUM FOR THE HONORABLE JAMES E. CONNOR

SUBJECT: Report of the Ad Hoc Advisory Group on  
Puerto Rico: Response to your memorandum  
of October 23

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/s/David Mathews  
Secretary

THE WHITE HOUSE  
WASHINGTON

December 1, 1975

Jim Falk -

Attached are the additional  
comments submitted by Department  
of Commerce on the Puerto Rico  
Report.

Trudy Fry

cc: Steve Low



**U.S. DEPARTMENT OF COMMERCE**  
**Office of the Secretary**  
Washington, D.C. 20230

November 28, 1975

Honorable James E. Connor  
Secretary to the Cabinet  
The White House  
Washington, D. C. 20005

Dear Mr. Connor:

This is in further response to your request of October 23 for the views of this Department on the proposed "Compact of Permanent Union Between Puerto Rico and the United States" drafted by the Ad Hoc Advisory Group on Puerto Rico.

In view of the time constraints in which we have had to consider the proposed Compact, this response will focus on those areas which fall within the particular interest of this Department, i.e., questions of trade and tariff policies and the concept of a common market as described in Section 9 of the proposed Compact. We defer comment on those provisions of the proposal which fall within the primary interest of other Federal agencies.

Several of the provisions in Section 9 represent little or no change from existing law. For example, General Headnote 2 to the Tariff Schedules of the United States (TSUS) (19 U.S.C. § 1202) already provides that Puerto Rico will be considered part of the Customs Territory of the United States. With the exception of coffee, articles imported into Puerto Rico from foreign countries incur the same rate of duty as they would were they imported directly into the United States (48 U.S.C. §739). U.S. imports from Puerto Rico and Puerto Rican imports from the United States enter duty-free (48 U.S.C. §738). Duties and taxes collected in Puerto Rico (less the cost of collection), and the gross amount of all collections of duties and taxes in the United States upon articles of merchandise coming from Puerto Rico, are paid into the Treasury of Puerto Rico (48 U.S.C. §740). Further, all taxes collected under the internal revenue laws of the United States on articles produced in Puerto Rico and transported to the United States or consumed in Puerto Rico are paid into the Treasury of Puerto Rico. (48 U.S.C. §734)

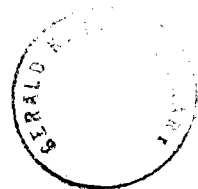
This Department, however, does have serious reservations with respect to other provisions of Section 9. First, there appears to be an inconsistency between the provisions of subsections 9(a) and (c). Subsection 9(c) provides, inter alia, that the "income from Internal Revenue taxes which may be collected on articles transported from Puerto Rico to the United States shall be paid into the Treasury of Puerto Rico." However, subsection 9(a) seems to negate this provision by providing that the United States shall not "impose restrictions, tariffs or taxes of any kind" on U.S. imports from Puerto Rico. An explanation appears in order to clarify this apparent inconsistency. Furthermore, the provisions of subsection 9(a) would appear to prohibit the imposition of excise taxes by either the United States or Puerto Rico with respect to each other's exports. Since the revenue generated by such excise taxes is now paid to Puerto Rico, we question whether such a result was intended by the drafters of the proposed Compact. To overcome this apparently unintended result, we suggest that the second paragraph of subsection 9(a) be revised to prohibit "restrictions, tariffs, or other charges of any kind imposed on or in connection with the importation of articles" imported from each other. In addition, the specific exemption for coffee, provided for in subsection 9(d), should be reflected in subsection 9(a).

Second, subsection 9(d) provides that Puerto Rico may "levy, increase, reduce or eliminate tariffs and quotas on articles imported from foreign countries or transshipped through the United States." The only restrictions placed on such authority are that the actions conform to the international obligations of the United States, that articles containing foreign components shipped or transshipped from Puerto Rico to the rest of the U.S. Customs Territory or from there to Puerto Rico conform respectively to the laws, and that changes in the duty rates be accompanied by consultation and coordination of trade policy with the Federal authorities concerned. Conformity with international obligations would constitute a limitation on the use of quotas, and on the upward movement of tariffs by Puerto Rico because of the upper limit bindings on duty rates resulting from the trade agreements which the

United States has entered into pursuant to the General Agreement on Tariffs and Trade (GATT). Article XXIV of the GATT states, in pertinent part, that its provisions "shall apply to the metropolitan customs area of the contracting parties . . . . Each such customs territory shall, exclusively for the purposes of the territorial application of this Agreement, be treated as though it were a contracting party." As noted above, General Headnote 2 to the TSUS provides that Puerto Rico is included in the Customs Territory of the United States. However, subsection 9(d) would leave open the possibility of selective reduction or elimination of duties by Puerto Rico subject only to prior consultation and coordination with the United States. We believe that this constitutes much too loose an arrangement and lacks sufficiently appropriate safeguards against possible adverse effects on U.S. industry. Moreover, not even the U.S. Government can arbitrarily raise or lower a duty or quota on goods entering the U.S. without conforming to the requirements of relevant tariff and trade legislation which provide various safeguards as conditions to reducing or eliminating tariffs. In this connection, we also note that the second restriction in subsection 9(d) is unclear as to its application. For example, is it to be read in conjunction with subsection 9(e) or does it relate only to those cases where Puerto Rico reduces but does not eliminate a tariff?

Accordingly, we suggest that subsection 9(d) be deleted. At a minimum it should be revised to require U.S. concurrence with respect to any change in tariffs or quotas.

Many of the problems stated as applying to subsection 9(d) apply equally to subsection 9(e). While this Department realizes the need to further develop the economy of Puerto Rico by providing industry with incentives to establish operations there, we feel that the provisions of this subsection may have serious adverse effects on mainland U.S. industry and employment. With the incentive of duty-free treatment for the importation of goods to which 35% value is added in Puerto Rico before shipment to the United States, many U.S. firms may be encouraged to leave the



mainland and establish operations in Puerto Rico. This could well result in a worsening of the critical unemployment situation which already exists in the fifty states. Moreover, not only would jobs on the mainland be lost, but those companies in the same industry that remained on the mainland would be put to a competitive disadvantage vis-a-vis those companies which had relocated in Puerto Rico. An example is provided in the separate remarks of Representative Don H. Clausen. He notes (p. 62 of the Report of the Ad Hoc Advisory Group on Puerto Rico) that "an entrepreneur could set up a textile processing plant in Puerto Rico, which the Puerto Rican Government would encourage in order to improve the island's economy. Subsequently, raw, unfinished textiles from abroad could be imported duty-free. Next, the merchandise would be processed, adding at least 35% value to the finished product. As a consequence, clothing could be shipped to the United States, again duty-free, permitting sale of the finished product in the fifty states at a much cheaper rate than that produced on the mainland."

