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# Coordination of Taxation Between the United States and Guam

by  
Bruce Leiserowitz\*

A recent Internal Revenue Service [I.R.S.] ruling<sup>1</sup> and proposals<sup>2</sup> to reform the coordination of taxation between the United States and Guam highlight the difficulties that exist in the current system. One of the principal problems is the tax system's inability to provide sufficient revenues for Guam, which is partially due to the fact that the system's complexity often leads to tax avoidance or evasion. In particular, some corporations have considered using Guam to replace the Netherlands Antilles as a "tax haven."<sup>3</sup> The I.R.S. revenue ruling is designed to prevent this outcome.

This Article will examine the variety of difficulties with the current tax regime. Part I contains an historical analysis of the tax system, while Part II discusses the major problems that have arisen as a product of the system's unique history. Lastly, Part III will review the various reforms that have been proposed, both past and present, and will examine their utility and likelihood of adoption.

## I

### HISTORY OF THE U.S.-GUAM TAX RELATIONSHIP

Guam, an unincorporated United States territory, is the largest island in the Mariana Islands archipelago in the Pacific Ocean. It was acquired from Spain by the Treaty of Paris at the end of the Spanish-American War in 1898.<sup>4</sup> According to a two-sentence executive order of President McKinley, sole responsibility for the administration of

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1. Rev. Rul. 83-9, 1983-2 I.R.B. 9.

2. Letter from Assistant Secretary of Treasury Pedro Sanjuan to the Governor of Guam, Ricardo J. Bordallo (Jan. 18, 1983) (discussing proposals of the United States Department of Treasury for reforming the U.S.-Guam tax system). These proposals are analyzed *infra* text accompanying notes 80-95.

3. TAX NOTES, Apr. 18, 1983, at 244-46.

4. Treaty of Peace, Dec. 10, 1898, United States-Spain, 30 Stat. 1754, 1755, T.S. 343.

Guam was placed in the hands of the Navy.<sup>5</sup> A succession of naval governors who exercised all legislative, judicial, and executive authority administered the island.<sup>6</sup>

By the end of World War II, the inhabitants of Guam had expressed their wish to obtain at least some measure of self-government.<sup>7</sup> The obligation to provide them with self-government derived both from the provisions of the Treaty of Paris and Chapter XI of the United Nations Charter.<sup>8</sup> In 1945, President Truman requested recommendations from various executive agencies concerning the administration of Guam and other Pacific islands, and their report suggested providing for a civil government on Guam.<sup>9</sup> In preparation for this action, President Truman issued Executive Order 10077 on September 7, 1949, which transferred the powers of administration of Guam from the Navy to the Secretary of the Interior.<sup>10</sup> The Secretary of the Interior submitted model legislation to Congress,<sup>11</sup> which was passed with some amendments as the Organic Act of Guam in 1950.<sup>12</sup>

The Organic Act of Guam was largely patterned after the organic acts of other United States territories.<sup>13</sup> It conferred United States citizenship on citizens of Guam and provided for executive, judicial, and legislative branches of government as well as a bill of rights.<sup>14</sup> Prior to 1950, the United States income tax did not extend to citizens of Guam or foreign nationals deriving income from Guam because the Internal Revenue Code [Code] did not include Guam in its definition of the United States.<sup>15</sup> In addition, United States citizens and United States corporations deriving their income primarily from Guam were exempt from United States taxation to prevent their being placed at a competitive disadvantage relative to other businesses in the possessions.<sup>16</sup> The 1950 Organic Act changed this situation by extending the United States

5. Exec. Order No. 108-A (Dec. 23, 1898), *reprinted in* S. REP. NO. 2109, 81st Cong., 2nd Sess. 15 (1950), *reprinted in* 1950 U.S. CODE CONG. & AD. NEWS 2840, 2856 [hereinafter cited as Organic Act of Guam Report].

6. *Id.* at 1, 1950 U.S. CODE CONG. & AD. NEWS at 2840.

7. *Id.*

8. *Id.* at 2, 1950 U.S. CODE CONG. & AD. NEWS at 2841.

9. *Id.*

10. *Id.* at 3, 1950 U.S. CODE CONG. & AD. NEWS at 2841-42.

11. *Id.* at 3, 1950 U.S. CODE CONG. & AD. NEWS at 2842.

