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U.S. INSULAR AREAS

Information on Fiscal Relations With the Federal Government

Statement of Natwar M. Gandhi, Associate Director
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U.S. INSULAR AREAS

SUMMARY OF STATEMENT OF
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American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands are all insular areas of the United States. And, the U.S. government has various fiscal arrangements with them. In anticipation of congressional considerations of new tax and welfare initiatives, GAO was asked to provide, in relation to these five insular areas or territories, information on (1) income and other tax rules and revenues, (2) current federal expenditures, and (3) the extent to which they receive major federal social programs.

Individuals who are residents of a territory and who earn income only from sources within the territory owe no federal tax on this income. U.S.-source income is treated differently for federal tax purposes, depending on the territory in which the individual resides.

Corporations organized in the territories are generally treated as foreign corporations for U.S. tax purposes and are taxed on their U.S. earnings but not their territorial income. U.S. corporations with subsidiaries in the territories can receive significant tax benefits through the possessions tax credit if certain qualifications are met. The Treasury Department has estimated these benefits to approximate $3 billion annually.

Other federal taxes include payroll taxes to fund Social Security and Medicare and excise taxes. The application and disposition of federal excise taxes are determined by where the excisable goods are produced and consumed. The tax law treats the territories unequally with regard to whether they keep the revenues from federal excise taxes.

In fiscal year 1993, total federal expenditures in the five territories amounted to $10.3 billion. The largest expenditure category was "direct payments to individuals," which were made mostly through Social Security benefits, Medicare benefits, unemployment compensation, and student education grants. About 86 percent of the $10.3 billion went to Puerto Rico, although Guam received the highest expenditure in per capita terms.

Major federal social programs, such as food stamps and Aid to Families with Dependent Children, extend in varying degrees to the territories. If these programs were extended as currently operating in the U.S., the cost to the federal government could exceed $3 billion annually.

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to present to the Subcommittee information on various fiscal arrangements between the U.S. government and the insular areas of American Samoa, Guam, the Commonwealth of the Northern Mariana Islands, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands. In anticipation of congressional considerations of new tax and welfare initiatives, Chairman Young of the Committee on Resources asked us to compile information on income and other tax rules and revenues that apply to these areas, current federal expenditures to these areas, and the extent to which major federal social programs are extended to these areas.

Although there are more U.S. territories than the five we discuss today, the five are provided special recognition in the Internal Revenue Code.[1] To prepare for this hearing, we collected and analyzed data from federal agencies and published sources, including past GAO reports. The latest year for which demographic, economic, and fiscal data were available varied among the five territories. Appendix I discusses our objectives, scope, and methodology, and appendix II lists relevant GAO reports.

INCOME TAX RULES AND REVENUES

I would like to highlight now the federal individual and corporate income tax rules that affect the five territories. Among the distinguishing characteristics of these rules are (1) the section 936 tax credits available to qualifying U.S. corporations, (2) the transfer of revenue from the U.S. Treasury to the territorial governments, and (3) the exemption of territorial residents from federal income taxation on their local income. More information about these rules and related revenues is contained in appendix III.

Federal Income Tax on Corporations

Corporations organized in the territories are generally treated as foreign corporations for U.S. tax purposes. Like foreign corporations, they are taxed on their U.S. earnings, but their territorial income is not subject to U.S. tax.

U.S. corporations with subsidiaries in the territories can receive significant tax benefits through the possessions tax credit if their subsidiaries meet certain qualifications under section 936 of the Internal Revenue Code. This credit was

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[1]The Internal Revenue Code refers to the five territories as "possessions." However, outside of the Code, they are more commonly referred to as territories and we use that term in this testimony.

established in 1976 to assist the U.S. territories in attracting employment-producing investments by U.S. corporations. Prior to 1994, this credit was available to qualified subsidiaries to the full amount of U.S. income tax liability on territorial source income. The credit effectively exempted from federal taxation all of the territorial source income earned by qualified subsidiaries. The Omnibus Budget Reconciliation Act of 1993 imposes a cap on the amount of credit that taxpayers can receive starting in 1994.

The Department of the Treasury estimates that the credit caused the federal government to forego $3.1 billion of tax revenues in 1993 before the cap was imposed. Treasury projects that, with the cap, the annual cost will fall (in nominal terms) to $2.6 billion in 1995 but, because of projected economic growth, climb to $3 billion by 1999.

Internal Revenue Service (IRS) studies, which covered the 1980s, showed that about 99 percent of the credit was earned by corporations operating in Puerto Rico. This is because Puerto Rico is many times larger than the other territories in population and gross national product. It also has a much larger industrial sector than the other territories (see app. IV).

Federal Income Tax on Individuals

Under the Internal Revenue Code, individuals who are residents of a territory and who earn income only from sources within the territory are to pay income tax only to the territory. They owe no federal tax on this income. Individuals who have U.S.-source income are treated differently for federal tax purposes, depending on their residence. Residents of Puerto Rico and American Samoa are to pay federal income tax on their U.S.- and foreign-source income if their income exceeds the federal filing threshold. The federal government is to transfer the tax collected from Samoan residents to the government of that territory, but retain the tax collected from residents of Puerto Rico. Residents of Guam and the Northern Marianas owe territorial income tax on any U.S.-source income that they may earn. The governments of those two territories are to transfer a portion of that tax revenue to the federal government.[2] The federal government does not tax, or receive any revenue from the territorial income tax on, Virgin Island residents who have U.S.-source income.

U.S. residents with territory-source income are also subject to differing requirements. U.S. residents with income from Puerto

[2]These rules would change if the government of Guam or the Northern Marianas were to enter into an agreement with the U.S. government as permitted under the Tax Reform Act of 1986.

Rico or American Samoa are to pay territorial income tax on that income and receive a credit against their federal tax liabilities. U.S. residents with income from Guam or the Northern Marianas owe federal tax on their territorial income, but the federal government transfers a portion of this revenue to the territorial governments. U.S. residents who earn income in the Virgin Islands are to file identical returns with both governments, which share the revenues on a ratio basis that takes into account where the income was earned.

Income Tax Revenues

The Government of Puerto Rico reported a preliminary figure of $2.4 billion from its own income taxes in 1993. The latest figures for Guam show $262 million in income tax receipts for 1990. The Virgin Islands reported receiving $239 million from income taxes in 1993. Income tax revenues reported for American Samoa and the Northern Marianas were less than $30 million in the early 1990s.[3]

RULES AND REVENUES FOR OTHER TAXES

In addition to income taxes, several other federal taxes may affect the residents of the five territories. The payroll taxes that fund Social Security and Medicare are collected in all five territories and the revenues are retained by the U.S. government. The unemployment insurance tax is collected in Puerto Rico and the Virgin Islands, but not in the other three territories. The revenues from that tax are retained by the U.S. government.

Federal estate and gift taxes generally do not apply to residents of the territories. Although the estate of a person who was born in the United States and moves to a territory would generally be subject to tax, the estate of a life long territory resident would not. However, all territorial residents who are U.S. citizens are subject to the federal estate and gift taxes on any tangible property they own that is situated in the United States.

The application and disposition of federal excise taxes in the territories are determined by where the excisable goods are produced and consumed. All merchandise shipped from the United States to any of the five territories is exempt from federal excise taxation.

Most federal excise taxes do not apply to products that are consumed in the territories. The tax law treats the territories

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[3]The income tax figures for Guam and the Northern Marianas included any amounts collected by IRS and transferred to the territory. Appendix V briefly describes the local income taxes imposed by the territories.

unequally with regard to whether they keep the revenues from federal excise taxes that may be collected on their products or within their territories. For example, Guam and the Northern Marianas are entitled to any revenues the taxes generate. American Samoa receives no revenue from U.S. excise tax, nor does Puerto Rico or the Virgin Islands except for the special tax discussed below.

A special excise tax is imposed by section 7652 of the Internal Revenue Code on articles that are manufactured in Puerto Rico or the U.S. Virgin Islands and are shipped into the United States for sale or consumption. The tax is equal to the federal excise tax that would have been imposed had the articles been manufactured in the United States.

The Guam Organic Act and the Northern Marianas Covenant provide that any excise taxes that are collected on articles shipped to the United States are to be transferred to their respective territorial governments. Currently, no products subject to federal excise taxes are shipped from Guam or the Northern Marianas.

An excise tax on rum accounts for most of the revenues collected under section 7652. This tax is to be imposed at a rate of $13.50 per proof gallon. Puerto Rico and the Virgin Islands are to receive most of the revenue collected from this tax. Their share is equal to $11.30 per proof gallon of all rum they ship to the United States or exported to the United States from any foreign country. The Department of the Treasury is to retain a portion of this revenue equal to its enforcement expenses. In fiscal year 1994, Puerto Rico received $202 million from this source while the Virgin Islands received $32 million.

