The Rum Excise Tax Cover-Over: Legislative History and Current Issues

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Summary

Under current law, any excise tax collected on rum imported into the United States is transferred to or "covered-over" to the Treasuries of Puerto Rico (PR) and the United States Virgin Islands (USVI). In 2008, PR received over $371 million in revenue and the USVI received almost $100 million. The law does not impose any restrictions on how PR and USVI can use the transferred revenues. Both territories use some portion of the revenue to promote and assist the rum industry.

The cover-over provisions for rum extend as far back as 1917 for PR and 1954 for USVI. Recently, the United States Virgin Islands has dedicated a larger share of current and future covered-over revenue to help finance public and private infrastructure that would directly benefit the rum industry.

In the 111th Congress, legislation has been introduced to expand federal control over the use of covered-over revenue. Passage of H.R. 2122 would result in severe limits on Puerto Rico's and the USVI's ability to finance economic development projects with this revenue source. The legislation is likely in response to the recent economic development initiatives in the USVI financed in part by rum cover-over revenue.

This report provides a history and analysis of the rum cover-over program and current legislative efforts to modify the program. The congressional debate on this legislation could also lead to debate on the broader issue of the cover-over program more generally. This report will be updated as legislative events warrant.
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Most federal excise taxes do not apply in the United States Virgin Islands (USVI) and Puerto Rico (PR) or the other possessions. An exception, however, is provided by Section 7652 of the Internal Revenue Code, which applies a special excise tax to items produced in PR or the USVI and shipped to the United States. The tax is equal to any excise tax that would apply to an identical item produced in one of the 50 states or the District of Columbia. The tax was first imposed to ensure that producers in the possessions would not have a tax advantage over goods produced in the United States that are subject to excise taxes.¹

For example, rum that is produced in either the USVI or PR and that is sold in the states is subject to the same tax as rum produced in the states. Most of the revenue from the so-called equalization tax, however, is returned ("covered over") by the federal government to the treasuries of PR and the USVI.² In addition, the Caribbean Basin Economic Recovery Act of 1983 (P.L. 98-67) provides that all revenue from federal excise taxes on rum imported into the United States from any source—including any foreign country—is remitted to the treasuries of PR and the USVI.³

The cover-over provisions for rum extend as far back as 1917 for PR and 1954 for the USVI. The covered-over revenue has never been designated for particular purposes by Congress. The territories have tended to dedicate some portion to fund marketing campaigns for the rum industry and general economic development. Annual cover-over revenues have been as high as $459 million for PR and $99.5 million for the USVI.

In the 111th Congress, legislation has been introduced to expand federal control over the use of covered-over revenue. Passage of H.R. 2122 would result in severe limits on Puerto Rico's and the USVI's ability to finance economic development projects with this revenue source. The legislation is likely in response to recent economic development initiatives in the USVI financed in part by rum cover-over revenue. The congressional debate on this legislation could also lead to debate on the broader issue of the cover-over program more generally.

History of the Rum Cover-Over

Congress initiated the principles behind the rum cover-over program for Puerto Rico under the Jones Act of 1917, even though, ironically, the same legislation prohibited the production and sale of alcohol. The act stipulated, "providing that hereafter all taxes collected under the internal revenue laws of the United States on articles produced in Porto Rico [sic] and transported to the United States, or consumed in the island shall be covered over into the treasury of Porto Rico [sic]."⁴ The House and Senate report language accompanying the Jones Act of 1917 both stated "it is believed to be just and fair that it [Puerto Rico] should receive the internal-revenue taxes collected upon its products, whether those products are used in Porto Rico [sic] or produced in

² The rebates are paid by the U.S. Alcohol and Tobacco Tax and Trade Bureau within the U.S. Treasury. According to data provided by that agency in the federal FY2009 budget, the payment to Puerto Rico in 2007 was $462 million.
³ The Caribbean Basin Initiative reduced customs duties on imported rum. This introduced the possibility that sales in the U.S. of rum shipped from the possessions would fall, and so too would cover-overs to the possessions of federal excise taxes from rum manufactured in the possessions. The additional cover-overs were enacted to offset the expected loss of revenue. U.S. Congress, House, Committee on Ways and Means, Caribbean Basin Economic Recovery Act, H.Rept. 98-266, 98th Cong., 1st Sess. (Washington: GPO, 1983), p. 26.
⁴ Jones Act of 1917, Sec. 9, 39 Stat. 951; 1910-1917.
Porto Rico [sic] and transported to and used in the United States." Importantly, there is no mention of congressional intent with regard to spending of such covered-over revenue.