Subsection 9(e) could also adversely affect the U.S. economy in yet another way. Under its provisions, foreign firms would be encouraged to move their final operation unit to Puerto Rico where they could import, duty-free, low-cost foreign-made semi manufactures, to which 35% value would be added in Puerto Rico. The final product could then be shipped duty-free to the U.S. mainland. U.S. jobs at all levels of the manufacturing process for that product would then be taken away, while the benefit to Puerto Rican employment would occur only in connection with the final operation necessary to add 35% local content to the final article coming to the U.S. mainland from Puerto Rico.

While we would prefer that subsection 9(e) be deleted, alternatively we would suggest that it be amended, adding the requirement of U.S. approval with respect to each article that may receive duty-free treatment under subsection 9(e). In addition, the commentary for Section 9

should indicate that the regulations implementing that Section should include the value-added criteria set forth in Title V of the Trade Act of 1974 concerning the requirements for the U.S. Generalized System of Preferences, for the purpose of determining whether the 35% value-added requirement has been met.

Such application of the Title V value-added criteria would eliminate the problems encountered with "front operations" under the special duty arrangement for insular possessions, such as the Virgin Islands. That arrangement works as follows. Under General Headnote 3(a)(i) to the TSUS, products of insular possessions are generally subject to column 1 rates of duty when imported into U.S. Customs Territory, except that General Headnote 3(a)(i) also provides that articles from insular possessions may be imported into the U.S. Customs Territory duty-free when they have had at least 50% value added in such insular possession. However, because the meaning of "value-added" in General Headnote 3(a)(i) is not limited to direct costs of processing, goods are exported from various developed nations to the Virgin Islands in nearly finished form, have small direct amounts of value added there, but for purposes of duty-free exportation to the United States, have indirect costs of manufacture and/or processing and a profit markup included in order to meet the 50% value added requirement. Thus, many products of developed countries which should be subject to a duty, enter the U.S. Customs Territory without incurring any duty. Moreover, this arrangement has had a negligible effect on economic development in the Virgin Islands because it has resulted in mere assembly plants, instead of complete manufacturing operations, being established on the Islands. We would not want economic development in Puerto Rico to be similarly frustrated.

Subsection 9(f) poses two issues. The first involves extending to Puerto Rico observer status within the U.S. negotiating delegations to international trade negotiations. Although this Department has no objection to the establishment of such observer status for Puerto Rico, we would defer to the views of the President's Special Representative for Trade Negotiations on this matter.



The second issue concerns the proposal that the U.S. seek to have Puerto Rico accepted by other developed countries as an "associated developing state" for purposes of inclusion in all benefits from any regional or worldwide system of preferences for developing countries. While we have no problem with the concept of other developed countries according "developing country status" to Puerto Rico and extending it preference benefits, we believe that the United States is not in a position to seek such status and benefits for Puerto Rico because the United States is not prepared to extend reciprocal "beneficiary developing country" status to other areas, such as the French West Indies, which are within the customs territory of a developed country. Moreover, the opportunity for channeling developed country products through such receiving areas within a customs territory are so great and the problems of policing such an arrangement are so formidable as to render such arrangement unacceptable in most instances.

Relative to the subject matter of Section 9 is subsection 2(d) which provides that the United States shall be responsible for the international relations and defense of Puerto Rico, but that Puerto Rico may participate in international organizations and may enter into educational, cultural, health, sporting, professional, industrial, agricultural, financial, commercial, scientific, or technical agreements with other countries consistent with the functions of the United States as determined by the President of the United States and the Governor of Puerto Rico. The implementation of agreements with foreign countries in most of these areas would, no doubt, require the cooperation and agreement of the United States. In particular, almost any industrial, agricultural, or commercial agreement of any substance would require close consultation because of the possible effects on the United States in view of the common market and dual citizenship aspects of the U.S.- Puerto Rican relationship. Financial arrangements would have to be agreed to by the U.S. Treasury so long as the dollar is maintained as a common currency. Consideration would also have to be given to requirements of the U.S. regulatory agencies, including such agencies as the U.S. Patent Office(which it is assumed will continue to protect and service the patents of Puerto Ricans). In short, to

merely state that the U.S. will be responsible for foreign relations and defense matters and Puerto Rico will have relative freedom of action in other areas would seem to be unrealistic where almost any agreement could have significant political, economic, or social implications for the United States and would require intimate coordination with U.S. authorities. It seems to us that merely to note that the agreements entered into are to be "consistent with the functions of the United States, as determined by the President of the United States and the Governor of the Free Associated State on a case-by-case basis" does not sufficiently take into account the considerable substantive and procedural problems that may flow from the provisions of subsection 2(d). At a minimum, it is suggested that the commentary on subsection 2(d) be revised to elaborate on these problems of implementation.

Although we have limited our comments to those sections of the proposed Compact which fall within the particular interest of this Department, we nevertheless feel it necessary also to express our reservations on certain aspects of Section 12 of the proposal. Subsection 12(d) allows Puerto Rico to be exempted from the coverage of certain enacted legislation if the appropriate committee or committees of Congress by vote express agreement with the objections thereto of the Governor or Resident Commissioner of Puerto Rico. While we do not object to a legislative mechanism whereby objections of Puerto Rico to proposed legislation that would apply thereto can be expressed prior to enactment, we feel that the arrangement proposed here may, in effect, allow a committee of the Congress to overrule and thereby frustrate the intent of Congress and the President. Aside from policy objections, it would appear that such a procedure raises issues of Constitutional dimension.

In addition, we question the procedural aspects of subsection 12(d). For example, what would be the result if the appropriate committee of one House of Congress agreed with the objections interposed and the appropriate committee of the other House reached the opposite conclusion? Would the legislation enacted by the whole Congress and approved by the President then apply to Puerto Rico?

