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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-194332 .

OCTOBER 3, 1979

The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives and
The Honorable Henry M. Jackson
Chairman, Committee on Energy
and Natural Resources
United States Senate

Subject: [The Government of Guam's Administration
of Its Income Tax Program] (GGD-80-3)

This report discusses the Government of Guam's effectiveness in administering its territorial income tax laws. Our observations should assist the Congress in evaluating those provisions of the Omnibus Territories Bill (H.R. 3756) which, if enacted, would transfer the administration and enforcement of the Guam territorial income tax from Guam to the Secretary of the Treasury. This bill was passed by the House of Representatives on May 7, 1979.

The Government of Guam is losing millions of dollars because of its continuing problems in assessing and collecting the territorial income tax. These problems have been repeatedly pointed out to the Government of Guam by professional auditors for at least 10 years. However, the problem appears to be getting worse. For example, delinquent taxes have increased from \$2.9 million in 1969 to over \$15 million in 1978, or about 16 percent of total local revenues collected by Guam.

The U.S. Internal Revenue Code was extended to Guam by the Organic Act of Guam, enacted in 1950. Subsequently, the Congress delegated to the Governor of Guam the administrative functions required to collect and retain income tax revenues for the purpose of operating the territorial government. The income tax is the major tax in Guam, providing 60 percent of its locally collected tax revenues. These revenues are supplemented by the transfer from the Federal treasury to the Guam treasury of Federal income taxes withheld from U.S. military and civilian personnel stationed in Guam. These transferred Federal income taxes amounted to \$15 million in 1979, while locally collected Guam income taxes were \$46 million.

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Presently, the Government of Guam lacks procedures for identifying individuals and businesses failing to file tax returns. We sampled 350 individuals and businesses in an attempt to identify nonfilers. It appears that over 20 percent of the individuals and businesses in our sample did not file a 1977 income tax return. However, due to the chaotic condition of the records, it was impossible to determine precisely how many returns should have been filed.

Another problem is that some employers failed to remit taxes withheld from employees. Unremitted withholdings totaled \$3.5 million as of June 30, 1978. In addition, an unknown amount of taxes withheld from employees is being lost from businesses which do not file withholding tax returns.

Guam's problem in administering the territorial income tax are contributing to Guam's inability to generate adequate revenues to meet its financial obligations and continue current levels of operation. Because of cash flow problems, the Government of Guam is having difficulties in meeting monthly payrolls, and cannot repay over \$13 million it has borrowed from special purpose funds to finance general fund expenses. Also, as of June 1, 1979, the Government of Guam could not pay income tax refunds of \$6 million and, by law, is incurring an interest expense on these unpaid refunds. In addition to the cash flow problems, the general fund deficit exceeded \$72 million as of June 30, 1978. Guam's financial problems are occurring in spite of increasing levels of Federal assistance, which in fiscal year 1979 amounted to \$110 million, or nearly 60 percent of the total revenues of the Government of Guam.

In commenting on a draft of this report, neither the Department of the Interior nor the Government of Guam denied the fact that Guam was having problems in effectively administering the territorial income tax program. However, both the Department of the Interior and Guam indicated that they were well aware of the problems and that measures were being taken to solve them.

These responses are similar to Guam's response to correct previously noted problems as pointed out over the last 10 years by other professional auditors.

Because of these continuing problems, and the similar responses, changes need to be made in the administration of the tax program. The Omnibus Territories Bill presents the opportunity for deciding the most appropriate means of administering Guam's territorial income tax program.

At a minimum there are three alternatives for administering the territorial income tax program. The alternatives are to

- take no congressional action;
- provide funds for the technical assistance necessary to improve the present administration of the program; or
- require the Secretary of the Treasury to administer the program.

TAKING NO CONGRESSIONAL ACTION

If the Congress takes no action on the laws relating to administering the Guam territorial income tax program, the autonomy of Guam to administer the program is retained. However, the problems with the present system are very serious and have existed for at least 10 years. On the basis of our review, it appears that significant improvement cannot be achieved under the present system. In addition, the Governor of Guam has indicated that Federal technical assistance to administer the program would be appreciated.

PROVIDING FUNDS FOR TECHNICAL ASSISTANCE

The alternative of providing substantial technical assistance has been available to Guam and the Department of the Interior for many years. However, while reports prepared by the U.S. Government Comptroller for Guam and certified public accountants pointed out serious problems in administering the program, no action was taken to provide substantial technical assistance.

We would be concerned about the value of technical assistance which is not substantial and which is not guaranteed to continue over an extended period of time. The "familia system," which refers to close family ties and the extended family concept, complicates collection of income taxes in Guam. This system creates opportunities for or the appearance of favoritism and conflicts of interest. In such an atmosphere, we do not believe that providing short term assistance while still maintaining Guam's administrative responsibility, will lead to correcting the extensive problems that exist. However, if such assistance were substantial and extended over a long time, it could improve the administration of the tax program and, to some extent, increase revenues.

