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Statement
of the
Honorable Donna M. Christensen
Before the
House Ways and Means Select Revenue Subcommittee

April 26, 2012

Mr. Chairman and Distinguished Members of the Select Revenue Subcommittee, I am pleased to have the opportunity to present testimony in support of H.R. 4374, legislation I introduced with Puerto Rico Resident Commissioner Pedro Pierluisi to extend the rum tax cover-over provision for the next two years.

First of all, I would like to explain what the rum tax cover-over is and what it is not. It is not a tax credit or a tax benefit for businesses or individuals. The cover-over does not increase taxes; it does not decrease taxes. The tax policy behind the cover-over is not temporary or new.

Rather, the cover-over is part of the fundamental tax relationship between the United States and its Territories that goes back over 100 years, before there was even an income tax. When the United States acquired Puerto Rico and the Virgin Islands at the turn of the last century, Congress generally exempted these new Territories — not then destined for

Statehood — from the application of the U.S. Internal Revenue laws, including federal excise taxes on manufactured goods.

In order to protect domestic manufacturers from untaxed Territorial manufacturers, however, Congress from the very beginning imposed on products manufactured in Puerto Rico and the Virgin Islands a tax “equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.” Thus, the tax imposed on rum manufactured in the Virgin Islands and Puerto Rico and shipped to the United States is not an ordinary excise tax intended to raise revenue for the United States, but rather, as the courts have recognized, an “equalization” tax intended to regulate commerce between the Territories and the United States and to preserve a “level playing field” between Territorial and mainland distillers. Accordingly, Congress, as part of the Organic Acts that govern the relationship between the United States and the Virgin Islands and Puerto Rico, provided that all such equalization taxes be returned, or “covered over,” to the treasuries of the respective Territories.

These fundamental principles have been in force since 1900. In 1984, Congress increased the excise tax of rum from \$10.50 per proof gallon to \$12.50, but also provided — for the first time in the history of the Territorial relationship — that the proceeds of the increase in the rum equalization tax would be retained by the United States. Congress later increased the rum tax to \$13.50 per proof gallon, but it was not until more than a decade later that Congress revisited and restored the cover-over policy that existed for the greater part of this past century.

In 1999, Congress increased the cap on the rum taxes covered back to the Territories to \$13.25, but for budget reasons was only able to do so for a two-year period. The so-called “rum tax extender” has been regularly and seamlessly extended ever since, along with a group of other expiring tax provisions.

Today, the Virgin Islands Government issues bonds, backed by these rum taxes, to finance construction of schools, hospitals, and other essential public works in the Territory. Any funds not encumbered are used to support general expenses of the Government and modernize the rum industry. In addition to maintaining the Federal-Territorial tax relationship, the cover-over legislation is critical to the Government’s efforts to resolve its fiscal crisis. Extension of the rum tax cover-over rate will also help mitigate significant revenue losses associated with the recent decision by HOVENSA to shut its oil refinery on St. Croix, the largest private sector employer in the Territory and one of the 10 largest refineries in the world.

Accordingly, I strongly urge the support of the Subcommittee for the timely extension of the rum tax cover-over rate.

Thank you very much.