Subsection 12(e) is also of questionable merit. That subsection provides that if Puerto Rico should object to the application to it of any rule, regulation, or order of a department or agency of the United States, such rule, regulation, or order would be inapplicable to Puerto Rico unless and until the department or agency finds and declares that the application is essential to the interests of the United States and is compatible with the Compact. Such a provision seems to us to be much too broad and burdening. At the very least such a provision should not apply to rules, regulations, or orders which directly affect the rights and duties of citizens, common market, security and common defense, foreign affairs, and currency. Moreover, we fail to see why present administrative procedure under the Administrative Procedure Act which provides for the opportunity to comment on proposed administrative regulations and judicial review thereof is inadequate for the interposition and consideration of objections to proposed rules and regulations. Requiring a separate determination for Puerto Rico with an "essential to the interests of the United States" standard seems to us to be too severe and unwarranted.

Notwithstanding this Department's expressed reservations to certain provisions of the proposed Compact, we welcome this opportunity to reexamine the legal relationship between Puerto Rico and the United States, especially in the area of trade and tariff policies. While in some cases our reservations are substantial, we feel that the problems posed are not insurmountable. Indeed, we view the proposed Compact as an important step in improving the relationship between Puerto Rico and the United States.

Sincerely,

  
Robert S. Milligan  
Director,  
Office of Policy Development



**UNITED STATES DEPARTMENT OF COMMERCE**  
**Office of the Secretary**  
Washington, D.C. 20230

NOV 4 1975

MEMORANDUM FOR JAMES E. CONNOR  
SECRETARY OF THE CABINET  
THE WHITE HOUSE

FROM : Robert S. Milligan *RS*  
Director  
Office of Policy Development

SUBJECT: Department of Commerce Status Report on Evaluation  
of Proposed "Compact of Permanent Union between  
Puerto Rico and the United States"

In response to your request of October 23rd for comment on the above subject, specialists are undertaking a detailed evaluation of the Compact's provisions which fall within the Department's expertise. In particular, we refer to SECTION 9 or "Common Market" aspects of this proposed Compact.

SECTION 9 is of crucial significance not only for the future development and well-being of the Puerto Rican economy, but is also of great practical importance to the U.S. mainland business community. For example, Puerto Rico is currently the world's largest per capita purchaser of mainland United States goods. In terms of volume, Puerto Rico with \$2.9 billion of mainland U.S. exports in 1974, ranked an impressive eighth place vis-a-vis our other trading partners being surpassed only by Canada, Japan, West Germany, Mexico, United Kingdom, Netherlands and Brazil.

Furthermore, we note that SECTION 9 has been in part revised from the April 12, 1975 version of the proposed Compact on which this Department already commented informally by letter of June 3, 1975 to Marlow W. Cook, Co-Chairman of the Ad Hoc Advisory Group on Puerto Rico. As a result of these revisions, it now requires further study and review.

As soon as an expeditious review is completed we will transmit our comments to you.



MEMORANDUM  
OF CALL

TO:

YOU WERE CALLED BY—  YOU WERE VISITED BY—

*Mr. Radspiehl*  
OF (Organization)

*X 189-2058*

PLEASE CALL → PHONE NO. CODE/EXT. \_\_\_\_\_

WILL CALL AGAIN  IS WAITING TO SEE YOU

RETURNED YOUR CALL  WISHES AN APPOINTMENT

MESSAGE

*Policy Development  
Office - Dept of  
Commerce  
Puerto Rico Compact*

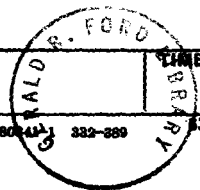
RECEIVED BY

DATE

TIME

STANDARD FORM 63  
REVISED AUGUST 1967  
GSA FPMR (41 CFR) 101-11.6

GPO : 1969-048-16-80441 332-289 63-108





THE GENERAL COUNSEL OF THE TREASURY  
WASHINGTON, D.C. 20220

NOV 5 1975

MEMORANDUM FOR: The Honorable  
James E. Connor  
Secretary to the Cabinet

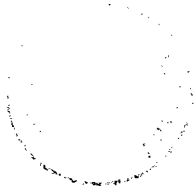
From: Richard R. Albrecht *RA*

Subject: Report of the Ad Hoc Advisory Group  
on Puerto Rico

On behalf of Secretary Simon, I am responding to your request for the views of the Treasury Department on the Report of the Ad Hoc Advisory Group on Puerto Rico on the proposed Compact of Permanent Union Between Puerto Rico and the United States.

The attached Treasury Memorandum discusses issues raised by the proposed Compact which are of interest to this Department.

Attachment



TREASURY MEMORANDUM

The following sections of the Report of the Ad Hoc Advisory Group on Puerto Rico on the proposed Compact of Permanent Union Between Puerto Rico and the United States are of interest to this Department:

Section 2

This section outlines the proposed jurisdiction and authority of the Free Associated State of Puerto Rico. Puerto Rico would delegate certain powers enumerated within this Compact to the United States. Powers not so delegated would be reserved to Puerto Rico. The enumerated powers delegated to the United States in the field of taxation are ambiguous. This ambiguity could create many administrative and substantive tax problems which would have to be resolved prior to enactment of the Compact. Also, the Compact should delegate to the United States the specific power to assess, collect and enforce the taxes imposed by the Internal Revenue Code of 1954 (hereinafter cited as "Code") with respect to all persons subject to taxation under the Code.

The proposed Compact would grant the United States responsibility for the foreign policy of Puerto Rico, while providing Puerto Rico with jurisdiction over matters of a domestic nature. Presumably, the United States power to determine Puerto Rico's foreign policy would include the power to determine its oceans policy. Section 2(a) of the draft bill would grant Puerto Rico jurisdiction over its seas and seas adjacent to Puerto Rico. This language could be construed to authorize Puerto Rico, in the exercise of its sovereignty over its seas, to extend unilaterally its jurisdiction over oceans adjacent to its territory or territorial sea in conflict with United States policy in the ongoing law of the sea negotiations. Accordingly, we recommend that a sentence be added to section 2(a) to read: "The Free Associated State of Puerto Rico shall exercise its national sovereignty over its seas in a manner consistent with the foreign policy of the United States."

