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October 23, 1973

MEMORANDUM FOR THE MARIANAS POLITICAL STATUS COMMISSION

Subject: Customs and Excise Taxes for the Marianas

One of the issues for discussion at the November 1973 U.S.-Marianas status negotiations is the extent to which the Marianas will have control of the customs laws and excise taxes applicable to the sale, import and export of goods.

It may be useful to state at the outset what is meant by the terms "customs" and "excise taxes." "Customs" refers to the schedule of taxes that are levied by a nation on goods entering or leaving its territory. The taxes may be based on the value or the quantity of the goods. "Excise taxes" are taxes levied on the manufacture or sale of goods within a nation's borders. There may be considerable overlap between the two forms of tax. For example, coconut oil may be imported into a country upon payment at the port of entry of a customs tax and also an excise tax equal to the tax that would have been payable had the coconut oil originally been processed within the country.

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This memorandum sets forth the results of our research and analysis in these two related areas. As an introduction to the body of the memorandum, we identify the principal issues and state our conclusions and recommendations. The memorandum then takes up each of these issues in turn, outlines the major alternatives, and gives the reasons for reaching our conclusions.

Attached to the memorandum is an appendix setting forth the customs and excise tax laws now applicable in Puerto Rico, Guam, American Samoa, the Virgin Islands and the Trust Territory of the Pacific Islands ("TTPI").

#### Introduction and Recommendations

##### A. CUSTOMS LAWS

The principal question is whether the Marianas are to be part of the "customs territory of the United States," that is, whether imports to the Marianas are to be treated as imports into the United States and thus subject to the same customs taxes as like goods entering the United States, or whether the Marianas are to be free to enact their own schedules of customs taxes. Different results follow depending on the answer to that question. Thus, if the Marianas is part of the customs territory of the United States, trade between the Marianas and the United States will be free of any customs taxes; imports to the Marianas from countries outside the customs territory of the United States will be

taxed at the rates applicable to like imports into the United States; and exports from the Marianas to foreign countries will be treated in those countries as exports from the United States. On the other hand, if the Marianas is not part of the customs territory of the United States, trade between the Marianas and the United States will not automatically be free of customs taxes, though it may be; imports to the Marianas may be taxed at the port of entry at whatever rates the Marianas government may choose; and exports from the Marianas to other countries should not automatically be treated by those countries as exports from the United States. At present the TTPI is not included within the customs territory of the United States.

1. General Conclusion. It is our general conclusion that the Marianas should not be included in the customs territory of the United States and that the Marianas government should have complete control over its own customs laws. A breakdown of the further specific conclusions with respect to customs laws follows.

2. Imports into the Marianas from the United States should be free of customs taxes, at least at the beginning. The Marianas should, however, have the right to enact customs laws applicable alike to goods from the United States and elsewhere. If the United States seeks assurances that the

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Marianas will not discriminate against United States goods, the Marianas should grant such assurances.

3. Imports into the Marianas from Countries

Outside the Customs Territory of the United States should be free of customs taxes, at least at the beginning. The Marianas should, however, have the right to enact customs laws applicable alike to goods from the United States and elsewhere.

4. Exports from the Marianas to the United States

should enter the United States free of customs taxes. The United States should be asked to agree to this principle; however the United States may wish to protect itself against unrestricted entry of purely foreign products that received only minimal processing in the Marianas on their way to the United States. In the past it has secured such protection by means of a percentage limitation on foreign material; the Marianas should seek a higher percentage limitation than that presently in effect for exports to the United States from its other insular possessions.

5. Exports from the Marianas to Countries Outside the Customs Territory of the United States will be subject

to such import taxes as may be negotiated with those countries. The United States should be asked to agree in principle to treatment of the Marianas as a "developing country" for purposes of the United Nations Conference on Trade and Development ("UNCTAD") and to agree to negotiate such status on behalf of the Marianas.

6. Export Duties. The Marianas government should be free to impose export taxes on any exports from the Marianas. The status agreement should expressly exempt the Marianas from the application of the constitutional prohibition against such taxes contained in U.S. Constitution, Article 1, Section 9, Clause 5, if there is any doubt whether that prohibition would otherwise apply.