The Internal Revenue Service could not estimate the costs of providing substantial technical assistance because it lacked the necessary information regarding the existing technical and management skills of the personnel on Guam. The Department of the Interior stated that it prefers the alternative of a comprehensive technical assistance program.

REQUIRING THE SECRETARY OF THE
TREASURY TO ADMINISTER THE
TERRITORIAL INCOME TAX PROGRAM

The third alternative is to transfer the administration of the territorial income tax program to the Secretary of the Treasury. The Omnibus Territories Bill provides for this transfer.

Although this transfer eliminates the autonomy of Guam to administer the territorial income tax program, significant opportunities exist to increase the tax revenues. The Internal Revenue Service could provide well-developed administrative machinery such as training programs, computer hardware and software, and experienced managers.

Internal Revenue Service officials advised us that they had the capability to implement such an administrative function if the Congress provided appropriate funding. If the Internal Revenue Service were to administer the Guam territorial income tax it estimates the cost would be in the range of \$2 to \$3 million per year.

In commenting on this alternative, the Department of the Interior stated that another course of action to be considered would be the assumption of the income tax administration by the Department of the Treasury for a period of time to be determined by the Governor of Guam.

SCOPE OF REVIEW

We reviewed certified public accountant reports and the U.S. Government Comptroller for Guam reports to become more familiar with the scope and background of the problem. We then independently evaluated and confirmed the findings developed in these reports by reviewing Guam's Department of Revenue and Taxation. We tested the timeliness of starting collection procedures, the administration of the installment agreement program, the use of property seizure,

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and the extent of nonfilers and delinquent accounts.
Details of our findings are included in enclosure I.

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We have obtained comments from the Departments of the Interior and Treasury, the Internal Revenue Service, and the Government of Guam on a draft of this report. The comments have been incorporated in this report, as appropriate, and are included as enclosures III, IV, V, and VI.

We are sending copies of this report to the Governor of Guam; the Secretaries of the Interior and the Treasury; and the Commissioner, Internal Revenue Service.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Thomas A. Hanks". The signature is written in a cursive style with a large initial "T".

Comptroller General
of the United States

Enclosure

THE GOVERNMENT OF GUAM IS LOSING
MILLIONS OF DOLLARS IN REVENUE
BECAUSE OF INEFFECTIVE ADMINISTRATION AND
ENFORCEMENT OF THE TERRITORIAL INCOME TAX LAW

The Government of Guam's problems in administering the territorial income tax are contributing to its inability to generate adequate revenues to meet its financial obligations and continue current levels of operation. Consequently, Guam is losing millions of dollars. Although auditors have pointed out these problems for 10 years, the situation seems to be getting worse.

This enclosure discusses the territorial income tax, the Omnibus Territories Bill (H.R. 3756), and problems relating to Guam's administration of the territorial income tax law.

GUAM'S TERRITORIAL INCOME TAX

The Organic Act of Guam, enacted on August 1, 1950, provides that the income tax laws of the United States shall also be applied in Guam. The Congress delegated to the Governor of Guam the administrative functions required to collect and retain the income tax revenues for the purpose of operating the territorial government.

Income taxes provided Guam \$61 million in fiscal year 1979. Of the \$61 million, Guam collected \$46 million, or 75 percent. The Federal Government collected the remaining \$15 million through wage withholdings from U.S. military and civil service personnel stationed in Guam. These Federal income taxes are transferred to the Guam treasury on a quarterly basis. (See enclosure II for a schedule of Guam--Government Finances and Tax Effort.)

The Guam Department of Revenue and Taxation administers and enforces the territorial income tax. In addition, it collects other local taxes and administers several regulatory activities. Of the department's \$2.5 million budget request for fiscal year 1980, an estimated \$900,000 is for the administration of the territorial income tax.

The Omnibus Territories Act of 1977 (Public Law 95-134) authorized the Guam Legislature to approve, if it desired, a separate tax of up to 10 percent of an individual's income

tax obligation due the territorial government. This separate taxing authority was to provide the territorial legislature income tax powers it lacked to obtain additional sources of revenue to meet rising program costs. The act enabled Guam to impose an additional tax on its citizens similar to a State income tax. As of June 30, 1979, the Guam Legislature had not enacted a separate income tax.

THE OMNIBUS TERRITORIES BILL

The Omnibus Territories Bill (H.R. 3756), which passed the House of Representatives on May 7, 1979, if enacted would transfer the administration and enforcement of the Guam territorial income tax from Guam to the Secretary of the Treasury by January 1, 1980. The bill directs the Secretary of the Treasury to administer and collect all income taxes at no cost to Guam and return those revenues to the territory. Similar provisions are contained in the legislation for the Commonwealth of the Northern Mariana Islands and the Virgin Islands.