It is not clear from the wording of this section whether the coastwise laws of the United States, which cover the transportation of passengers and merchandise on water between points embraced by the coastwise laws and towing and dredging operations in United States waters (see 46 U.S.C. 289, 292, 315, and 883), would continue to be applicable to Puerto Rico itself, or only to water transportation



between Puerto Rico and the United States. The Department believes the language in this section should be more specific in this regard. We assume that such coastwise laws may continue to apply to Puerto Rican waters provided that the conditions specified under the provisions of section 3(b), are complied with, although this is far from clear. There is also some question of the applicability of other navigation laws such as those relating to entry and clearance of vessels (see 19 U.S.C. 1434 and 1435 and 46 U.S.C. 91) and to the fisheries (46 U.S.C. 251 and 16 U.S.C. 1081-1094). Another question relates to the applicability of laws relating to aircraft, such as the report of arrival requirement, air cabotage prohibitions, etc.

The above-stated questions are raised in spite of and particularly in light of section 12(a), which states that "The laws of the United States applicable to the Free Associated State on the date of approval of this Compact shall continue in effect except to the extent repealed or modified by this Compact or incompatible with it, and except as hereafter modified, suspended or repealed in accordance with law." It appears that section 2(a), is, in fact, incompatible with said section 12(a), and that clarification is especially warranted in view thereof. Examples of how the draft bill might be revised to specify applicable statutes are 19 U.S.C. 81e and 43 U.S.C. 1333(c) to (g).

Section 2(d) would authorize Puerto Rico to participate in international organizations and to enter into international agreements with other countries with respect to, inter alia, financial and commercial relations consistent with the functions of the United States, as determined by the President of the United States and the Governor of Puerto Rico on a case by case basis. This provision would authorize Puerto Rico to join organizations, such as the GATT, the IMF, and the IBRD and to enter into financial and commercial agreements with other countries. Puerto Rico's exercise of this authority could conflict with United States international economic and foreign policy. The draft Compact of Free Association which the United States has negotiated with the Trust Territory of the Pacific Islands (Micronesia) provides for the United States to have full responsibility for and authority over the foreign affairs of Micronesia while enabling Micronesia to become a member of certain international organizations of which the U.S. is a member, to enter into agreements with certain international organizations of which the U.S. is a member, and to request the U.S. to negotiate certain types of bilateral agreements which would apply to Micronesia. The preferable, most consistent course of action may be to make section 2(d) less broad by revising it along the lines of similar provisions in the draft Micronesian Compact.

Section 2(d) should also be modified to provide specifically that Puerto Rico may not enter into income tax agreements with other countries covering matters generally handled by conventions for the avoidance of double taxation.



Section 4

This section should be carefully restudied and redrafted. The thrust of the provision is unclear in the light of present income tax provisions of the Code. We would recommend that this section be drafted to provide that the income tax laws presently in effect will remain in force except as may specifically be provided to the contrary. Exceptions should then be carefully and specifically stated. Our specific objections to this section are summarized below.

1. It is unclear whether Puerto Rico would continue to be a possession for purposes of the Code. Section 7701(c) of the Code presently provides as follows:

Sec. 7701. Definitions.

"(c) Commonwealth of Puerto Rico. Where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, references in this title to possessions of the United States shall be treated as also referring to the Commonwealth of Puerto Rico."

Even in the event Puerto Rico is to continue as a possession, this paragraph (c) must be modified to refer to Puerto Rico as the Free Associated State of Puerto Rico. A number of other income tax provisions of the Code would also have to be amended to change formal references to Puerto Rico or reconsidered in view of the proposed compact.

2. Section 931 of the Code provides an exclusion from gross income for United States corporations carrying on a trade or business in Puerto Rico but only if certain conditions are satisfied. Such corporations may often be treated as resident in Puerto Rico by virtue of having engaged in business in Puerto Rico and, as such, would be exempt from United States taxation of income from sources within Puerto Rico under section 4(b) without satisfying the conditions of section 931.

3. Section 4(b) would provide that the Federal income tax may be imposed only on the U.S. source and the foreign-source income of Puerto Rican residents, and that in computing the Federal income

tax on such amounts a credit would have to be allowed by the United States for the Puerto Rican tax imposed on the same income.

Under present law, Federal income tax is imposed on the U.S.- and foreign-source income of Puerto Rican residents, but Puerto Rican-source income is excluded from gross income under section 933 of the Code where the taxpayer is a "bona fide resident" of Puerto Rico. The U.S. - and foreign-source income of Puerto Rican residents is also subject to Puerto Rican income tax, but Puerto Rico allows a foreign tax credit for the U.S. tax imposed on such income. 26 P.R.L.A. § 3131(b)(2). The proposed Compact would thus retain the first rule but change the foreign tax credit rules.

The Department would have no objection to a rule which required the United States to grant a foreign tax credit for the Puerto Rican income tax imposed on foreign-source income, because that is the rule which would be in effect under Federal law if Puerto Rico did not allow a tax credit, for Puerto Rican purposes, for the U.S. tax imposed on such income. The Department would object, however, if the United States were to be required to give a foreign tax credit for the Puerto Rican tax imposed on U.S.-source income. At the present time, most U.S.-source income received by Puerto Rican residents escapes U.S. tax anyway, because Puerto Rican residents are entitled to claim the standard deduction, personal exemptions for all dependents, and if married to file a joint return with respect to U.S. - and foreign-source income subject to U.S. tax. The amount of additional tax that Puerto Rico would collect if such a change were instituted, moreover, would be only about \$7 million annually. If the United States were to agree to such a rule, however, there might be pressure to grant similar rights to foreign countries in our income tax treaties.

4. Section 933 of the Code exempts from taxation income derived from Puerto Rican sources by an individual resident there only if he was a Puerto Rican resident for his entire taxable year (or if he had been such a resident for the 2 years preceding his change of residence from Puerto Rico). Section 4(b) has no similar requirement of residence for the entire year.

5. Section 4 seems patently inconsistent with paragraphs 1 through 3 of section 7651 of the Code which provide for administration and collection of taxes in possessions. Is it the intention of section 4 to repeal these provisions as they apply to Puerto Rico?

6. There are a number of other provisions of the Code not pertaining to the income tax which have special application to Puerto Rico. See, for example, section 5001(a)(10), relating to distilled spirits; section 5314, relating to applicability of certain laws to Puerto Rico; section 7652, relating to shipments from Puerto Rico to the United States; and section 7653, relating to shipments from the United States to Puerto Rico. The Department is uncertain of the impact of section 4(a) upon such sections. This should be clarified.

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Section 5(b) would direct officials of the United States and Puerto Rico to assist each other in the execution of their respective functions when compatible with their legal responsibilities and authority. The Department would be opposed to officials of the Internal Revenue Service or Customs Service collecting taxes of the Free Associated State.

