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April 30, 1974

MEMORANDUM FOR MICHAEL S. HELFER

SUBJECT: Taxation in the Marianas

In a memorandum dated April 26, 1974 to Noel Kramer you indicated that Herman Marcuse has raised a question concerning the effect of Section I(D)(1) of the last Joint Communique. That section provides that persons who become citizens of the United States pursuant to the Status Agreement would be subject to federal income tax only on United States source income, not on income earned in the Marianas, and would not be subject to United States gift and estate taxation except with respect to property situated in the United States. Marcuse apparently asked if this special treatment would be available to those persons who are already U.S. citizens residing in the Marianas. I think the answer is and should be no.

Persons who are U.S. citizens resident in the Marianas are presently subject to the U.S. income tax (which generally taxes all U.S. citizens on their worldwide income) and to the U.S. estate and gift tax laws. Such citizens currently receive the benefit of section 911 which excludes from gross income \$20,000 (in some cases \$25,000) of income earned in a foreign country where the taxpayer is a bona fide resident or is present for a specified period of time. When the Marianas becomes a U.S. possession for tax purposes,

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section 911 will no longer apply. But Section I(D)(2) of the Joint Communique would extend section 931 to United States citizens doing business in the Marianas so that such citizens would not be subject to U.S. federal income tax on any foreign source income (including income earned in the Marianas) if they derive 80 percent of their gross income from Marianas sources and 50 percent from the active conduct of a trade or business in the Marianas.

Accordingly, I see no need to add a new section 601(b) to the Commonwealth Agreement providing in effect that U.S. citizens who are domiciled in the Marianas for five years prior to the effective date of termination would be considered as becoming U.S. citizens by virtue of the Status Agreement.

F. D. Lake

cc: H. Willens

N. Kramer

Handwritten notes:

still 2 diff:
 (1) no 80% reqt
 (2) estate + gift tax

subject to political
 criticism if lower
 taxes on these sources

Examining status. Gov to
 both groups

do it as in PR
 931 doesn't
 apply -
 base for resident
 of PR doesn't apply
 on source income

931 program for
 corporations
 P.L. 92-23

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Signature: F. D. Lake