12. Pub. Law No. 81-630, 64 Stat. 384 (1952) (codified as amended at 48 U.S.C. § 1421 (1952)).

13. Organic Act of Guam Report, *supra* note 5, at 7, 1950 U.S. CODE CONG. & AD. NEWS at 2846.

14. For a full analysis of the Act, see Organic Act of Guam Report, *supra* note 5, app. 1, at 13-15, 1950 U.S. CODE CONG. & AD. NEWS at 2853-56.

15. Hoff, *U.S. Federal Tax Policy Towards the Territories: Past, Present and Future*, 37 TAX L. REV. 53, 78 (1981).

16. *Id.*

income tax to Guam and by providing that such revenues collected would be "covered [paid] into the treasury of Guam."<sup>17</sup>

The legislative history suggests that the tax provisions of the Organic Act were not considered to be the more important features of the Act. The Senate Report on the Organic Act did not discuss the tax provisions, except in the appendix to the report which briefly summarized all provisions of the Act.<sup>18</sup> Since the Organic Act of Guam was modeled after those of other United States territories, it is not surprising that the Senate Report failed to emphasize the purpose of the tax provisions. The debate on the proposed Organic Act, however, suggests two purposes for the extension of United States tax laws to Guam. First, the extension would ensure that no taxpayer escaped taxation on its Guamanian income.<sup>19</sup> Secondly, the tax revenue thereby collected would make the government of Guam self-sufficient.<sup>20</sup> These two purposes, prevention of tax avoidance and raising of sufficient revenue, are useful measures of the effectiveness of the current tax system.

Controversy soon arose over the interpretation of the 1950 Organic Act. Some taxpayers challenged Guam's authority to assess and collect income tax and also argued that they were exempt from such taxes in any case.<sup>21</sup> While Guam usually prevailed in court on these issues, Congress was concerned about the effect on Guam's revenues should the taxpayers ever prevail in their litigation.<sup>22</sup> In 1958, Congress clarified the tax provisions of the 1950 Organic Act.<sup>23</sup> The 1958 Amendments stated that the income tax laws in force in Guam were deemed to be a separate territorial tax administered by the Government of Guam.<sup>24</sup> The 1958 Amendments also established a "mirror system" of taxation, whereby the provisions of the Code were to be read so as to substitute "Guam" for "United States."<sup>25</sup> This provision, however, was modified by the clauses "except where it is manifestly otherwise required," and "where necessary to effect the intent of this section."<sup>26</sup> These clauses have given the I.R.S. some discretion in interpreting how

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17. 48 U.S.C. § 1421(i) (1952) and 48 U.S.C. § 1421(h) (1952), respectively.

18. Organic Act of Guam Report, *supra* note 5, at 13-15, 1950 U.S. CODE CONG. & AD. NEWS at 1853-1856.

19. 96 CONG. REC. 7577 (1950) (remarks of Rep. Miller).

20. *Id.*

21. S. REP. NO. 2176, 85th Cong., 2nd Sess. 9 (1958), *reprinted in* 1958 U.S. CODE CONG. & AD. NEWS 3647.

22. *Id.*

23. Pub. L. No. 85-688, 72 Stat. 681 (1958) (codified as amended at 48 U.S.C. § 1421(i) (Supp. 1982)).

24. 48 U.S.C. § 1421(i)(b)-(c) (Supp. 1982).

25. 48 U.S.C. § 1421(i)(e) (Supp. 1982). For a more detailed description of the "mirror system," see Hoff, *supra* note 15, at 66-72.

26. 48 U.S.C. § 1421(i)(e) (Supp. 1982).

the Code will be administered in Guam.<sup>27</sup>

The mirror system had three major consequences. First, the mirror system treated United States nationals as foreign persons for purposes of taxation in Guam. The Code defines domestic corporations as those created or organized in the United States, and foreign corporations as those which are not domestic corporations.<sup>28</sup> When the Code was mirrored in Guam, United States corporations were thus treated as foreign corporations, and vice-versa. Second, the mirror system subjected some United States corporations to additional taxes. The Code provided for a thirty percent tax on certain types of income received by foreign corporations, such as interest, dividends, or rents, which were not effectively connected with the conduct of a trade or business.<sup>29</sup> Since United States corporations were treated as foreign corporations in Guam, they became subject to this tax. This tax allegedly created a disincentive for United States corporations to invest in Guam.<sup>30</sup> Finally, the tax system imposed a requirement of filing tax returns in both Guam and the United States if the individual taxpayer derived income from both jurisdictions.<sup>31</sup> Dual filing was required even though the foreign tax credit often served to eliminate the taxpayers's liability to one of the jurisdictions.<sup>32</sup>