Section 8

The Department recommends that section 8 of the proposed compact be amended to insert "and Coinage" in the heading and to read as follows:

"The currency and coinage of the United States shall be the exclusive currency and coinage of Puerto Rico. The laws of the United States relative to currency, coinage, gold and silver shall apply to Puerto Rico."

Section 9

Section 9(a) would prohibit the United States from imposing excise taxes on articles imported into the United States from Puerto Rico, and would prohibit Puerto Rico from imposing excise taxes on articles imported into Puerto Rico from the United States. We question whether the ramifications of such a proposal are fully understood. The effect of the proposal would be to repeal the Federal excise taxes on Puerto Rican rum, tobacco products, and refined gasoline that are imported into the United States, and which account for about \$100 million in Federal tax collections each year. Of this amount, about \$60 million (attributable to alcohol and tobacco tax collections) is rebated by the U. S. Treasury to the Puerto Rican government. If the proposal were adopted, therefore, Puerto Rico would lose the \$60 million which it now receives in rebates from alcohol and tobacco collections, and the United States would lose the remaining \$40 million in revenue attributable to gasoline tax collections.

The effect of the second half of this proposal -- which would prohibit Puerto Rico from imposing excise taxes on articles imported into Puerto Rico from the United States -- would probably have a much more severe impact on Puerto Rico than the first. The Puerto Rican Treasury is heavily dependent on excise taxes on imported goods, much more so than is the U. S. Treasury, and we understand that an emergency 5 percent excise tax on all imported goods was recently imposed in order to help balance the Puerto Rican budget. All Puerto Rican excise taxes are applied equally whether the goods are imported from foreign countries, or from the United States.

Section 9(b) purports to limit generally the applicability of section 739, title 48, United States Code, which states that "The same tariffs, customs, and duties shall be levied, collected and paid upon all articles imported into Puerto Rico from ports other than those of the United States which are required by law to be collected upon articles imported into the United States from foreign countries. All books and pamphlets printed in the English language shall be admitted into Puerto Rico free of duty when imported from the United States."

Section 9(c) would require that the income from customs duties, licenses for imports, tariffs and taxes collected in Puerto Rico be paid into the Treasury of Puerto Rico. Current law requires only that income from duties and taxes collected in Puerto Rico shall be paid into the Puerto Rican Treasury. 48 U.S.C. 740. The intent of the proposed section 9(c) obviously is to require that the import license fees on petroleum collected in Puerto Rico also be paid into the Puerto Rican Treasury.

The Administration has agreed, however, that only that portion of the oil import license fees collected in Puerto Rico attributable to imported oil consumed in Puerto Rico should be covered over to the Puerto Rican Treasury. If the full amount of the fees were paid over, Puerto Rico would receive a windfall to the extent that the fees were not borne by Puerto Rican consumers. Accordingly, the language "licenses for imports" should be deleted from section 9(c).

It is unclear whether section 9(c) applies to income taxes. If so, it would be inconsistent with section 7651(2)(A) of the Code, which provides that all taxes collected by the Secretary in Puerto Rico must be paid into the Treasury of the United States. On this point, section 7809 of the Code is very relevant, since it provides that collections under the internal revenue laws must be paid into the United States Treasury unless otherwise provided. One of the exceptions is under section 7652(a)(3), which provides that certain collections of internal revenue taxes in Puerto Rico are to be covered into the Treasury of Puerto Rico, after deduction of expenses under section 5314(a)(4).

Section 9(d) would authorize Puerto Rico to levy, increase, reduce or eliminate tariffs on goods imported into Puerto Rico from foreign countries or transshipped through the United States, provided that it exercises this authority "in a manner consistent with the international obligations of the United States and after prior consultation and coordination with the Federal authorities concerned." In addition, exercise of this authority would be conditioned upon the establishment of procedures mutually agreed upon by the United States and Puerto Rico to (1) assure conformity with international obligations; (2) assure that articles containing components shipped or transshipped from Puerto Rico to the rest of the United States customs territory or from there to Puerto Rico conform respectively to the laws; and (3) assure continuous communication and coordination between the United States Executive Branch and Puerto Rico on economic and trade policy and implementation.

Section 9(e) would prohibit any article imported into Puerto Rico at a tariff rate lower than the applicable U. S. tariff rate from being shipped to any other point in the United States customs territory unless the appraised value on shipment contains at least 35 percent in value added in Puerto Rico.

Section 9(d) would grant Puerto Rico wide latitude to establish separate tariffs. In view of the fact that most U. S. tariff rates are bound under the GATT, its authority to increase tariff levels above the U. S. rates would be limited by the requirement that such increases be consistent with United States international obligations. Puerto Rico would have, however, virtually unlimited discretion to reduce or eliminate tariffs.

The economic relationship between the United States and Puerto Rico presently represents a true common market possessing unrestricted trade between the two areas, a common currency, common economic policies, and a common external tariff. The proposed compact would take a step backward from a common market and economic union.

The proposed compact would create a free trade area with different external tariffs. The United States has discouraged free trade agreements for sound commercial policy reasons. Free trade agreements lead to trade distortions because trade can respond to differences in tariffs between the two areas rather than differences in relative efficiencies.

There are practical problems in maintaining free trade between two areas with different external tariffs. A major difficulty lies in preventing goods from being imported into the area with the lower tariff for re-exportation to the high tariff area, thereby avoiding the latter's higher tariffs. To some degree this problem is mitigated by rules of origin and other regulations, but loopholes always remain.

Section 9(e) of the proposed compact would attempt to deal with this problem by requiring that 35 percent of value of an imported product be added in Puerto Rico before it can be shipped to the United States. This is similar to the rule of origin applicable to our Generalized System of Preferences (GSP), which was authorized by the Trade Act of 1974. However, the GSP provisions contain built-in safeguards, e.g., the tariff preferences are applicable only to nonsensitive products, and are subject to a \$25 million limit. Escape clause relief is available if such imports cause or threaten injury. None of these safeguards would apply to Puerto Rico under the compact. Thus, goods could be imported into Puerto Rico, processed sufficiently to meet the 35 percent rule, and then exported to the United States duty free without limitation. The absence of safeguards, or of any other measures to prevent injury to U. S. producers, makes the proposal unacceptable on practical as well as policy grounds.

