



OFFICE OF THE GOVERNOR
TERRITORY OF GUAM

March 5, 1996
 3:25 pm
 Sent by: *Phiselle*
 Name: *Roberto*

**REFER TO
LEGISLATIVE SECRETARY**

MAR 05 1996

The Honorable Don Parkinson
Speaker
Twenty-Third Guam Legislature
424 West O'Brien Drive
Julale Center - Suite 222
Agana, Guam 96910

OFFICE OF THE LEGISLATIVE SECRETARY
 ACKNOWLEDGMENT RECEIVED
 Received By *Chapman*
 Time *4:12 P.M.*
 Date *3-5-96*

Dear Speaker Parkinson:

Enclosed please find a copy of Substitute Bill No. 481 (LS), "AN ACT TO ADD A NEW §4108 TO TITLE 11, GUAM CODE ANNOTATED, RELATIVE TO MAKING THE EARNED INCOME TAX CREDIT APPLICABLE TO GUAM", which I have numbered as **Public Law 23-74**.

Very truly yours,

Madeleine Z. Bordallo
Madeleine Z. Bordallo
Acting Governor of Guam

Attachment

231018

TWENTY-THIRD GUAM LEGISLATURE
1996 (SECOND) Regular Session

CERTIFICATION OF PASSAGE OF AN ACT TO THE GOVERNOR

This is to certify that Substitute Bill No. 481 (LS), "AN ACT TO ADD A NEW §4108 TO TITLE 11, GUAM CODE ANNOTATED, RELATIVE TO MAKING THE EARNED INCOME TAX CREDIT APPLICABLE TO GUAM," returned to the Legislature without approval of the Governor, was reconsidered by the Legislature and after such reconsideration, the Legislature did, on the 28th day of February, 1996, agree to pass said bill notwithstanding the objection of the Governor by a vote of two-thirds or more of all the members thereof, to wit; by a vote of seventeen (17) members.



DON PARKINSON
Speaker

Attested:



JUDITH WON PAT-BORJA
Senator and Legislative Secretary

This Act was received by the Governor this 1st day of MARCH,
1996, at 5:40 o'clock P.M.



Assistant Staff Officer
Governor's Office

Public Law No. 23-74

TWENTY-THIRD GUAM LEGISLATURE
1996 (SECOND) Regular Session

Bill No. 481 (LS)
As substituted by the author

Introduced by:

F. P. Camacho
A. C. Blaz
S. L. Orsini
T. C. Ada
E. Barrett-Anderson
J. M. S. Brown
M. C. Charfauros
M. Forbes
A. C. Lamorena
C. A. Leon Guerrero
L. A. Leon Guerrero
T. S. Nelson
V. C. Pangelinan
D. Parkinson
A. L. G. Santos
F. E. Santos
A. R. Unpingco
J. Won Pat-Borja

AN ACT TO ADD A NEW §4108 TO TITLE 11, GUAM
CODE ANNOTATED, RELATIVE TO MAKING THE
EARNED INCOME TAX CREDIT APPLICABLE TO
GUAM.

1 **BE IT ENACTED BY THE PEOPLE OF THE TERRITORY OF GUAM:**
2 **Section 1.** The legislature hereby disagrees with the legal analysis and
3 policy conclusions enumerated by the Director of the Department of Revenue
4 and Taxation in Revenue Ruling 96-001, a ruling which has been approved by
5 the Attorney General of Guam.

1 The Legislature intends to make the Earned Income Tax Credit (EIC)
2 available to the taxpayers of Guam both as a matter of tax policy and social
3 policy.

4 **Section 2.** A new §4108 is added to Title 11, Guam Code Annotated, to
5 read as follows:

6 “§4108. **Earned Income Tax Credit Applicable to Guam.** (a)
7 Title 26 U.S.C. Section 32, also known as Section 32 of the
8 Internal Revenue Code, all related federal tax statutes and
9 regulations necessary for the enforcement of the Earned Income
10 Tax Credit which it creates, are hereby made applicable to Guam.
11 The Department of Revenue and Taxation shall make the Earned
12 Income Tax Credit (EIC) available to Guam taxpayers to the full
13 extent permitted by federal law.

14 (b) The Department of Revenue and Taxation shall certify to
15 the Department of Administration every year the amounts
16 necessary to pay such sums as are required by this statute to be
17 paid to Guam taxpayers.

18 (c) There is hereby appropriated from the General Fund, on
19 a continuing basis, such funds as are necessary to give this statute
20 its full force and effect.”

21 **Section 3. Transfer Authority Increased.** In addition to the transfer
22 authority authorized by P. L. 23-45 and P. L. 23-46, the Governor is
23 authorized to transfer up to an additional Three percent (3%) from any
24 outstanding appropriations for the sole purpose of paying valid claims for the
25 earned income tax credit.

26 **Section 4.** This Act will take effect immediately after its enactment.

TWENTY-THIRD GUAM LEGISLATURE

1996 (SECOND) Regular Session

Overridden

Date: 2/28/96

VOTING SHEET

Bill No. VB 481

Resolution No.

Question: "Shall VB 481 be enacted into law, without amending the Government Code"

NAME	YEAS	NAYS	NOT VOTING/ ABSTAINED	ABSENT/ OUT DURING ROLL CALL
ADA, Thomas C.	✓			
AGUON, John P.		✓		
BARRETT-ANDERSON, Elizabeth	✓			
BLAZ, Anthony C.	✓	✓		
BROWN, Joanne S.	✓			
CAMACHO, Felix P.	✓			
CHARFAUROS, Mark C	✓			
CRISTOBAL, Hope A.	✓			
FORBES, MARK III		✓		
LAMORENA, Alberto C., V III		✓		
LEON GUERRERO, Carlotta	✓			
LEON GUERRERO, Lou	✓			
NELSON, Ted S.	✓			
ORSINI, Sonny L.	✓			
PANGELINAN, Vicente C	✓			
PARKINSON, Don	✓			
SAN AGUSTIN, Joe T.		✓		
SANTOS, Angel L. G.	✓			
SANTOS, Francis E.	✓			
UNPINGCO, Antonio R.	✓			
WONPAT-BORJA, Judith	✓			

TOTAL 17 ⁺⁶ ~~17~~ 4 0 0

CERTIFIED TRUE AND CORRECT:

Recording Secretary 3 passes is a no vote.

23-74



**TWENTY-THIRD
GUAM LEGISLATURE**
155 Hesler St.
Agana, Guam 96910

Senator Francis E. Santos

Chairperson, Committee on Ways & Means

Phone: (671) 472-3414/5 Fax: (671) 477-3048

96 FEB 15 PM 3:50

February 13, 1996

Honorable W. Don Parkinson
Speaker,
Twenty - Third Guam Legislature
155 Hesler Street
Agana, Guam 96910

Dear Speaker Parkinson:

The Committee on Way and Means, now reports its findings on Bill #481 **An act to make the earned income tax credit applicable to Guam** to the full legislature with the recommendation to pass.

Votes of the Committee members are as follows:

To Pass:	<u>7</u>
Not To Pass:	<u>3</u>
Abstain:	<u>0</u>
Inactive File:	<u>0</u>
Off Island:	<u>0</u>
Unavailable	<u>0</u>
Report out only	<u>0</u>

Copies of the Committee Report and all pertinent documents are attached for your information.

