

JOINT WORKING DRAFT

October 4, 1974

REPORT OF THE JOINT LAND COMMITTEE

INTRODUCTION

The Joint Land Committee has held three sets of working sessions since Marianas IV. The results of the first two of these sessions are discussed in a draft working report, not officially adopted, entitled "Interim Report of the Joint Land Committee" dated September 1, 1974. Since that date, the final session of the Joint Land Committee was held in Washington, D.C., starting September 19, 1974, and concluding on September 27, 1974. Many meetings were held, both at the Department of Interior and at the offices of Wilmer, Cutler and Pickering. In addition to these meetings individual meetings were held by each side. Terms of reference as approved by the principals for the United States and the Marianas Political Status Commission on August __, 1974~~4~~ are attached.

Individuals at various times present for this series of talks with the Joint Land Committee were as follows: For the United States: James Wilson, Jr., Emmett Rice, Walter Appelle, Athol Smith, Dale Strait, Saeger Poole, Roy Markon, Arthur Youngren, Joseph Samaritano,

and Verne Hilderbrand. For the Marianas: Pedro ^A Tenorio,
Jose R. Cruz, Benjamin G. Manglona, James E. White,
Howard Willens, James ^R E. Leonard, Michael Helfer, Maurice
^{Seldin}
~~Sheldon~~, Ina Bechoffer, Paul Amundsen, and Robert Greigg.

The problems faced by the Joint Land Committee in many respects were the most serious faced by the Marianas Political Status Commission and the U.S. Delegation in the whole of the negotiations. It was apparent to both sides that not all of the land problems could be resolved at the Committee level. To the maximum extent possible, all issues were discussed thoroughly, and each side presented at least tentative positions. A large measure of understanding was reached on a number of issues and technical points which are reflected in this ^R Report. But on some major issues the Committee was unable to develop a recommendation for the ^{principals.} ~~principles~~. These issues must be referred to the principals of the respective delegations in the Marianas Political Status Negotiations.

Most of the discussions during the final session of the Joint Land Committee centered on price for the land to be acquired by the United States, the port facilities at San Jose Harbor, joint use of West Field by the civilian community and general joint uses of the utilities and facilities of the military complex to be developed on Tinian. The results of these discussions are described in this ^R Report

Also discussed, ^{but} not commented upon further here, was the survey work to be completed, which the Marianas Delegation has been assured by the United States is now complete and will be made available to the Commission as a whole prior to the next Commission meeting. This survey work is to show the southern boundary of the U.S. requirements on Tinian, the boundaries at Tanapag Harbor Area and Isley Field, and descriptive language for the island of Farallon de Medinilla. Previously ~~by~~ positions relative ~~of to~~ method of acquisition and method of payment were reiterated. Both delegations felt constrained to make no change in their respective positions. The position of the United States is acquisition by purchase in fee simple. The position of the Marianas Political Status Commission is that the land should be leased to the United States for a term of fifty years with an automatic option to renew for an additional fifty years. Lease payments should be made periodically and adjusted periodically. This issue is to be referred to the principals on both delegations for further discussion.

MAJOR SUBJECTS OF DISCUSSION

I. San Jose Harbor - Tinian

The position of the United States in reference to San Jose Harbor - Tinian, is that it requires the entire

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MEMORANDUM FOR MARIANAS-UNITED STATES JOINT DRAFTING COMMITTEE

SUBJECT: Tax System in the Marianas

In order to implement the principle of maximum local self-government, the Marianas Political Status Commission early in these negotiations proposed that the status agreement recognize the right of the Marianas to develop its own internal tax laws. The MPSC also proposed general principles, based on the treatment of U.S. territories, to determine the applicability of the U.S. Internal Revenue Code to the Marianas. The United States Delegation agreed to these proposals, and this agreement is reflected in the Joint Communique of December 1973.

Since that date, however, the United States Delegation has decided that this resolution of the problem is no longer satisfactory. The reason for this decision, as we understand it, is that the Delegation has found some congressional objection to the previous agreements. The Commission continues to believe that the previous agreement was well-precedented, and was fair to all concerned. But, recognizing that there is strong feeling about this issue in Congress and desiring to continue the progress made in the negotiations to

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date, we have developed an alternative, compromise proposal which we believe is fully responsive to the reported congressional concern and may be acceptable to the Marianas Political Status Commission.

This memorandum first describes the proposal previously agreed to by both parties, and then outlines the new proposal.

THE PROPOSAL PREVIOUSLY AGREED TO

The essence of the agreement previously reached between the Commission and the U.S. Delegation concerning taxation was that the Marianas would develop its own internal tax system, and that the Internal Revenue Code of the United States would apply to the Marianas as it applies to the territories and possessions generally. As this section will demonstrate, the proposal previously agreed to was a fair and reasonable one which protected the interests of the Marianas in maximum local self-government and protected all the legitimate interests of the United States as well. Under that proposal the Marianas would not — indeed, could not — have become a tax haven for wealthy Americans, or in any fashion have impaired the economy of Guam.

Individuals. Under the proposal previously agreed to, section 931 of the Internal Revenue Code would apply to stateside U.S. citizens in the Marianas. This means that a

stateside U.S. citizen would always be taxed on his U.S. source income.^{*/} His non-U.S. source income would be exempted from federal tax if — but only if — 80 percent of his income was earned in the Marianas or other U.S. possessions and 50 percent was from the active conduct of a trade or business in such possession.^{**/} This proposal would have given the Marianas the primary right to tax Marianas source income and would have preserved the U.S. tax on U.S. source income. Thus a U.S. taxpayer with interest and dividend income of \$100,000 from U.S. sources would have been subject to a U.S. tax on the entire \$100,000 even if he resided in the Marianas. Regardless of the kind of territorial tax that might have been adopted in the Marianas, then, a wealthy stateside citizen with large amounts of passive investment income from U.S. securities could not have avoided U.S. tax simply by moving to the Marianas. And, of course, there is no reason to think the Marianas would not exercise its legislative powers responsibly to tax such persons fairly.