Subsection (d) would also provide that "Puerto Rico shall continue to enjoy the right to levy tariffs upon or otherwise to restrict the import of coffee from foreign countries or the United States." However, under current law, Puerto Rico has authority only to impose duties on imports of coffee from foreign countries or from the United States if the coffee is grown in a foreign country. 19 U.S.C. 1319. The Department is opposed to this provision to the extent that it would modify existing law.

Finally, with regard to customs procedures, the Department is uncertain of the overall applicability of section 2(b) and section 3(b) to duty on vessel repairs (19 U.S.C. 1466) and tonnage tax (46 U.S.C. 121 and 128), and of the applicability of the Outer Continental Shelf Lands Act and the Deepwater Ports Act of 1974.

#### Section 12

Section 12(a) would provide that the laws of the United States applicable to the Free Associated State shall continue in effect except to the extent repealed or modified by the compact, or incompatible with it.

There should be specific listing of the proposal's effect on relevant laws rather than reliance on the general statement in section 12(a).

Section 12(b) would provide that no new Congressional enactments would be applicable to Puerto Rico except as provided in subsections (c) and (d). Subsection (d) would provide that laws which directly affect the rights and duties of citizens and the security and common defense, and laws which relate to foreign affairs and currency would apply. It is unclear whether it is intended that future Federal tax legislation affect Puerto Rican citizens. It is uncertain if payment of taxes would be considered a duty for purposes of the Compact and whether application of Federal tax legislation to Puerto Rico would be essential to United States interests and would be compatible with the Compact.

Section 12(e) would provide that new Federal rules, regulations, and orders will be applicable to Puerto Rico over its objection if the promulgating authority makes a finding and declaration that application to Puerto Rico is essential to the interests of the United States and compatible with the Compact. Subjection of such declarations to judicial review will add to the uncertainty of whether specific Federal tax rules, regulations, and orders may affect Puerto Rican citizens.

To summarize, it is not clear from the proposed compact what legal status is intended for the Commonwealth of Puerto Rico. If it is intended that Puerto Rico be treated as a foreign country for purposes of the Internal Revenue Code of 1954, this should be expressed. In the alternative, if Puerto Rico is to be considered a possession, this should be stated. The proposed compact may represent an attempt to assign to Puerto Rico a legal status heretofore unknown and unrecognized or contemplated by the Code. If this be the case and this compact were adopted, many provisions of the Code would have to be amended to clarify their application to Puerto Rico. Further, new provisions may have to be added to the Code to deal exclusively with matters of income taxation involving both the United States and Puerto Rico.

If one of the objectives of the proposal is to foster the development of Puerto Rico as a tax haven in order to boost its economy, consideration should be given to whether subpart F (secs. 951 and following) of the Code is incompatible with such an objective.



Section 16

Section 16(d) would require that the U. S. District Court not intervene to prevent the collection of any tax imposed under Puerto Rican law. It appears to us that such a rule might be unconstitutional under article III, § 2 of the United States Constitution where the tax in question violated the Compact between the United States and Puerto Rico. This is because the Compact would be passed in the form of an Act of Congress, and any violation by the Puerto Rican government of the Compact would probably constitute a Federal question. The Department of Justice should consider this issue.



## TREASURY MEMORANDUM

The following sections of the Report of the Ad Hoc Advisory Group on Puerto Rico on the proposed Compact of Permanent Union Between Puerto Rico and the United States are of interest to this Department:

### Section 2

This section outlines the proposed jurisdiction and authority of the Free Associated State of Puerto Rico. Puerto Rico would delegate certain powers enumerated within this Compact to the United States. Powers not so delegated would be reserved to Puerto Rico. The enumerated powers delegated to the United States in the field of taxation are ambiguous. This ambiguity could create many administrative and substantive tax problems which would have to be resolved prior to enactment of the Compact. Also, the Compact should delegate to the United States the specific power to assess, collect and enforce the taxes imposed by the Internal Revenue Code of 1954 (hereinafter cited as "Code") with respect to all persons subject to taxation under the Code.

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It is not clear from the wording of this section whether the coastwise laws of the United States, which cover the transportation of passengers and merchandise on water between points embraced by the coastwise laws and towing and dredging operations in United States waters (see 46 U.S.C. 289, 292, 315, and 883), would continue to be applicable to Puerto Rico itself, or only to water transportation

between Puerto Rico and the United States. The Department believes the language in this section should be more specific in this regard. We assume that such coastwise laws may continue to apply to Puerto Rican waters provided that the conditions specified under the provisions of section 3(b), are complied with, although this is far from clear. There is also some question of the applicability of other navigation laws such as those relating to entry and clearance of vessels (see 19 U.S.C. 1434 and 1435 and 46 U.S.C. 91) and to the fisheries (46 U.S.C. 251 and 16 U.S.C. 1081-1094). Another question relates to the applicability of laws relating to aircraft, such as the report of arrival requirement, air cabotage prohibitions, etc.

The above-stated questions are raised in spite of and particularly in light of section 12(a), which states that "The laws of the United States applicable to the Free Associated State on the date of approval of this Compact shall continue in effect except to the extent repealed or modified by this Compact or incompatible with it, and except as hereafter modified, suspended or repealed in accordance with law." It appears that section 2(a), is, in fact, incompatible with said section 12(a), and that clarification is especially warranted in view thereof. Examples of how the draft bill might be revised to specify applicable statutes are 19 U.S.C. 81e and 43 U.S.C. 1333(c) to (g).

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Section 9(e) would prohibit any article imported into Puerto Rico at a tariff rate lower than the applicable U. S. tariff rate from being shipped to any other point in the United States customs territory unless the appraised value on shipment contains at least 35 percent in value added in Puerto Rico.

Section 9(d) would grant Puerto Rico wide latitude to establish separate tariffs. In view of the fact that most U. S. tariff rates are bound under the GATT, its authority to increase tariff levels above the U. S. rates would be limited by the requirement that such increases be consistent with United States international obligations. Puerto Rico would have, however, virtually unlimited discretion to reduce or eliminate tariffs.

The economic relationship between the United States and Puerto Rico presently represents a true common market possessing unrestricted trade between the two areas, a common currency, common economic policies, and a common external tariff. The proposed compact would take a step backward from a common market and economic union.

The proposed compact would create a free trade area with different external tariffs. The United States has discouraged free trade agreements for sound commercial policy reasons. Free trade agreements lead to trade distortions because trade can respond to differences in tariffs between the two areas rather than differences in relative efficiencies.