Puerto Rico is to receive all U.S. customs duties, net of refunds and expenses, that are collected within its territory. This transfer to Puerto Rico amounted to $133 million in fiscal year 1994. The four other territories are outside of the U.S. customs area. Nevertheless, the U.S. Customs Service helps the Virgin Islands to collect local customs duties and is to keep 1 percent of the total revenues collected to cover its expenses. The Virgin Islands received roughly $5 million from these collections in 1994.

CURRENT FEDERAL EXPENDITURES

I will move now to the federal expenditures that went to the five territories. Our data are for fiscal year 1993, the latest year for which data were readily available.

In fiscal year 1993, total federal expenditures in the five territories amounted to $10.3 billion. Eighty-six percent of this amount went to Puerto Rico, 9 percent went to Guam, and 4 percent to the Virgin Islands. American Samoa and the Northern Marianas each received less than 1 percent. In per capita terms, Guam received the highest expenditure, $6,364 per resident, while the Northern Marianas received the lowest, $1,124 per resident.

The largest category of expenditures was "direct payments to individuals;" it accounted for 46 percent of the total expenditures. Social Security benefits accounted for more than half of the expenditures in this category. Medicare benefits, veterans' benefits, unemployment compensation, and educational grants to needy students made up most of the remainder.

The next largest category was "grants to local governments," which accounted for 35 percent of total federal expenditures in the territories. For Puerto Rico, the largest portion of these grants was from the Department of Agriculture's Food and Nutrition Service. Puerto Rico also received sizeable grants from the Departments of Education, Health and Human Services, Housing and Urban Development, and Transportation.

In contrast to the case of Puerto Rico, grants from the Department of Agriculture represented much smaller proportions of the total grants received by the other territories. Those territories receive most of their grants from the Departments of the Interior, Education, Health and Human Services, Housing and Urban Development, and Transportation. It is important to note that the various transfers of revenues that we identified previously are included in the grant totals shown in table VII.1.

The third largest category of U.S. expenditures in the territories, "salaries and wages," accounted for 11 percent of total expenditures. This category represented the current compensation of federal civilian employees and members of the armed forces stationed in the territories. The remaining 8 percent of federal expenditures went for procurement and other expenditures.[4]

FEDERAL SOCIAL PROGRAMS

The final area I will cover pertains to major social programs that the U.S government extends in varying degrees to the territories.[5] Discussion has occurred on fully extending major social programs to the territories. Extending certain federal programs in Puerto Rico as they operate in the states would not

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[4]The costs of IRS' operations in the territories are discussed in appendix VI. Appendix VII provides a detailed breakdown of all federal expenditures in the territories.

[5]Appendix VIII provides further information on the extension of federal social programs to the territories.

only increase federal expenditures but also enrollment and benefits.

The Congressional Budget Office in a 1990 paper estimated that additional federal expenditures in fiscal year 1995 could be as much as $3 billion if food stamp, Aid to Families with Dependent Children (AFDC), Medicaid, Medicare, Supplemental Security Income (SSI), and foster care benefits were fully extended to Puerto Rico. In addition, Puerto Rico would be subject to more federal examinations, for example, in the food stamp program as all states are subject to extensive oversight by the Department of Agriculture. Extending the programs to the other territories would increase expenditures further but the cost is unknown.

Guam and the Virgin Islands operate a food stamp program like that in the 50 states. The food stamp program in Puerto Rico was replaced with a block grant, which began operations in 1982. For fiscal year 1995, a $1.1 billion block grant was appropriated for Puerto Rico. A variant of the food stamp program operates in the Northern Marianas. The food stamp program is not extended to American Samoa.

Puerto Rico's block grant--the Nutrition Assistance Program--provides participants monthly checks rather than food stamps. Unlike food stamp recipients, Nutrition Assistance Program participants are not restricted in what they can purchase with their checks. A ceiling limits the amount of the block grant. Nutrition Assistance Program participants must meet more restrictive participation criteria than food stamp program recipients.

Currently, only Guam, Puerto Rico, and the Virgin Islands operate a limited AFDC program. American Samoa and the Northern Marianas have not chosen to participate in AFDC. Federal funding for the AFDC programs in the three territories is capped. Total spending in combination with adult assistance and foster care expenditures should not exceed the following ceilings: Puerto Rico--$82 million, Guam--$3.8 million, and the Virgin Islands--$2.8 million.

The U.S. government is to pay 50 percent of the Medicaid expenditures in the territories up to a ceiling amount that varies by territory. The ceiling amount, which is imposed by statute, is American Samoa--$1.45 million, Guam--$2.5 million, Northern Marianas--$0.75 million, Puerto Rico--$79 million, and Virgin Islands--$2.6 million.

Federal payments under the Medicare program are available to all five territories. Puerto Rico is treated like a state, except that hospital reimbursement rates under the special prospective payment system in Puerto Rico are lower than in the states.

The SSI program operates only in the Northern Mariana Islands. Instead of SSI, Guam, Puerto Rico, and the Virgin Islands receive federal grants for old-age assistance, aid to the blind, and aid to the permanently disabled.

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Mr. Chairman, this concludes our prepared statement. We would be pleased to answer any questions.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives in preparing this testimony were to determine

-- federal taxes and customs duties collected in the U.S. territories, including amounts which are covered over to their treasuries;

-- estimated tax expenditures related to section 936 of the Internal Revenue Code before and after 1993;

-- local income taxes paid by individuals and corporations to the territories' governments;

-- IRS resources and programs operating in the territories;

-- the amount of federal expenditures in the territories, by program; and

-- the extent to which residents of the territories participate in the main federal social programs, and the available federal spending estimates of fully extending those programs to the territories.

To ascertain federal taxes and customs duties collected in, and covered over to, the U.S. territories, we reviewed IRS reports and federal budget documents; gathered excise tax information from the Bureau of Alcohol, Tobacco, and Firearms; and obtained customs data from the U.S. Customs Service. We also studied federal tax arrangements in the territories by reviewing many sources. These included previous GAO reports; a Department of Interior 1993 report on applying federal laws in American Samoa, Guam, the Northern Mariana Islands, and the U.S. Virgin Islands; and IRS' Tax Guide for Individuals With Income From U.S. Possessions. Lawyers from our Office of General Counsel reviewed the current Internal Revenue Code to update and extend the information from those secondary sources. We did not, however, attempt to compile a comprehensive analysis of all aspects of the tax systems of the United States and the territories.

To determine estimated section 936 tax expenditures, we obtained Treasury Department estimates, published in February 1994, for fiscal years 1993 through 1999.

We obtained data on local income taxes paid to the four territories other than Puerto Rico from A Report on the State of the Islands, which was published in 1994 by the Office of Territorial and International Affairs of the U.S. Department of the Interior. We acquired information for Puerto Rico from a 1993 economic report to the Governor.

To determine IRS resources and programs operating in the territories, we interviewed IRS officials and collected budget and staffing figures as well as descriptions of IRS' activity in the territories.

To determine the amount of federal expenditures in the U.S. territories, by program, we used the report Federal Expenditures by State, for Fiscal Year 1993, published by the U.S. Bureau of the Census.

We used several other sources to discern how territorial residents are treated under the principal federal programs and the available federal spending estimates of extending those programs to the territories. Specifically, we reviewed publications from the House Ways and Means Committee, GAO, the Congressional Budget Office, the Congressional Research Service, the Social Security Administration, and the Department of Agriculture.

We did our work in December 1994 and January 1995 in accordance with generally accepted government auditing standards. We did not audit the reliability of the data collection systems that produced the information we used.

SELECTED GAO PRODUCTS RELATED TO THE U.S. TERRITORIES

U.S. Insular Areas: Development Strategy and Better Coordination Among U.S. Agencies Are Needed (GAO/NSIAD-94-62, Feb. 7, 1994).

Tax Policy: Puerto Rico and the Section 936 Tax Credit (GAO/GGD-93-109, June 8, 1993).

Food Assistance: Nutritional Conditions and Program Alternatives in Puerto Rico (GAO/RCED-92-114, July 21, 1992).

Pharmaceutical Industry: Tax Benefits of Operating in Puerto Rico (GAO/GGD-92-72BR, May 4, 1992).

American Samoa: Inadequate Management and Oversight Contribute to Financial Problems (GAO/NSIAD-92-64, Apr. 7, 1992).

U.S. Insular Areas: Applicability of Relevant Provisions of the U.S. Constitution (GAO/HRD-91-18, June 20, 1991).

U.S. Customs Service: Unresolved Audit Issues Between Customs and the Virgin Islands (GAO/GGD-90-21, Dec. 8, 1989).

Puerto Rico: Background Information on Applicable Federal Legislation, Its Government Structure, and Its Finances (GAO/HRD-90-7T, Nov. 15, 1989).

Puerto Rico: Update of Selected Information Contained in a 1981 GAO Report (GAO/HRD-89-104FS, Aug. 9, 1989).

Welfare and Taxes: Extending Benefits and Taxes to Puerto Rico, Virgin Islands, Guam, and American Samoa (GAO/HRD-87-60, Nov. 15, 1987).