The bill contains other provisions relating to the territories. These pertain to such items as funding levels for the territories and health care for radiation victims on selected islands. This enclosure only addresses the administration of the Guam territorial income tax and therefore pertains only to that aspect of the bill.

CORRECTIVE ACTION NOT TAKEN ON CHRONIC TAX ADMINISTRATION PROBLEMS

We reviewed reports relating to Guam's tax administration procedures prepared by certified public accountants (CPAs) and by the U.S. Government Comptroller for Guam. 1/ In addition, we independently evaluated and confirmed the findings developed in these reports. As far back as 1969 these reports have cited Guam's failure to effectively

1/The Organic Act of Guam, as amended, established the position of the U.S. Government Comptroller for Guam under the Department of the Interior. The act prescribed that the U.S. Government Comptroller's audits be directed to evaluating Guam programs, to recommending improvements which will result in greater economy and efficiency, and to insuring that Federal revenues deposited into the Treasury of Guam are accounted for properly.

- enforce collections,
- identify nonfilers,
- automate operations, and
- select returns for audit.

Over this 10-year period, Guam has not taken any substantial corrective actions even though it has received since 1969, specific recommendations on the types of corrective action that should be taken. The unwillingness, or inability, of Guam to do anything to correct these problems for such a long period of time leads us to question its capacity to operate an efficient, effective, and equitable tax administration system.

The following sections summarize Guam's problems in administering the territorial income tax.

Enforcing collections

Lack of timely and aggressive actions in collecting delinquent accounts have caused substantial revenue losses for Guam. The value of these accounts has increased from \$2.9 million in 1969 to over \$15 million in 1978, as reported by the U.S. Government Comptroller. The \$15 million delinquency represents 16 percent of the total local revenues that Guam collected in 1978.

The June 30, 1978, delinquent tax balances follow:

Income taxes:	
Individual	\$ 7,952,000
Corporate	708,000
Payroll taxes withheld and not remitted	<u>3,586,000</u>
Subtotal	<u>\$12,246,000</u>
General taxes (Gross receipt, alcohol, use tax, tobacco, admissions, hotel occupancy and liquid fuel)	<u>2,940,000</u>
Total	<u><u>\$15,186,000</u></u>

As far back as 1969, CPA reports have stated that Guam should improve its procedures for collecting delinquent accounts. The 1969 CPA report recommended that immediate action be taken to collect taxes at the time the delinquency occurs. The report continued:

"The collection of all income taxes due and payable is of primary importance to the Government in that it is the largest single source of revenue from which various programs are financed. The effectiveness of tax collection enforcement should be maintained at a high level of efficiency to properly insure that required revenues will be available when needed. Additionally, adequate collection enforcement is necessary to assure those individuals and firms who willingly meet tax-paying requirements that proper action is being taken in regard to those who do not properly meet their responsibilities and obligations."

The 1970 CPA report made several recommendations regarding collecting delinquent accounts, including aging receivables. The 1971, 1976, 1977, and 1978 CPA reports included recommendations for improving collections. However, the recommendations were generally limited to internal controls and accounting procedures. The 1978 CPA report indicates that serious internal control procedures still exist and states:

"* * * controls over tax return documents were found to be extremely weak and many selected returns could not be located for examination. Due to lapses in the recording of filed returns in the control logs, it was impossible to even determine precisely which tax returns had been filed during the year."

In 1970, the U.S. Government Comptroller for Guam reported that Guam's Department of Revenue and Taxation should make substantial improvements in practices and procedures relating to collecting taxes. The report continued that substantial revenues were lost because of the lack of sufficient collection efforts. It stated that the U.S. Government Comptroller identified over \$400,000 in delinquent taxes owed by legislators, Government employees, businessmen, and professionals.

The 1970 report recommended that aggressive, systematic, and continued periodic collection efforts be implemented immediately. The report also included the Department of Revenue and Taxation's response that corrective actions were taken or would be taken immediately.

In March 1979, the U.S. Government Comptroller for Guam issued another audit report on the Department of Revenue and

Taxation. It referred to an increase in delinquent income and business taxes and made several related recommendations. The recommendations on collection procedures included such items as collecting financial information on delinquent taxpayers, aging delinquent accounts, referring delinquent taxes for timely collections, filing timely notice of liens, and monitoring payment agreements. The Director of Revenue and Taxation agreed, in part, to the above recommendations.

We conducted an independent review of the collection activities of Guam's Department of Revenue and Taxation during May and June of 1979. In our review we tested the timeliness of starting collection procedures, the administration of the installment agreement program, and the use of property seizure.