Respectfully,

Francis E. Santos

Member,

Committee on
Economic-Agricultural
Development & Insurance

Member,

Committee on
Electrical Power &
Consumer Protection

Member,

Committee on Federal
& Foreign Affairs

Member,

Committee on Rules

Member,

Committee on
Tourism & Transportation

Member,

Commission on
Self-Determination

Member,

Guam Finance Commission



**TWENTY-THIRD
GUAM LEGISLATURE**
155 Hesler St.
Agana, Guam 96910

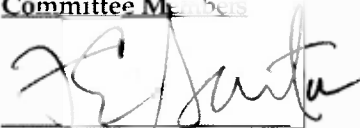

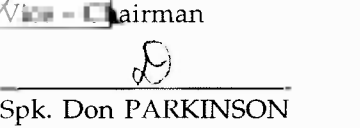
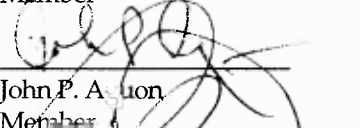

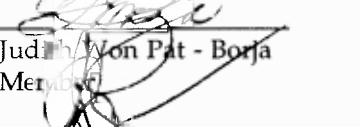
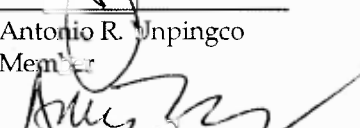
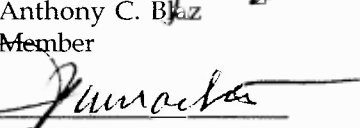
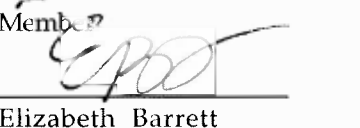
Senator Francis E. Santos

Chairperson, Committee on Ways & Means

Phone: (671) 472-3414/5 Fax: (671) 477-3048

Voting Sheet

On Bill #481 An act to make the earned income tax credit applicable to Guam.

	<u>Committee Members</u>	<u>To Pass</u>	<u>Not To Pass</u>	<u>To Abstain</u>	<u>For the Purpose Discussion</u>
	 Francis E. SANTOS Chairman	<input checked="" type="checkbox"/>			
Member, Committee on Economic-Agricultural Development & Insurance	 Joe T. SAN AGUSTIN Vice - Chairman		<input checked="" type="checkbox"/>		
Member, Committee on Electrical Power & Consumer Protection	 Spk. Don PARKINSON Member		<input checked="" type="checkbox"/>		
Member, Committee on Federal & Foreign Affairs	 John P. A. Ison Member		<input checked="" type="checkbox"/>		
Member, Committee on Rules	 Sohy L. Orsini Member		<input checked="" type="checkbox"/>		
Member, Committee on Tourism & Transportation	 Judith Won Pat - Borja Member		<input checked="" type="checkbox"/>		
Member, Commission on Self-Determination	 Antonio R. Unpingco Member		<input checked="" type="checkbox"/>		
Member, Guam Finance Commission	 Anthony C. Blas Member		<input checked="" type="checkbox"/>		
	 Felix P. Camacho Member		<input checked="" type="checkbox"/>		
	Elizabeth Barrett -Anderson Member				

**Twenty Third Guam Legislature
Committee on Ways and Means
SENATOR FRANCIS E. SANTOS, CHAIRMAN
Committee Report**

**on
Bill #481 AN ACT TO MAKE THE EARNED
INCOME TAX CREDIT APPLICABLE TO
GUAM**

Introduction

A public hearing was held on Friday, February 2, 1996 at 9:00 a.m. to hear public testimony on Bill #481, **An act to make the earned income tax credit applicable to Guam.**

Committee Members Present

Senator Francis E. Santos, Chairman; Senator Tony C. Blaz; Senator Felix P. Camacho; Senator Tony R. Unpingco; Senator Judith Won Pat Borja; Senator Elizabeth Barrett-Anderson; Non Members Present included, Senator Tom Ada; Senator Ben Pangelinan; Senator Lou Leon Guerrero; Senator Hope Cristobal; and Senator Ted S. Nelson.

Witnesses Present

Mr. Joseph T. Duenas, Director Department of Revenue and Taxation was the only witness present.

Testimony

Mr. Duenas testified that he would stand by his ruling number 96-001 and that if the legislature so chose to appropriate the sum necessary for the Earned Income Credit he would gladly pay it out. There were no detailed questions regarding this issue.

Also entered into the record is a legal opinion issued by the National Legal Research Group, Inc. based in Virginia on this issue at the request of the Speaker.

Findings

The Committee on Ways and Means finds that the Director of Revenue and Taxation did not have the authority to issue the ruling declaring that the Earned Income Tax Credit did not apply to Guam. (Page 6. National Legal Research Group, Inc. Ruling).

Recommendations

The Committee on Ways and Means now reports out bill #481 with the recommendation to do pass.

TWENTY-THIRD GUAM LEGISLATURE
1995 (Second) Regular Session

Substitute Bill No. 481
as substituted by the author

Introduced By:

F.P. Camacho
A.C. Blaz
S.L. Orsini

**AN ACT TO MAKE THE EARNED INCOME TAX CREDIT
APPLICABLE TO GUAM.**

1

2 BE IT ENACTED BY THE PEOPLE OF THE TERRITORY OF
3 GUAM:

4 **Section 1.** The legislature hereby disagrees with the legal
5 analysis and policy conclusions enumerated by the Director of the
6 Department of Revenue and Taxation in Revenue Ruling 96-001, a
7 ruling which has been approved by the Attorney General of Guam.

8 The legislature intends to make the Earned Income Tax Credit
9 (EIC) available to the taxpayers of Guam both as a matter of tax
10 policy and social policy.

11 **Section 2.** A new section 4108 is added to Title 11, GCA, to read
12 as follows:

13 "Section 4108 Earned Income Tax Credit Applicable to Guam (
14 a) Title 26 U.S.C. Section 32, also known as Section 32 of the Internal
15 Revenue Code, all related federal tax statutes and regulations
16 necessary for the enforcement of the Earned Income Tax Credit
17 which it creates, are hereby made applicable to Guam. The
18 Department of Revenue and Taxation shall make the Earned Income

1 Tax Credit (EIC) available to Guam taxpayers to the full extent
2 permitted by federal law.

3 (b) The Department of Revenue and Taxation shall certify to
4 the Department of Administration every year the amounts necessary
5 to pay such sums as are required by this statute to be paid to Guam
6 taxpayers.

7 (c) There is hereby appropriated from the General Fund, on a
8 continuing basis, such as are necessary to statute its full force and
9 effect.”

10

11 **Section 3. Funding source.** The Tax Reserve Fund is hereby
12 identified as a funding source for the Earned Income Tax Credit
13 payments.

14

15 **Section 4.** This Act will take effect immediately after its
16 enactment.

FISCAL NOTE
BUREAU OF BUDGET AND MANAGEMENT RESEARCH

BBMR-F7

Bill Number: 481 Date Received: February 01, 1996
 Amendatory Bill: No Date Reviewed: February 14, 1996

Department/Agency Affected: Department of Revenue & Taxation
 Department/Agency Head: Joseph Duenas, Director
 Total FY Appropriation to Date: \$12,414,644

Bill Title (preamble): AN ACT TO MAKE THE EARNED INCOME TAX CREDIT APPLICABLE TO GUAM.

Change in Law: N/A

Bill's Impact on Present Program Funding:

Increase XXX Decrease _____ Reallocation _____ No Change _____

Bill is for:

Operations XXX Capital Improvement _____ Other _____

FINANCIAL/PROGRAM IMPACT

ESTIMATED SINGLE-YEAR FUND REQUIREMENTS (Per Bill)			
PROGRAM CATEGORY	GENERAL FUND	OTHER	TOTAL
Economics & Finance	<u>11</u>		

ESTIMATED MULTI-YEAR FUND REQUIREMENTS (Per Bill)						
FUND	1st	2nd	3rd	4th	5th	TOTAL
GENERAL	<u>11</u>					
OTHER						
TOTAL						

FUNDS ADEQUATE TO COVER INTENT OF THE BILL? No - IF NO, ADD'L AMOUNT REQUIRED \$11,030,740
 AGENCY/PERSON/DATE CONTACTED: Department of Revenue & Taxation/Joseph Bamba/February 14, 1996

ESTIMATED POTENTIAL MULTI-YEAR REVENUES						
FUND	1st	2nd	3rd	4th	5th	TOTAL
GENERAL FUND	<u>N/A</u>					
OTHER						
TOTAL						

ANALYST MS
 Maerica M. Dizon

DATE 2/14/96

DIRECTOR Francisco Balaguer
 Joseph E. Rivera, Acting

DATE FEB 14 1996

FOOTNOTES: See attached.