There are practical problems in maintaining free trade between two areas with different external tariffs. A major difficulty lies in preventing goods from being imported into the area with the lower tariff for re-exportation to the high tariff area, thereby avoiding the latter's higher tariffs. To some degree this problem is mitigated by rules of origin and other regulations, but loopholes always remain.

Section 9(e) of the proposed compact would attempt to deal with this problem by requiring that 35 percent of value of an imported product be added in Puerto Rico before it can be shipped to the United States. This is similar to the rule of origin applicable to our Generalized System of Preferences (GSP), which was authorized by the Trade Act of 1974. However, the GSP provisions contain built-in safeguards, e.g., the tariff preferences are applicable only to nonsensitive products, and are subject to a \$25 million limit. Escape clause relief is available if such imports cause or threaten injury. None of these safeguards would apply to Puerto Rico under the compact. Thus, goods could be imported into Puerto Rico, processed sufficiently to meet the 35 percent rule, and then exported to the United States duty free without limitation. The absence of safeguards, or of any other measures to prevent injury to U. S. producers, makes the proposal unacceptable on practical as well as policy grounds.

Subsection (d) would also provide that "Puerto Rico shall continue to enjoy the right to levy tariffs upon or otherwise to restrict the import of coffee from foreign countries or the United States." However, under current law, Puerto Rico has authority only to impose duties on imports of coffee from foreign countries or from the United States if the coffee is grown in a foreign country. 19 U.S.C. 1319. The Department is opposed to this provision to the extent that it would modify existing law.

Finally, with regard to customs procedures, the Department is uncertain of the overall applicability of section 2(b) and section 3(b) to duty on vessel repairs (19 U.S.C. 1466) and tonnage tax (46 U.S.C. 121 and 128), and of the applicability of the Outer Continental Shelf Lands Act and the Deepwater Ports Act of 1974.

#### Section 12

Section 12(a) would provide that the laws of the United States applicable to the Free Associated State shall continue in effect except to the extent repealed or modified by the compact, or incompatible with it.

There should be specific listing of the proposal's effect on relevant laws rather than reliance on the general statement in section 12(a).

Section 12(b) would provide that no new Congressional enactments would be applicable to Puerto Rico except as provided in subsections (c) and (d). Subsection (d) would provide that laws which directly affect the rights and duties of citizens and the security and common defense, and laws which relate to foreign affairs and currency would apply. It is unclear whether it is intended that future Federal tax legislation affect Puerto Rican citizens. It is uncertain if payment of taxes would be considered a duty for purposes of the Compact and whether application of Federal tax legislation to Puerto Rico would be essential to United States interests and would be compatible with the Compact.

Section 12(e) would provide that new Federal rules, regulations, and orders will be applicable to Puerto Rico over its objection if the promulgating authority makes a finding and declaration that application to Puerto Rico is essential to the interests of the United States and compatible with the Compact. Subjection of such declarations to judicial review will add to the uncertainty of whether specific Federal tax rules, regulations, and orders may affect Puerto Rican citizens.

To summarize, it is not clear from the proposed compact what legal status is intended for the Commonwealth of Puerto Rico. If it is intended that Puerto Rico be treated as a foreign country for purposes of the Internal Revenue Code of 1954, this should be expressed. In the alternative, if Puerto Rico is to be considered a possession, this should be stated. The proposed compact may represent an attempt to assign to Puerto Rico a legal status heretofore unknown and unrecognized or contemplated by the Code. If this be the case and this compact were adopted, many provisions of the Code would have to be amended to clarify their application to Puerto Rico. Further, new provisions may have to be added to the Code to deal exclusively with matters of income taxation involving both the United States and Puerto Rico.

If one of the objectives of the proposal is to foster the development of Puerto Rico as a tax haven in order to boost its economy, consideration should be given to whether subpart F (secs. 951 and following) of the Code is incompatible with such an objective.

Section 16

Section 16(d) would require that the U. S. District Court not intervene to prevent the collection of any tax imposed under Puerto Rican law. It appears to us that such a rule might be unconstitutional under article III, § 2 of the United States Constitution where the tax in question violated the Compact between the United States and Puerto Rico. This is because the Compact would be passed in the form of an Act of Congress, and any violation by the Puerto Rican government of the Compact would probably constitute a Federal question. The Department of Justice should consider this issue.



DEPARTMENT OF AGRICULTURE  
OFFICE OF THE SECRETARY  
WASHINGTON, D. C. 20250

November 5, 1975

SUBJECT: Report of the Ad Hoc Advisory Group on Puerto Rico  
FROM: *J. Phil Campbell* J. Phil Campbell, Acting Secretary  
TO: James E. Connor, Secretary to the Cabinet  
The White House

We have reviewed the Report of the Ad Hoc Advisory Group on Puerto Rico entitled "Compact of Permanent Union Between Puerto Rico and the United States". In particular, we are concerned with the implementation of such provisions as those contained in Article 3, Legal Title to Crown Lands and Navigable Waters; Article 12, Applicability of Federal Laws; Article 13, Assignment of Federal Functions to the Free Associated State; Article 15, Judicial Review; and Article 18, Ecology.

It is not possible to determine from either the proposed compact or the commentary contained in the report, the manner in which the provisions of the Compact would in fact be administered by the Free Associated State. We do not, therefore, know precisely the degree to which programs of the Department of Agriculture would be affected in the event of ratification of the Compact. However, we have noted below some of the problems which might arise for the Department and Puerto Rico if the Compact is adopted:

1. Article 3. Legal Title to Crown Lands and Navigable Waters.

Subsection a. of this Article transfers title to all land and other property of the United States in Puerto Rico acquired by cession under the treaty of peace with Spain to the government of the Free Associated State. USDA administers such Federal lands in Puerto Rico as those within the jurisdiction of the Forest Service and the Agricultural Research Service. To the degree that title to these lands was acquired by the United States under the treaty of peace with Spain, they would be transferred to the Free Associated State. Although the United States could continue to hold to and use such property for public purposes, disputes as to the exercise of rights by the United States in lands, the timber thereon, any any other propriety interests it may have therein might arise between the Department of Agriculture and the Free Associated State.