Issues Affecting U.S. Territory and Insular Policy (GAO/NSIAD-85-44, Feb. 7, 1985).

THE APPLICATION OF FEDERAL TAXES AND DUTIES IN THE TERRITORIES

Federal Income Tax Treatment of Individuals

While the United States taxes the worldwide income of U.S. citizens and residents, the rules that apply to residents of the territories differ, depending on both the residence of the individual and the source of the income. Under current tax rules, individuals who are residents of a territory and who earn income only from sources within the territory file one income tax return with the territory and pay tax only to the territory. Individuals who have U.S.-source income are treated differently, depending on their residence. U.S. residents with territory-source income are also subject to differing requirements.

The Tax Reform Act of 1986 granted Guam, the Northern Marianas, and American Samoa authority over their own local income tax systems and provided that residents of these territories were entitled to exclude territory source income for U.S. tax purposes. However, both the grant of authority and the exclusion are contingent on the existence of an implementing agreement between the territory and the United States. To date, only American Samoa has entered into an implementation agreement.

Table III.1 summarizes how federal income tax rules apply to individual residents of the territories and residents of the United States with territory-source income. The term "cover over," which is used in the table, refers to the transfer of taxes collected by the federal government to a territorial government, or vice versa.[6]

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[6]Income tax transfers (in either direction) between the federal government and the governments of Guam and the Northern Marianas apply only in the case of taxpayers with $50,000 or more of adjusted gross income and $5,000 or more of gross income from the jurisdiction where the individual is not required to file a tax return.

Table III.1: Federal Tax Rules That Apply to Individual Residents of the Territories and Residents of the U.S. With Territories-Source Income

Territory	Resident of territory with U.S.-source income	Resident of U.S. with territory-source income	Rules applicable after 1986 Act becomes effective
American Samoa	Files two returns, entitled to exclude income from Samoa, Guam, or the N. Marianas from U.S. return.	Taxable on income from American Samoa; tax paid would be creditable against individual's U.S. tax.	Same as column 1. U.S. and American Samoa have signed an implementation agreement.
Puerto Rico	A U.S. citizen who is a year-round resident of P.R. pays taxes to the U.S., but excludes P.R. source income.	U.S. citizen who is not present long enough in P.R. to qualify for the exclusion would have to file tax returns with both jurisdictions, but would be entitled to a foreign tax credit for P.R. income tax.	N/A
Virgin Islands	Files one return with the V.I. reporting worldwide income. no tax liability to U.S.	Tax liability to V.I. will be a fraction of U.S. tax liability, based on ratio of V.I. source income to worldwide income. Files identical returns with V.I. and U.S.	N/A
Guam	Files one return with territory reporting worldwide income. Guam covers over tax collected from certain individuals on U.S.-source income.	Files one return with U.S. reporting worldwide income. U.S. covers over tax collected from certain individuals on Guamanian source income.	Resident of Guam must file return with U.S. if has any income from source outside Guam, Northern Marianas or American Samoa. U.S. will cover over all income tax paid by resident.
Northern Marianas	Same as Guam.	Same as Guam.	Same as Guam.

FEDERAL INCOME TAX TREATMENT OF ALL CORPORATIONS

Corporations organized in the territories are generally treated as foreign corporations for U.S. tax purposes. Like other foreign corporations, they are taxed on their U.S. earnings, but their territory income is not subject to U.S. tax. Foreign corporations pay U.S. tax at two rates--a flat 30 percent tax is withheld on certain forms of nonbusiness income from U.S. sources, and tax is imposed at progressive rates on income from a U.S. trade or business. Much interest income is exempt from the withholding tax.

Corporations from Guam, Samoa, the U.S. Virgin Islands, and the Northern Marianas do not pay the flat 30 percent withholding tax if they meet certain tests relating to close connections with the territory in which the corporation is created.

Congress established the Possessions Tax Credit (Section 936 of the Internal Revenue Code) as part of the Tax Reform Act of 1976. The stated purpose of the credit was to "assist the U.S. territories in obtaining employment producing investments by U.S. corporations."

Prior to 1994, the section 936 tax credit was equal to the full amount of the U.S. income tax liability on territory-source income. Firms qualified for the credit if, over a 3-year period preceding a taxable year, 80 percent or more of their income was derived from sources within a territory and 75 percent or more of their income was derived from the active conduct of a trade or business within a territory. This provision effectively exempted from U.S. taxation all territory-source income of qualified subsidiaries. Dividends repatriated from a U.S. subsidiary to a mainland parent qualified for a dividend-received deduction, thus allowing tax-free repatriation of territories income. In addition, the provision exempted from U.S. taxation the income earned on qualified investments made by section 936 firms from their profits earned in the territories. This income is called qualified territories source investment income, or QPSII. Puerto Rico established rules to ensure that QPSII funds invested through the island's financial intermediaries meet the act's requirements.

The 1993 Budget Act limited the section 936 credit.[7] After 1993, taxpayers are to calculate the credit as under prior law, but the credit would be capped under one of two alternative options selected by the taxpayer:

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[7]Omnibus Budget Reconciliation Act of 1993, Pub.L. No. 103-66, S 13227, 107 Stat. 312, 489 (1993).

-- The "percentage limitation" option provides for a decreasing credit equal to a decreasing percentage of the amount computed under prior law. The percentages are set by law at 60 percent in 1994, 55 percent in 1995, 50 percent in 1996, and 45 percent in 1997. The percentage will be 40 in 1998 and thereafter.

-- The "economic-activity limitation" option provides a credit equal to the sum of three factors:

- -- The first factor is 60 percent of the firm's wages paid in the territory, with wages limited for each employee to 85 percent of the amount subject to Social Security taxes.

- -- The second factor is a specified percentage of the firm's depreciation deductions for each taxable year. The type of property defines the applicable percentage: 15 percent for property with a relatively short recovery period, 40 percent for property with a medium-length recovery period, and 65 percent for assets with a long recovery period.

- -- The third factor, which applies only to firms that do not use the 50-percent profit-split method of income allocation, is a portion of the income taxes paid to the territorial government. Included taxes, however, cannot exceed a 9-percent effective tax rate.

Table III.2 shows the Treasury Department's estimates for FY 1993 through FY 1999 of the federal tax revenues foregone due to the Possessions tax credit. These estimates are the most recent ones available that span the period before and after the revision of the credit by the 1993 Budget Act. The estimates reflect a temporary decline in the revenue cost of the credit after FY 1993. By FY 1996, however, income growth among credit recipients is expected to make revenue costs rise again. Of course, the cost of the credit in each year after FY 1993 is lower than it would have been without the change made by OBRA 1993.

IRS studies, which covered the 1980s, showed that about 99 percent of the credit was earned by corporations operating in Puerto Rico. This is because Puerto Rico is many times larger than the other territories in population and gross national product. It also has a much larger industrial sector than the other territories.

Table III.2: Estimated Tax Expenditures for the Section 936 Credit

Dollars in billions

Fiscal year	Tax expenditure
1993	$3.1
1994	2.9
1995	2.6
1996	2.7
1997	2.7
1998	2.8
1999	3.0

Source: U.S. Executive Office of the President, Budget of the United States Government, Fiscal Year 1995 (published February 1994).

TAX COLLECTION DATA FROM IRS

IRS does not regularly compile tax collection data for any of the territories, except for Puerto Rico and on selected income tax revenues for Guam.[8] Table III.3 shows the revenues that IRS collected in Puerto Rico from fiscal year 1990 through 1993. The U.S. government retains all of this revenue, except, possibly, some of the excise tax revenue. IRS was not able to identify (by the time that this testimony needed to be written) how much, if any, of the excise taxes shown were transferred to Puerto Rico.

Table III.4 shows the U.S. income tax that was withheld from Puerto Rican taxpayers on their U.S.-source income. The tax

[8]We do have data for each territory on its total income tax revenues, which include revenues from the territory's own income taxes and any amounts collected by IRS and transferred to the territory. These data are presented in appendix V. Revenues collected by the Bureau of Alcohol, Tobacco, and Firearms and by the Customs Service are reported below.

withheld from corporations is additional to the corporate taxes shown in the previous table. Some of the tax withheld from individuals may be included in the individual income tax collections shown in the previous table. The effective withholding tax rates for corporations were much lower than the statutory rate in the 1989-1991 period. One reason may be the withholding tax exemption for much interest income. Puerto Rico corporations reported that 99 percent of their (nonbusiness) U.S.-source income was interest income.

Table III.3: Federal Internal Revenue Collections in Puerto Rico, 1988-1993

Dollars in millions

	1990	1991	1992	1993
Corporation income tax	$133.5	$111.2	$45.8	$181.8
Individual income tax and Social Security contributions	1,668.8	1,801.8	2,137.6	2,225.9
Unemployment insurance	35.2	29.0	35.6	37.8
Estate and gift tax	1.6	6.0	9.4	6.5
Excise taxes collected by IRS	29.8	32.1	52.0	45.4
Total	$1,868.8	$1,983.3	$2,280.4	$2,497.5

Source: Internal Revenue Service Annual Report, various issues.