Bill 481 proposes to make the Earned Income Tax Credit available to Guam taxpayers to the full extent every year permitted by federal law. In tax year 1994 the Department of Revenue & Taxation paid out \$11,030,740 of Earned Income Tax Credit, on top of the estimated \$6,000,000 in income tax refunds to those Guam Taxpayers that qualified for the Earned Income Tax Credit. According to Joseph Bamba of the Department of Revenue & Taxation, the proposed payment of Earned Income Tax Credit is estimated to be approximately between \$14 and \$16 million, on top of the income tax refunds to Guam Taxpayers that qualify for the Earned Income Tax Credit.

TWENTY-THIRD GUAM LEGISLATURE
1995 (FIRST) Regular Session

Bill No. 481 AD SUB. TAX. BY REV.
Introduced by:

F.P. Camacho
ACBLAZ MB

**AN ACT TO MAKE THE EARNED INCOME TAX CREDIT
APPLICABLE TO GUAM.**

1 BE IT ENACTED ON BY THE PEOPLE OF THE TERRITORY OF GUAM:
2
3

4 **Section 1.** The legislature hereby disagrees with the legal analysis and policy conclusions
5 enumerated by the Director of Revenue and Taxation in Revenue Ruling 96-001, a ruling which
6 has been approved by the Attorney General of Guam.

7 The legislature intends to make the Earned Income Tax Credit (EIC) available to the
8 taxpayers of Guam both as a matter of tax policy and social policy.

9 **Section 2.** A new section 4108 is added to Title 11, GCA, to read as follows:

10 "Section 4108 Earned Income Tax Credit Applicable to Guam. (a) Title 26 U.S.C. Section 32,
11 also known as Section 32 of the Internal Revenue Code, all related federal tax statutes and
12 regulations necessary for the enforcement of that statute and the Earned Income Tax Credit which
13 it creates, are hereby made applicable to Guam. The Department of Revenue and Taxation shall
14 make the Earned Income Tax Credit (EIC) available to Guam taxpayers to the full extent
15 permitted by federal law.

16 (b) The Department of Revenue and Taxation shall certify to the Department of Administration

1 every year the amounts necessary to pay such sums as are required by this statute to be paid to
2 Guam taxpayers.

3 (c) There is hereby appropriated from the General Fund, on a continuing basis, such funds as are
4 necessary to give this statute its full force and effect.”

5 **Section 3.** This Act will take effect immediately after its enactment.

JAN. 17. 1996 3:40PM

NAT. LEGAL RESEARCH

NO. 444

P. 2

W. ANDREW McCAUGHEY
 ALVIN B. H. MIRMELSTEIN, JR.
 EDWARD E. CEJNER
 STEPHEN R. HAN
 JAMES P. WITT
 MICHAEL D. JAFFE
 GARY B. CARGILL
 JOHN M. STONE
 DOUGLAS C. FLANK
 DENNIS T. BURNS
 JOSEPH ROBINSON
 ROBERT B. MCKINNEY
 EDWARD F. SULLIVAN, III
 MARK S. LINDENSMITH
 JOAN L. COBB
 TIMOTHY J. SNIDER
 THOMAS H. ROMER
 MARGARET H. POTTS

NADINE E. RODDY
 KATH A. BRASWELL
 DAVID R. HARTMAN
 CHRISTOPHER C. HUDSON, JR.
 JEFFREY L. COLE
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 BRETT R. TURNER
 MARK V. NEENA
 DOUGLAS E. MCKUSICK
 ELIZABETH E. SWING
 MARK C. BROCKI
 KAREN E. MICHIE
 ELEANOR L. CROSSMAN
 STEVEN SHARER
 ALFRED C. SHACKELFORD, III
 JOHN F. BUCKLEY
 WENDY SIMPSON BUCKETTS
 D. BRADLEY PETTIT

NATIONAL LEGAL RESEARCH GROUP, INC.

25 Years of Service to the Legal Profession

2421 IVY ROAD
 POST OFFICE BOX 7187
 CHARLOTTESVILLE, VIRGINIA 22906-7187
 800-727-6674 FAX # 804-295-4667

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 PHOEBE FROECH
 LESLIE L. WILCOX
 SANDHYA K. KOWDLEY
 CHARLES W. DAVIS
 STEVEN M. CARLSON

January 17, 1996

Honorable Speaker Don Parkinson
 Suite 222
 Julale Center
 424 West O'Brien Drive
 Agana, Guam 97910

Re: Guam-Federal/Tax/Individual Income/Earned Income Tax
 Credit

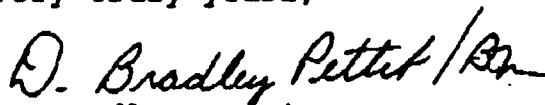
File: 49-12174-112

Dear Mr. Speaker:

I am sending herewith a draft of a memorandum of law addressing the questions you have posed regarding the applicability of the earned income tax credit in Guam. Please review the draft memorandum and let me know if I have missed any question or need to explore a particular issue in greater depth. To date, I have expended approximately \$4,000 of the \$4,500 budget that we initially established. Thus, there would be time for me to answer any additional questions that you may have and still stay within the parameters of our budgetary arrangement.

You can send a responding letter to our fax number (804) 295-4667. I look forward to hearing from you. Thank you for using our services.

Very truly yours,



D. Bradley Pettit
 Senior Research Attorney

DBP/bjm
 Enclosures



M E M O R A N D U M

TO: Honorable Speaker Don Parkinson, Esquire

FROM: National Legal Research Group, Inc.
D. Bradley Pettit, Senior Research Attorney

RE: Guam-Federal/Tax/Individual Income/Earned Income Tax
Credit

FILE: 49-12174-112 January 17, 1996

STATEMENT OF THE CASE

The United States Code states that "[t]he income-tax laws in force in the United States of America and those which may hereinafter be enacted shall be held to be likewise in force in Guam[.]" 48 U.S.C. § 1421i(a). The United States Code goes on to say that "[t]he income-tax laws in force in Guam . . . include but are not limited to . . . Subtitle A [of the Internal Revenue Code]." Id. § 1421i(d)(1).

The purpose and intent 48 U.S.C. § 1421i is to require Guam, a territorial possession of the United States, to apply the Internal Revenue Code to persons and income within its boundaries. Sayre & Co. v. Riddell, 395 F.2d 407 (9th Cir. 1968); Government of Guam v. Kaaneche, 124 F. Supp. 15 (D. Guam 1954).

The Internal Revenue Code states:

All provisions of the laws of the United States applicable to the administration, collection, and enforcement of [any tax imposed by the Internal Revenue Code] . . . shall . . . extend to and be applicable in such possession of the United States in the same manner and to the same extent as if such possession were a State, and as if the term "United States" when used in a geographical sense included such possession.

I.R.C. § 7651(2)(B).

The authorities cited make it clear that Guam must follow and use the Internal Revenue Code of the United States with respect to its imposition of the Guam Territorial Income Tax ("GTIT"). In the present case, the Director of Guam's Department of Revenue & Taxation (the "DRT") issued a controversial Revenue Ruling in which he took the position that Guam's DRT is not required to follow § 32 of the Internal Revenue Code. Guam Rev. Rul. 96-001 (Jan. 4, 1996). The Director of the DRT also ruled in the alternative that

even if Guam must follow § 32 of the Internal Revenue Code, it is not required to follow all of the provisions in that statute. Id.