The Revised Organic Act of 1954 (P.L. 83-517) extended the rum cover-over program to the USVI; following is the relevant legislative language:

There shall be transferred and paid over to the government of the Virgin Islands from the amounts so determined a sum equal to the total amount of revenue collected by the government of the Virgin Islands during the fiscal year, as certified by the Government Comptroller of the Virgin Islands. The money so transferred and paid over shall constitute a separate fund in the treasury of the Virgin Islands and may be expended as the legislature may determine....

The next clause in the legislative language does provide that the President of the United States or his designated representative must approve of such expenditures before the cover-over revenue is obligated.

In the Senate report language accompanying the Revised Organic Act of 1954, Congress expressed a desire that the USVI use the covered-over revenue to loosen the dependence of the USVI on periodic appropriations from the U.S. government. According to the report language, under a cover-over system, "the people of the Virgin Islands would have a far greater degree of control over their finances than under the present system." The report continues, recommending that "the people of the Virgin Islands bend their efforts to stimulating and increasing business in every way possible." Again, Congress does not outline specific uses for the covered-over revenue. That same year, two rum manufacturers began production in the USVI, Cruzan VIRAL Ltd., and Brugal.

As noted earlier, the Caribbean Basin Economic Recovery Act of 1983 (P.L. 98-67) provides that all revenue from federal excise taxes on rum imported into the United States from any source—including any other foreign country—is to be remitted to the treasuries of PR and the USVI. This provision increased the amount covered over to PR by roughly 8.5% and to the USVI by roughly 7.5%. The formula for dividing the "other" revenue between the USVI and PR is complicated but is roughly based on the relative market share of rum each possession produces.

In the report language accompanying the act, Congress clarified that "the bill does not impose restrictions on the uses to which the Government of the Virgin Islands or the Government of Puerto Rico may put the revenues they receive under this provision."

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6 Section 28(b) of P.L. 83-517, 68 Stat. 508.
8 Ibid., p. 6.
9 Information from the proposed legislation presented to the USVI legislature by Gov. DeJongh. Brugal is a rum maker based in the Dominican Republic and is no longer producing rum in the USVI. Cruzan is still operating in the USVI.
10 CRS calculation based on data for FY1986 through FY2003.
The law also stipulates that the PR share of excise tax on other rum shall not exceed 87.626889% and not fall below 51%. Accordingly, the USVI share cannot drop below 12.373111% or exceed 41%. The floors are important because even if all rum production were to leave Puerto Rico or the USVI for another country, the possessions would still receive a significant share of cover-over revenue from “other” revenue as under the formula in P.L. 98-67. However, if production shifts between the two possessions, the “losing” possession would lose all of the revenue generated by the relocated rum production. Thus, the possession losing the rum producer would be better off if the rum producer relocated outside of PR, USVI, or the U.S.

The Deficit Reduction Act of 1984 (P.L. 98-369) placed a cap on the rebate of excise taxes on rum and other distilled spirits. The 1984 act increased the federal tax rate on spirits from $10.50 per proof-gallon to $12.50; subsequent legislation increased the rate to $13.50 per proof-gallon. The 1984 act also provided, however, that the rebate to PR and the USVI would be calculated based on prior law’s $10.50 rate. In imposing the cap, Congress stated that it did not wish to expand the rebate (as would have occurred automatically with the tax-rate increase) until it had addressed the question of whether the rebates were proper, given that similar cover-overs were not made to the 50 states.

The Omnibus Budget Reconciliation Act of 1993 (OBRA93; P.L. 103-66) temporarily increased the cap to $11.30 per proof-gallon, effective for shipments of rum and distilled spirits brought into the U.S. during the five-year period October 1, 1993, through September 30, 1998. The increase was enacted in the context of a scaling-back by the act of the possessions tax credit.