In order to address both the problems of the additional thirty percent tax and the dual filing, Congress modified the tax law in 1972.<sup>33</sup> The 1972 law amended I.R.C. §§ 881 and 1442 to provide that, for the purposes of those sections, the term "foreign corporation" did not include a Guam corporation.<sup>34</sup> When mirrored in Guam, the amended Code meant that United States corporations would not be considered foreign corporations for the purpose of the thirty percent tax.<sup>35</sup> The rest of the mirror system, as applied to corporations, was left unchanged.<sup>36</sup>

As to individual taxpayers, the 1972 tax law added a new I.R.C. § 935. Section 935 provides that the taxpayer shall file his return with either Guam or the United States, depending upon the taxpayer's resi-

27. See *infra* text accompanying notes 60-66 for a discussion of the I.R.S. revenue ruling.

28. I.R.C. § 7701(a)(4)-(5) (1967).

29. I.R.C. §§ 881, 1442 (1967).

30. H. R. REP. NO. 1479, 92nd Cong., 2nd Sess. 3 (1972), *reprinted in* 1972 U.S. CODE CONG. & AD. NEWS 5401, 5402-3 [hereinafter cited as 1972 Report].

31. *Id.* at 4, 1972 U.S. CODE CONG. & AD. NEWS at 5403.

32. *Id.*

33. Pub. L. No. 92-606, 86 Stat. 1494 (1972) (codified at I.R.C. § 881(b) (Supp. 1982) and I.R.C. § 1442(c) (1982)).

34. I.R.C. § 881(b) (Supp. 1982) and I.R.C. § 1442(c) (1982).

35. 1972 Report, *supra* note 30, at 3, 1972 U.S. CODE CONG. & AD. NEWS at 5403.

36. *Id.* at 3-4, 1972 U.S. CODE CONG. & AD. NEWS at 5403.

dence at the end of the taxable year.<sup>37</sup> The taxpayer need only pay income tax to the jurisdiction in which he files his return.<sup>38</sup> In addition, § 935 provides that, except for §§ 935 and 7654, the United States shall be treated as including Guam, and vice-versa.<sup>39</sup> This addition was a significant change in the mirror system. In the case of a taxpayer who derived income from both the United States and Guam during the tax year, and thus paid taxes in both jurisdictions via withholding or estimated tax payments, § 935 allowed full credit for taxes paid to both jurisdictions when the taxpayer filed his return in the jurisdiction of residence.<sup>40</sup>

This system of single filing, however, had the potential to distort the allocation of revenue between the United States and Guam.<sup>41</sup> The general rule of § 935 provided that the taxpayer had to file his return only in the jurisdiction of residence at the end of the year. The revenue collected would go to the jurisdiction of residence, depriving the jurisdiction of non-residence of tax revenue from the income derived there. I.R.C. § 7654 was enacted to reduce this potential distortion. Section 7654 provides for a division of revenue between the two jurisdictions based on the source of income for those taxpayers whose adjusted gross income was at least \$50,000 and who earned at least \$5,000 in gross income in the non-residence jurisdiction.<sup>42</sup> The net collections attributable to United States source income would be paid into the United States treasury, and net collections attributable to Guam sources would be paid into the Guam treasury. All other net collections (such as income from foreign sources) would go to the jurisdiction of residence.<sup>43</sup>

Section 7654 also provides that transfers of funds between the United States and Guam be made at least once a year.<sup>44</sup> In addition, § 7654 provides that the amount of taxes deducted and withheld on wages paid to military personnel stationed in Guam be turned over to Guam, even though such military personnel do not generally have income tax liability to Guam based on their military wages.<sup>45</sup> Finally, § 7654 gives the Secretary of the Treasury broad authority to issue regulations necessary to insure that the Guam Territorial income tax will

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37. I.R.C. § 935(b)(1)-(2) (Supp. 1982).

38. I.R.C. § 935(c)(3) (Supp. 1982). Section 935 also contains special rules for joint returns and declarations of estimated income tax. I.R.C. § 935(b)(3), (d) (Supp. 1982).

39. I.R.C. § 935(c)(1)-(2) (Supp. 1982).

40. 1972 Report, *supra* note 30, at 5-6, 1972 U.S. CODE CONG. & AD. NEWS at 5405. *See also* Treas. Reg. § 1.935-1(b)(1) (1975).