We found that the department has inadequate procedures to assure that collection actions begin within a reasonable time. According to department officials, collection action should begin within 30 days after a tax becomes delinquent. However, our sample of 50 collection cases disclosed that 60 percent failed to meet this criteria. In more than 25 percent of the cases, it required over 90 days to inform the collection branch of the delinquency. This delay in beginning collection activity increases the difficulty in collecting delinquent accounts.

Delinquent taxpayers may agree to settle their accounts with installment agreements. However, the department does not effectively administer the installment agreement program. In our test of this program, we sampled 40 outstanding agreements and found approximately 45 percent of them to be delinquent for over 60 days.

The Department of Revenue and Taxation has the authority to file liens or seize delinquent taxpayers' properties to settle delinquent accounts. Seizure of property can be an effective tool in collecting delinquent taxes. However, the department has initiated only six seizure actions since January 1978. Two of these seizures resulted in full payment, and three others resulted in partial payment of the delinquent taxes.

In commenting on a draft of this report, Guam admitted that there have been problems in the past with collections and added it has been working to improve collections. Guam also noted a task force has been established to review all facets of tax collection.

Identifying nonfilers

The Department of Revenue and Taxation does not have a program to determine whether all persons required to file tax returns have done so.

The 1969 CPA report noted that during its audit, based on tests and random samples, it determined that many businesses and individuals had not filed tax returns. Division of Revenue and Taxation personnel stated that they were aware of the situation and would take appropriate action.

The 1970, 1971, and 1972 CPA reports included statements regarding the need for the Division of Revenue and Taxation to do more to identify nonfilers. The 1977 CPA report noted that "* * * there are no set procedures to assure that all individuals and organizations subject to taxes are filing their returns." The report also recommended that followup procedures be implemented for those individuals and organizations which have not filed. The 1978 CPA report contained similiar recommendations.

After reporting in 1970 that several Guam legislators had not filed tax returns, the U.S. Government Comptroller for Guam recommended that the Division of Revenue and Taxation establish controls to assure that all taxpayers file income tax returns.

In 1979 the U.S. Government Comptroller for Guam again found that the Department of Revenue and Taxation has no reasonable assurance that all taxpayers have filed tax returns. The U.S. Government Comptroller for Guam listed several cross checks for finding persons who have not filed tax returns. The Department of Revenue and Taxation agreed with the finding and stated that they planned corrective action.

We independently determined the seriousness of the non-filer problem. We sampled business listings and identified a significant number of potential nonfilers from those lists. We could not locate 26 percent of the 1977 returns for 152 businesses in our sample. We also identified firms which failed to obtain business licenses and did not pay gross receipts taxes. We obtained names of the businesses from the Guam telephone book and business listings maintained by the Guam Department of Labor and the Department of Revenue and Taxation.

The following table shows the results of our sample of businesses in Guam:

	<u>Number of firms</u>	<u>Nonfilers (note a)</u>	<u>No business licenses</u>	<u>Delinquent gross receipts taxes</u>
Telephone book	63	27	11	16
Revenue & taxation list	51	5	-	4
Labor list	<u>38</u>	<u>7</u>	<u>9</u>	<u>5</u>
Total	<u>152</u>	<u>39</u>	<u>20</u>	<u>25</u>
Percent	100	26	13	16

a/Because of the chaotic condition of the department's records, it was impossible to determine precisely how many returns had not been filed.

To identify individual nonfilers we compared a listing of Guam elected officials and employees from various offices to a Department of Revenue and Taxation listing of all taxpayers who had filed 1977 income tax returns. We also compared a listing of dentists, physicians, and attorneys obtained from the Guam telephone directory yellow pages to the master list. We could not locate 21 percent of the 1977 income tax returns for individuals included in our sample.

	<u>Individuals</u>	<u>Nonfilers (note b)</u>	<u>Percent</u>
Government of Guam employees and elected officials	143	27	19
Dentists	11	4	36
Physicians	16	4	25
Attorneys	<u>28</u>	<u>7</u>	<u>25</u>
Total	<u>198</u>	<u>42</u>	21

b/Because of the chaotic condition of the department's records, it was impossible to determine precisely how many returns had not been filed.

The lack of a formal program to identify and take aggressive action on nonfilers weakens Guam's territorial tax program. This was pointed out to Guam as early as 1971 when the CPA report for that year stated:

"In order for a self-assessing tax system to be successful, the public must be convinced that the government intends to police the filing of returns. Although tax collections resulting directly from follow-up on returns not filed may not appear to warrant the costs involved in the effort, additional economic benefits are present in the form of a public image which will induce wider compliance with the requirement to file returns."

Department officials agreed that nonfilers are a problem. In the 1980 budget request the Director of the Department of Revenue and Taxation informed the Guam Legislature that because of the manual system his ability to determine if taxes are filed is restricted. He stated that it would be necessary to automate the department's operations. Without these procedures the Government of Guam stands to lose millions of dollars.

