

The Virgin Islands Consortium

U.S. Senate's \$1.5 Trillion Tax Cut Bill Includes Reductions For Rum Industry, Exposing VI Bonds To Volatility

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When ratings firms Fitch, Moody's and S&P consider rating U.S. Virgin Islands bonds, a variety of data is used before determining the final outcome. After poring over the data, traditionally provided by the government, one of the main indicators in deciding how to rate the USVI is whether the territory can continue to pay its debtors. This is based on multiple factors, of course: The overall state of the economy; whether there are indicators of growth, its pension system (which is heading towards collapse as early as 2023), and the unemployment rate (twice that of the national average), among other important factors.

The ratings firms have all decided that the indicators show signs of decline, not growth, and have downgraded USVI bonds to [junk status](#) -- a rating that has caused investors to steer clear of Virgin Islands bonds, and resulted in failed attempts by the Mapp administration in January to secure \$150 million from the bond market to satisfy its structural deficit.

The local government continues to maintain that it has never defaulted on its obligations, and local officials have consistently said that the territory -- being lumped with Puerto Rico -- has been treated unfairly.

Servicing most of the USVI's debt is what is called Matching Fund Bonds, or rum cover over funds, which are taxes collected yearly by the U.S. Department of Interior on behalf of the local government from Captain Morgan Distillery (Diageo) and Cruzan Rum Distillery rum sales. This year, [the total sum was \\$224 million](#), up from almost \$203 million the year prior.

The majority of the funds, however, never arrive in the coffers of the U.S. Virgin Islands government. Instead, the funds are transferred directly to the bondholders, leaving the territory with a fraction of the total sum -- \$48 million this year. Of the remaining \$48 million, \$18 million went to the government's general fund, and the remainder to Cruzan Rum and Diageo for promotional fees and molasses subsidies, as per the 2007 agreement. The local government was left with only \$30 million from the \$224 million.

The Matching Fund Bond is stretched, and the ratings agencies are wary of the government's constant burdening of a fund that is near -- if not at -- its limit.

Now, in the U.S. Senate's version of the Republicans' \$1.5 trillion tax cut bill, lawmakers have proposed excise tax reductions for liquor, wine and beer.

For beer, which is currently taxed at \$18 per barrel, the proposal would lower the tax rate to \$16 per barrel for the first two million barrels produced or imported, and thereafter would go back up to \$18. Spirits are currently taxed at \$13.50 per gallon. The proposal calls for lowering it to \$2.70 per gallon for the first 100,000 gallons produced or imported by the industry. The tax rate would go up to \$13.34 per gallon for anything between 100,000 gallons and 22,130,000 gallons. Anything larger than that would be taxed at \$13.50 per gallon.

While it is unclear how much the USVI would lose if the law were to pass with the Senate line item, it puts on unstable ground the USVI's most dependable source of income to pay bondholders. And though the cuts are to last only two years if the Senate inclusion prevails, officials in the alcohol industry have vowed to fight for longterm changes.

"We're gratified to have achieved this and we're hoping to build on it in the future," said Mark Gorman (via [CNN](#)), senior vice president for the Distilled Spirits Council, the industry group for the \$65 billion liquor industry.

"It's terrific recognition that distilled spirits have been overtaxed for a long time and this would be the first distilled spirits tax reduction since the Civil War," he said.

The territory's other source of income that it uses to pay debts, is Gross Receipt Tax (GRT) bonds. But there, too, a level of volatility exists, because GRT collection is reliant

on the condition of the economy. If things are booming, the higher the collection. However, if the economy is struggling, it is reflected in lower GRT collections.

Governor Kenneth Mapp has said that for the next two years, the local economy will be fueled in great part by growth in the construction industry, noting the high number of job opportunities currently available through the Dept. of Labor associated with the aftermath of Hurricanes Irma and Maria. The surge in employment will bolster GRT collection, the governor has said.

But the Senate's inclusion of the excise tax cuts for the alcohol industry shows how fragile the local government's dependence on rum taxes is. With a stroke of President Donald Trump's pen, what has been a reliable source of dollars could be altered for the worse, and could cause the USVI to unravel.