B. EXCISE TAXES; REVENUE ON MARIANAS GOODS TO BE RETURNED TO THE MARIANAS.

The issues with respect to excise taxes are much less complex than those with respect to customs. With respect to internal excise taxes, no reason whatever appears why those taxes should not remain within the exclusive control of the Marianas government.

It is likely that goods entering the United States from the Marianas will be subject to the same excise taxes as like goods manufactured or sold in the United States. Any revenues so collected in the United States should be returned to ("covered into") the treasury of the Marianas.

It is also possible that, by virtue of a percentage limitation on foreign materials, certain goods entering the United States from the Marianas may be subject to some or all of the customs taxes ordinarily imposed on foreign goods. In that event any revenues so collected should likewise be covered into the Marianas treasury. A summary of these conclusions follows:

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1. Internal Excise Taxes, if any, imposed on the manufacture or sale of goods in the Marianas should remain within the exclusive control of the Marianas government.

2. Customs or Excise Taxes Collected in the United States on goods imported from the Marianas should be "covered into" the Marianas treasury.

### Discussion

#### A. CUSTOMS LAWS

1. General Conclusion. The Marianas Should Not Be a Part of the Customs Territory of the United States. This conclusion is consistent with the agreement in principle reached at the May 1973 session of the U.S.-Marianas status negotiations that the future government of the Marianas should exercise "maximum self-government" in regard to local affairs. More important, it will permit the Marianas to have a "duty-free port" if they so desire, thus reducing the cost of imported consumer goods. This consideration is of particular significance to an insular economy that is largely dependent on imports to supply the everyday needs of its inhabitants. A duty-free port may also operate as an attraction to tourists seeking bargains while visiting the Marianas. Finally, it will allow the Marianas government to tailor its customs laws to protect local industries, should such protection ever appear desirable, and will give the Marianas government a greater degree of control over the Islands' economy.

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Other advantages, and some disadvantages, are discussed below in the context of the results that flow from the General Conclusion. But on balance, the advantages to the Marianas of having autonomous control of their own customs laws manifestly outweigh any disadvantages. Accordingly, we recommend that the Marianas remain outside the customs territory of the United States. This recommendation is in accord with current practice since all insular territories and possessions of the United States, with the exception of Puerto Rico, are outside that territory.

2. Imports into the Marianas from the United States.

Since we have concluded that the Marianas should not be a part of the customs territory of the United States, no preferential treatment for imports from the United States follows automatically. The Marianas government will be free to impose any customs taxes it likes on any goods entering the Marianas from any part of the world, including the United States. We believe, however, that at least at the outset the Marianas should be a duty-free port for the reasons outlined in the General Conclusion above.

In the event the Marianas ever desires to impose customs taxes on goods entering the Marianas, it should do so even-handedly. That is, it should not accord more favorable treatment to goods entering from one nation rather than another

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since to do so would invite retaliation by the nation discriminated against. Thus, if the United States seeks assurances that the Marianas will accord goods entering the Marianas from the United States the same treatment it accords like goods entering from any other country, the Marianas should be prepared to grant such assurances.

The alternative is to have the Marianas included within the customs territory of the United States. Goods entering the Marianas from the United States could not be subject to any customs taxes whatever. Thus, should the Marianas ever seek to protect a local industry in that industry's formative years, it would not have the power to do so. To that extent, the Marianas government would have lost some degree of control over its own economy.

3. Imports into the Marianas from Countries Outside the Customs Territory of the United States. The same considerations outlined in the General Conclusion and paragraph 2 above apply with respect to customs taxes imposed on goods entering the Marianas from countries outside the customs territory of the United States. If the Marianas is not a part of that customs territory, it may choose to be a duty-free port and, should the need arise, the Marianas government will have

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the power to use a customs barrier to protect local industry.

The alternative is to have the Marianas included within the customs territory of the United States. If the Marianas is part of the customs territory of the United States, foreign goods entering the Marianas will be subject to the same customs taxes collected on like goods entering the United States; the Marianas will suffer correspondingly higher costs on consumer goods sold to both local inhabitants and tourists, and will be powerless to protect local industry.