In commenting on a draft of this report, Guam agreed that its methods for locating nonfilers have not been as effective as they should be, but added that the Internal Revenue Service is having similar problems. The nonfiler problems experienced by the Internal Revenue Service are not similar to those of Guam if the complexities and volume of the problems are considered. In addition, the Service already has in place mechanisms for detecting nonfilers and is currently taking additional steps to solve this perplexing problem. We believe Guam should also be working toward this objective.

Automating operations

Since 1970 the CPAs and the U.S. Government Comptroller have recommended that the Department of Revenue and Taxation automate its operations. The reports stated that through automation, the department could increase revenues, better allocate resources, and potentially reduce costs. In 1977 the CPA recommended that the department make a major commitment to automate the processing of tax returns. The CPA suggested the department request assistance from the Internal Revenue Service, which has long been involved in automated processing techniques. Action has not been taken on these recommendations to date because of budgetary constraints.

There are several areas in which automated processing would enable the department to increase revenues, increase voluntary compliance with tax laws, and provide a more effective management information system. Department officials agreed but were unable to provide any definite plans to automate in the near future.

The antiquated manual system is the cause of some of the problems being encountered in administering the tax program. However, we believe that any decision to automate operations should be accompanied by a major commitment of funds and resources for such a project. Automating operations, in itself, will not solve all of the present problems in administering the territorial income tax and, if not adequately planned and implemented, may not bring about any improvement.

In commenting on a draft of this report, Guam indicated there were budget restrictions in the past; however, the present administration is "fully committed" to an all out effort to computerize the Department of Revenue and Taxation.

Effectively selecting returns for audit

The Department of Revenue and Taxation lacks comprehensive standards and guidelines to insure an effective and unbiased selection of tax returns for audit. Furthermore, after a return is selected for audit, the department has inadequate procedures to insure uniformity in examining returns.

The 1975 CPA report commented on the judgmental basis of audit selection and added that comprehensive standards and guidelines should provide for more effective and unbiased selection. In 1975 Guam stated that improvement was needed in selecting returns for audit.

In 1979 the U.S. Government Comptroller for Guam noted that the Division of Revenue and Taxation has not (1) identified and concentrated audit efforts on return classes having unacceptably low levels of voluntary compliance with the law, (2) established criteria for identifying and selecting for examination returns with the highest audit potential, and (3) adequately documented questionable or unusual items in the screening of returns to show the basis for selection. The report also criticized the lack of evidence to indicate that quality audits had been performed.

The U.S. Government Comptroller for Guam estimated that \$1.2 million in additional taxes, penalties, and interest

during the 3 1/2 year-period ended June 30, 1978, was lost because questionable returns were not audited.

The Department of Revenue and Taxation agreed with the criticism concerning the lack of evidence relating to quality audits. However, the department disagreed with the comments regarding selecting of returns and stated that judgment was sufficient for selecting items to be audited.

In commenting on a draft of this report, Guam reiterated its belief that judgment is sufficient for selecting items to be audited.

Although judgment is important in selecting of returns for audit, it is not sufficient in the case of Guam. Guam's culture has developed around the "familia system," which refers to close family ties and the extended family concept. This familia system creates opportunities for or the appearance of favoritism through the elimination of returns selected for audit. This fact has been pointed out to Guam by the U.S. Government Comptroller for Guam. Because of this "system," it is imperative that criteria and procedures be established and followed. Such measures would insure that tax return selection for audit is unbiased and based primarily on a high probability of the need for tax changes.

Guam--Government Finances and Tax Effort
(Dollars in Millions)

	: FY 76 :	FY 77 :	FY 78 :	FY 79 1/ :	FY 80 1/ :
I. Federal assistance, total	<u>55.9</u>	<u>95.2</u>	<u>88.5</u>	<u>111.5</u>	<u>73.8</u> 2/
Ad hoc appropriations 3/	6.2	26.5	15.5	47.9	5.5 2/
Income taxes, covered over	13.4	18.4	14.8	15.4	15.0
Alcohol and tobacco excise taxes, covered over	1.7	1.6	2.0	1.7	2.6
Grants-in-aid	34.6	48.7	56.2	46.5	50.7
II. Net local taxes, total	<u>69.1</u>	<u>63.8</u>	<u>77.4</u>	<u>81.7</u>	<u>94.2</u>
Individual income tax	31.6	24.5	36.4	36.0	41.0
Corporate income tax, net of rebates	8.3	8.7	9.5	10.1	11.6
-- Gross receipts tax	18.8	23.1	25.8	27.2	33.0
Property tax	2.0	2.6	1.8	3.5	3.6
Other taxes and fees	8.4	4.9	3.9	4.9	5.0
III. Operating expenditures, General Fund	115.7	121.4	137.6	156.3	150.3
IV. General Fund operating surplus/deficit 4/	-19.9	-3.6	-10.1	-21.8	-11.0
V. Percentages of total revenues (I + II)					
Federal assistance	45%	60%	53%	58%	44% 2/
Net local taxes	<u>55%</u> <u>100%</u>	<u>40%</u> <u>100%</u>	<u>47%</u> <u>100%</u>	<u>42%</u> <u>100%</u>	<u>56%</u> <u>100%</u>
VI. Indicators of tax effort					
Net local taxes and covered over income taxes as percentage of gross territorial product	18% 5/	n.a.	n.a.	n.a.	n.a.
Net local taxes per capita, excluding military population 6/	\$782	\$689	\$800	\$810	\$897
Property tax as percentage of property assessment	0.5%	0.7%	0.5%	0.9%	0.9%