With the expiration of OBRA93’s temporary increase in the rebate’s cap, the limitation returned to its previous $10.50 level. The Ticket to Work and Work Incentives Improvement Act of 1999: (P.L. 106-170) and the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147), however, provided temporary increases in the cap to $13.25 per proof-gallon through December 31, 2003. In conjunction with the extension of a number of other tax provisions not related to the possessions, the Working Families Tax Relief Act of 2004 (P.L. 108-311) extended the $13.25 amount through 2005; the Tax Relief and Health Care Act of 2006 (P.L. 109-432) extended the $13.25 amount through 2007. On October 3, 2008, the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (P.L. 110-343) extended the cover-over through the 2008 and 2009 tax years. In the 111th Congress, the House passed the Tax Extenders Bill of 2009 (H.R. 4213) on December 9, 2009, which included an extension of the cover-over at the $13.25 level through the 2010 tax year. The Senate has yet to act on similar extender legislation.

Cover-Over Revenue

In FY2008, PR received $371 million in covered-over revenue and the USVI received $91 million from the Interior Department and $7.6 million from the Treasury Department’s Tax and

12 For a complete description, see the Federal Register, vol. 51, No. 150, August 5, 1986, pp. 28071-28078. Also, additional data are from a memorandum titled “Virgin Islands and Puerto Rico Cover-over,” from Kahan Morrison, ATF Office of Congressional Liaison, U.S. Department of Treasury to David Brumbaugh, Congressional Research Service, April 2, 2001, p. 5.
13 A proof gallon is a combination of alcohol content and volume. A proof gallon is the volume in gallons, multiplied by the percent alcohol, multiplied by 2, and divided by 100.
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Trade Bureau (TTB) for almost $100 million combined.\textsuperscript{15} Table 1 reports the amount covered over to PR and USVI for each fiscal year since 1990. Since 1990, PR has received $5.4 billion and the USVI $1.1 billion. The TTB remits the entire cover-over to PR, which includes the tax collected on PR-sourced production and the PR share of the "other" revenue from U.S. imports from non-PR and non-USVI sources. In contrast, the cover-over for taxes collected on U.S. imports from the USVI is remitted by the U.S. Department of the Interior based on data provided by the TTB. The share of "other" revenue is remitted by the TTB.\textsuperscript{16}

Table 1. Total Cover-Over Transferred to Puerto Rico and the U.S. Virgin Islands, 1990-2008

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>U.S. Virgin Islands</th>
<th>Puerto Rico (TTB)</th>
<th>Combined Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TTB</td>
<td>Interior</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>$3,533,462</td>
<td>$28,964,426</td>
<td>$32,497,888</td>
</tr>
<tr>
<td>1991</td>
<td>$3,753,763</td>
<td>$27,519,219</td>
<td>$31,272,982</td>
</tr>
<tr>
<td>1992</td>
<td>$3,093,815</td>
<td>$28,529,864</td>
<td>$31,623,679</td>
</tr>
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<td>1993</td>
<td>$2,325,883</td>
<td>$29,935,672</td>
<td>$32,261,555</td>
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<td>1994</td>
<td>$2,563,681</td>
<td>$30,328,453</td>
<td>$32,892,134</td>
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<td>1995</td>
<td>$1,976,015</td>
<td>$41,023,107</td>
<td>$42,999,122</td>
</tr>
<tr>
<td>1996</td>
<td>$2,308,206</td>
<td>$42,709,124</td>
<td>$45,017,331</td>
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<tr>
<td>1997</td>
<td>$2,482,988</td>
<td>$45,623,700</td>
<td>$48,106,688</td>
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<td>1998</td>
<td>$2,317,382</td>
<td>$50,308,123</td>
<td>$52,625,504</td>
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<td>1999</td>
<td>$2,782,349</td>
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<td>$53,922,334</td>
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<td>2000</td>
<td>$2,962,685</td>
<td>$62,690,658</td>
<td>$65,653,343</td>
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<td>2001</td>
<td>$3,532,356</td>
<td>$68,091,719</td>
<td>$71,624,074</td>
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<tr>
<td>2002</td>
<td>$5,145,305</td>
<td>$60,336,534</td>
<td>$65,481,839</td>
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<td>2003</td>
<td>$6,404,541</td>
<td>$64,102,856</td>
<td>$70,507,396</td>
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<td>2004</td>
<td>$6,323,734</td>
<td>$75,000,536</td>
<td>$81,244,270</td>
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<td>2005</td>
<td>$6,010,064</td>
<td>$75,125,610</td>
<td>$81,135,673</td>
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<td>2006</td>
<td>$6,491,552</td>
<td>$70,879,354</td>
<td>$77,370,906</td>
</tr>
<tr>
<td>2007</td>
<td>$8,053,810</td>
<td>$86,710,345</td>
<td>$94,764,155</td>
</tr>
<tr>
<td>2008</td>
<td>$7,614,959</td>
<td>$91,938,530</td>
<td>$99,553,489</td>
</tr>
<tr>
<td>Total</td>
<td>$79,596,547</td>
<td>$1,030,957,815</td>
<td>$1,110,554,361</td>
</tr>
</tbody>
</table>

Source: Data are from e-mail correspondence with Thomas Hogue from the U.S. Department of Treasury, TTB, and Charlene Leizear from the U.S. Department of the Interior, Office of Insular Affairs.