## 2. Article 12. Applicability of Federal Laws.

In general this Article provides the laws of the United States applicable to Puerto Rico on the date of approval of the Compact will continue in effect unless they are repealed or are "modified by this Compact or incompatible with it." In addition, laws enacted by Congress in the future would not be applicable to the Free Associated State unless such laws explicitly referred to the Free Associated State and were incompatible with the Compact. Further, the Free Associated State would have the right to object to the applicability of future laws prior to their passage and if the committee of Congress concerned expressed agreement with such objections the Free Associated State would be exempt from such laws. Rules, regulations and orders issued by USDA and other agencies of the United States would apply unless they are incompatible with the Compact. While the agency involved would have the right to decide whether a rule, regulation, or order applied to the Free Associated State, that determination would be subject to judicial review. These provisions of the Compact would significantly change the relationship which now exists between the United States and Puerto Rico with respect to the effectiveness of Federal laws and regulations in Puerto Rico. In the case of USDA such a change might impair the ability of the Department to carry out programs of the Forest Service, Farmers Home Administration, and the Food and Nutrition Service. The latter two programs involve the expenditure of large amounts of money in Puerto Rico and operations under these programs might require substantial change if the Compact were ratified and the Free Associated State exercised its rights under this Article to challenge the applicability of future legislation and regulations.

## 3. Article 13. Assignment of Federal Functions to the Free Associated State.

This Article contemplates that the United States would, from time to time, transfer certain of its functions to the Free Associated State if that State agreed to perform them. Provision is also made for maximum flexibility in the use of funds appropriated by Congress for the Free Associated State consonant with the purposes and objectives of the appropriations so that the use of the funds may be adapted to circumstances considered relevant by the State to the administration of whatever program might be involved. Under this Article it appears that agencies of the Federal Government, such as USDA, could transfer operations such as those involved in the food stamp program or the programs of the Farmers Home Administration to

the government of the Free Associated State for administration in that jurisdiction. The Article, under certain circumstances, would permit utilization of funds appropriated by Congress for such programs in the Free Associated State in a manner different from that applied in the United States, if that state concluded that because of different economic, social and administrative conditions modifications in the program were appropriate.

#### 4. Article 15. Judicial Review.

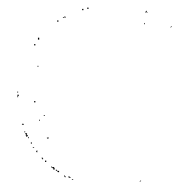
Provision is made in this Article for concurrent jurisdiction for the courts of the United States and of the Free Associated State with respect to justiciable questions arising under the Compact. Actions involving such questions brought in the courts of the Free Associated State may not be removed to the Federal District Courts. While in the final analysis review might be had by the Supreme Court of the United States from decisions on such questions, it would be possible for disputed issues involving the applicability and construction of the terms of the Compact to USDA programs to be heard by the courts of the Free Associated State, even though substantial Federal questions might be involved.

#### 5. Article 18. Ecology.

This Article would vest the primary authority to regulate the ecology and environmental quality in Puerto Rico in the Free Associated State. It is possible, therefore, that the government of that State might change or modify existing principles of law relating to the protection of the environment. Such changes would impinge upon programs of the USDA in Puerto Rico. In particular, it would seem likely that operations of the Forest Service in its management of Federal lands in the State would be most immediately affected.

It is possible that further analysis of the Compact would develop more fully these and other concerns with respect to areas of Departmental administrative responsibility. The proposed Compact is, of course, drafted in broad terms and much of the practical impact which could occur if the Compact were adopted cannot be determined without operating experience. Accordingly, the comments above should be considered as merely suggestive of areas for consideration, discussion and analysis.

COMPACT OF PERMANENT UNION BETWEEN  
PUERTO RICO AND THE UNITED STATES





THE WHITE HOUSE  
WASHINGTON

Jim -

Jim Falk gave these reports to Dave Hoopes with the request that we staff them to Domestic Council and NSC to prepare recommendations and response.

He said Cannon has acknowledged (I am checking this out with Cannon's office -- we should have a copy of memo) acknowledgment)

Also Jim Falk suggests that it be staffed to all Cabinet Members.

I have given it to Bob Linder to record.

Trudy

AD HOC ADVISORY GROUP  
ON PUERTO RICO  
1016 16th Street, NW.  
Washington, DC 20036

October 9, 1975

The President  
The White House  
Washington, D. C. 20500



Dear Mr. President:

You will find transmitted herewith eight copies of the "Compact of Permanent Union Between Puerto Rico and the United States". This proposal is submitted pursuant to the appointment of a Joint Commission by the President of the United States and the Governor of the Commonwealth of Puerto Rico, which Commission went into operation in September of 1973.

It has been my honor, pursuant to the President's request that I serve as Co-Chairman, a duty which I gladly assumed, and as you are well aware, since January of 1974 has been my contribution of pro bono work to the White House.

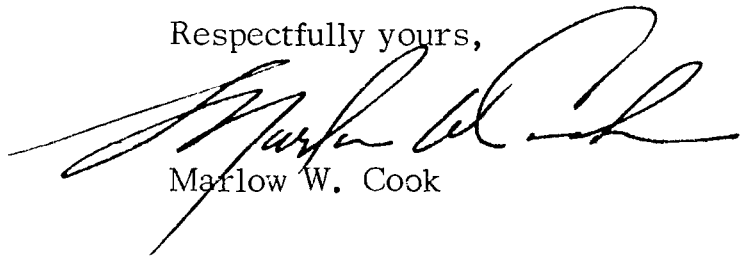
Mr. President, there will not be a Department in Government that will not find fault with this Compact, for it possesses the ability of the United States to move into a new form of federalism with those peoples outside of the 50 States who wish to be bound constitutionally to the United States and yet not being a State functioning within a term which this Compact appropriately designates as a "free associated state". The myriad of bureaucratic agencies treat Puerto Rico as a State and administrate to Puerto Rico as a State, but all Puerto Ricans know they are not a State and their prospects of being one are remote. In that light, we propose for your consideration and the consideration of Congress a new form of federalism.

There has been much discussion as to why we did not consider alternative proposals such as statehood, but for those who would request the desecration of this proposal because of that omission, I am reminded of our Presidential admonition in 1967, and I quote:

"In order to implement the express desires of the people of Puerto Rico freely made in the plebiscite of 1967, this Ad Hoc Advisory Group will be charged further to develop the maximum of self-government and self-determination within the framework of Commonwealth, etc. --"

It is with that admonition in mind that I submit herewith our final work constituting scores of meetings and hundreds of hours of debate and ask with its receipt that I be relieved of the Commission received in September of 1973.

Respectfully yours,

A handwritten signature in black ink, appearing to read "Marlow W. Cook", written in a cursive style.

Marlow W. Cook