APPENDIX III

Table III.4: U.S.-Source Income and Withholding Taxes Paid by Puerto Rico Individuals and Corporations on U.S.-Source Income, 1989-1991

Dollars in millions

	1989	1990	1991
U.S.-source income			
Corporations	$9.9	$44.9	$91.9
Individuals	$1.2	$1.5	$1.0
U.S. withheld tax			
Corporations	$0.3	$0.6	$0.2
Individuals	$0.2	$0.2	$0.2
Effective withholding tax rates			
Corporations	3.2%	1.3%	0.2%
Individuals	17.6%	14.4%	19.3%

Source:
1991: IRS, Statistics of Income Bulletin, Summer 1994.
1990: IRS, Statistics of Income Bulletin, Fall 1994.
1989: IRS, Statistics of Income Bulletin, Spring 1992.

PAYROLL TAXES

Social Security/Medicare

The Federal Insurance Contributions Act imposes wage-based taxes on employers and employees to support Social Security and Medicare. These taxes are collected with respect to wages paid for employment, including services performed within the United States. The act's definition of the United States includes Guam, American Samoa, Puerto Rico, and the U.S. Virgin Islands. The act also applies to the Northern Marianas due to the Northern Marianas Covenant's link to Guam. Taxes collected under this act are not transferred to the territorial treasuries.

Unemployment Insurance

The Federal Unemployment Tax Act imposes a tax on employees, based on wages paid. The act expressly applies to the U.S. Virgin Islands and Puerto Rico. Since Guam, American Samoa, and the Northern Marianas are not otherwise defined as part of the United States, they are not subject to the act. The proceeds of the tax are used to support the federal-state unemployment compensation program and, thus, are not returned to the territorial governments.

ESTATE AND GIFT TAXES

Federal estate and gift taxes generally do not apply to residents of the territories. A special provision exempts these residents in the same manner as nonresident aliens if their U.S. citizenship is derived solely from their birth or residence in a territory. The estate of a person who was born in the United States and moves to a territory would generally be subject to tax; the estate of a lifelong territory resident would not. All territory residents who are U.S. citizens (as well as noncitizen nationals in American Samoa) are subject to the federal estate and gift taxes on any property they own that is situated in the United States.

Federal estate and gift taxes collected from residents of the Virgin Islands, Guam or the Northern Marianas are returned to the treasuries of those territories. The federal government retains the revenue from such taxes when they are collected from residents of Puerto Rico and American Samoa.

EXCISE TAXES

The application of federal excise taxes in the territories is largely determined by where the excisable goods are produced and consumed. The territories are treated unequally in terms of whether they are allowed to keep the revenues from federal excise taxes that are collected on their products or within their territories.

Products Consumed in the Territories That Are Imported From the United States

Section 7653 of the Internal Revenue Code provides that "merchandise going into Puerto Rico, the Virgin Islands, Guam, and American Samoa from the United States shall be exempted from the payment of any tax imposed by the internal revenue laws of the United States." The Northern Marianas' Covenant makes the same treatment applicable to the Northern Marianas.

Products Consumed in the Territories That Are Produced in the Territories or Imported From Foreign Countries

Most federal excise taxes do not apply to products that are consumed in the territories, even if they are not imported from the United States. Specific language extending a tax beyond the "United States," which is generally defined for tax purposes to include only the fifty states and the District of Columbia, must be present for that tax to apply in the territories. The following is a list of the excise taxes that apply on products consumed in the territories but not imported from the United States:

-- the tax on certain vaccines (code sections 4131-4132),

-- the tax on petroleum (code sections 4611-4612),

-- the tax on certain chemicals (code sections 4661-4662),

-- the tax on certain imported substances (code sections 4671-4672).

These taxes apply in all of the territories, but few (or none) of the excisable products may actually be consumed in the territories. If any revenue from these excise taxes is actually collected in Guam or the Northern Marianas, the governments of those territories are to receive that revenue. The federal government is to retain any revenue collected from those taxes in the other territories.

Products Produced in the Territories and Shipped to the United States

A special excise tax is imposed by section 7652 of the Internal Revenue Code on articles that are manufactured in Puerto Rico or the U.S. Virgin Islands and are shipped into the United States for sale or consumption. The tax is equal to the federal excise tax that would have been imposed had the articles been manufactured in the United States.

Section 7652 also provides that most of the revenues collected under this section are to be transferred to the treasuries of Puerto Rico and the Virgin Islands. Prior to transferring funds to Puerto Rico, the Department of Treasury deducts the amount needed to pay refunds and drawbacks to producers, as well as amounts needed to cover the Department's enforcement expenses. Prior to transferring funds to the Virgin Islands, Treasury deducts amounts needed to pay refunds and drawbacks, plus 1 percent of the total tax collected.

The Guam Organic Act and the Northern Marianas Covenant provide that any excise taxes that are collected on articles shipped to the United States are to be transferred to their respective territorial governments. Currently, no products subject to federal excise taxes are shipped from Guam or the Northern Marianas.

The tax on rum accounts for most of the revenue transferred to Puerto Rico and the Virgin Islands under section 7652. This tax is to be imposed at a rate of $13.50 per proof gallon. Puerto Rico and the Virgin Islands are to receive $11.30 per proof gallon of all rum they ship to the United States. These two territories also receive revenue, at that same rate, from the tax collected on all rum imported into the United States from any foreign country. The two territories share the revenue from the imports from other countries in proportion to the relative sizes of their shipments to the United States during the prior fiscal year. By statute, Puerto Rico's share of the revenue from the other imports cannot exceed 87.626889 percent or drop below 51 percent. Puerto Rico's share over the last three fiscal years has averaged 86.2 percent.

Tables III.5 and III.6 show the amounts of excise tax collected on shipments of rum from Puerto Rico and the Virgin Islands to the United States during the last three fiscal years. The tables also show the amounts of revenue from this tax that were turned over to the treasuries of Puerto Rico and the Virgin Islands. In fiscal year 1992, Puerto Rico received $208.7 million in transfers from the rum excise tax; it received a total of $270.8 million from all section 7652 excise taxes. In fiscal year 1993, the rum excise tax transfer of $197.5 million represented all of Puerto Rico's revenues under section 7652. For the years that we have data, the rum tax revenues shown in table III.6 represented all of the U.S. Virgin Islands' revenues under section 7652. If the two territories had received the full $13.50 per proof gallon from their own rum, Puerto Rico would have received an additional $40.2 million in 1994. The Virgin Islands would have received an additional $6.6 million.

Table III.5: Federal Excise Taxes on Puerto Rican Rum and Revenue Shares Transferred to Puerto Rico

Dollars in millions

	1992	1993	1994
Tax collected on Puerto Rican Rum	$247.4	$231.1	$224.4
Total amount transferred to Puerto Rico	208.7	197.5	201.5
Transfer of tax on Puerto Rican Rum	192.9	180.2	184.2
Share of tax on foreign rum	16.5	17.2	16.4
Audit adjustments	0.2	1.2	1.6
Subtraction for Treasury's enforcement expenses	(0.9)	(1.1)	(0.7)
Amount retained by Treasury due to limitation on rate of transfer	54.5	50.9	40.2

Note: Tax collections are net of refunds and drawbacks to producers.

Source: Department of the Treasury, Bureau of Alcohol, Tobacco, and Firearms and GAO computations.

Table III.6: Federal Excise Taxes on Virgin Island Rum and Revenue Shares Transferred to the Virgin Islands

Dollars in millions

	1992	1993	1994
Tax collected on Virgin Island Rum	$36.0	$39.3	$35.6
Total amount transferred to the Virgin Islands	31.5	31.8	32.4
Transfer of tax on Virgin Island Rum	28.0	30.6	29.0
Share of tax on foreign rum	2.9	2.5	2.6
Audit adjustments	0.6	(1.2)	0.7
Amount retained by Treasury due to limitation on rate of transfer	8.0	8.7	6.6

Note 1: Tax collections are net of refunds and drawbacks to producers and the 1 percent deducted to cover Treasury's expenses.

Note 2: Numbers do not add due to rounding.

Source: Department of the Treasury, Bureau of Alcohol, Tobacco, and Firearms and GAO computations.

CUSTOMS DUTIES

The federal government collects tariffs on goods imported into "U.S. customs territory." U.S. customs territory includes the 50 states, the District of Columbia, and Puerto Rico.[9]

U.S. customs duties collected in Puerto Rico are deposited into a special U.S. Treasury account. After such items as refunds and the expenses of administering customs activities in Puerto Rico are deducted, the remaining amounts are transferred to the Treasury of Puerto Rico. Table III.7 shows these collections and transfers as well as similar amounts for the Virgin Islands.