\textsuperscript{15} Unlike PR, the IRS does not have a USVI branch that collects the excise tax. Instead, the Customs Service within the Interior Department collects the excise tax on USVI imports. In addition, the Customs Service makes advance payments to the USVI based on rum import projections. The Customs Service then reconciles at the close of the fiscal year with TTB data on the amount of rum actually imported from the USVI.

\textsuperscript{16} The reason for the Department of the Interior remittance is based on budgetary and administrative reasons.
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Notes: The USVI cover-over is paid by the Trade and Tax Bureau of the U.S. Department of Treasury and the U.S. Department of the Interior. The amount of the cover-over collected per proof gallon was $10.50 from FY1990 through FY1994, $11.30 from FY1995 to FY1998, $10.50 in FY1999, and $11.25 for FY2000 through FY2008.

The Use of Cover-Over Revenue

Puerto Rico uses cover-over revenue to finance marketing and promotional activities for the rum industries. The exact amounts and extent of these activities is unclear as there is not separate publicly available budget accounting. However, a letter from Puerto Rico Resident Commissioner Pierluisi (and three other Members of Congress) states, “Puerto Rico currently uses a small fraction of its annual federal excise tax revenue—about 6%—to promote Puerto Rican rums in general.” The remaining 94% would be available for general expenditures in Puerto Rico, perhaps some of which could benefit the rum industry.

The USVI uses several tools to subsidize the production of rum in the USVI. The Virgin Islands Public Finance Authority (VIPFA) issues tax-exempt bonds whose proceeds are used to finance public infrastructure spending, such as schools and roads, and infrastructure used almost exclusively by the rum industry. The size of the subsidy for the rum industry through state-sponsored debt finance is not transparent or easily measured. Debt for public infrastructure indirectly helps the rum industry and is not typically considered an industrial subsidy. The debt used for rum manufacturing infrastructure is direct, though measuring the subsidy is still problematic. Quantifying the subsidy requires establishing what costs, including taxes and fees, the industry would have incurred without the public assistance through tax favored debt.

Recently, the VIPFA has issued a series of bonds backed by the rum tax. These bonds are often referred to as “rum-tax bonds.” In July 2008, according to a press report, the legislature of the USVI voted 10-5 in favor of a 30-year contractual agreement with Diageo, the maker of the Captain Morgan® brand rum among other beverages, to begin operations in the USVI (Diageo had contracted with a Puerto Rican based distiller to produce Captain Morgan®) and remain there for at least 30 years. Since that agreement, the VIPFA has moved forward issuing so-called “rum-tax bonds” that are secured by cover-over revenues. There have been two bond issues from the VIPFA backed by rum-tax revenues in 2009.

On July 9, 2009, the VIPFA offered $250 million of rum-tax bonds that would be subordinate to the agency’s outstanding $477.8 million of senior rum-tax bonds. The new issue will be used to “make a loan to the Government to provide a grant to Diageo USVI to finance the acquisition, design, construction, development and equipping of a rum production and maturation warehouse.

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18 News reports have indicated that Puerto Rico uses no more than 10% of covered over rum tax revenue for the promotion of Puerto Rican rum in the United States. The Puerto Rico Industrial Development Corporation (PRIDCO) website did not provide detailed accounting for any industrial incentives explicitly for the rum industry or any information on the cover-over of rum taxes. The presumption is that the covered over revenues are included in the general fund.
20 Subordinate bonds are second in line to the revenue dedicated to the “senior” debt. This means the bonds are less secure than the senior debt.
facility, and any improvements thereto, to be located on St. Croix."21 According to the bond offering statement, these new bonds will create $12.2 million in annual debt service costs in 2010, $16.7 million from 2011 to 2013, and $20.6 million from 2014 through 2038.