Section 32 of the Internal Revenue Code allows certain low-income working taxpayers to claim a credit against their income tax liabilities. I.R.C. § 32(a). This credit is popularly known as the "earned income tax credit" or the "EITC." Section 32 of the Code also provides that if the earned income tax credit available to a taxpayer in a given case exceeds the taxpayer's adjusted gross income, the taxpayer is entitled to receive from the Government an amount equal to the difference between the credit amount and his adjusted gross income, up to an amount designated as the "phaseout amount." Id. § 32(b).

In Guam Rev. Rul. 96-001, it was held that Guam's DRT is no longer required to recognize the EITC. In that Ruling it was also held that even if Guam's DRT still must recognize the EITC, the Government of Guam is not required to issue a check to a taxpayer whose earned income tax credit exceeds his or her adjusted gross income. Id.

In light of the controversy surrounding Guam Rev. Rul. 96-001, the Honorable Speaker of the Twenty-Third Guam Legislature seeks legal research with respect to several procedural and substantive issues raised by the DRT's recent ruling. This Memorandum of Law addresses those issue.

QUESTIONS PRESENTED

1. Did the Director of Guam's DRT exceed his authority in issuing a revenue ruling that purports to excuse Guam's Government from following all or some of the provisions contained in I.R.C. § 32?

Conclusion

Yes. Since there is no evidence that the earned income tax credit is manifestly inapplicable to the Guam territorial income tax or manifestly incompatible with the separate tax structure of Guam, the Director of Guam's DRT exceeded his power and authority by issuing a ruling that is at odds with the provisions of § 32 of the Internal Revenue Code of the United States.

2. Is Guam absolutely required by United States law to follow I.R.C. § 32 until such time as the Guam Legislature expressly excludes all or part of the provisions of that section of the Internal Revenue Code from the Guam Territorial Income Tax?

Conclusion

There is little doubt that Guam must follow § 32 of the Internal Revenue Code until the Government of Guam exercises its express authority to adopt a new tax code that is distinct from the federal tax code.

3. If the Director of Guam's DRT acted illegally in issuing Guam Rev. Rul. 96-001 or if Guam is absolutely required by federal law to follow the provisions of I.R.C. § 32, is the United States Government obligated to reimburse the Government of Guam for tax revenues lost as a result of the EITC?

Conclusion

Although the Organic Act gives Congress the authority to appropriate funds for Guam's Government that may be necessary to carry out the provisions of I.R.C. § 32 and the Unfunded Mandates Reform Act of 1995 requires Congress to give 'full consideration' to any federal statute that requires Guam to expend funds, there appears to be no federal or Guam statute which makes it absolutely incumbent upon Congress to reimburse Guam for expenses incurred in following § 32 of the Internal Revenue Code.

4. If the Director of Guam's DRT acted illegally in issuing Guam Rev. Rul. 96-001 or if Guam is absolutely required by federal law to follow the provisions of I.R.C. § 32, must the Guam Legislature appropriate the funds that are necessary to implement the EITC?

Conclusion

Relevant provisions in the Organic Act regarding appropriations of funds by the Legislature of Guam do not appear to make it mandatory that the Legislature appropriates funds to meet the expenses associated with carrying out the terms of I.R.C.

§ 32. The Act merely gives the Legislature the authority to appropriate funds for carrying out the terms of § 32.

5. If the Director of Guam's DRT acted illegally in issuing Guam Rev. Rul. 96-001, what remedies are available to compel the Director of the DRT to revoke the ruling and follow I.R.C. § 32?

Conclusion

The Organic Act gives the Guam Legislature the unrestricted authority to 'petition' for judicial relief. Presumably, such authority gives the Legislature the authority to petition a court to issue a writ of mandamus ordering the Director of the DRT to revoke Guam Rev. Rul. 96-006 because the Director of the DRT violated his statutory obligation under the Guam Code to enforce all provisions of the Internal Revenue Code, including I.R.C. § 32.

DISCUSSION OF AUTHORITY

I. Did The Director Of Guam's DRT Exceed His Authority In Issuing A Revenue Ruling That Purports To Excuse Guam's Government From Following All Or Some Of The Provisions Contained In I.R.C. § 32?

The United States Code states that "[t]he administration and enforcement of the Guam Territorial income tax shall be performed by or under the supervision of the Governor [of Guam]." 48 U.S.C. § 1421i(c). The United States Code goes on to say that "[a]ny function needful to the administration and enforcement of the income-tax laws in force in Guam . . . shall be performed by any officer or employee of the government of Guam duly authorized by

the Governor . . . to perform such function." Id. (emphasis added). The United States Code also says:

The Governor [of Guam] or his delegate shall have the same administrative and enforcement powers and remedies with regard to the Guam Territorial income tax as the Secretary of the Treasury, and other United States officials of the executive branch, have with respect to the United States income tax.

48 U.S.C. § 1421(d) (2) (emphasis added).

The Guam Code similarly provides that "[t]he Department [of Revenue & Taxation] shall be responsible under the Governor [of Guam] for the enforcement of the Guam Territorial Income Tax set out in [48 U.S.C.] § 1421." 11 Guam Code Ann. § 1104(a) (1993). The Guam Code also makes it clear that the Director of Guam's DRT "[s]hall enforce the provisions of [Title 11 of the Guam Code] and of any other laws imposing any power, duty or other function upon the Department." Id. § 1197(c).

The United States Court of Appeals for the Ninth Circuit held that since Guam officials only have the authority to make rules and regulations regarding administration and enforcement of Guam's tax laws, as derived from the Internal Revenue Code of the United States, Guam officials do not have the power or authority to make substantive modifications of any tax laws set forth in the Internal Revenue Code. Government of Guam v. Koster, 362 F.2d 248, 251 (9th Cir. 1966) (Guam officials cannot substantively modify the statutory definition of "gross income"). The Ninth Circuit also has held that Congress did not give Guam officials the authority to vary terms of tax laws made applicable to that Territory when it enacted 48 U.S.C. § 1421 and gave Guam officials the power to

enforce tax laws and to collect income taxes. Bank of America, National Trust & Savings Association v. Chaco, 539 F.2d 1226 (9th Cir. 1976).

The United States Claims Court has expressly held that since the Internal Revenue Service does not have the power or authority to make tax laws through the issuance of rulings, any ruling issued by the IRS which is in contravention of a tax statute is invalid as a matter of law. Hirshon v. United States, 116 F. Supp. 135, 137 (Ct. Cl. 1953). The decision in Hirshon is consistent with a later ruling by the United States Supreme Court that since "[t]he Commissioner [of the IRS]'s rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law," an erroneous ruling by the Commissioner cannot bar the United States from collecting a tax otherwise lawfully due. Dixon v. United States, 381 U.S. 68, 73 (1965).

There is only one recognized exception to the general rule that officials of the Government of Guam do not have the power to make substantive changes with respect to federal income tax laws. The Ninth Circuit has recognized that officials of the Government of Guam may "vary the terms of [a] federal income tax law as applied to Guam" where the terms of the federal income tax law are "manifestly inapplicable or incompatible" with the "separate tax structure of Guam." Bank of America, National Trust & Savings Association v. Chaco, *supra*, 539 F.2d at 1226-28 (citing 48 U.S.C. § 1421i(d)(1)); Government of Guam v. Koster, *supra*, 362 F.2d at 251-52. The Ninth Circuit has said that "what provisions [of the

federal tax code] are deemed [manifestly] incompatible [with the separate tax structure of Guam] must be construed strictly within the Congressional intent." Bank of America, National Trust & Savings Association v. Chaco, supra, 539 F.2d at 1227. Furthermore, the Ninth Circuit has said that there must be evidence "in the record" which indicates that a particular term in the federal tax code is "manifestly inapplicable" to the Guam Territorial income-tax law, or is incompatible with [the separate tax structure of Guam]" before an official of the Government of Guam will receive judicial approval of his modification, adaptation, or setting aside of that particular term of the federal tax code. Government of Guam v. Koster, supra, 362 F.2d at 251.

