The Virgin Islands Consortium

Ruling On Fate Of Excise Taxes Could Come 'Any Day Now,' New B.I.R. Director Says

With the government losing millions of dollars, the Bryan administration is hoping for a favorable outcome.

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What could be a fateful ruling on the state of the collection of excise taxes in the U.S. Virgin Islands could be handed down any day now, said Bureau of Internal Revenue Director nominee Joel Lee. During a Committee on Finance Hearing Tuesday, Mr. Lee, chosen by Governor Albert Bryan to lead the important government arm, said the government had made its case before the courts and was awaiting a judgement.

"We have done everything we can and we have submitted our argument to the attorney general's office, who has since presented our case to the courts, so we are basically currently waiting for the court's decision any day now," Mr. Lee told lawmakers.

Since a District Court ruling on November 15 ordering the halt of excise tax collection, the Government of the Virgin Islands has lost $9 million, according to Mr. Lee. In Fiscal Year 2018, collection in excise tax was approximately $40 million; in 2017 the collection was $34 million; in 2016 the government collected $24 million, Mr. Lee said.

The District Court ruling, handed down by Judge Curtis Gomez, was originally delivered in September, 2018. However, the government filed a motion requesting that the ruling be stayed until its appeal to the Third Circuit Court of Appeals was heard. Judge Gomez denied the motion and ordered the government to halt excise tax collection.

On November 16, the Government of the Virgin Islands filed a motion with the Third Circuit Court of Appeals to stay the District Court's order and lift the injunction, which would allow the government to continue collecting excise taxes. On December 4, however, the Third Circuit Court of Appeals agreed with Gomez's order and denied the government's motion. On January 20, the government was given an extension to file its brief no later than January 30, however the G.V.I. -- which is now arguing a different scheme that it argues would legally allow it to continue collecting the excise taxes -- was given an additional extension to March 1.

“The motion of the GVI to stay judgment pending appeal docketed at ECF Number[82] is denied,” read the Judge Gomez's ruling. “The GVI is enjoined from collecting excise taxes in a manner inconsistent with the Court’s holding in its September 28, 2018, Judgment; that is, the GVI is enjoined from collecting excise taxes in a manner that violates Commerce Clause principles.”

The ruling added: “To the extent it wishes to do so, the GVI may advise the Court if and when it is prepared to collect excise taxes in a manner consistent with the Court’s September 28, 2018, Judgment and Memorandum Opinion, at which point the Court may reconsider the injunctive relief ordered herein.”

If the ruling stands in the Third Circuit Court of Appeals, the territory — barring a Supreme Court appeal — would have to relinquish for good what has been a stable source of revenue.

In December, then-Governor-elect Bryan told The Consortium that once the government puts the right rules and regulations in place, collections should continue. Mr. Bryan was also hoping for a favorable outcome before former Governor Kenneth Mapp left office.

“Governor Mapp’s team has been working on the matter,” Mr. Bryan said, revealing that he had spoken with the former governor's financial team, whose members had given him an update on the territory’s financial condition. “It’s a matter of having the right rules and regulations.”

Mr. Bryan added, “The way that it is administered is illegal, but if you accompany the law with the right set of rules and regulations, then we will be able to collect. The bad news is that Christmas is one of the buying seasons and a lot of stuff is being shipped in, so we’re losing a considerable amount of money on this. But hopefully we’ll be able to get this matter wrapped up before Governor Mapp leaves office."

The challenge was first brought by Reefco Services, Inc., a corporation organized in the USVI and engages in the marine refrigeration business, in December 2014. The company installs and provides repair services for refrigeration units, air conditioning units, ice markers, and water makers on boats.

Reefco, which was charged for equipment that it brought into the territory dating back to 2011, contended in its complaint that the taxes violated the Commerce Clause

The complaint included five counts: Count one asserts a claim for an unconstitutional taking; count two asserts that the excise tax violates the Commerce Clause; count three asserts that the excise tax violates the Import/Export Clause; count four asserts a claim for a refund of excise taxes paid; and count five also asserts a claim for an unconstitutional taking.

The District Court in 2015 granted the GVI a motion to dismiss, but only in part, while denying the motion to dismiss relative to counts four and five. In April 2017, however, the court moved to vacate the trial, settling the matter.

But there was reconsideration this year of count two, according to court documents The Consortium has obtained. Count two contends that the excise tax law violates the Commerce Clause of the U.S. Constitution. "The excise tax is facially unconstitutional under the Commerce Clause as the excise tax discriminates against interstate commerce," reads a portion of count two. Citing precedent, the District Court said it was "necessary to reconsider its decision dismissing count two of the amended complaint and revive that count."

According to the September 28 District Court judgement, Reefco was assessed excise taxes in accordance with 33 Virgin Islands Code, Section 42 for items that Reefco imported into the territory. Section 42 was passed by the Virgin Islands Legislature in 1959. The section says ostensibly, the law requires the payment of "an excise tax on all articles, goods, merchandise or commodities manufactured in or brought into the Virgin Islands for personal use" or "any business use or purpose," unless the items are "specially taxed, exempted or excluded."

In 1984, the Virgin Islands amended Section 42 to require the payment of excise taxes on "all articles, goods, merchandise and commodities manufactured in or brought into or manufactured in the Virgin Islands." Section 42b outlined the procedure for collection of excise taxes on foreign imports, while 42c outlined the procedure for collection of excise taxes on domestic imports. However, no statutory provision exists outlining the procedures for the collection of excise taxes on locally manufactured goods. Instead, Section 42a directs the director of the Bureau of Internal Revenue to "promulgate rules concerning procedures for the valuation of goods and payment of excise taxes on items manufactured in the Virgin Islands." According to the District Court, "Significantly, however, such regulations were never promulgated."

In a separate case cited as precedent in the Sept. 28 proceedings, an appeal to the Third Circuit Court in JDS Realty Corp. v. Gov't of Virgin Islands explained that "[a] cardinal rule of Commerce Clause jurisprudence is that '[n]o state, consistent with the Commerce clause, may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business."

"By imposing a tax only on imported goods" but not locally manufactured goods, the excise tax did just that, the Third Circuit said in its ruling of the JDS Realty Corp. v. Gov't of Virgin Islands matter.

The District Court's Sept. 28 ruling noted that the Third Circuit was "hard pressed to imagine a taxing scheme more patently violative of the Commerce Clause than [the excise taxes under Section 42]." Accordingly, the Third Circuit held that, "because the challenged excise tax ha[d] a discriminatory purpose and effect, it violate[d] the commerce clause," added the District Court.

Depending on the ruling when the new case is heard in the Third Circuit, the repercussions could be significant for the local government, which for years has been struggling with a structural deficit, and is in continuous need of funds to meet its obligations. A diminishing or complete rejection of the excise tax would force the government to look elsewhere to recoup those funds.