On October 1, 2009, the VIPFA offered another $458,849,000 in bonds of which $363,840,000 was for the refunding of outstanding debt (rum-tax bonds that had been issued in 1998) and the remaining $95 million was for new money. The rum-tax bond new money ($95 million) was for capital projects including "school construction, water and sewer upgrades, building and road renovations, open space initiatives, and land acquisitions for affordable housing programs among other projects."22

On October 8, 2009, the VIPFA was reported to have plans to issue $105 million of rum bonds for a second rum maker, Cruzan. In return, Cruzan would agree to remain in the USVI for 30 years. The report indicates that $30 million of the bond issue would finance a new wastewater treatment facility and $75 million would help expand the Cruzan distillery.23 On October 27, 2009, the USVI legislature approved the bond issue for Cruzan rum. As of January 19, 2010, the VIPFA has not offered these bonds.

The USVI Subsidy for Rum Production

The legislation proposed by USVI Governor deJongh formalizing the agreement with Diageo USVI, Inc., includes the following list of statutory incentives the government of the USVI is already providing to support rum production and has expanded to attract Diageo USVI, Inc.:

a. A Molasses Subsidy Fund to assist distillers engaged in the processing of molasses into rum within the Virgin Islands (33 V.I.C. § 3036);

b. Statutorily provided marketing support payments designed to support the long-term growth of branded rum products to build a stable long-term rum industry;

c. Statutory exemptions on property, excise, gross receipts and income taxes and other local tax incentives; and

d. Environmental mitigation support.

In the documents accompanying the October 1, 2009, bond issue, the VIPFA listed three sources of subsidy and support for Cruzan rum production: (1) a molasses subsidy; (2) a marketing support agreement with a termination of November 21, 2011; and (3) a professional services agreement with Cruzan entered into on June 23, 2006, extended annually and set to expire on December 31, 2009 (as of this writing, the status of this agreement is uncertain). Table 2 lists the support of Cruzan rum from calendar year 2003 through 2008. In the most recent year listed, the USVI provided direct support of $18.7 million for Cruzan rum, the only rum producer in the USVI. This represents roughly 19% of the amount received in covered-over revenue from the excise tax on rum imported from the USVI.

23 Michelle Kaske, “Virgin Islands Deal for Cruzan Rum,” the Bond Buyer, October 8, 2009.
Table 2. USVI Subsidies for Cruzan Rum, 2003 Through 2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Rum Promotion</th>
<th>Marketing Support</th>
<th>Molasses Subsidy</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>$1,358,684</td>
<td>$ -</td>
<td>$3,477,651</td>
<td>$4,836,335</td>
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<tr>
<td>2004</td>
<td>$2,246,601</td>
<td>$ -</td>
<td>$4,000,000</td>
<td>$6,246,601</td>
</tr>
<tr>
<td>2005</td>
<td>$1,982,402</td>
<td>$ -</td>
<td>$4,400,000</td>
<td>$6,382,402</td>
</tr>
<tr>
<td>2006</td>
<td>$2,412,691</td>
<td>$ -</td>
<td>$6,900,000</td>
<td>$9,312,691</td>
</tr>
<tr>
<td>2007</td>
<td>$2,200,000</td>
<td>$2,796,000</td>
<td>$15,261,000</td>
<td>$20,257,000</td>
</tr>
<tr>
<td>2008</td>
<td>$2,204,000</td>
<td>$2,777,863</td>
<td>$13,700,000</td>
<td>$18,681,863</td>
</tr>
</tbody>
</table>

Source: USVI Office of Management and Budget as reported in the VIPFA Bond Offering Statement of June 26, 2009, cited earlier.

Recent Legislative Activity: H.R. 2122

On April 27, 2009, Resident Commissioner Pedro Pierluissi introduced H.R. 2122, legislation that would limit the ability of the governments of Puerto Rico and the United States Virgin Islands to provide “unreasonable” subsidies to rum producers. The legislation would define a subsidy as unreasonable if the U.S. Secretary of the Treasury determines that the subsidy (1) is excessive relative to the amount which would (without regard to this subsection) be covered into the treasury of the government providing the subsidy with respect to the articles to which the subsidy relates, and (2) has the effect of encouraging the transfer of production of such articles [rum] from the jurisdiction of the other specified government.

