

Historical Perspective – Origins of USVI Tax Incentives and Federal Support

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In RE: Investigation of Rates of Virgin Islands Telephone Company (d/b/a Innovative Communications)
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Historical Backdrop

The USVI joined the United States in 1917 but by then US-Caribbean tax policy was already in place. The outcome of the Spanish-American war meant that Puerto Rico and Cuba (and Guam and the Philippines on the other side of the planet) were U.S. possessions. When the United States began its relationship with the territories in the Caribbean in 1898, the newly acquired territories were poor and had been economically oppressed and the US Government sought to help create financial independence. This was not wholly altruistic – if the territories were not financially independent – they would be financially dependent on the United States.

From the start, merchants in the United States who were required to pay additional duties on goods emanating from Puerto Rico challenged the special revenue laws as unconstitutional in violation of Article 1, Section 8 which required that “all duties, imposts, and excises shall be uniform throughout the United States.” The Supreme Court in a line of cases known as the *Insular Cases* used a line of deprecating and racially insensitive reasoning to accord all inhabitants of the territories less than full constitutional rights. The less than satisfying trade-off in the outflow from the *Insular Cases*, was that the territories’ ability to use special tax laws to develop their economies was not restrained by Article 1, Section 8 of the US Constitution.

The key event in the USVI tax history surrounds the Naval Appropriation Act of 1922. When the Navy Governors arrived in the Virgin Islands they found a territory swarming with malaria and filled with poor and neglected inhabitants. The Navy began with the premise that it was to administer a port with military significance and the Navy was challenged by the need for infrastructure investment in the Virgin Islands. So the Navy went to Congress in 1921 and requested an appropriation to enhance life in the islands. Congress, as it had in 1900, continued its policy of making very little direct investment in the territories through direct appropriations. Instead they gave the Virgin Islands the right to use the federal income tax (heretofore inapplicable to inhabitants of the Virgin Islands) as a purely local tax to fund necessary investments in infrastructure development. Unwilling to send the US Treasury to the Virgin Islands to collect the tax, Congress told the Navy Governor that it would be the Navy’s responsibility to collect it.

From the start the purpose of this 1922 law was “to assist the islands in becoming self-supporting.” While economic development of the Virgin Islands was part of stated US policy it did not occur during the period when the US Navy administered the Virgin Islands (1917-1931). Thereafter, the administration of the Territory was transferred to the Interior Department. President Herbert Hoover became the first US President to visit the Virgin Islands and opined during that visit:

“...[W]e acquired an effective poorhouse, comprising 90 percent of the population. The people cannot be self-supporting either in living or government without discovery of new methods and resources. The purpose of the transfer of administration from the naval to a civil department is to see if we can develop some form of industry or agriculture which will relieve us of the present costs and liabilities in support of the population or the local government from the Federal Treasury or from private charity... [H]aving assumed the responsibility, we must do our best to assist the inhabitants” (from The New York Times, March 27, 1931, p.1. and p. 23).

The major US sponsored developmental program developed by Governor Pearson and President Franklin Roosevelt was the establishment of the Virgin Islands Company (VICORP), the only United States sponsored sugar processing company. So strong was the US goal of economic development of the Virgin Islands that at the height of anti-socialism and anti-communism in the United States, the US government formed a socialist

Historical Perspective...

collective and sponsored it for 32 years. Congress provided subsidies to operate VICORP from 1934-1966 when the sugar processing plant was disassembled and moved to Venezuela.

Thereafter, a policy shift from Congressional subsidies to indirect grants in the form of tax incentives was made to help two industrial concerns establish the Harvey Aluminum and Hess Oil refineries. The measures used to create special tax laws to promote industrial development were the predecessor to the EDC (and subsequently the RTPark) program.

The history of the EDC law is complex. The first antecedent to the law appeared in 1957 with Act No. 224 of the Virgin Islands Legislature. It was enacted to encourage new business enterprises in the Virgin Islands and provided a tax exemption to those entities.

The preamble to Act No. 224 stated,

“Whereas it is deemed of great benefit to the people of the Virgin Islands, as well as to the economy of the Virgin Islands, to establish as many self-sustaining enterprises in the Virgin Islands as is practical – to attract additional investment capital – to promote tourism – to promote the building of hotels, guest houses, and housing projects – to the end that the economic life of the Virgin Islands may be as diverse and stable as possible, and the people of the Virgin Islands trained and employed in investments, in finance, in modern techniques of production, mechanical skills, services and trades; and

Whereas it is deemed to be in the public interest to extend such inducements and render such aid as will encourage persons, firms and corporations to establish and develop new business enterprises; to make additional investment capital available to new and existing business; to promote tourism and the building of hotels, guests houses and housing projects...”

The USVI Legislature got a little ahead of Congress in this regard but Congress, agreeing with the objective of the law, ratified it by amending 26 U.S.C. 934 in 1960. “Accepting the ‘invitation’ extended by Section 934, the Virgin Islands Legislature enacted the Industrial Incentive Program which was substantially the same as Act No. 224, except that it contained the limitations required by Section 934(b). See VIC Title 33 §4071(a(2)).” *HMW Industries, Inc. v. Wheatley*, 504 F.2d 146, 151-152 (3d Cir. 1974).

The United States Department of Interior continues to recognize that the tax incentives the Virgin Islands is authorized to offer USVI businesses is necessary to help offset significant economic hurdles to development. In July, 2005, the Interior Department filed a written statement concerning their own concerns with new tax regulations for the Territories. Their paper noted that:

“[t]he Secretary of the Interior has stated that her top priority for the Insular Areas is to promote private sector economic development there. Under the Secretary’s leadership, the Department of the Interior has been implementing a comprehensive program to advance this priority... Because of the special fiscal and economic challenges faced by the Insular Areas, it has been the policy of successive administrations from both parties to support tax and trade provisions to help the Insular Areas generate sufficient tax revenue and economic activity to meet the most basic needs of their people. Notwithstanding these incentives, each of the Insular Areas continues to experience severe economic and fiscal difficulties. Special tax provisions for the Insular Areas, in particular, manifest an important underlying principle of US territorial policy: The Federal Government does not treat the Insular Areas as sources of revenue. The US has a strong interest in maintaining and enhancing the economic and fiscal well-being of the Insular Areas.” Statement of the US Department of the Interior, Office of Insular Affairs on Temporary and Proposed Regulations to Implement the American Jobs Creation Act of 2004 (July, 2005).”