4. Exports from the Marianas to the United States.

At least in its early stages, local industry in the Marianas will probably be labor intensive rather than capital intensive. Assuming a low wage scale for the Marianas as compared to the wage scale in more developed countries, Marianas manufactured goods may have a competitive advantage over like goods manufactured in the more developed countries. This advantage will be lost if Marianas manufactured products are subject to a high customs tax at the foreign port of entry. Accordingly, in order to encourage the development of local industries producing goods for export to other countries, the Marianas government must seek preferential customs tax rates for its exports to foreign countries.

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\*/ "Labor intensive" industries use a higher proportion of manual labor in the production of goods than do "capital intensive" industries. The latter are generally associated with more industrialized societies than the former.

One such market may be the United States. In order to provide goods manufactured in the Marianas with a competitive advantage over goods manufactured in other countries outside the customs territory of the United States, the United States should be asked to agree in principle to receive goods manufactured or grown in the Marianas free of any customs taxes. As will be seen from the appendix attached hereto, other insular territories or possessions of the United States have been accorded such preferential treatment.

The United States is a signatory nation to the General Agreement on Tariffs and Trade ("GATT"). The underlying principle of GATT is that the signatory nations must accord one another the same customs tax treatment as they accord the "most favored nation." For example, if the United States imposes a customs tax of 10% on binoculars imported from Japan, the most favored nation principle requires that it must tax binoculars imported from other GATT signatory nations at the same rate.

The original GATT contract permitted an exclusive preference in tariff treatment to be given only to territories held by the contracting nations in 1939. Since the TTPI was not held by the United States in 1939, it did not fall within this special exception. Accordingly, the United States

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sought, and the other signatory nations of GATT agreed to, a special waiver in respect of the TTPI to permit the United States to accord preferential treatment to products of the TTPI. The United States was given permission to accord customs-free treatment to all products of the TTPI (except coconut oil, as to which it could impose the same tax as that applicable to coconut oil of the Philippines), but it has not done so. At present the United States does not accord preferential treatment to any imports (other than copra and coconut oil) from the TTPI into the United States.

No reason appears in the special dispensation from GATT secured by the United States why the permission to accord preferential treatment to imports into the United States from the Marianas should be considered discontinued after the relationship between the Marianas and the United States changes from a trust territory to a commonwealth arrangement. Thus, the United States should continue to be able to accord customs-free entry of Marianas goods into the United States without doing violence to its contract under GATT.

Against the possibility that one of the other contracting nations of GATT may object, however, the United States should be asked to agree in principle to preferential treatment for imports from the Marianas, and to agree to negotiate another special exception to GATT should that prove necessary.

As it has also done in the case of goods from its other insular territories or possessions, the United States may wish to protect itself against unrestricted entry of foreign products that received a minimum of manufacturing or processing in the Marianas. Thus, goods from Guam may enter the United States free of any customs taxes provided 50% or less of the value of the product (whether manufactured, produced or grown) derives from foreign materials, and if (in the case of goods manufactured in whole or in part from United States material) there was no refund of United States taxes paid upon export of the U.S. material for further manufacture in Guam. If more than 50% of the value of the product derives from foreign materials, or if there was a refund of United States taxes previously paid upon export of the U.S. material for use in the Guamanian manufactured product, then the Guamanian product is permitted to enter the United States subject to the usual customs taxes imposed by column 1 of the United States Tariff Schedules.\*

The Marianas should accept such a protective restriction if the United States requests it; but in view of the

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\*/ The Tariff Schedules imposed by the United States customs laws on goods entering the United States are contained in 19 U.S.C. § 1202. The schedules consist of a voluminous compendium of goods that may be imported into the United States, each item or category being subject to a particular tax. The tax is computed in accordance with two different rates for each category of imported goods; the rates are listed under column 1 and column 2. Generally speaking, the lower rates imposed by column 1 are applicable to goods entering the United States from all non-Communist countries; the higher rates imposed by column 2 are applicable to goods entering the United States from most Communist countries.

embryonic state of Marianas manufacturing and agriculture, the Marianas should try to negotiate a higher percentage limitation on foreign material, for instance 75%. In support of such a request, the Marianas may wish to point out that the United States has done very little to discharge its obligation undertaken in the United Nations Agreement establishing the TTPI to

"promote the economic advancement and self sufficiency of the inhabitants . . .; encourage the development of fisheries, agriculture and industries . . .; and improve the means of transportation and communication. . . ." Article 6 of the Agreement for the Trust Territory of the Pacific Islands, July 18, 1947.