Although American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands are outside U.S. customs territory, Customs officials help collect local duties in the Virgin Islands. These collections are deposited into a separate fund and, after Customs' operational expenses and other amounts are deducted, transferred to the Virgin Islands.

Items imported into U.S. customs territory from American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands are subject to U.S. customs duties unless they are exempt. According to a Department of the Interior official, as a practical matter, items that do not qualify for duty exemption are not imported, and U.S. customs duty on imports from the territories is not an issue.

[9]Under the authority of the Tariff Act of 1930, Puerto Rico has imposed its own duty upon coffee entering the island from foreign or U.S. sources.

Table III.7: Customs Amounts Collected in, and Transferred to, Puerto Rico and the Virgin Islands, Fiscal Years 1990-1994

Dollars in millions

	Fiscal year				
	1990	1991	1992	1993	1994
Collections in Puerto Rico	$116.4	$116.7	$123.5	$133.3	$164.5
Transfers to Puerto Rico	92.5	92.4	93.4	100.0	132.8
Collections in the Virgin Islands	9.6	9.2	9.1	10.4	9.5
Transfers to the Virgin Islands	4.7	4.5	5.2	6.6	5.3

Note: Collections include duties collected in Puerto Rico and the Virgin Islands and collections made on behalf of the two locations in other Customs districts.

Source: U.S. Customs Service.

ECONOMIC AND DEMOGRAPHIC CHARACTERISTICS OF THE TERRITORIES

	Puerto Rico	Virgin Islands	Guam	American Samoa	Northern Mariana Islands	United States
Land area (sq. miles)	3,459	135	209	77	184	3,539,244
Population (1994, in thousands)	3,802	97.6	149.6	55.2	49.8	260,714
Median age in years (1990)	28.4	28.2	25.0	20.9	27.4	32.8
Labor force (1992 in thousands)	1,170	45.5	46.9[b]	14.4[b]	28.7[b]	129,525[e]
GDP or GNP (1992 in billions)	$26.8	$1.2[a]	$2[c]	$0.128[c]	$0.541	$6,379[e]
Nation product per capita (1992)	$7,100	$11,000[a]	$14,000[c]	$2,600[c]	$11,500	$24,700[e]
Unemployment rate (1993)	18%	3.7%[d]	2%[d]	12%[d]	N/A	6%[d]
Main economic sector	Manufacturing	Tourism	Tourism	Tuna canneries	Tourism	Varied

[a]1987
[b]1990
[c]1991
[d]1992
[e]1993
[f]1994

Sources: The World Factbook 1994, November 9, 1994; Statistical Abstract of the United States, 1994, September 1994.

LOCAL INCOME TAXES PAID BY INDIVIDUALS AND CORPORATIONS TO THE TERRITORY GOVERNMENTS

The income tax laws of the United States are in effect in the U.S. Virgin Islands, Guam, the Northern Mariana Islands, and American Samoa as their local income tax systems. To transform the Internal Revenue Code into a local tax code, each territory substitutes its name for the "United States" in the Code where appropriate. These local income tax systems, known as "mirror" systems, were established to create a source of revenue for the territory governments and to lessen the need for direct federal appropriations.

While the Virgin Islands, the Northern Marianas, Guam, and American Samoa each has a "mirror" tax code, the tax relationship of each with the United States is governed by different rules. The Naval Service Appropriations Act of 1922 provided that "the income tax laws now in force in the United States and those which may hereafter be enacted shall be held to be likewise in force in the Virgin Islands." However, the proceeds of the taxes were to be paid into the Virgin Islands treasury. The Virgin Islands has the authority to impose nondiscriminatory local income taxes in addition to mirror taxes. The Internal Revenue Code restricts the ability of the Virgin Islands to reduce or rebate taxes on income that is not from Virgin Island sources or earned by residents of the Virgin Islands or domestic corporations.

The Guam Organic Act of 1950 established a mirror system in Guam. An individual resident of Guam is required to file only one tax return if he or she is a Guamanian resident on the last day of the taxable year. Taxes paid to the United States can be claimed as a credit against Guamanian taxes. The Northern Marianas Covenant required the Marianas to implement the mirror system in substantially the same way the mirror system was in effect in Guam. U.S. law also provided that the Northern Marianas could, by local law, impose additional taxes and permit tax rebates, but only for taxes on local income.

While American Samoa also has a mirror system, the local income tax system in American Samoa has been created by local law. In 1963, American Samoa enacted legislation adopting the Internal Revenue Code as its local income tax.

The Tax Reform Act of 1986 granted authority to Guam, American Samoa, and the Northern Marianas to determine their own tax laws rather than applying the mirror system, provided that a bilateral agreement is implemented between the United States and a particular territory on a number of double taxation and information-exchange issues. As of this date, only American Samoa has executed an implementation agreement.

In 1918, Congress authorized Puerto Rico to enact its own income tax system. The Puerto Rican Income Tax Act was adopted by the Puerto Rican legislature using the 1939 U.S. Internal Revenue Code as a model. Puerto Rico taxes individuals only if they are resident in Puerto Rico or have Puerto Rican-source income.

Apart from its different tax rates and different values for personal exemptions and the standard deduction, Puerto Rico's individual income tax is broadly similar to the U.S. federal income tax on individuals.[10] One significant divergence between the two taxes is the favorable treatment that the Puerto Rican tax provides to income from investments in Puerto Rico.

Up to $2,000 of interest received from banks and thrift institutions in Puerto Rico may be excluded annually. Amounts in excess of $2,000 are to be taxed at a flat rate of 17 percent. Dividends received from Puerto Rico corporations, and from corporations that have derived 80 percent or more of their gross income during the preceding 3-year period from Puerto Rican sources, are eligible to be taxed at a flat rate of 20 percent. Capital gains are also to be taxed at a flat rate of 20 percent.

Other individual income is taxed according to a graduated rate schedule, ranging from 9 percent on taxable income below $2,000 ($1,000 for married couples filing separately) to 36 percent on taxable incomes above $30,000 ($15,000 for married couples filing separately).

Puerto Rico imposes a 22-percent tax on the worldwide income of Puerto Rico corporations. The same tax applies to resident foreign corporations on their Puerto Rico-source income and to certain foreign income effectively connected with Puerto Rico operations. Puerto Rico also imposes an alternative minimum tax with the same 22 percent rate as the regular tax, but with a broader definition of income.

Businesses may receive tax incentives if they manufacture products that are new to the island or are specially designated. These businesses may obtain partial exemptions from income, property, and municipal taxes for periods of up to 25 years, depending on where they are located in Puerto Rico.

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[10]The Description of Puerto Rico's income tax system in this appendix is based on Price Waterhouse, Corporate Taxes: A Worldwide Summary, 1992; Price Waterhouse, Individual Taxes: A Worldwide Summary, 1994; and Commonwealth of Puerto Rico, Department of Treasury, Individual Income Tax Return, 1991. The description does not reflect the changes made to the Puerto Rico income tax laws in 1994.

APPENDIX V

Tables V.1 through V.5 show the revenues collected from local taxes in the territories, including any taxes transferred from the U.S. government.

APPENDIX V

Table V.1: Local Taxes and Fees Collected in Puerto Rico

Dollars in millions

Type of revenue	1990	1991	1992	1993[a]
Property tax	$170.0	$200.0	$75.5	$80.3
Income tax on individuals	1,025.1	1,123.7	1,122.3	1,241.9
Income tax on corporations and partnerships	843.8	941.9	1,032.5	987.4
Other income taxes	196.9	265.9	192.7	183.1
Inheritance and gift tax	0.8	1.4	1.1	1.1
Excise taxes	985.7	951.2	982.3	1,099.2
Licenses	46.4	43.3	51.2	55.7
Nontax revenues	232.2	221.0	294.4	323.7
Total revenue from local sources	$3,500.9	$3,748.5	$3,752.1	$3,972.3

[a]These are preliminary numbers.

Source: Planning Board of Puerto Rico, Economic Report to the Governor, 1993.

Table V.2: Local Taxes and Fees Collected in American Samoa

Dollars in millions

Type of revenue	1990	1991	1992	1993
Taxes	$25.3	$33.7	NA	NA
Licenses and permits	0.4	0.4	NA	NA
Charges for service	6.8	6.9	NA	NA
Fees and fines	0.7	0.7	NA	NA
Miscellaneous	0.8	0.7	NA	NA
Total	$34.0	$42.4	NA	NA

Note: Includes mirror taxes and revenue transfers established by federal law. In 1991, the income tax on individuals yielded $7.4 million and the income tax on corporations yielded $4.2 million.

Sources: Department of the Interior, A Report on the State of the Islands, June 1994 and officials in the Office of Territorial and International Affairs, Department of the Interior.