Office of the Secretary of the Treasury
Office of Tax Analysis

August 2, 1979

- 1/ All FY 79 and FY 80 amounts, with the exception of FY 79 ad hoc appropriations, are estimated.
- 2/ Figure is based on ad hoc funds authorized as of July 1, 1979.
- 3/ Laws which authorized ad hoc funds for Guam include P.L. 95-26, P.L. 95-134, P.L. 95-348, P.L. 95-373, and P.L. 95-465.
- 4/ The General Fund operating surplus/deficit does not correspond to the difference between total revenues (I + II) and operating expenditures of the General Fund (III) because certain Federal grants-in-aid and ad hoc appropriations do not go into the General Fund for operating expenses, but go for capital improvement projects or into funds for special purposes.
- 5/ This percentage is the share of gross territorial product represented by net local taxes (tabulated in II) plus Federal income taxes on U.S. military and civilian employees in Guam, covered over to Guam (tabulated in I). These taxes may be considered taxes of local origin, even though federally collected and covered over. The share of gross territorial product represented by net local taxes alone (corresponding to II, above) is 14%. These percentages are estimated on the basis of gross product statistics for the previous calendar year in Russell C. Kreuger and Clara M. Okada, "The Gross Island Product of Guam," Department of Commerce, Government of Guam.
- 6/ In dollars. This amount is the ratio of net local taxes (tabulated in II) to non-military population in the previous calendar year. It is estimated on the basis of 1975 and 1980 population statistics provided by the Guam Bureau of Planning.

n.a. - Not available

Source: U.S. Treasury Department. The underlying data were provided by the U.S. Government Comptroller for Guam.



United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

SEP 11 1979

Mr. Henry Eschwege, Director
Community and Economic Development
Division
United States General Accounting
Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This is in response to your letter of September 7, 1979, in which you requested comments by September 14, on your draft report concerning the Government of Guam's effectiveness in administering its territorial income tax laws. We regret that we have had so little time to review this very important report. We would have liked to have had time to confer with the Government of Guam concerning the points made. In the usual case, we would want to consider its views before we develop our position.

As is mentioned throughout your report, this Department's comptrollers for Guam have, for approximately ten years, detailed specific areas of the Guam tax collection effort that needed to be strengthened. It is part of our responsibility to the territories to point out aspects of territorial administration that can be improved. Such constructive criticism is of assistance to governments that are in the process of developing their administrative expertise and is also a method for the Federal Government to ascertain the benefits of its financial assistance to the territories. The problems that our comptrollers have reported in Guam exist in the other territories as well. The problem is not a new one nor has it only recently been brought to the attention of Congress. The tax collection effort of the Government of Guam has been under continual study, recommendations have frequently been made, and efforts have been undertaken by Guam to improve its tax collection.

Your report frequently mentions "a concept of 'sovereign right'",¹ and suggests that as an argument in favor of Guam's retention of its income tax administration responsibilities. We do not know who espouses such a concept, and we have not earlier encountered that argument. If there were an argument that Guam has a "sovereign right" to collect the Federal income tax, a responsibility that Guam is actually given by Federal law, we believe that argument would not merit the attention the report gives it.

¹/See GAO comments this enclosure page 4.

Guam is not "sovereign",^{1/} as the word is usually used. United States laws apply to Guam, the flag of the United States flies over Guam, and Guamanians are United States citizens by birth. There is no question that Guam is a part of the United States, although it is a unique part, with a distinct relationship to the Federal Government.

Because Guam is not a State, but rather a territory, it falls under the jurisdiction of the United States Congress, in accordance with Article IV, Section 3 of the Constitution. In exercising its jurisdiction over the territories, Congress has consistently followed a policy of encouraging the Government of Guam and its other territories to accept the authority and the responsibility of administering their own internal governmental affairs. This policy is exemplified by Section 30 of the Organic Act of Guam (64 Stat. 392, 48 USC 1421n.) that gave the Government of Guam the power to collect and administer the Federal income tax as a territorial tax.