Such a higher percentage limitation on foreign material would have the effect of securing a market in the United States for goods only 25% of the value of which had been added by manufacturing or processing in the Marianas, thereby further encouraging the beginnings of such industries. In the event the United States resists this request, the Marianas should ask for such preferential treatment for a term of years, subject to reconsideration at the end thereof. In any event, the Marianas should not accept a lower percentage of foreign materials restriction than that presently allowable as a condition to customs-free entry of goods from the other insular possessions of the United States (50%).

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The alternative is for the Marianas to be included within the customs territory of the United States. In that event goods manufactured in the Marianas would enter the United States free of any customs taxes; however, any foreign material used in the manufacture of such Marianas products would, upon entering the Marianas, be subject to the full United States customs taxes imposed on like foreign goods entering the United States. This disadvantage might work to discourage the commencement of local industry in the Marianas, and is a further reason for not becoming a part of the customs territory of the United States.

5. Exports from the Marianas to Countries Outside the Customs Territory of the United States. Absent some special agreement or treaty, goods entering a foreign country from the Marianas will be subject to the same customs taxes as like goods entering that country from any other foreign country. Thus, goods from the Marianas entering Japan will receive the same customs treatment as goods entering Japan from, for instance, India. However, the treatment of trade between countries is always subject to negotiation.

The United States should be asked to negotiate favorable trade treaties with other countries for the Marianas wherever possible.

One opportunity for negotiating such favorable treaties on behalf of the Marianas exists with respect to the general agreement reached by the signatory nations at the United Nations Conference on Trade and Development ("UNCTAD"). In 1970, over 120 member states of UNCTAD, including the United States, approved the proposals of 18 industrialized countries for a mutually acceptable system of generalized tariff preferences for manufactured and semi-manufactured goods from developing countries. When implemented, the generalized preferences will give certain imports from developing countries access to the markets of industrialized nations at a lower tariff rate than those imposed on like goods imported from other countries. The purposes of such a system are to increase export earnings of the developing countries, to promote their industrialization, and to accelerate their economic growth. The prospective donor countries that are also contracting parties of GATT committed themselves to seek a waiver as soon as possible of the most favored nation principle, the cornerstone of GATT, with respect to such preferences. It may be possible, with appropriate safeguards against U.S. manufactured products, to secure such preferential treatment for the Marianas by having it classified as a developing country for purposes of the UNCTAD agreement. The United States should be asked to agree in principle to such treatment for products of the Marianas

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and should be asked to commit itself to negotiate such preferential treatment on behalf of the Marianas with the other donor countries.

If the Marianas is a part of the customs territory of the United States, it is unlikely that the other member nations of UNCTAD would or could acquiesce in such a proposal. In effect, the Marianas would be a part of the United States, which is a fully-developed industrial nation. For other industrialized nations to grant such preferential treatment to exports from the Marianas would be tantamount to granting preferential treatment to a city or state in the United States.

6. Export Duties. In accordance with the agreement in principle that the future government of the Marianas would exercise "maximum self-government," the United States should be asked to permit the Marianas government to impose whatever export duties it sees fit on exports from the Marianas. The TTPI government at present may and does impose export duties.

This proposal may present some problems in the event the United States Constitution applies, in whole or in part, to the Marianas since Article 1, Section 9, Clause 5, of the United States Constitution states that "No Tax or Duty shall be laid on Articles exported from any State." In the event this Constitutional provision is thought to raise

any problems with respect to the imposition of export duties by the Marianas government, the status agreement should state expressly that the Constitutional prohibition is not applicable.

B. EXCISE TAXES; REVENUE ON MARIANAS GOODS TO BE RETURNED TO THE MARIANAS.

1. Internal Excise Taxes. No reason whatever appears why the Marianas should not have exclusive control over excise taxes imposed on the sale or manufacture of goods within the Marianas. At present the TTPI government exercises such control. As will be seen from an examination of the appendix attached hereto, all the territories and possessions of the United States have control over their own internal excise taxes.