Table V.3: Local Taxes and Fees Collected in Guam

Dollars in millions

Type of revenue	1990	1991	1992	1993
Taxes	$413.0	$497.9	$518.5	$494.5
Licenses, fees, and others	10.0	13.4	10.6	12.7
Uses of money and property	17.1	18.5	12.9	10.5
Other	13.4	9.1	8.7	9.6
Total	$453.5	$538.9	$550.7	$527.3

Note: Covers general fund revenues and includes mirror taxes and revenue transfers established by federal law. In 1990, income taxes yielded $261.6 million. Transfers of U.S. income taxes were as follows: $43.9 million in 1990, $35.3 million in 1991, $52.6 million in 1992, and $66.3 million in 1993.

Sources: Department of the Interior, A Report on the State of the Islands, June 1994; U.S. Executive Office of the President, Budget of the United States Government, various years; and officials in the Office of Territorial and International Affairs, Department of the Interior.

APPENDIX V

Table V.4: Local Taxes and Fees Collected in the Northern Marianas

Dollars in millions

Type of revenue	1990	1991	1992	1993
Individual income tax	$14.2	$16.9	$18.5	$22.5
Corporate income tax	2.5	3.6	3.2	4.0
Gross receipt tax	46.4	60.2	56.5	63.2
Excise tax	22.6	22.8	22.4	28.7
Hotel room tax	4.6	5.3	6.5	6.0
All other taxes	20.6	27.3	27.5	33.0
Total	$110.8	$136.0	$134.6	$157.5

Note 1: Includes mirror taxes and revenue transfers established by federal law.

Note 2: Numbers do not add due to rounding.

Source: Department of the Interior, A Report on the State of the Islands, June 1994.

Table V.5: Local Taxes and Fees Collected in the Virgin Islands

Dollars in millions

Type of revenue	1990	1991	1992	1993
Individual income tax	$145.2	$183.9	$193.4	$205.6
Corporate taxes	28.5	41.5	30.9	33.8
Real property	29.3	27.8	40.1	50.1
Excise	14.6	15.2	16.0	18.5
Hotel	1.1	--	--	--
Gross receipts tax	--	--	--	88.4
Other taxes	68.2	81.1	84.3	3.8
Other revenues	66.4	37.7	11.9	16.6
Contributions, other funds	2.0	30.0	18.5	34.2
Total	$355.4	$417.3	$395.0	$451.0

Note 1: Includes mirror taxes and revenue transfers established by federal law.

Note 2: The above figures are subject to $40.9 million in tax refunds and other charges.

Note 3: Numbers do not add due to rounding.

Source: Department of the Interior, A Report on the State of the Islands, June 1994.

APPENDIX VI

IRS RESOURCES AND PROGRAMS IN THE TERRITORIES

According to IRS, its programs in the territories are operated out of Puerto Rico. There were 197 IRS staff in the territories at a budgeted cost of $11.3 million in fiscal year 1994. Of the 197, 190 were in Puerto Rico, 4 were employees in the Virgin Islands, and 3 were employees in Guam. The employees in the Virgin Islands and Guam were revenue officers and clerical staff. The people stationed in Guam also serve American Samoa and the Northern Mariana Islands.

The IRS programs in the territories include Taxpayer Services, Collections, and Examinations. In addition, the Criminal Investigations Division has a branch in Puerto Rico to investigate matters relating to money laundering and drug trafficking throughout the Caribbean and Latin America. For the most part, the IRS programs in Puerto Rico serve not only those in the territories, but many U.S. taxpayers living outside of the country. For instance, Taxpayer Services in Puerto Rico serves walk-ins and telephone callers from Puerto Rico and also handles callers from the Caribbean and Latin America. Collections operates an Automated Collection System that handles calls from the Caribbean and Latin America and a Special Procedures group that handles suits that require the services of a lawyer or court to settle. Examinations handles worldwide corporate tax returns and does tax audits relating to employment taxes in Puerto Rico, casinos, money laundering and drug trafficking.

FEDERAL EXPENDITURES IN THE U.S. TERRITORIES, BY PROGRAM

Table VII.1: Federal Expenditures in the U.S. Territories and in the United States, FY 1993

Dollars in millions

	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	Territories Total	United States
Grants to local governments	$59	$161	$47	$3,132	$181	$3,580	$195,201
Salaries and wages	3	472	3	619	36	1,133	166,189
Direct payments for individuals	18	137	4	4,484	125	4,768	650,953
Procurement	11	166	1	410	33	621	201,369
Other programs	6	17	1	153	5	182	46,500
Total	$98	$952	$56	$8,798	$380	$10,284	$1,260,213

Source: Federal Expenditures by State for Fiscal Year 1993, Bureau of the Census, 1994.

Table VII.2: Federal Grants to the U.S. Territories and to the United States, FY 1993

Dollars in millions: The number "0" in this table represents an amount between $500 and $500,000, and the notation "--" represents an amount less than $500.

Department of Agriculture						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Agricultural Marketing Service	$--	$--	$--	$0	$0	$465
Cooperative State Research Service	0	1	1	8	1	387
Extension Service	0	1	0	4	1	438
Farmers Home Administration	--	--	--	13	0	287
Food and Nutrition Service						
Child Nutrition Program	6	3	0	131	5	6,340
Food Stamp Program	--	2	4	1,019[a]	2	3,106
W.I.C.	--	4	--	116	5	2,839
Commodity Distribution	--	0	0	6	0	226
Other	0	0	0	8	0	547
Total	6	9	4	1,280	12	13,058
Food Safety and Inspection Service	--	--	--	--	--	36
Forest Service	--	--	0	0	0	396
Soil Conservation Service	--	--	--	0	--	92
Total grants, Dept. of Agriculture	$6	$11	$5	$1,303	$14	$15,159

Department of Commerce						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Economic Development Administration	$0	$0	$0	$6	$3	$209
National Oceanic and Atmospheric Admin.	1	1	0	2	1	263
National Telecommunications and Information Administration	--	--	--	0	--	19
Total grants, Department of Commerce	$1	$1	$0	$8	$4	$491

Department of Defense						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
National Guard	$--	$0	$--	$1	$0	$236
Corps of Engineers	--	--	--	--	--	6
Total grants, Dept. of Defense	$--	$0	$--	$1	$0	$242

Department of Education						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Bilingual education and minority language affairs	$--	$0	$--	$1	$--	$101
Educational research and improvement-libraries	0	0	0	2	0	159
Office of Elementary and Secondary Education						
Compensatory education for disadvantaged	4	4	3	262	9	6,582
School improvement programs	3	6	2	42	5	1,903
Other	--	--	--	1	0	559
Total	7	10	5	305	14	9,044
Office of Postsecondary Education	--	0	--	1	0	119
Office of Special Education and Rehabilitative Services						
Education for the handicapped	2	6	2	18	4	2,356
Rehabilitation services and handicapped research	1	2	0	32	2	1,804
Total	3	8	2	50	6	4,160
Office of Vocational and Adult Education	0	1	0	22	1	1,133
Other	0	0	--	0	0	23
Total grants, Dept. of Education	$10	$18	$7	$381	$21	$14,740

Environmental Protection Agency						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Construction of wastewater treatment works	$--	$1	$1	$17	$1	$2,126
Abatement, control, and compliance	--	1	1	3	1	663
Hazardous substance response trust fund	--	0	0	2	0	239
Total grants, Environmental Protection Agency	$--	$2	$2	$22	$2	$3,028

Federal Emergency Management Agency						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Disaster relief	$0	$16	$0	$9	$11	1,155
Emergency planning, preparedness, and mitigation	--	0	--	1	0	106
Total grants, Federal Emergency Management Agency	$0	$16	$0	$10	$11	$1,261

Department of Health and Human Services						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Administration for Children and Families						
Family support payments (AFDC)	$--	$6	$--	$88	$4	$15,641
Social services block grant	0	0	0	14	3	2,771
Children and family services	3	4	2	135	6	3,907
Foster care and adoption assistance	--	--	--	--	--	2,770
Low-income home energy assistance	0	0	0	2	0	1,346
Community services block grant	0	0	0	17	0	458
Refugee assistance	--	--	--	--	0	435
Assistance for legalized aliens	--	--	--	--	--	582
Other	--	0	--	6	0	437
Total	3	10	3	261	13	28,347
Medicaid	1	2	1	74	3	75,774
Public Health Service	1	3	0	39	4	1,834
Alcohol, Drug Abuse, and Mental Health Administration	0	1	0	17	0	1,338
Social Security Administration - supplemental security income	--	--	--	--	--	34
Total grants, Dept. of Health and Human Services	$5	$16	$4	$391	$20	$107,326

Department of Housing and Urban Development						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Community development	$0	$1	$--	$119	$2	$3,198
Emergency shelters and homeless assistance	0	0	-	2	0	76
Low rent housing-operating assistance	--	0	--	63	20	2,453
Lower income housing assistance						
Housing payments-section 8	--	6	4	155	0	9,239
Public housing	--	0	5	73	27	3,199
Housing payments-college housing	--	--	--	0	--	19
Total	--	6	9	228	27	12,457
Other	--	0	--	19	2	871
Total grants, Dept. of Housing and Urban Development	$0	$9	$10	$432	$50	$19,056