^{*/} Under the prior proposal a Marianas citizen who becomes a U.S. citizen or national under the status agreement would also be subject to tax on his U.S. source income, but not on foreign source income.

^{**/} The Ways and Means Committee has recently announced a number of tentative tax reform decisions, including the following proposed changes to section 931: (1) make section 931 elective, which election could not be revoked for at least ten years; (2) change the present requirement that the taxpayer obtain 50 percent of its gross income from the active conduct of a trade or business in a possession to 65 percent; (3) require that income received by a taxpayer from sources outside of the possession be currently taxable.

The requirement that a taxpayer earn 80 percent of his income in a possession and 50 percent in an active trade or business in a possession is narrowly drawn precisely to avoid making any possession a tax haven. The stateside citizen who fails to meet the percentage requirements of section 931 would be subject to U.S. tax on his worldwide income, including any Marianas source income, with a tax credit for income tax paid in the Marianas on Marianas source income. This means that even if the Marianas had no income tax, the stateside citizen would still pay the same total tax bill as he would if the Marianas adopted the Internal Revenue Code in haec verba -- the only difference being that all the revenue would be collected by the United States in the latter instance.

Corporations. One objection to the proposal previously agreed to by the United States and the Commission is that, unless the Marianas adopts the Internal Revenue Code as a territorial tax, the Marianas could provide tax incentives (through reduced corporate tax rates, for example) that might unfairly compete with neighboring Guam. Actually, the problem is precisely the reverse -- how to protect fledgling businesses in the Marianas from the competition of the more fully developed economy of Guam.

Guam presently has in force tax rebate provisions for new industry that substantially reduce the imposition of the Guam territorial income tax. Under Title LIV of the

Guam Code a system of incentives for corporations engaged in a variety of businesses is created. In order to qualify for the incentive, a corporation must either be a Guam corporation or a United States corporation limited to doing business in Guam and qualifying under section 931 of the Internal Revenue Code (i.e., having 80 percent of its income from possession sources and 50 percent from the active conduct of a trade or business in a possession). It is our understanding that a qualified corporation is eligible for, among other benefits, a rebate of up to 75 percent of all corporate income tax payable to the Government of Guam for a period of up to twenty years. In other words, a Guam corporation which is subject to the corporate income tax at a rate of 48 percent under the mirror image of the United States Internal Revenue Code may receive a 75 percent rebate so that in fact it pays an effective rate of only 12 percent. A rebate of up to 75 percent of corporate income tax on dividends paid by a qualified corporation is also provided for a period of up to five years, in addition to a ten-year rebate on real property tax and a ten-year rebate of the Guam tax on income derived from certain leasing operations.

There is more to the point about the Guamanian tax rebate program than the need to protect the Marianas against unfair competition from its neighbor. The rebate program also shows that the mere fact that a possession adopts the United States Internal Revenue Code as a territorial tax —

as Guam has done through the mirror image system — is no guarantee that it will not alter the effective rate of tax of a taxpayer by providing cash rebates or other sorts of benefits outside the income tax system, or by reducing the impact of other taxes such as the property tax. Accordingly, it is simply not tenable to argue that the Marianas must adopt the exact replica of the United States Internal Revenue Code as a territorial tax in order to avoid unfair competition with Guam. Guam already has in effect a full panoply of tax incentive provisions designed to attract new business. Under these circumstances, and considering the difference in economic development, it is highly unlikely that any type of tax system adopted by the Marianas would have any effect on the Guam economy.

THE COMPROMISE PROPOSAL

As the foregoing analysis indicates, the case for requiring the imposition of the Internal Revenue Code as a territorial tax in the Marianas is far from persuasive. We continue to believe that the proposal the Commission originally put forward and which the United States accepted after review is well-precedented and entirely fair. In the spirit of compromise, however, we are willing to recommend to the Commission the following proposal. The status agreement will provide that the Marianas will adopt the Internal Revenue Code of the United States as a territorial income tax. The

legislature of the Northern Mariana Islands would retain the power to amend that tax to suit local conditions. This proposal would go into effect when the new Government of the Northern Mariana Islands is established, which is the date, prior to termination of the Trusteeship, on which U.S. laws generally become applicable.

The compromise here proposed is very similar to the system which is presently in effect in Puerto Rico. It recognizes that there may be strong feelings in Congress that the Internal Revenue Code is an appropriate starting place for the territorial income tax of the Marianas. On the other hand, the compromise also recognizes that local control of tax policy is an important aspect of local self-government. It reserves to the popularly elected representatives of the people of the Marianas the right to fashion an appropriate tax structure by amendment to the Internal Revenue Code, insofar as it constitutes a territorial tax.

The necessity for the Marianas Legislature to retain the power to amend the tax to suit local conditions is plain not only as a matter of principle but also as a practical matter. The complexity of the Internal Revenue Code and its well-documented deficiencies provide a strong argument for local control over its application as a territorial tax. Numerous court cases under the Guam and Virgin Islands territorial tax provisions provide ample testimony that the mirror

image system can have serious potential technical pitfalls. Indeed, we understand that at this very moment the Virgin Islands is considering a request to Congress to amend its territorial tax to correct serious interpretive problems. We further have been informed that the Treasury Department may be contemplating legislation to clarify ambiguities in the 1972 Guam legislation — legislation which was itself designed to cure problems in the original mirror image system.

Accordingly, we suggest the compromise proposal that the Marianas adopt the Internal Revenue Code as a territorial tax with the right to amend that tax as the need may arise.

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