41. 1972 Report, *supra* note 30, at 6, 1972 U.S. CODE CONG. & AD. NEWS at 5405.

42. I.R.C. § 7654(a) (Supp. 1983).

43. *Id.*

44. I.R.C. § 7654(c) (Supp. 1983).

45. I.R.C. § 7654(d) (Supp. 1983). *See* 1972 Report, *supra* note 30, at 7, 1972 U.S. CODE CONG. & AD. NEWS at 5406-5407.

be applied in a manner consistent with the intent of the bill.<sup>46</sup> The 1972 amendments also prevent the Government of Guam from promulgating inconsistent regulations.<sup>47</sup>

## II CURRENT PROBLEMS

One of the major problems with the current tax system involves the division of revenue between the United States and Guam. The legislative history of the 1972 law suggests that Congress intended for Guam to have the exclusive right to tax full year residents of Guam.<sup>48</sup> The 1972 law, however, did not make federal tax withholding obligations consistent with the liability rules set down in § 935, nor (in the alternative) did it provide a comprehensive mechanism for the federal government to transfer these taxes to the Guamanian treasury.<sup>49</sup> Inconsistencies exist in three areas:

1. The United States withholds (and retains) tax on pension payments to retired military and civil service employees resident in Guam.
2. The United States withholds (and retains) tax on compensation paid to citizens of Guam serving in the U.S. armed forces.
3. The United States withholds tax on compensation paid to U.S. government employees in Guam. Currently, these withholding taxes are being covered over to Guam. In 1973, the Treasury advised the IRS that it should continue to cover over these withholding taxes as if section 30 of the Organic Act had not been fully superseded.<sup>50</sup>

The Guam Legislature has petitioned Congress to resolve these division of revenue problems,<sup>51</sup> and the Treasury Department has indicated that it would be prepared to seek statutory clarification.<sup>52</sup> The Treasury Department's unofficial tax reform proposal<sup>53</sup> would clarify the uncertainties surrounding the sums withheld and retained by the United States Government by explicitly approving the transfer of such sums to the treasury of the territories.<sup>54</sup> As an unofficial proposal, however, the Treasury Department's reform has not yet been adopted.

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46. 1972 Report, *supra* note 30, at 7, 1972 U.S. CODE CONG. & AD. NEWS at 5407.

47. 48 U.S.C. § 1421(i)(d)(2) (Supp. 1982).

48. U.S. DEP'T OF THE TREASURY, *Territorial Income Tax Systems*, 22 (1979).

49. *Id.*

50. *Id.*

51. Hoff, *supra* note 15, at 82.

52. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 23.

53. This proposal, the Possessions Tax Act of 1982, was never officially released by Treasury, although copies have been made available to the government of Guam, among others. Proposal II of the Sanjuan letter (*see infra* text accompanying notes 89-95), appears to be largely patterned after the 1982 proposed act.

54. § 211(b) of the proposed Possessions Tax Act of 1982.

A second major problem is that complications in the tax system can lead to federal tax avoidance and evasion. For individual taxpayers, a person who claims residence in Guam is relieved of the obligation to report his income or pay tax to the United States. The Treasury Department has stated that it is not able to deal effectively with cases of individuals who have dubious claims to residence in a territory,<sup>55</sup> presumably because such persons need not file returns with the I.R.S. if they claim residence in the territories at the end of the taxable year.

Taxpayers have an incentive to claim residence in the territories because the territorial tax administrations, including that of Guam, often do not have the resources or expertise to enforce the tax laws effectively. Guam's problems in administering the tax laws were detailed in a 1979 report of the Comptroller General of the United States.<sup>56</sup> Among the problems described in the report were delinquent taxes not yet collected, lack of procedures for identifying those taxpayers who failed to file returns, and failure of employers to remit taxes withheld from employees.<sup>57</sup> Thus, taxpayers could escape much federal tax liability by claiming residence in Guam.