In the years since 1970 during which Guam has had an elected Governor, the Government of Guam has made efforts to improve its tax collection. We do not think it is appropriate, given such a short period of elected administration in Guam, to conclude, as the report does on page 3, that no significant improvement can be made under the present system. In recent years, the Federal Comptroller for Guam has criticized not only the tax collection efforts but also a number of administrative efforts of the Guam Government. The Office of Territorial Affairs of this Department has followed this criticism with technical assistance whenever feasible. In late 1978, at the request of the governor, our Department initiated the development of an automated financial management system to handle appropriation accounting, revenue accounting, the general ledger and the accounts payable journal, and budget preparation and execution. While this system is not now directly geared to the administration of the income tax on Guam, it will be adaptable for future programming and is now setting the stage for the computerization of other GovGuam administrative functions.

We understand from the Government of Guam that the technical assistance in income tax collection that has been provided to them has, in the past, been occasional and unorganized. The few Internal Revenue employees who have provided short-

^{1/} See GAO comments this enclosure page 4.

term assistance to Guam have been at Guam's expense. A full technical assistance project to the Government of Guam has yet to be tried.

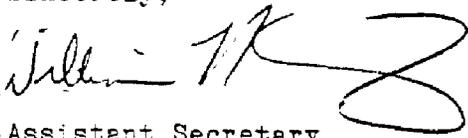
Congress's longstanding policy of encouraging self-government in the United States territories has been wise, in our view, and highly praised. The application of the federal income tax to Guam in 1950 made it possible for Guam to utilize a well-tested and equitable system of taxation without having to devise such a system on its own. Guam has benefited from the tax because the revenues are covered into its treasury, and it seems to us proper that those who benefit from the tax have the responsibility to enforce it. To terminate the Government of Guam's responsibility to administer the federal income tax collection on Guam at this time, now that the chief executives of Guam are elected rather than appointed, would, almost certainly, inspire criticism in this territory as well as in the committees of the United Nations that frequently allege that the United States' interest in Guam is colonial.

We believe that all of the alternatives to terminating this responsibility of the Government of Guam's have not been adequately addressed in this report. We advocate a comprehensive effort, funded by the Federal Government, organized and implemented by the U.S. Treasury Department at the request of the Government of Guam, to train GovGuam employees in the efficient execution of their authority. This could be accomplished by either of two methods: (1) a comprehensive technical assistance program conducted by the Department of the Treasury at the request of the Government of Guam, the method we prefer, or (2) the assumption by the Department of the Treasury of Guam's income tax administration, for a period of time determined by the Governor of Guam, employing and training Guamanian personnel. We believe that these are better alternatives than divesting Guam of its income tax collection responsibility.

We are glad to have had an opportunity to comment.

Sincerely,

Acting
Deputy


Assistant Secretary
Policy, Budget and
Administration

GAO COMMENTS:

Our earlier reference to "sovereign right" was not intended to imply that Guam possessed the attributes of "sovereignty" as that concept is commonly understood. Rather, by using the phrase "sovereign right" in quotes, we were rather trying to convey the concept of local autonomy given to Guam to administer and collect its taxes. In view of the confusion engendered by this phrase, we have deleted it from the final report and substituted "autonomy" where it earlier appeared.

ENCLOSURE IV

ENCLOSURE IV



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

SEP 17 1979

Dear Mr. Staats:

We have reviewed your draft report to the Chairman, Senate Committee on Energy and Natural Resources, entitled "Government of Guam's Effectiveness in Administering its Territorial Income Tax Laws." We find it to be an excellent and welcome analysis of tax administration problems in Guam. It will prove useful both to the Administration and the Congress in considering the merits of the Omnibus Territories Bill, H.R. 3756.

We are enclosing a separate memorandum of specific recommendations for revisions. We have discussed these comments with your staff and have been assured that they will be considered.

Sincerely yours,

Donald C. Lubick

The Honorable
Elmer B. Staats
Comptroller General of the United States
441 G Street, N.W.
Washington, D.C. 20548

Enclosure

GAO NOTE: The enclosure contained technical and editorial recommendations which we considered and changes were made where applicable. These changes did not affect the position stated in the draft report.

COMMISSIONER OF INTERNAL REVENUE

Washington, DC 20224

Mr. Allen R. Voss
Director, General Government Division
General Accounting Office
Washington, DC 25048

Dear Mr. Voss:

We appreciate the opportunity to review your draft report entitled, "Government of Guam's Effectiveness in Administering its Territorial Income Tax Laws." The report indicates that there are administrative problems and presents the following three alternatives for consideration by the Congress: take no action; fund substantial technical assistance; or require Treasury administration of the territorial income tax. We are unable to forecast the effect of these alternatives on Guam tax receipts.

The cost of providing substantial technical assistance to Guam cannot be estimated since we do not have the necessary information regarding the existing technical and managerial skills of the personnel on Guam.

