

2

Excerpt from Appendix A to the
Memorandum for the Commission
Concerning the United States
Internal Revenue Code

B. Income Taxation in Guam, the Virgin Islands, American Samoa and Puerto Rico

1. Guam.

The income tax laws applicable in Guam follow what is known as the "mirror image" system, i.e., Guam income taxes are determined by applying the United States income tax laws but by substituting the word "Guam" for the words "United States" wherever they appear in the Internal Revenue Code. Under the "mirror image" system, the tax laws of Guam are automatically changed whenever the Internal Revenue Code is amended. Thus, Section 31 of the Organic Act of Guam provides that "the income tax laws enforced in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam." 48 U.S.C. § 1421(i)(a). The income tax laws in Guam are deemed to be a separate territorial income tax payable to the government of Guam and designated the "Guam Territorial Income Tax." 48 U.S.C. § 1421(i)(b). The tax system is administered and enforced by the government of Guam. 48 U.S.C. § 1421(i)(c).

In 1972 Congress enacted Public Law 92-606 to correct significant aberrations in the "mirror image" tax system of Guam. One important change of the legislation was to eliminate dual filing and tax requirements for individuals previously subject to the jurisdiction of both Guam and the United States. Prior to the amendment, most

individual taxpayers who derived income from both Guam and the United States had to file tax returns with both jurisdictions, although application of the foreign tax credit generally eliminated liability in one jurisdiction. To eliminate the burden and complication of dual filings, section 935 was added to the Internal Revenue Code, effective beginning in 1973.

Section 935(b) provides that an income tax return need be filed with only one jurisdiction -- either with Guam or with the United States -- depending on the taxpayer's residence at the end of the taxable year. The taxpayer's entire tax liability under both Guam and U.S.^{*/} income tax laws is then discharged by paying a single tax to the jurisdiction where the return is filed. If the individual is a U.S. resident at the end of the taxable year, his return and payment of tax are made to the United States. If the individual is a Guam resident at the end of the taxable year, his return and payment of tax are made to Guam. If the individual is a resident of neither jurisdiction at the end of the taxable year, Guam is the controlling jurisdiction if the individual is a Guam citizen but not a U.S. citizen. Otherwise, he must file his return with the United States. In the

*/ Section 932 was amended in 1972 to exclude Guamanians from treatment as nonresident aliens. As a result, Guamanians who are U.S. citizens are now taxed under the usual rules applicable to U.S. citizens.

case of a joint return, the return is filed with the jurisdiction where the spouse having the greater adjusted gross income would be required to file a return. Section 935(d) provides that declarations of estimated tax are filed with the jurisdiction where the taxpayer would be required to file his return if his taxable year closed on the date he is required to file such declaration.

In the case of U.S. corporations, the dual application of the Guamanian and U.S. income tax laws is eliminated by section 931 which excludes Guamanian-source income from gross income for U.S. tax purposes if sufficient income is earned from possession sources. ^{*/}

The 1972 amendments corrected another problem with respect to the dual taxation of certain corporations under U.S. and Guamanian law. Under section 881 of the Internal Revenue Code a 30% tax is imposed on certain passive income (such as interest and dividends) received by a foreign corporation from U.S. sources; this tax is required to be withheld at its source under section 1442. Under the mirror image system, these same provisions are in effect in Guam. The 1972 amendments provide that a Guam corporation will not be considered a foreign corporation for purposes of sections 881 and 1442 and, accordingly, that a U.S. corporation will

*/ Section 931 does not apply to U.S. individuals earning income in Guam (§ 931(c)); they are eligible for relief under § 935.

not be considered a foreign corporation for purposes of the identical Guam provisions. See sections 881(b) and 1442(c). As a result of this change, U.S. corporations will not be subject to the 30% Guam withholding tax on their Guam-source passive income which is not effectively connected with a Guam business.

In addition to the substantive changes in the Guam Territorial Tax, the 1972 legislation made major changes with respect to the sharing of U.S. tax revenues as described below.

Section 30 of the Organic Act of Guam, 48 U.S.C. § 1421(h), provides that customs duties, U.S. federal income taxes and certain other proceeds derived from Guam be remitted to Guam:

"§ 1421h. Duties and taxes to constitute fund for benefit of Guam

All customs duties and Federal income taxes derived from Guam, the proceeds of all taxes collected under the internal-revenue laws of the United States on articles produced in Guam and transported to the United States, its Territories, or possessions, or consumed in Guam, and the proceeds of any other taxes which may be levied by the Congress on the inhabitants of Guam, and all quarantine, passport, immigration, and naturalization fees collected in Guam shall be covered into the treasury of Guam and held in account for the government of Guam, and shall be expended for the benefit and government of Guam in accordance with the annual budgets except that nothing in this chapter shall be construed to apply to any tax imposed by chapter 2 or 21 of Title 26."

We were informed by the U.S. Treasury that it is administratively impossible to determine the U.S. tax revenue derived from Guam as required by Section 30 of the Organic Act. Accordingly, the U.S. worked out a procedure with Guam to pay over on a quarterly basis U.S. income tax withheld from the wages of U.S. military and civilian employees stationed in Guam.

As a result of the 1972 legislation a new system of tax sharing was instituted under section 235 of the Internal Revenue Code, requiring U.S. tax liability to be paid directly to Guam if the taxpayer is a resident of Guam at the end of the taxable year. To prevent a distortion in the allocation of revenue between the U.S. and Guam which might result from the rules of section 935, Congress in 1972 added section 7654 to the Internal Revenue Code entitled "Coordination of United States and Guam Individual Income Taxes." Section 7654 provides that where an individual (and his spouse if filing joint returns) has at least \$5,000 of gross income from sources within the other jurisdiction and at least \$50,000 of adjusted gross income from all sources, there is to be a division of the net collections of income taxes between the United States and Guam at least annually. Net collections attributable to U.S. source income are to be covered into the U.S. Treasury, and net collections attributable to Guam sources are to be covered into the Guam Treasury.

All other net collections (i.e., those attributable to foreign source income) are to be retained by the jurisdiction in which the taxpayer files his return.

Section 7654(d), also added to the Internal Revenue Code in 1972, provides that in addition to other amounts allocated to Guam, the United States will pay to Guam all amounts of taxes deducted and withheld by the United States with respect to military wages paid to Armed Forces personnel situated in Guam. Such personnel otherwise would have no tax liability to Guam with respect to those wages because of the operation of the Soldiers and Sailors Civil Relief Act, 50 App. U.S.C. § 574, which has the effect of treating such personnel as nonresidents of Guam receiving U.S.-source income. As recognized by the Ways and Means Committee report, section 7654(d) appears to have restated existing law, since income taxes withheld from Armed Forces personnel in Guam historically have been paid over to Guam pursuant to Section 30 of the Guam Organic Act, 48 U.S.C. § 1421(h) (quoted above). However, the specific amendment sanctioning payment to Guam of military withholding has called into question the legality of paying over civilian withholding. We are informed by Treasury that it is considering remedial legislation to clarify this point and to correct other inadequacies that it has noted in the 1972 Guam legislation.