The authorities cited above indicate that the Director of Guam's DRT may not issue a revenue ruling or any other ruling or regulation which purports to set aside, modify, or adapt any part of I.R.C. § 32 unless he or she can demonstrate that all or part of § 32 is manifestly inapplicable to the Guam Territorial Income Tax or is manifestly incompatible with the separate tax structure of Guam. The Director's burden of demonstrating the manifest inapplicability or incompatibility of all or part of I.R.C. § 32 to or with the separate tax structure of Guam is especially heavy because of the rule that the terms of I.R.C. § 32 must be 'construed strictly' within the intent of the United States Congress.

The authorities cited above make it clear that the DRT and its Director are statutorily obligated to follow and enforce all

provisions of the Internal Revenue Code, including I.R.C. § 32. The authorities cited also make it clear that neither the DRT nor its Director may vary any terms of the Internal Revenue Code, including I.R.C. § 32. Finally, the authorities cited demonstrate that since a revenue ruling does not have the force of law, any such ruling by the Director of Guam's DRT that is at odds with federal tax laws cannot prevent the Government of Guam from collecting a tax or granting a tax credit that is otherwise due.

The only recognized exception to the rule requiring the DRT and its Director to follow and enforce the provisions of the Internal Revenue Code as written is where the evidence shows that a provision of the federal tax code is either 'manifestly inapplicable' to the Guam Territorial Income Tax or 'manifestly incompatible' with the separate tax structure of Guam.

In Guam Rev. Rul. 96-001, the Director of Guam's DRT argues that the provisions of § 32 of the Internal Revenue Code are manifestly inapplicable to the Guam Territorial Income Tax and manifestly incompatible with the separate tax structure of Guam. Guam Rev. Rul. 96-001 at 7. In reaching this conclusion, the Director of Guam's DRT asserts that since the earned income tax credit granted by I.R.C. § 32 is a social welfare benefit program masquerading as a tax law, the statute is manifestly incompatible with the purpose of the GTIT to generate revenues for Guam. The Director cites no authority for his assertion that such reasoning is sufficient evidence to meet the 'manifest inapplicability' or 'manifest incompatibility' test for determining whether a Guam

official was entitled to modify, vary, or set aside a provision of the Internal Revenue Code.

Courts have generally defined the term "manifestly" as meaning "clearly or obviously." Thompson v. Audobon Insurance Co., 101 So. 2d 752, 754 (La. Ct. App. 1958). The term "manifestly" also has been defined as meaning "easily understood or recognized." State v. Wright, 96 N.J. 170, 475 A.2d 38, 39 (1984). Therefore, Guam. Rev. Rul. 96-001 will not withstand judicial scrutiny unless the court determines that the provisions of I.R.C. § 32 are clearly or obviously inapplicable to the Guam Territorial Income Tax or incompatible with the separate Guam tax structure. A court would have to determine that such inapplicability or incompatibility is easily recognized or understood.

It is doubtful that a court would reach such a conclusion in this case. Congress has already expressly recognized that a tax credit represents a revenue loss attributable to provisions of the federal tax laws. 2 U.S.C. § 622(3). Moreover, credits against the federal income tax have been part of the Internal Revenue Code since the sixteenth amendment to the Constitution (recognizing the constitutionality of the federal income tax) was passed. J. Maule, "Tax Credits: Concepts and Calculation," 506 T.M. (BNA) at A-3 (1994 & Supp. 1995). Thus, it is specious to argue that a tax credit is incompatible with an income tax such as the Guam Territorial Income Tax or the federal income tax. Under such reasoning, neither Guam nor the United States should ever grant any

tax credits to their citizens or residents simply because tax credits reduce tax revenues.

It is also specious to argue that a tax credit is incompatible with the goal of generating revenues for Guam's Government because the United States Code expressly gives Guam the right to impose income taxes in addition to those provided for in the Internal Revenue Code if the Guam Legislature determines that it is necessary to raise additional revenues. 48 U.S.C. § 1421i(a).

In sum, it appears that the Director of Guam's Department of Revenue & Taxation exceeded his authority in attempting to set aside or modify the provisions of I.R.C. § 32. Accordingly, Guam Rev. Rul. 96-001 is invalid as a matter of law.

II. Is Guam Required By United States Law To Follow I.R.C. § 32 Until Such Time As The Guam Legislature Expressly Excludes All Or Part Of The Provisions Of That Section Of The Internal Revenue Code From The Guam Territorial Income Tax?

The United States Congress has expressly recognized that if certain conditions are met, there is "nothing in the laws of the United States [that] shall prevent Guam . . . from enacting tax laws (which shall apply in lieu of the mirror system) with respect to income[.]" Tax Reform Act of 1986, Pub. L. No. 99-514, § 1271(a), 1986 U.S. Code Cong. & Admin. News (100 Stat.) 2591. Guam can enact tax laws which would apply in lieu of the Internal Revenue Code as long as there is an "implementing agreement" between Guam and the United States at the time such laws are enacted. Pub. L. No. 99-514, § 1271(b). The necessary implementing agreement between Guam and the United States is in

place, but thus far the Guam Legislature has taken no steps to "delink" from the Internal Revenue Code. Guam Rev. Rul. 96-001 at 6.

Therefore, it appears that until the Guam Legislature exercises its power to enact its own tax laws, the Government of Guam is statutorily required to follow the income tax laws "in force in the United States of America." 48 U.S.C. § 1421i(a); 11 Guam Code § 1104(a). Accordingly, the Government of Guam must follow I.R.C. § 32 until the Territorial Legislature acts to repeal § 32.

III. If The Director Of Guam's DRT Exceeded His Authority In Issuing Guam Rev. Rul. 96-001 Or If Guam Is Required By Federal Law To Follow The Provisions Of I.R.C. § 32, Is The United States Government Obligated To Reimburse The Government Of Guam For Tax Revenues Lost As A Result Of The BITC?

The United States Congress has expressly recognized that "tax expenditures" includes "those revenue losses attributable to provisions of the Federal tax laws which . . . provide a special credit." 2 U.S.C. § 622(3).

Congress is "authorized" to appropriate annually "such sums as may be necessary and appropriate to carry out the provisions and purposes of the [Organic] Act (48 U.S.C. §§ 1421 et seq.)." 48 U.S.C. § 1421j. Thus, Congress has the authority to appropriate funds that may be 'necessary and appropriate' to carry out the provisions of 48 U.S.C. § 1421i. (Note: As stated in Parts I and II, 48 U.S.C. § 1421i requires the Government of Guam to follow the

Internal Revenue Code, including the provisions of the Code relating to the earned income tax credit.)

Since revenues lost as a result of tax credits are in the nature of tax "expenditures" and Congress has the authority to appropriate funds which may be 'necessary and appropriate' to carry out the terms of the Organic Act, Congress should be urged to reimburse Guam for any expenditures it makes in connection with the earned income tax credit. Unfortunately, since 48 U.S.C. § 1421j merely states that Congress is "authorized" to appropriate funds that are necessary to carry out the terms of the earned income tax credit statute, it does not appear that § 1421j requires Congress to provide Guam with funds to pay for revenues lost as a result of the EITC.