The problems in effectively administering the tax laws also can work in the corporate taxpayer's favor. In particular, the territorial tax rebate systems provide significant rate reductions for companies doing business in the territories.<sup>58</sup> These tax rebate systems give United States corporations an incentive to shift profits artificially to the territories. The I.R.S. has encountered many transfer-pricing problems with transactions between United States parent corporations and their territorial subsidiaries.<sup>59</sup>

Foreign corporations could also have taken advantage of the complexity of the tax laws, and this possibility is addressed by a 1983 I.R.S. revenue ruling.<sup>60</sup> The ruling cites an example of a foreign corporation organizing a wholly owned subsidiary in Guam. The subsidiary in turn acquires all the stock of a United States corporation which derives all of its income from United States sources. The subsidiary is not engaged in a trade or business in the United States, and the foreign parent is not engaged in a trade or business in Guam. The United States cor-

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55. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 40.

56. Comptroller General of the U.S., *The Government of Guam's Administration of Its Income Tax Program*, Oct. 3, 1979.

57. *Id.* at 1-2.

58. Hoff, *supra* note 15, at 84-85.

59. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 40. U.S. parent corporations can lease plants and equipment to their territorial subsidiaries at an artificially low price in order to shift profits to the territories. *Id.* For an analysis of recent developments on I.R.S. use of I.R.C. § 482 to reallocate intercompany pricing, see Singer and Karlin, *Multinationals and New Customs Laws Will Have Broad Impact on Intercompany Pricing*, 58 J. TAX'N 226 (1983).

60. Rev. Rul. 83-9, 1983-2 I.R.B. 9.

poration pays interest on indebtedness to the Guam subsidiary, which constitutes all of the subsidiary's income. The subsidiary in turn pays interest on indebtedness to the foreign parent. This scheme could be employed to avoid the thirty percent tax imposed and withheld by I.R.C. §§ 881 and 1442, respectively. Because §§ 881(b) and 1442(c) provide that the term "foreign corporation" does not include a Guam corporation, the payment of interest from the U.S. corporation to the Guam subsidiary would not be subject to the thirty percent tax.

The issue in the revenue ruling, however, was whether the tax would be imposed when the Guam subsidiary paid the interest to the foreign corporation. While some taxpayers interpreted the law as allowing the avoidance of the thirty percent tax at this stage, the I.R.S. held that since the interest received by the Guam subsidiary from the United States corporation was not subject to United States income tax, it must be treated as income from sources within Guam and therefore subject to the thirty percent tax.<sup>61</sup> The I.R.S. relied on the language in the Organic Act which specifies that "Guam" would be substituted for "United States" where appropriate. The I.R.S. also stressed that the tax system should not be interpreted in a manner which allows income to escape taxation by both Guam and the United States.<sup>62</sup>

The Treasury Department and Guam have taken opposing positions on the need for this ruling and the accompanying temporary regulations.<sup>63</sup> The Treasury Department's view is that the ruling prevents the exploitation of the territories as a tax haven by residents of foreign countries.<sup>64</sup> Guam officials, on the other hand, view the ruling as undermining Guam's efforts to attract international finance companies to the area, such efforts being aimed at broadening Guam's economic base and decreasing its dependence on federal assistance.<sup>65</sup> Even if Guam's efforts were successful, however, this approach puts the Treasury Department in the uncomfortable position of allowing "abuses" to develop in the territories at the same time that it is attempting to cope with foreign tax havens.<sup>66</sup>

The last major difficulty with the current tax system is its inability to provide sufficient revenue for the Government of Guam. Recent

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61. *Id.*

62. *Id.*

63. Treas. Reg. § 4a.861-1, T.D. 7865, 1983-2 I.R.B. 10.

64. Sanjuan letter, *supra* note 2, Alternative Proposals.

65. Letter from Governor of Guam Ricardo J. Bordello to Secretary of the Interior James J. Watt (Jan. 7, 1983) (discussing the revenue ruling).

66. Sanjuan letter, *supra* note 2, Alternative Proposals. For a further discussion of the revenue ruling and its possible effect on international finance companies in the territories, see Lacy, *Guam and Northern Mariana Islands Finance Companies After the New Temporary Regulations*, 9 Int'l. Tax J. 149 (1983).

figures show that approximately eighty percent of Guam's total revenue comes from locally collected taxes, and approximately sixty percent of these local taxes come from Guam's income taxes.<sup>67</sup> Guam's shortfall in revenue is substantial, however, and runs into the millions of dollars.<sup>68</sup> For example, Guam suffered a \$15.6 million deficit in its general fund for fiscal year 1981, which brought its cumulative general fund deficit to \$83.2 million as of September 30, 1981.<sup>69</sup> While the United States Government Comptroller for Guam attributed most of the deficit to lack of budget discipline,<sup>70</sup> the tax system clearly played a part.