Department of Interior						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Bureau of Land Management						
Payments in lieu of taxes and shared revenues	$--	$0	$--	$0	$0	$178
Fish and Wildlife Service	1	1	1	4	1	373
National Park Service						
Land and water conservation	--	--	0	0	0	24
Preservation of historic properties	0	0	0	0	0	30
Urban parks and recreation	--	--	--	0	--	7
Total	0	0	0	0	0	61
Office of Territorial Affairs	25	70[b]	9	--	33[c]	162
Total grants, Dept. of the Interior	$27	$71	$10	$4	$35	$1,566[d]

Department of Justice						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Total grants, Dept. of Justice	$1	$1	$1	$8	$1	$853

Department of Labor						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Employment and Training Administration						
Job Training Partnership Act	$0	$3	$0	$102	$3	$3,291
State unemployment insurance and employment service	0	1	--	27	2	3,436
Community service employment for older americans	1	1	0	1	1	84
Total	1	5	0	130	6	6,811
Occupational Safety and Health Administration	--	0	--	2	0	87
Other	--	--	--	--	--	5
Total grants, Department of Labor	$1	$4	$1	$131	$6	$6,903

Department of Transportation						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Coast Guard	$0	$0	$0	$0	$0	$34
Airport and airway trust fund	1	3	3	15	6	1,931
Federal Highway Administration						
Highway trust fund	4	7	4	68	8	16,152
Motor carrier safety grants	0	0	--	0	--	63
Other	1	0	0	0	0	313
Total	5	7	4	68	8	16,528
Federal Transit Administration	--	1	--	21	1	3,516
Other	0	0	0	1	0	144
Total grants, Department of Transportation	$7	$11	$8	$106	$15	$22,153

Department of the Treasury						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Total grants, Dept. of Treasury	$--	$--	$0	$325[a]	$--	$439

Department of Veterans Affairs						
Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Total grants, Dept. of Veterans Affairs	$--	$--	$--	$6	$--	$236

Note: Totals may not be the sum of the detailed amounts due to rounding.

[a]The amount shown is for the nutritional assistance block grant program, which is administered differently from the regular food stamp program in the states (see table VII.3).

[b]Includes transfers of income tax revenues.

[c]Includes transfers of excise tax revenues.

[d]Total grants in this column may not be the sum of the detailed amounts because certain programs were not included.

[e]Includes transfers of customs duties and excise tax revenues.

Source: Federal Expenditures by States for Fiscal Year 1993, Bureau of the Census, 1994 and officials in the Office of Territorial and International Affairs, Department of the Interior.

'able VII.3: Federal Direct Payments for Individuals in the U.S. Territories ınd for Those in the United States, FY 1993

)ollars in millions: The number "0" in this table represents an amount between ;500 and $500,000, and the notation "--" represents an amount less than $500.

Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Social Security						
Retirement insurance payments	$5	$26	$--	$1,321	$40	$203,804
Survivors insurance payments	5	15	--	576	14	60,337
Disability insurance payments	3	5	--	705	8	33,805
Total Social Security	$14	$45	$--	$2,602	$63	$297,945
Medicare						
Hospital insurance payments	$--	$3	$--	$276	$7	$100,594
Supplementary medical insurance	--	3	--	257	5	54,128
Total Medicare	$--	$6	$--	$533	$12	$154,722
Federal retirement and disability payments						
Civilian	$0	$27	$--	$90	$5	$35,573
Military	2	22	0	68	2	25,752
Total	$2	$49	$0	$158	$7	$61,325

Program	American Samoa	Guam	Northern Marianas	Puerto Rico	Virgin Islands	United States
Federal payments for unemployment compensation	--	--	--	319	8	34,930
Veterans compensations, pensions and other benefits	2	5	0	338	3	17,482
Supplemental security income payments	--	--	2	--	--	21,137
Food stamps[a]	--	17	--	--	19	22,033
Social insurance payments for railroad workers	0	--	--	2	0	7,920
Housing assistance	0	12	--	181	11	10,496
Pell grant program	0	1	1	297	1	5,872
Excess earned income tax credits	--	--	--	--	--	10,183
National guaranteed student loan interest subsidies	0	--	--	3	0	1,311
Federal workers compensation	0	1	--	11	0	1,822
Black lung payments	0	0	--	0	0	1,343
Other	0	1	0	40	1	2,430
Total direct payments for individuals	$18	$137	$4	$4,484	$125	$650,952

Note: Totals may not be the sum of the detailed amounts due to rounding.

[a]The food stamp entry for Puerto Rico is not comparable to the entries for the other locations, because, as shown in table VII.2, food stamps are supplied to Puerto Rico in the form of block grants.

Source: Federal Expenditures by State for Fiscal Year 1993, Bureau of the Census, 1994.

THE EXTENT TO WHICH RESIDENTS OF THE TERRITORIES PARTICIPATE IN FEDERAL SOCIAL PROGRAMS

This appendix briefly describes the extent to which six social programs are extended to residents of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands. Total federal expenditures for each of the programs in each of the territories, where applicable, is also included in the description. In addition, this appendix presents estimates prepared by the Congressional Budget Office (CBO) on additional costs to the federal government of extending these programs to Puerto Rico as they operate in the states.

FOOD STAMP PROGRAM

The food stamp program established by the Food Stamp Act of 1964 (P.L. 88-525) is designed to improve the diets of individuals in low-income households by increasing their purchasing power through the provision of food coupons. Guam and the Virgin Islands operate a food stamp program like that in the 50 states and the District of Columbia. However, effective July 1982, Congress replaced the food stamp program in Puerto Rico with a block grant program, and a variant of the food stamp program began operating in the Northern Marianas. The program is not extended to American Samoa.

Amendments to the Food Stamp Act directed that traditional food stamp assistance in the Commonwealth of Puerto Rico be ended and replaced with an annual "block grant" of federal funds--the Nutrition Assistance Program (NAP). The amount of funds was reduced and the standards were tightened to cope with the funding reduction. The 1990 act reauthorizing food stamp appropriations through fiscal year 1995 (P.L. 101-624) set Puerto Rico's block grant at $1.0 billion in fiscal year 1994 and $1.1 billion in fiscal year 1995. Under this new version of the food stamp program, Puerto Rico was given rein to design its own initiatives for nutrition assistance to the needy without reference to the federal rules of the food stamp program. The Committee on Ways and Means[11], U.S. House of Representatives, reported that in fiscal year 1993 Puerto Rico's NAP helped about 1.44 million people per month with monthly benefits averaging $58 per person.

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[11]U.S. Congress, House Committee on Ways and Means, Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means,1994.

Under the terms of the 1976 Covenant with the Commonwealth of the Northern Mariana Islands and implementing legislation (P.L. 96-597), a variant of the food stamp program was negotiated with the Commonwealth, and it began operations in July 1982. The Committee on Ways and Means reported that in fiscal year 1993 the Northern Mariana's program helped about 2,900 people per month with monthly benefits averaging $72 per person.

The differences between the regular food stamp program, the NAP in Puerto Rico, and the food stamp program in the Northern Marianas are summarized in table VIII.1.

Table VIII.1: Differences of the Puerto Rico and Northern Marianas Nutrition-Related Assistance Programs from the U.S. Food Stamp Program

Puerto Rico	Northern Marianas
Funding is limited to an annual amount specified by law (for fiscal year 1995 Congress appropriated $1.1 billion).	The program is funded entirely by federal money, up to a maximum grant of $3.7 million per year.
Maximum benefit levels are about one-quarter less than in the 48 contiguous States and the District of Columbia.	Maximum benefits are about 20 percent higher than in the 48 contiguous States and the District of Columbia.
Income and liquid assets eligibility limits are about half those used in the regular food stamp program.	Income eligibility limits are about half those in the regular program.
Benefits are paid in cash (checks) rather than food stamp coupons.	A portion of each household's food stamp benefit must be used to purchase locally produced food.
The Food Stamp Act allows the Commonwealth a great deal of flexibility in program design, as opposed to the regular program's extensive federal rules.	
NAP participants must meet more restrictive participation criteria than regular food stamp program recipients.	
Different rules are used in counting income for eligibility and benefit purposes.	

Source: U.S. Department of Agriculture, The Nutrition, Health, and Economic Consequences of Block Grants for Federal Food Assistance Programs, January 1995.