With regard to Treasury's administering the Guam territorial income tax, while we have not run detailed analyses of projected costs of administering a "mirror image" Code, we would estimate that the cost of administering such a Code for the 100,000 persons on Guam would be in the range of \$2 million and \$3 million per year. Of course, this estimate could change depending on the content of enacted legislation.

With kind regards,

Sincerely,

A handwritten signature in black ink, appearing to read "James B. ...". The signature is written in a cursive style with a large initial "J" and a long horizontal stroke.

Department of the Treasury Internal Revenue Service



Territory of Guam
 OFFICE OF THE GOVERNOR
 AGANA, GUAM 96910
 U.S.A.

SEP 24 1979

Victor L. Lowe, Director
 United States General
 Accounting Office
 Prince Jonah Kuhio Kalaniana'ole
 Federal Building
 300 Ala Moana Boulevard
 Honolulu, Hawaii 96813

Dear Mr. Lowe:

The following comments are submitted in reply to the draft of your proposed report to the Honorable Henry M. Jackson, Chairman, Committee on Energy and National Resources, United States Senate.

Enforce collection

The Department has established a task force to review all facets of processing of returns and the collection of taxes. This study is intended to lend itself to computerization, but will be the basis of a revised manual system to expedite operations until converted. It is ultimately planned that taxpayer statements and aged receivable listings will be provided through data processing. Computerization will also allow for expeditious processing and referral which will afford prompt collection follow-up.

While admitting that there have been difficulties in the past, we have been working to improve collections. The revenue officers' case loads are now being closely reviewed. Small inactive accounts are being documented and 53'd. Larger accounts, which promise to be more productive, are being assigned. Liens are being filed to protect the Government's interest and seizures are being initiated. The collection of delinquents has improved but continuous efforts are being applied.

Identifying non-filers

We agree that our methods for locating non-filers have not been as effective as they should be, however, in the area of matching W-2s and other documents we have had to perform this function manually on a sampling basis. In a speech given by Internal Revenue

Commissioner Kurtz on March 12, 1979, he stated that it wasn't possible in the past to match Form W-2 filed on paper, but now that Health, Education and Welfare is processing Forms W-2 into tape files, IRS will be able to use their tapes to match all returns against Form W-2 information.

In the September 1979 issue of Tax Administrators News, at page 106, an article points out that the GAO "estimates that five (5) million people owing \$2 billion in income taxes did not file returns in 1972 (the most recent year for which reasonable complete data was available). In this report, GAO recommends that IRS develop better criteria for selecting potential non-filers for investigation", etc.

Automate operation

The present Administration is fully committed to an all out effort to computerize the Department of Revenue and Taxation. The Department is currently seeking price quotations for assistance in systems design and programming from various firms in the private sector as well as the Internal Revenue Service. It is presently making limited use of the Department of Administration computer by controlling tax returns through controlled locator numbers and in the preparation of income tax refunds. In the past budgetary restrictions precluded the Department from computerizing although management intended to convert manual operations to data processing.

Selecting returns for audit

We believe that the auditors are incorrectly assuming that Guam's method of selecting tax returns for audit is different from the Internal Revenue Service.

Although the IRS is a large organization with millions of filed tax returns on hand they also rely on the judgment of experienced technical personnel for the selection of returns for audit. While it is true that IRS has certain criteria programmed into their computer system which identifies returns for audit, this is only the initial procedure used to screen out the large volume of filed returns that are least likely to require an audit. The Audit Technique Handbook for Internal Revenue Agents, Section 220, Chapter 200 states, "(6) The identified returns are then made available to district employees designated as classifiers who were selected from experienced tax auditors and revenue agents. They screen and select those returns most in need of examination."

Retired former Internal Revenue managers working for the Department of Revenue and Taxation have assured me that local group managers and revenue agents of the Internal Revenue Service also screen the returns selected by the classifiers, and on a judgmental basis determine which selected returns should be audited. Returns not selected for audit are then returned to the Service Center files. All returns not under audit at the end of an established audit cycle, which may be 24 or 26 months after the filing due date, are returned to the Service Center files. The amount of potential tax in these unaudited returns is ignored.

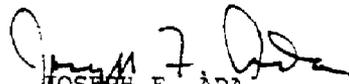
Returns selected for audit do not require documented reasons for selection. It is sufficient if a classification form is attached listing the principal items which in the judgment of the classifier warrant examination.

The judgmental selection of tax returns for audit at the local level, especially in small communities, can be compared to the situation on Guam. The so called "Familia System" referred to in your report is an unfounded accusation. Under the previous administration, and the current administration, the tax returns of many high ranking governmental officials and influential professional and business people have been selected for audit.

A security area has now been erected to house all tax returns.

I believe that consideration should be given to our comments before your report has been finalized for submission to the Committee.

Sincerely yours,


JOSEPH F. ADA
Acting Governor