However, on March 22, 1995, Congress passed the much publicized Unfunded Mandates Reform Act of 1995, Pub. L. No. 104-4, (109 Stat.) 48 (March 22, 1995) (codified at 2 U.S.C. §§ 1501 et seq.). One of the stated purposes of the UMRA of 1995 is

To end the imposition, in the absence of full consideration by Congress, of Federal mandates on States, local, and tribal governments without adequate Federal funding, in a manner that may displace other essential State, local, and tribal governmental priorities.

2 U.S.C. § 1501(2).

The term "Federal mandate," as it is used in UMRA of 1995, is statutorily defined as meaning "any provision in statute or regulation or any Federal court ruling that imposes an enforceable duty upon State, local, or tribal governments." 2 U.S.C. § 1555. The definitions of the terms "States" and "local and tribal

governments," as used in UMRA of 1995, are found at 31 U.S.C. § 6501. 2 U.S.C. § 1502(1); Pub. L. No. 104-4, § 421(8), (12), (13). Section 6501 of Title 31 of the United States Code expressly defines the term "State" as including "a territory or possession of the United States[.]" 31 U.S.C. § 6501(9).

The authorities cited above indicate that § 1421i of Title 48 of the United States Code and § 32 of the Internal Revenue Code arguably constitute an unfunded "Federal mandate" that is within the scope of coverage of the Unfunded Mandate Reform Act of 1995. Taken together, 48 U.S.C. § 1421i and I.R.C. § 32 are statutes that impose an enforceable duty upon Guam (a United States territory or possession) to grant a citizen or resident the right to claim the earned income tax credit and to receive any amount by which the EITC might exceed his or her adjusted gross income. The only problem in this case is that a close reading of UMRA of 1995 reveals that the Act does not expressly prohibit Congress from enacting or enforcing legislation that constitutes an 'unfunded mandate'. The Act merely prevents Congress from enforcing or enacting legislation that constitutes an unfunded mandate without giving such enforcement or enactment "full consideration." 2 U.S.C. § 1501(2).

In short, UMRA of 1995 does not absolutely prohibit Congress from continuing to require Guam to follow the provisions of I.R.C. § 32. However, UMRA, along with 48 U.S.C. § 1421j, which gives Congress the authority to appropriate funds that may be necessary to carry out the terms of the Organic Act, require Congress to give

full consideration as to whether Guam must continue to follow I.R.C. § 32 and, if so, as to whether federal funds must be appropriated to cover the expense of the continued application of the earned income tax credit in Guam.

IV. If The Director Of Guam's DRT Acted Illegally In Issuing Guam Rev. Rul. 96-001 And/Or If Guam Is Absolutely Required By Federal Law To Follow The Provisions Of I.R.C. § 32, Must The Guam Legislature Appropriate The Funds That Are Necessary To Implement The EITC?

The Organic Act states that "appropriations, except as otherwise provided in this chapter, and except such appropriations as shall be made from time to time by the Congress of the United States, shall be made by the legislature [of Guam]." 48 U.S.C. § 1423j(a). The Act goes on to say that, "[i]f at the termination of any fiscal year the legislature [of Guam] shall have failed to pass appropriations bills providing for payments of the necessary current expenses of the government [of Guam] and meeting its legal obligations for the ensuing fiscal year, then the several sums appropriated in the last appropriation bills for the objects and purposes therein specified, so far as the same may be applicable, shall be deemed to be re-appropriated, item by item." 48 U.S.C. § 1423j(b).

The foregoing provisions of the Organic Act appear to be the only statutes dealing with the issue of whether the Legislature of Guam must appropriate those funds that are necessary in order to comply fully with the terms of I.R.C. § 32. Neither § 1421j nor § 1423 contain language which expressly makes it incumbent upon the

Legislature to continue appropriating funds necessary to implement the earned income tax credit or any other provision of the Internal Revenue Code. However, both §§ 1421j and 1423 clearly give the Guam Legislature full authority to appropriate funds that may be needed to carry out the provisions of I.R.C. § 32.

V. If The Director Of Guam's DRT Acted Illegally In Issuing Guam Rev. Rul. 96-001, What Remedies Are Available To Compel The Director Of The DRT To Revoke The Ruling And Follow I.R.C. § 32?

The Director of Guam's Department of Revenue & Taxation "[s]hall enforce the provisions of [Title 11 of the Guam Code] and of any other laws imposing any power, duty or other function upon the Department." 11 G.C.A. § 1107(c). The Organic Act states that "[t]he legislature [of Guam] or any person or group of persons in Guam shall have the unrestricted right of petition." 48 U.S.C. § 1423k.

If 11 G.C.A. § 11087(c), which requires the Director of the DRT to enforce all tax laws, including the EITC, and 48 U.S.C. § 1423k are read together, it would appear that the Legislature of Guam has standing to file a petition in the District Court of Guam seeking to compel the Director to comply with I.R.C. § 32 (the earned income tax credit). The proper remedy under such a petition by the Legislature would be either a "writ of mandate" (7 G.C.A. § 31202) or a "writ of prohibition" (7 G.C.A. § 31302). The remedies of writs of mandate and prohibition can be issued by "any court except [a] police or commissioner's court, to any inferior tribunal . . . or person[.]" 7 G.C.A. §§ 31202, 31302. The remedy

of a "writ of mandate" is used "to compel the performance of an act which the law specifically enjoins, [such] as a duty resulting from an office, trust, or station." 7 G.C.A. § 31202. The judicial remedy of a "writ of prohibition" operates to "arrest the proceedings of any tribunal, corporation, board or person exercising judicial functions, when such proceedings are without or in excess of the jurisdiction of such tribunal, corporation, board or person." 7 G.C.A. § 31301.

RESEARCHER'S NOTE

Extensive research of federal tax law failed to reveal any authorities relating to the proper remedy for compelling the Commissioner of the Internal Revenue Service to revoke an illegal or erroneous Revenue Ruling. It is clear that the Director of the IRS has the power to retroactively revoke an erroneous Revenue Ruling. Dixon v. United States, 381 U.S. 68 (1965). The Dixon court explained that the Commissioner's power to withdraw an erroneous ruling stems from "the fact that Congress, not the Commissioner [of the IRS], prescribes the tax laws." Id. at 73. The Dixon court went on to emphasize that "[t]he Commissioner's rulings have only such force as Congress chooses to give them, and Congress has not given them the force of law." Id. Accordingly, the Dixon court expressly ruled that a mistaken ruling by the Commissioner of the IRS "cannot in and of itself bar the United States from collecting a tax otherwise lawfully due." Id.

SPADE SHEET

OUR FILE: 49-12174-112

SOURCES CHECKED

GOVERNING JURISDICTION

1. Legislation

- 5 G.C.A. §§ 4104, 4105, 6101 et seq.; 7101 et seq.; 22101 et seq.;
22401 et seq. (1993)
- 11 G.C.A. §§ 1101 et seq.; 4100 et seq.; 15101 et seq.; 32101 et
seq.; 34101 et seq.; 36101 et seq.; 38101 et seq.; (1993)
- 7 G.C.A. §§ 31201 et seq.; 31301 et seq. (1993)

NATIONAL

1. Legislation

- 31 U.S.C.S. § 3501
- 2 U.S.C.S. §§ 658, 1501 et seq.
- 48 U.S.C.S. §§ 1401 et seq.
- 26 U.S.C.S. §§ 931, 32, 7805
(Law Co-op. 1986 & Supps. through Oct. 1995)

2. Encyclopedias

- 86 C.J.S. "Territories" §§ 35-38 (1954 & Supp. 1995)

3. Looseleaf Services

- U.S. Tax Rep. "Income Taxes" ¶¶ 320; 76,557.11;
79,007.75-76,007.81, 76,545.01 (RIA 1995 &
Cross Ref. Table)
- Std. Fed. Tax Rep. ¶¶ 24,840-28,845; 28,960-28,962; 42,018.1203;
43,868-43,877 (CCH 1995 & New Matter)

4. Other

- J. Maule, 506 T.M. "Tax Credits: Concepts and Calculation" (BNA
1994 & Supp. Oct. 2, 1995)
- A. Sturrs, 104-7th T.M. "IRS National Office Procedures--
Rulings, Closings, Agreements" (BNA 1990 & Supp. Feb.
6, 1995)

ALL CASES SHEPARDIZED

REVENUE AND TAXATION

GOVERNMENT OF GUAM

JOSEPH T. DUENAS, Director CARL E. TORRES, Deputy Director

January 26, 1996

GOOD MORNING MR. CHAIRMAN, AND MEMBERS OF THE COMMITTEE. MY NAME IS JOEY DUENAS AND I AM THE DIRECTOR OF THE DEPARTMENT OF REVENUE AND TAXATION. I AM HERE TO PROVIDE TESTIMONY ON BILL 481, HOWEVER, I BELIEVE THAT MY REVENUE RULING NO. 96-001 SPEAKS FOR ITSELF. I WILL BE HAPPY TO ANSWER ANY QUESTIONS FROM THE MEMBERS OF THE COMMITTEE.