Generally, the legislation would limit the territories from offering more than 10% of their covered over revenue as an industrial subsidy. The restriction seems intended to make it more costly for the Virgin Islands to provide incentives to rum producers currently in Puerto Rico to relocate to the United States Virgin Islands.24

Resident Commissioner Pierluissi, in a news item that appears on his congressional website in support of his legislation, states that “one provision in the bill would create a categorical rule that a subsidy in excess of 10% of the cover-over funds is, by definition, unreasonable.”25 The same news item claims that “The purpose of the cover-over program is, and has always been, to help the two territories provide for the general welfare of their residents and to promote broad-based economic development.”

24 The bond offering statements identified earlier include mention of the legislation as one of the “risks” to bond holders implying if the legislation were to become law, the bonds would be at greater risk of default.

Potential Impact

The legislation would make the direct subsidy to rum producers with rum excise tax cover-over payments more difficult. However, the legislation would also seem to preclude the USVI from using general revenue to subsidize rum producers. As identified earlier, the subsidy the USVI is offering would include the continuation of (1) rum promotion, (2) marketing support, and (3) a molasses subsidy. In addition, news reports have also suggested that the USVI would provide income tax breaks and a complete exemption from property taxes. The news report also claims that the sum of these subsidies approaches 46% of the total amount covered over to the USVI and is not directly linked to the rum cover-over. All of these benefits accompany the debt finance support outlined earlier. The so-called rum-tax bonds are clearly linked to the rum tax as they are secured by the revenue generated by the production and export of Captain Morgan®. The mix of marketing subsidies and tax incentives used to attract Diageo to the USVI would more than likely exceed the limits proposed in H.R. 2122. What is unclear is how the legislation would affect the Diageo agreement, enacted in July 2008, to manufacture rum in the USVI.

Analysis

Supporters of H.R. 2122 claim that the tax incentives and subsidies offered by the USVI to large profitable corporations, such as Diageo, are a misuse of taxpayer dollars. Others make the same argument against many government-funded sub-federal economic development incentives. Some researchers "have begun to write off economic development incentives as ineffective or inefficient for a host of reasons." Nevertheless, the justification for using tax incentives and subsidies to attract industry has long been a part of sub-federal economic development strategies. There are numerous examples of states offering manufacturing firms reduced property taxes, access to tax-exempt financing, and favorable corporate income tax policies. The success of these programs has been mixed, and in many cases critics assert that the programs unnecessarily sacrifice tax revenues to influence a location decision that has already been made.

From the federal government’s perspective, state and local incentives for industrial development are a redistribution of tax dollars from state and local governments to manufacturing firms without a net gain in national GDP. From this perspective, the incentives shift economic activity from one location in the United States to another. The intended improvement of social welfare (i.e., helping economically disadvantaged areas) is usually the justification for such policies in light of what many economists identify as the “zero-sum” nature of the incentives.

The size and scope of the USVI agreement with Diageo (and, to a lesser degree, Cruzan) is unique in that it involves the cover-over of rum excise tax revenues from the U.S. Departments of

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26 Molasses is the key input for rum production.
the Treasury and the Interior to the USVI and PR to directly and indirectly support the rum industry. The legislation would not prohibit tax incentives and direct subsidies; just limit them such that the status quo is maintained.

However, the limit could be seen as inconsistent with the intent of the cover-over as expressed in the legislation and report language cited earlier. As noted in the legislative history in this report, Congress explicitly stated that the government receiving the covered-over revenue was charged with its disposition, not the U.S. Congress.

In the case of Diageo, news reports indicate that Diageo had already decided to leave Puerto Rico and the USVI presented the most attractive option. While other Caribbean countries were said to be in the competition for the Diageo facility, Diageo’s decision to produce rum in the USVI presents the worst case scenario for PR because PR loses not only Diageo but also future excise tax revenue from USVI production. As mentioned previously, a portion of rum-tax revenue collected from other countries’ imports to the United States is paid to PR, but not on imports from the USVI.

The recent economic crisis has elevated the interest in the rum cover-over program. From the perspective of U.S. taxpayers, some may question the efficacy of the rum cover-over, regardless of the historical precedent. Further, proponents of H.R. 2122 have alluded to the possibility that Congress may reconsider the cover-over principle generally, possibly ending the program, if the USVI uses the revenue for “unreasonable” subsidies.

Appendix. Congressional Hearings on the Rum Cover-over


- Hearing includes consideration of H.R. 4578, to require the U.S. to pay to the Virgin Islands the full amount of excise taxes imposed on rum produced in the Virgin Islands.


- Hearing includes consideration of H.R. 4702, to disallow federal excise tax rebates to Puerto Rico and the Virgin Islands for redistilled spirits originally distilled in the U.S.