2. Customs or Excise Taxes Collected in the United States on Goods Imported from the Marianas Should Be "Covered Into" the Marianas Treasury. At present, even goods entering the United States free of any customs taxes from territories or possessions of the United States may be subject to an excise tax equivalent to that imposed on like goods sold or manufactured within the United States. With the exception of the Virgin Islands (as to which certain matching and dollar limitations apply), all revenues so collected are held for the benefit of the territory or possession from which the goods were imported. Thereafter, the revenues so collected are returned to ("covered into") the treasury of the source territory

or possession. The United States should be asked to accord similar treatment to the Marianas.

If the United States agrees in principle, as recommended above, to duty-free treatment for imports into the United States from the Marianas, it is still possible that certain goods may enter the United States subject to the tariff rates imposed by column 1 of the United States Tariff Schedules. (This could occur if either the percentage of foreign materials limitation is exceeded, or if the manufactured product contains goods originally exported from the United States to the Marianas as to which a refund or "drawback" of United States taxes was allowed.)

At present, goods entering the United States from other territories or possessions may similarly be subject to tax imposed by column 1 of the Tariff Schedules; such customs revenues are held for the benefit of the source country and are covered into the treasury of that territory or possession. The United States should be asked to agree to similar treatment of customs revenues derived from goods imported into the United States from the Marianas.

No reason appears why the United States should not be willing to grant such treatment to the Marianas since it accords similar treatment to its other territories and possessions. Such treatment may be justified on the grounds

that the Marianas government has at least as great a need for the revenues so collected as any other territory or possession, and that such a return of revenues collected on goods exported from the Marianas to the United States will operate as an inducement to the Marianas government to encourage an export industry.

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NOTES

- P2. 1. The provisions relating to the "General Principles" are now being reworded to provide broader coverage, and will follow the style of the joint communiques.
- Sect. 105  
P. 3 2. The provisions relating to citizenship are those as proposed by the US legal group to the Marianas lawyers. Since then, the MSC legal group has submitted a counter proposal that has some merit and which we may wish to consider inserting, with some modification, into this agreement in lieu of the current language.
- SECT 304  
P. 8 3. It may be desirable to include a specific section to apply Section 1423 (d) of Title 48, as relates to oaths of affirmation and support. Further research is being done on this matter.
- ART. IV  
P. 10 4. The financial provisions may be reworked. Mr. Silver has a proposal now under consideration and the MSC legal group has surfaced some US tax provisions and customs statutes which they would like to see modified to meet the needs of the Mariana Islands. Generally, they follow current tax and customs treatment in the US territories of Puerto Rico, Virgin Islands and Guam and the MSC approach is to pick the best situation in each of these territories and have it apply to the Marianas, ie. Puerto Rico's income tax approach, Guam's customs approach and the Virgin Islands excise tax application. These are being reviewed more carefully, and we may wish to incorporate some of their suggestions into our agreement before hand.

5. The creation of a Presidential Commission to study the applicability of US laws after the Commonwealth is established is a focus of concern by the MSC legal group. Willens believes that the MSC should have the opportunity to review the laws to be extended to the Marianas and to study how these laws will affect the Mariana Islands. It is also argued that the MSC should be assured that the fundamental elements of government [such as banking and currency laws, communications laws, FAA regulations, etc.] should be available to the new Commonwealth immediately upon effect of the agreement to enable the Commonwealth government to be viable. This concern appears to be centered upon the regulatory statutes of the Federal government, rather than the US programs and services and grants available from the USG. Willens would like to have the USG present a list of statutes it feels will be essential for USG operations in the Mariana Islands and some advice on how these statutes may affect the Commonwealth. The USG has responded by noting that it might be easier to have the MSC refer to the DOJ statute print-out and assume that those statutes made applicable to Guam under its organic act will also be desired by the US Congress to apply to the Marianas. The USG has also noted that Willens appears to be asking for an impossible task, ie. to draft an Omnibus Act before we get an agreement on status, which would take several years and which is better performed by the Presidential Commission and the US Congress in consultation with the Mariana Islands. Willens appears to be very firm on this position, however, to the point of blocking <sup>the</sup> agreement until we comply.