

MEMORANDUM TO THE MARIANAS FILE

On March 25, 1974 I met with Tom Bissell at the Treasury Department to discuss the applicability of the Internal Revenue Code to the Marianas. Tom made the following comments.

1. He asked whether there were any plans to set up a federal district court for the Marianas, as Congress did in the Virgin Islands and Guam. Under 48 USC 1421 i (h) (1) the District Court of Guam has exclusive original jurisdiction over all judicial proceedings in Guam with respect to the Guam territorial income tax. Under 48 USC 1421 i (h) (4) Guam may bring a civil action for the collection of Guam territorial income tax in the District Court of Guam or in any district court in the United States. It also appears that under Section 19700 of the Guam Code the District Court of Guam is given the same jurisdiction as the United States Tax Court, i.e. collection of tax will be stayed pending an appeal to such court. (I am not sure how the Guam Legislature can alter the jurisdiction of the United States Federal Court.)
2. If there is not a Marianas district court, Tom questioned how the U.S. Nationality Act would operate. Apparently that Act provides that a naturalized citizen acquires citizenship in the local district court. He raised the question of whether a Marianas citizen, for example, naturalized before a Guam court would be a Guam citizen.
3. He pointed out a recent ruling that may be of some application to our case. The ruling concerned the United States estate tax of a Puerto Rican citizen who moved to the Virgin Islands. Since Puerto Rico only taxes residents but not citizens, the taxpayer owed no Puerto Rican estate tax, and the ruling held that he owed no U.S. estate tax because he moved from one possession to another. In other words, you can go "possession hopping" and still retain certain benefits.
4. There may be problems in certain fact situations in determining what laws apply. For example, what about children of the U.S. military born in the Marianas?

5. Section 931 only helps individuals if Marianas tax rates are lower. At the moment tax rates in the four possessions are equal to U.S. tax rates. Thus the main benefit of 931 is to prevent the necessity for filing two tax returns if you only have possession sources income. (Check this.)

6. The Marianas tax provisions should attempt to cure two problems:

(a) If a Marianas citizen has U.S. source income, and is treated as a nonresident alien, he will be subject to U.S. tax but will only receive one personal exemption and will lose other U.S. tax benefits.

(b) A Marianas citizen who is treated as a nonresident alien for U.S. tax purposes will be subject to the 30% withholding rates on passive investment income from U.S. sources.

The first problem could be cured by making Section 932 inapplicable to Marianas citizens, i.e. do not treat them as nonresident aliens for purposes of taxing U.S. source income. The same benefits of Section 931 can be achieved by using the Section 933 approach of simply stating that Marianas citizens are not subject to U.S. tax on Marianas source income (or foreign source income). In other words you could adopt a system that says Marianas citizens are subject to U.S. tax under Section 1 on U.S. source income and are not subject to tax on Marianas source (or foreign source) income.

This may raise a problem in applying the Guam mirror image tax. Under Section 935 b of the Code a Marianas citizen who is not resident in Guam but earns income in Guam would only file his income tax return with the United States. It would seem that this produces an incorrect tax result in that this tax instead should be paid to Guam.

The second problem of taxing passive income from U.S. sources at a 30% rate could be cured by a specific amendment to Section 871 or 1491 providing that the withholding provisions do not apply to Marianas citizens.

This apparently is done under the Section 1441 regulations for the Virgin Islands. There is also no withholding between Guam and the U.S.

7. We talked about some of the problems of the mirror image system. One problem is that for U.S. tax purposes a possession citizen is treated as a non-resident alien, but nothing says that U.S. citizens are nonresidents for purposes of the mirror Code in a possession. This produced several cases (Blaze, 73-1 USTC 9368 and Flores, 71-1 USTC 9486) holding that U.S. citizen is not nonresident alien for purposes of applying possessions tax.

8. Our tax proposals must consider whether any changes must be made in Guam Territorial Tax.

9. If adopt provision which says Marianas citizens will not be nonresident aliens for purposes of withholding, this may require as a quid pro quo treating U.S. citizens under Marianas tax as residents. This apparently is what they do in Puerto Rico thus allowing full personal exemptions etc. Must also think of doing this with respect to Guam, if Marianas citizens are treated as residents under Guam law. This may require change in Guam Territorial Tax! Better do some more thinking on how Marianas citizens would be taxed under Guam Territorial Tax when they become U.S. citizens.

10. Note that in the Virgin Islands, dual filing is only avoided for Virgin Island citizen resident in the Virgin Islands.

11. The Guam regulations are not yet out. Apparently they include a provision that Guam income is not foreign source income for purposes of computing foreign tax credit and that taxpayer gets \$100 dividend exclusion on Guam dividends.

12. Treasury is working on amendments to the Guam legislation. The main problem appears to be whether withheld wages on civilian U.S. employees are still required to be paid over.

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