Because of these deficits, the United States Congress appropriated \$15 million to Guam,<sup>71</sup> which Guam had argued was needed to offset changes in the federal tax law reducing territorial revenue, such as the Tax Reduction Act of 1975. The Treasury Department, however, argued that the federal tax changes did not cause a reduction in the well-being of the territories but only a transfer of funds from the territorial treasuries to the territorial taxpayers. Since Guam could impose an additional ten percent income tax,<sup>72</sup> the Treasury Department's position was that the federal government was simply making an additional general appropriation to these territories, while allowing a tax reduction to the territorial taxpayers.<sup>73</sup> But regardless of which interpretation is correct, the tax system has not served the purpose of providing the Guam government with sufficient revenues.

### III POSSIBLE SOLUTIONS

Four distinct alternatives to the present tax system have been proposed over the years: 1) I.R.S. administration of the territorial income tax program; 2) I.R.S. provision of technical assistance to Guam; 3) extension of United States income tax jurisdiction to include Guam; and 4) creation of parallel federal and territorial income tax systems.

Transfer of administration of the territorial income tax to the Secretary of the Treasury was rejected by Congress in 1979<sup>74</sup> and is no

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67. United States Government Comptroller for Guam, Department of the Interior, *Report on the Fiscal Condition of Guam for the Year Ended September 30, 1981*, at 62 (1982) [hereinafter cited as *Fiscal Condition of Guam*].

68. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 31-37.

69. *Fiscal Condition of Guam*, *supra* note 67, at i.

70. *Id.*

71. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 37.

72. 48 U.S.C. § 1421(i)(a) (Supp. 1982).

73. U.S. DEP'T OF THE TREASURY, *supra* note 48, at 37.

74. H. R. Res. 3756, 96th Cong., 1st Sess. (1979). This bill was passed by the House, but the Senate version struck the language which would have transferred the administration of the tax system to Treasury. See S. REP. No. 467, 96th Cong., 1st Sess. 1 (1979).

longer being considered by the Treasury Department as a separate alternative. To the extent that revenue is lost due to difficulties in administering the tax laws, however, this proposal is designed to improve tax collections by having the I.R.S. administer the tax laws.<sup>75</sup>

One drawback to this proposal is the cost. When Congress considered it, the I.R.S. estimated that the cost of administration of the territorial income tax system in Guam would be approximately \$2 to \$3 million per year.<sup>76</sup> The costs would most likely be even higher today. The increased revenues, however, presumably would exceed the costs. If the increased revenues led to lower levels of federal appropriations to Guam, there could be a net savings from the proposal.

The cost argument notwithstanding, the most significant problem with this proposal is that it eliminates Guam's autonomy over the administration of its income tax, Guam's chief objection to the proposal when it was considered in Congress. The Department of the Interior itself neither supported nor opposed the proposal, preferring instead to defer to the Treasury Department.<sup>77</sup> A final objection to the proposal is that while it facilitates administration of the mirror tax system, it does nothing to simplify the system's troublesome complexities.

The second proposal, that of providing technical assistance to the territories, is only a watered-down version of the first proposal. It answers concerns about taking away Guam's autonomy over its tax laws, as well as concerns about the cost to the I.R.S. Nevertheless, it does not affect the underlying complexities of the tax system, and doubts have been raised as to whether such assistance would even be effective in improving the administration of the tax laws unless such assistance is substantial and sustained.<sup>78</sup> While the Department of the Interior favored the alternative of comprehensive technical assistance,<sup>79</sup> this alternative has not made much headway in Congress.

The remaining two proposals resolve the underlying problems of the mirror system by eliminating it altogether. One method is to extend the United States income tax jurisdiction to include the Virgin Islands and Guam and to have the federal government remit all taxes attributable to the territories to their respective treasuries.<sup>80</sup> This proposal radically simplifies current law by eliminating the problems of interpreting the mirror system.<sup>81</sup>

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75. H. R. REP. No. 120, 96th Cong., 1st Sess. 3 (1979).

76. Comptroller General of the U.S., *supra* note 56, at 4.

77. S. REP. No. 467, 96th Cong., 1st Sess. 35-36 (1979).

78. Comptroller General of the U.S., *supra* note 56, at 3-4.

79. *Id.* at 4.