- Hearing includes consideration of S. 589, to authorize FY1984 appropriations for certain Guam public works projects, and to authorize or revise various programs pertaining to Guam, NMI, and Virgin Islands. Includes provision to eliminate the Federal approval requirement for Virgin Islands spending of rum excise tax rebates.


- Hearing to examine the implications of President Reagan’s Feb. 1982 Caribbean Basin Initiative (CBI) for the Virgin Islands and Puerto Rico. Focuses on CBI provision to rebate rum excise tax revenue to the Virgin Islands and Puerto Rico to protect their economies from adverse CBI effects. Includes brief consideration of S. 544, the Caribbean Basin Economic Recovery Act, to authorize trade and tax incentives to encourage Caribbean area economic revitalization.


- Hearing to consider H.R. 2769, to authorize trade and tax incentives to encourage Caribbean area economic revitalization. Includes provisions to require Treasury Dept to transfer to Puerto Rico and the Virgin Islands excise tax revenues from all rum imported into the U.S.


- Hearing to consider S. 544, the Caribbean Basin Economic Recovery Act (summary, p. 3-10), the Administration bill, to authorize trade and tax incentives to encourage Caribbean area economic revitalization, including duty-free treatment through Sept. 30, 1995, of qualifying Caribbean products imported into...
the U.S. Includes witness statements on the potential adverse effect of S. 544 on Puerto Rico and U.S. Virgin Islands, particularly on local bulk rum industries and U.S. imported rum excise tax rebate revenues; presentation of Puerto Rico-Virgin Islands alternative to proposed duty-free treatment of rum.


- Hearing to consider S. 2237, the Caribbean Basin Economic Recovery Act, to implement President Reagan's Feb. 1982 Caribbean Basin Initiative (CBI) to promote economic revitalization in the Caribbean area and Central America through duty-free treatment of certain articles, increased economic assistance, and tax credit for U.S. capital investment in Caribbean Basin countries. Includes statement by the Puerto Rico Manufacturers Association on the impact of the act on the Puerto Rican rum industry.


- Hearings to consider S. 2237, to implement President Reagan's Feb. 1982 Caribbean Basin Initiative (CBI) to encourage Caribbean area economic revitalization through duty-free treatment of certain articles, increased economic assistance, and tax credits for U.S. capital investments in Caribbean Basin countries. Includes discussion of concerns about impact of CBI duty-free provisions on competitive position of Virgin Islands industries, focusing on rum industry; views on overall U.S. policies and program priorities for Caribbean region.


- Hearings to consider H.R. 5900, to implement President Reagan's Feb. 1982 Caribbean Basin Initiative (CBI) to encourage Caribbean area economic revitalization through duty-free treatment of certain articles, increased economic assistance, and tax credits for U.S. capital investment in Caribbean Basin countries. Also assesses CBI effects on Puerto Rico and the Virgin Islands, and includes discussion on concerns about foreseen anticompetitive effect on Virgin Islands rum industry of duty-free entry for all Caribbean rums.


- Hearings to examine the advantages and disadvantages of the Multilateral Trade Negotiations (MTN) agreements for U.S. industries. Includes statements by representatives from Puerto Rico and the U.S. Virgin Islands on the importance of rum industry to represented islands' economic stability and development; impact of rum tariff reduction; objections to duty and excise taxes assessment based on proof content as opposed to current gallonage standards.

• Hearings to consider S. 1014 and H.R. 4979, which provide that proceeds from Federal taxes imposed on articles produced in the Virgin Islands be made available to the territorial legislature.

U.S. Congress, House Committee on Insular Affairs, To Assist in Relieving Economic Distress in Puerto Rico and the Virgin Islands, Part 4, 78th Cong., 2nd sess., May 16-17, 1944.

• Hearing to consider H.R. 3777. Includes consideration of Virgin Islands civil works projects and rum industry tax allocations for public works programs.

U.S. Congress, House Committee on Insular Affairs, To Assist in Relieving Economic Distress in the Virgin Islands. Part 3: Virgin Islands, 78th Cong., 1st sess., October 21, 27, November 2, 10, 17, and December 2, 6, 1943.

• Hearing includes discussion of proposals for Virgin Islands rum industry tax allocations for public works programs.


• Hearing to consider S. 1685 and H.R. 4773. Involves the covering of taxes collected on articles of Virgin Islands manufacture into the treasury of the Virgin Islands.

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