# OFFICE FOR MICRONESIAN STATUS NEGOTIATIONS
WASHINGTON, D.C. 20240

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To: James M. Wilson, Jr.

From: Adrian deGraffenried

Subject: MPSC Draft Sections 601 and 602, Review of

The MPSC income tax proposal in Sections 601 and 602 would require that citizens of the Mariana Islands (who become U.S. citizens or nationals under the agreement) be subject to a local territorial tax on income derived locally and be subject to the U.S. IRC only to income earned from United States sources. Mariana citizens will also pay U.S. estate and gift taxes only to property situated in the United States.

U.S. citizens and corporations will be subject to both the Marianas territorial tax and to the locally applied U.S. IRC to all income derived locally; as to income derived from U.S. sources, and as to property situated in the Marianas and the United States U.S. citizens (other than those from the Marianas) will continue to be subject to U.S. revenue laws. All revenues collected from the U.S. income tax from persons situated in the Marianas would be returned to the local treasury for appropriation by the Commonwealth legislature; all revenues collected under the local territorial tax will also be deposited into the Commonwealth treasury for local appropriation.

In essence, the MPSC proposal creates a tax system that parallels a State revenue taxing system: a local tax coexisting with a federal income tax; however, two major exceptions arise: (1) all revenues collected (either under the territorial tax or the U.S. income tax) from locally derived sources will be returned for the sole use of the Marianas; and (2) local Marianas residents who become U.S. citizens will pay only the territorial tax and will be exempted from payment of the U.S. income tax extended to the Marianas. The converse of the situation is that U.S. citizens will be subject to both the territorial tax and the applicable U.S. income tax for income derived locally and for the U.S. income tax on income derived from U.S. sources. Added to this factor is that the Marianas is requesting the power to amend the U.S. income tax applied to the Commonwealth so that the possibility arises that taxes due could be discriminatorially applied or could be applied disportionately as compared with local residents who become U.S. citizens; this ~~would~~ be severely attacked by the U.S. Congress and by the territory of Guam.

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Treasury notes that it continues to have substantial difficulties with the MPSC approach. It is preparing a working document that outlines the various consequences of the MPSC tax scheme. Treasury also notes that this approach is somewhat different than that taken by the U.S. with Puerto Rico. In Puerto Rico, the only applicable tax is the 1939 U.S. IRC which was adopted as a local territorial tax and which is applied to both U.S. citizens and local Puerto Ricans on locally derived income; the 1954 IRC is applied only to income from U.S. sources and that revenue is returned to Puerto Rico for local appropriation.

In essence, the MPSC tax proposal will create a tax structure as if the Marianas were a state will all taxes collected on locally derived revenue to be returned to the Marianas.



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