80. Hoff, *supra* note 15, at 94.

81. *Id.*

The plan was introduced in Congress by Senator Bennett Johnston in 1979, and in 1980, President Carter announced his support of the extension of the United States income tax system to the territories.<sup>82</sup> Nevertheless, the extension proposal has faced the same difficulty as the proposal for I.R.S. administration of the territorial income tax law; namely, that it reduces the territorial governments' autonomy over their own tax laws. Territorial opposition was strong enough to persuade the Carter administration to postpone indefinitely transmittal of legislation to Congress.<sup>83</sup>

The extension concept, however, has resurfaced in the Treasury Department's latest proposals for amending the federal income tax relationship with the territories.<sup>84</sup> This latest version, which is called "unification" of the federal and territorial tax jurisdictions, is similar to the 1979 and 1980 proposals. Under the plan, the I.R.S. will administer the federal income tax as it exists in the territories, and will remit much of the tax collected to the territorial governments.<sup>85</sup> In addition, this proposal allows the territories to rebate taxes only on territorial source income.<sup>86</sup>

Guam has not reacted any more favorably to the latest incarnation of this approach. Much of the opposition is again based upon the issue of Guam's sovereignty over its own tax laws.<sup>87</sup> In addition, the limit on what income is subject to tax rebates by the territories is opposed on the grounds that it will prevent Guam from becoming a financial or business center.<sup>88</sup> Thus, if any future changes in the tax system require the acceptance of the territories, the unification proposal is unlikely to be adopted.

The last proposal currently being considered by the Treasury Department also eliminates the mirror system, but does so by going so far as to make the territories independent for purposes of taxation. Under the plan, territories will administer their own separate tax laws and be treated under the I.R.C. as foreign countries with applicable foreign tax credits.<sup>89</sup> It provides financial and technical *assistance* by the federal government to develop alternatives to the present tax system and remits to the territories any federal income taxes paid by territorial residents.<sup>90</sup>

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82. *Id.* at 95.

83. *Id.* at 96.

84. Sanjuan letter, *supra* note 2, Alternative Proposals, Approach I.

85. *Id.*

86. *Id.*

87. OFFICE OF COMPILER OF LAWS FOR GUAM, ANALYSIS OF FEDERAL TAX PROPOSALS 1 (1983).

88. *Id.*

89. Hoff, *supra* note 15, at 96.

90. *Id.* at 96-97.

This approach is embodied in the second of the Treasury Department's proposals,<sup>91</sup> under which the territories inherit the current tax system (the Code as mirrored in their territory), but can change it to suit their individual needs. This proposal also results in the United States transferring to Guam more tax revenues than it does under current law. For example, taxes withheld from compensation received by individuals who work in the United States for part of the year, but who are resident in Guam at the end of the taxable year, are to be paid to Guam instead of retained by the United States under I.R.C. § 7654.<sup>92</sup>

Guam's reaction to this proposal has been much more favorable than toward the "unification" proposal. Nevertheless, there is concern that this proposal will lead to a dual filing requirement, as was the case before the 1972 amendments.<sup>93</sup> In addition, the proposal will eliminate I.R.C. §§ 881(b) and 1442(c), raising the possibility that United States corporations operating in Guam would again be subject to the thirty percent passive investment tax.<sup>94</sup> Even so, since the proposal lets the territories inherit the tax law as it is now mirrored in the territories, while allowing them to change their tax law to meet their own needs, the elimination of these sections may not be as great a problem as is currently believed.

This reform has the advantage of eliminating the underlying complexities of the mirror system while retaining territorial autonomy. This proposal, however, rests on the assumption that a new, relatively simple tax system can be developed which can be easily administered by the territories. Before any new tax systems can be developed, the territories may require more information regarding their potential sources of revenue and how they can and should be taxed.<sup>95</sup> The recent Treasury Department proposals may pave the way for future work on this alternative since there are likely to be more demands to develop independent income tax systems for the territories in the near future.

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91. Sanjuan letter, *supra* note 2, Alternative Proposals, Approach II.

92. For a discussion of I.R.C. § 7654, see *supra* text accompanying notes 41-47.

93. OFFICE OF COMPILER OF LAWS FOR GUAM, *supra* note 87, at 3-4.

94. *Id.* at 4.

95. The most recently published Census figures, based on payroll figures for 1977, show that the economy of Guam is divided as follows: 35% retail trade, 27% construction, 23% selected services (such as hotels), 8% manufacturing, and 7% wholesale trade. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, ECONOMIC CENSUSES OF OUTLYING AREAS: GUAM, vi (1980).