AID TO FAMILIES WITH DEPENDENT CHILDREN

AFDC is a formula grant through which cash payments are provided for needy children who are deprived of parental support. AFDC is authorized by Title IV-A of the Social Security Act, as amended (42 U.S.C. 601). Currently, only Guam, Puerto Rico, and the Virgin Islands operate a limited AFDC program. Although 1988 legislation provided that American Samoa could participate in the AFDC program, as of April 1994 it had not chosen to do so. The Northern Mariana Islands do not operate an AFDC program; however, section 502 of Public Law 94-241 specifies that all federal services and financial assistance programs applicable to Guam shall be applicable to the Northern Marianas. The 50 states and the District of Columbia receive open-ended funding, with a minimum federal matching rate for benefits of 50 percent and a maximum federal matching rate of 83 percent. However, federal funding for the AFDC programs in the three territories is limited to a 75-percent match subject to a cap for the territories' combined AFDC, adult assistance, and foster care expenditures. The ceilings are as follows: Guam--$3.8 million, the Virgin Islands--$2.8 million, and Puerto Rico--$82 million. Federal expenditures in fiscal year 1993 in each of the covered territories were Guam--$6 million, Puerto Rico--$88 million, and the Virgin Islands--$4 million.

MEDICAID

Medicaid is a federal-state matching program providing medical assistance to low-income persons. It was enacted in 1965 (P.L. 89-97) as Title XIX of the Social Security Act, as amended (42 U.S.C. 1396). Medicaid is available in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands. Each state and territory designs and administers its own Medicaid program within broad federal guidelines. Federal matching percentages vary by state; however, the federal matching rate for the states is no more than 83 percent. The federal share in the territories is fixed at 50 percent and total federal funding is subject to a cap. The cap on the amount each territory can receive is as follows: American Samoa--$1.45 million, Guam--$2.5 million, the Northern Marianas--$0.75 million, Puerto Rico--$79 million, and the Virgin Islands--$2.6 million. Medicaid federal expenditures in fiscal year 1993 were American Samoa--$1.5 million, Guam--$2.3 million, the Northern Marianas--$0.7 million, Puerto Rico--$73.7 million, and the Virgin Islands--$2.7 million.

The Medicaid program in Puerto Rico operates under special federal funding rules and is exempt from certain requirements relating to eligibility, service coverage, and program administration. Puerto Rico is exempt from the requirement that beneficiaries be allowed to obtain services from any qualified provider. All services are provided through public hospitals and clinics. Payment amounts to the participating public facilities are based on the facilities' budgets, with the Medicaid share determined by comparing a sample of provider treatment records to Medicaid eligibility listings. In addition, Puerto Rico is exempt by statute from several rules relating to program administration. Puerto Rico is not subject to financial penalties under the Medicaid quality control system, nor is it required to operate a Medicaid management information system. However, Puerto Rico operates its own internal quality control system, which has found eligibility errors in 20 to 30 percent of the cases reviewed.

MEDICARE

The Medicare program, authorized under title XVIII of the Social Security Act, provides health insurance protection for aged and disabled individuals regardless of income. Medicare has two parts: hospital insurance (Part A) and supplementary medical insurance (SMI) (Part B). Part A of Medicare covers inpatient hospital care. Part B is a voluntary program and individuals must enroll and pay a premium to receive benefits. All persons entitled to Part A and all persons over age 65 are eligible to enroll. The Medicare program is extended to all 50 states, the District of Columbia, Guam, the Northern Marianas, Puerto Rico, and the Virgin Islands. However, the hospital prospective payment system in the Northern Marianas is not applicable. The federal expenditures in the territories for the Medicare program during fiscal year 1993 were Guam--$6 million, Puerto Rico--$532.8 million, and the Virgin Islands--$11.9 million.

In Puerto Rico the program operates like in any state, except that hospitals in Puerto Rico are reimbursed for inpatient services under a special prospective payment system (PPS) distinct from the PPS used for hospitals in the states. In addition, unlike the Medicaid program in the states, Puerto Rico's Medicaid program does not pay Medicare premiums and cost-sharing for low-income aged and disabled persons.

SUPPLEMENTAL SECURITY INCOME

The SSI program was established in 1972 under Public Law 92-603 and became effective in 1974 as title XVI of the Social Security Act, as amended. SSI is a federal program administered by the Social Security Administration that guarantees a minimum level of cash income to needy aged, blind, and disabled persons. Federal

SSI benefits and the cost of administering the program are financed from general funds of the Treasury. Guam, Puerto Rico, and the Virgin Islands do not have an SSI program, but they instead operate an adult assistance program--aid to the aged, blind, or disabled (AABD)[12]. However, the SSI program operates in the Commonwealth of the Northern Mariana Islands. Adult assistance programs are authorized under Title I of the Social Security Act--Old Age Assistance, Title X--Aid to the Blind, Title XIV--Aid to the Permanently and Totally Disabled, and Title XVI--Aid to the Aged, Blind or Disabled. Guam and the Virgin Islands operate separate programs for each needy group. Puerto Rico operates the combined Aid to the Aged, Blind or Disabled Program. The federal government provides a grant to Guam, Puerto Rico, and the Virgin Islands to meet a share of the program's cost subject to a cap. Similar to the way AFDC operates, the federal government pays a 75-percent match of assistance payments to aged, blind, or disabled persons subject to a cap for the territories' combined AFDC, adult assistance, and foster care expenditures. The caps for each territory are as follows: Guam--$3.8 million, Puerto Rico--$82 million, and the Virgin Islands--$2.8 million.

FOSTER CARE

The foster care program is authorized under title IV-E, Federal Payments for Foster Care and Adoption Assistance of the Social Security Act. The foster care program provides open-ended federal matching funds to states for maintenance payments made for AFDC-eligible children in foster care. The program is required of all states participating in AFDC. The federal matching rate for a given state is that state's Medicaid matching rate. States may also claim open-ended federal matching of 50 percent for administrative costs and of 75 percent for training costs. Currently, American Samoa, Guam, the Northern Marianas, Puerto Rico, and the Virgin Islands are eligible to participate in this program, but have chosen not to participate. Therefore, none of the territories receives funding under the Title IV-E programs. If the programs were implemented, for example, American Samoa would have a federal matching rate of 75 percent subject to the same ceiling imposed for AFDC and adult assistance programs.

[12]This was the program operating in the states before SSI became effective in 1974.

ADDITIONAL COSTS OF EXTENDING CERTAIN PROGRAMS IN PUERTO RICO[13]

Extending certain federal programs in Puerto Rico as they operate in the states would not only increase federal expenditures but also enrollment and benefits. Additional federal expenditures in fiscal year 1995 could be as much as $3 billion if food stamp, AFDC, Medicaid, Medicare, SSI, and foster care benefits were fully extended to Puerto Rico. In addition, Puerto Rico would be subject to more federal examinations, for example, in the food stamp program as all states are subject to extensive oversight by the U.S. Department of Agriculture's Food and Nutrition Service.

Food Stamps

Extending the food stamp program to Puerto Rico as it operates in any of the states would increase enrollment, benefits, and costs both to Puerto Rico and the federal government. CBO estimated that for fiscal year 1995 federal spending could increase about $700 million. The increase in federal spending would be as a result of higher benefits and larger administrative costs. On the other hand, Puerto Rico would become liable to the federal government for limited quality control sanctions if its rate of erroneous eligibility and benefit determinations exceeded food stamp program tolerance levels. At that time, it would have to return to the federal government the majority of any improperly issued benefits that were recouped.

AFDC

If AFDC funding were extended to Puerto Rico as in the states, the cap on federal funding would be removed and the federal matching rate would be raised from 75 percent to the maximum permitted by law, 83 percent. CBO estimated that in fiscal year 1995 AFDC federal spending could increase by $100 million.

SSI

If Puerto Rico were treated like the states, SSI would replace AABD, probably providing much larger benefits and much higher eligibility limits. Puerto Rico no longer would have to pay the 25 percent matching rate required under the AABD program. In addition, the SSI program would cover disabled children, excluded from the AABD program. CBO estimated a $900 million increase in

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[13]All estimates in this section were prepared by CBO in 1990 in its paper Potential Economic Impacts of Changes in Puerto Rico's Status Under S. 712.

federal spending during fiscal year 1995 for extending the SSI program to Puerto Rico.

Medicaid

If the Medicaid program were implemented in Puerto Rico as it operates in the states, CBO estimated that during fiscal year 1995 federal funding could increase by $1.2 billion. The increased benefits would be offset by requirements that Puerto Rico furnish more extensive coverage to some classes of individuals while eliminating coverage to some others. Medicaid funds might be shifted from public to private providers.

Medicare

If Medicare benefits were extended, hospitals would be paid under the national PPS. Revenues would rise by an amount less than the current payment differential, because the inclusion of Puerto Rico in the averages on which the national rates are based would reduce those rates for all hospitals. However, the major impact of extending Medicare benefits would be a significant increase in the number of Part B enrollers because in contrast to the states, Puerto Rico does not pay Medicare premiums and cost-sharing for low-income aged and disabled persons. CBO estimated for fiscal year 1995 a $100 million increase in federal spending for extending Medicare benefits to Puerto Rico.

Foster Care

If Puerto Rico were to receive funding for this program, CBO estimated that federal outlays during fiscal year 1995 would be less than $50 million.

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