JOSEPH T. DUENAS
Director

REVENUE AND TAXATION

GOVERNMENT OF GUAM

JOSEPH T. BUENAS, Director CARL E. TORRES, Deputy Director

REVENUE RULING NO. 96-001**ISSUES**

- (1) Does the Earned Income Tax Credit ("EITC") apply in Guam, must it be administered by the Department of Revenue and Taxation ("DRT") and must DRT certify to the Department of Administration ("DOA") for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns?
- (2) Can DRT lawfully certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns to the extent such refunds exceed the amounts of the income tax liabilities appearing on the returns when the Guam Legislature has not appropriated funds to DOA for this purpose?
- (3) If the answer to either issue is in the negative, must DRT audit and adjust the income tax returns of individuals who have claimed the EITC and must DRT seek to recover from those individuals any EITC cash refunds received from DOA?

CONCLUSIONS

The answer to all three issues is in the negative.

- (1) The EITC is not applicable in Guam. It should not be administered by DRT and DRT should not certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns.
- (2) Even if the EITC were applicable in Guam, DRT could not lawfully certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns to the extent such refunds exceed the amounts of the income tax liabilities appearing on the returns because the Guam Legislature has not appropriated funds to DOA for this purpose.
- (3) Based on the discretion vested in the Director of DRT to determine whether a ruling shall have retroactive or prospective effect, the Director concludes that this ruling shall be applied only to calendar years beginning after December 31, 1994. Thus, DRT will not audit or adjust the income tax returns of individuals claiming the EITC for calendar years ending before January 1, 1995 and DRT will not seek to recover from such individuals any EITC cash refunds received from DOA for calendar years ending before January 1, 1995.

FACTS

A. Background of EITC.

The EITC was first enacted by the United States Congress in 1975 and was codified as Section 43 of the U.S. Internal Revenue Code of 1954, as amended ("1954 IRC" or "IRC"). U.S. Public Law 94-12, §204. It was adopted as a social welfare measure to help the working poor.

This new refundable credit will provide relief to families who currently pay little or no income tax. These people have been hurt the most by rising food and energy costs. Also, in most cases, they are subject to the social security payroll tax on their earnings. Because it will increase their after-tax earnings, the new credit, in effect, provides an added bonus or incentive for low-income people to work, and therefore, should be of importance in inducing individuals with families receiving Federal assistance to support themselves.

Leg. Hist., U.S. Code, Cong. & Admin. News,
94th Cong., 1st Sess., Vol. 1, pg. 64.

The EITC allows an eligible individual to claim a tax credit against the amount of income tax liability, if any, reported on his or her annual income tax return. As originally enacted, an eligible individual could claim an amount equal to 10% of so much of his or her earned income for the taxable year as did not exceed \$4,000. 1954 IRC §43(a). The amount of the EITC was reduced by an amount equal to 10% of so much of adjusted gross income or earned income, whichever was greater, as exceeded \$4,000. 1954 IRC §43(b). The maximum amount of EITC possible in 1975 was \$400.

The EITC is a refundable credit. It can be used to offset an eligible individual's income tax liability and, depending on the circumstances, can be used to reduce a taxpayer's income tax liability below zero. Thus, an eligible individual who has a low income on which little or no tax would otherwise be due can receive a cash payment from the U.S. Treasury in an amount greater than the amount of tax due, if any. The excess credit is treated as a refundable overpayment of tax. 1954 IRC §35, §6401(b) & (c), §6402(a). In effect, the EITC establishes a "negative income tax" for certain low income individuals who are given the right to receive an income tax refund in an amount greater than the amount of income tax, if any, they owe to and have paid-into the Treasury.

Under the original EITC, an individual could claim the EITC if he or she maintained a household in the United States which was his or her principal place of abode and was the principal place of abode of his or her dependent child or children. 1954 IRC §43(c)(1). Earned income was defined as wages, salaries, tips and other employee compensation and the amount of a taxpayer's net earnings derived from self-employment. 1954 IRC §43(c)(2). Excluded from

the EITC were individuals having foreign source income within the meaning of 1954 IRC §911 and individuals having income derived from sources in a U.S. possession within the meaning of 1954 IRC §931. Also, no amount of income of a non-resident alien individual within the meaning of 1954 IRC §871(a) could be taken into account in calculating the EITC.

B. Amendments to EITC.

The EITC has been amended numerous times since 1975, primarily to increase its benefits. However, the basic structure of the EITC has remained the same. See: U.S. Public Laws 94-455, 95-600, -96-222, 98-21, 98-369, 99-514, 97-34, 100-647, 101-508, 103-66, 103-465. In 1984, the EITC was recodified as 1954 IRC §32 and, with the enactment of the Internal Revenue Code of 1986, as amended ("1986 IRC" or "IRC"), has continued as Section 32. U.S. Public Law 98-369, §471(c)(1); U.S. Public Law 99-514, §111.

In 1978, advance payment of the EITC was provided for. U.S. Public Law 95-600, §105; 1954 IRC §3507. Thus, an individual eligible to receive the EITC no longer has to wait until filing his or her annual income tax return to obtain the EITC. He or she can elect to receive the EITC on a current basis throughout the year from his or her employer. The employer is required to pay to the electing employee at the time the employer pays the electing employee's wages an additional amount equal to the employee's "earned income advance amount". 1954 IRC §3507(a) & (c). The employer's payment of these amounts to the electing employee is not treated as additional compensation to the employee. Instead, the EITC advance payments are treated as payments of withholding taxes and FICA taxes that the employer makes to the electing employee in lieu of paying them to the Internal Revenue Service. 1954 IRC §3507(d). The advance payment of the EITC remains in effect today. 1986 IRC §3507.

In 1990, the EITC was increased for eligible individuals having two or more qualifying children and a supplemental young child credit was added for eligible individuals having a qualifying child who had not attained the age of one year old. A refundable "health insurance credit" was also included to offset the cost of health insurance. U.S. Public Law 101-508, §11111(a). The "health insurance credit" was in addition to the "basic earned income credit" but could not be received on an advanced basis in the manner of the "basic earned income credit". The supplemental young child credit and the refundable health insurance credit were repealed in 1993. U.S. Public Law 103-66, §1313(a).

Subsection (j) was added in 1990 to make clear that the receipt of EITC refunds and EITC advance payments should not be counted as income for purposes of qualifying for certain U.S. social welfare programs including the United States Housing Act of 1977, title V of the Housing Act of 1949, section 101 of the Housing and Urban Development Act of 1965, sections 221(d)(3), 235 and 236 of the National Housing Act and the Food Stamp Act of 1977. U.S. Public Law 101-508, §11111(b).

In 1993, individuals having no qualifying children were allowed for the first time to apply for and receive the EITC. 1986 IRC §32(c)(1)(A)(ii).

The maximum allowable amounts of the EITC has increased dramatically since 1975. U.S. Public Laws 95-600, 98-369, 99-514, 100-

67, 101-508 and 103-66. As of the present time, 1995, the maximum amounts of the EITC is as follows: \$2,040 for eligible individuals having one qualifying child; \$3,033 for eligible individuals having two or more qualifying children; and \$306 for eligible individuals having no qualifying child or children. For 1996 and years thereafter, the maximum amount of the EITC for eligible individuals having two or more qualifying children will increase to \$3,370. 1986 IRC §32(b). The EITC is also adjusted annually for inflation. 1986 IRC §32(i).

C. Application of EITC in Guam.

Guam territorial income tax returns claiming the EITC have been filed with DRT for many years. DRT has routinely accepted them and has certified to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their returns. DOA has paid these amounts to the individuals claiming them although the Guam Legislature has not appropriated funds for the EITC. It is unknown to what extent Guam taxpayers have elected to use the EITC advance payment program although the amount is believed to be small due to its unfamiliarity among Guam residents. See: Leg. Hist., P.L.-103-66, §13131, U.S. Code, Cong. & Admin. News, 103rd Cong., 1st Sess., 1993, Vol. 2, pg. 841.

Unlike the United States where the U.S. Treasury Department is responsible for collecting, holding and disbursing U.S. tax revenues, these functions are separated in Guam. 1986 IRC §6151; 31 USC §3301 et seq. Under Guam law, DRT is responsible for collecting Guam tax revenues whereas DOA is responsible for holding and disbursing them. 5 GCA §22101. Thus, EITC cash refunds are paid by the U.S. Treasury Department in the U.S. and by DOA in Guam.

D. Prior Guam Interpretation of EITC.

In 1989, DOA requested an opinion from the Attorney General of Guam ("AG") interpreting the applicability of the EITC in Guam. Specifically, DOA sought answers to the following two issues:

- (1) Is the Territory obligated to pay amounts qualified for the Earned Income Credit, specifically the sums in excess of actual taxes withheld? - and,
- (2) If the answer to 1) is yes, must the amounts so paid be appropriated by the Legislature?

On June 23, 1989, the AG issued legal opinion DOA 89-0750. The AG determined that (a) the EITC applies in Guam under the Guam

Territorial Income Tax ("GTIT") and (b) the Guam Legislature is not required to appropriate funds to cover sums payable by DOA for EITC cash refunds, i.e., refundable amounts in excess of the amounts of actual taxes paid to the Government of Guam ("GovGuam") by or for these taxpayers. A copy of AG opinion DOA 89-0750 is attached hereto as Exhibit "A".

E. Need for Ruling by Director of DRT.

The Director of DRT has never issued a tax ruling on these issues although he is charged with the exclusive administrative responsibility under the GTIT and Guam law to interpret and administer the GTIT. 48 USC §1421i(c); 1986 IRC §7805(a); 11 GCA §1102(a), §1103, §1104(a), §1106(a), §1107(a) & (d). DRT has assumed in the past that the EITC applies in Guam and must be administered by DRT. DRT has also relied on the Attorney General's opinion issued to DOA, DOA 89-0750.

A definitive ruling by the Director of DRT is necessary at this time because GovGuam has experienced large amounts of lost revenue and cash outlays under the EITC. See Exhibit "B" attached hereto.

DISCUSSION

A. The EITC Does Not Apply in Guam, DRT is not Required to Administer it and DRT is not Required to Certify to DOA for Payment the Amounts of EITC Cash Refunds Reported by Guam Taxpayers on their Guam individual Income Tax Returns.

1. The GTIT.

The GTIT is a Federal law imposed on Guam by the U.S. Congress under Sections 30 and 31 of the Organic Act of Guam. 48 USC §1421h and §1421i. It was enacted to provide GovGuam with a source of locally generated tax revenue to be used to fund governmental operations and, thereby, to eliminate the need of Congress to appropriate funds to GovGuam from the U.S. Treasury for that purpose. The GTIT is administered by GovGuam through DRT and all funds collected under the GTIT must be deposited into the Guam Treasury. 48 USC §1421h, §1421i(b) & (c); 11 GCA §1103, §1104(a), §1106, §1107; 5 GCA §22101; Laguana v. Ansell, 212 F.2d 207 (9th Cir. 1954); Phelan v. Taitano, 233 F.2d 117 (9th Cir. 1956); Wilson v. Kennedy, 232 F.2d 153 (9th Cir. 1956); Lamkin v. Brown and Root, Inc., 233 F.2d 320 (9th Cir. 1956); Flores v. Government of Guam, 444 F.2d 284 (9th Cir. 1971); Manning v. Blaz, 479 F.2d 333 (9th Cir. 1973).

The GTIT is a territorial income tax separate from the U.S. income tax. Nevertheless, it consists of most of the same income tax laws that were in force in the U.S. at the time the GTIT was enacted in 1950 and those income tax laws that have been enacted thereafter in the U.S. 48 USC §1421i(a) & (b); See cases cited immediately above, supra. Thus, the GTIT has successively comprised most of the income tax provisions of the Internal Revenue Code of 1939, the Internal Revenue Code of 1954 and, currently, the Internal Revenue

Code of 1986. 48 USC §1421i(d) & (e); U.S. Public Law 99-514, §2(a), §1271(a), §1277(b). The applicable provisions are "mirrored" for purposes of the GTIT, hence the term "mirror code" or "mirror system". Sayre & Company v. Riddell, 395 F.2d 407, 410 (9th Cir. 1968); Flores v. Government of Guam, supra; U.S. Public Law 99-514, §1271(a); U.S. Code, Cong. & Admin. News, 99th Cong., 2nd Sess., 1986, Vol. 5, pgs. 4767 - 4770.

In the Tax Reform Act of 1986, Congress gave Guam the right to delink from the mirror code and the right to adopt its own income tax code. U.S. Public Law 99-514, §1271 & §1277; U.S. Code, Cong. & Admin. News, 99th Cong., 2nd Sess., 1986, Vol. 5, pgs. _____. On April 3, 1989, the Governor of Guam and the U.S. Treasury Department signed an implementing agreement to delink Guam from the mirror system, to become effective on January 1, 1991. However, the implementing agreement was not put into effect. It was suspended indefinitely pending Guam's enactment of its own income tax code. See 11 GCA §4100 & §4106. To date, the Guam Legislature has not adopted an income tax code for Guam.

The Tax Reform Act of 1986 also gave another mirror code possession, the Commonwealth of the Northern Mariana Islands ("CNMI"), the right to delink from the mirror code. To date, the CNMI has not chosen to delink from the mirror system. The other mirror code jurisdiction, the U.S. Virgin Islands ("Virgin Islands"), was not given the option in the Tax Reform Act of 1986 to delink from the mirror system and remains on the mirror system. U.S. Public Law, 99-514, §1271 & §1274; U.S. Code, Cong. & Admin. News, 99th Cong., 2nd Sess., 1986, Vol. 5, pgs. 4767 - 4770.

2. Mirroring.

Guam's failure to delink from the Federal income tax system has left Guam with the income tax provisions of the 1986 IRC intact, to the extent applicable. Under 48 USC §1421i(d), the "income tax laws in force in Guam pursuant to subsection (a) of this section include but are not limited to the following provisions of the Internal Revenue Code of [1986], where not manifestly inapplicable or incompatible with the intent of this section: Subtitle A (not including chapter 2 and section 931)" [Emphasis Added].

In "applying as the Guam Territorial Income Tax the income tax laws in force in Guam pursuant to subsection (a) of this section, except where it is manifestly otherwise required, the applicable provisions of the Internal Revenue Codes of 1954 and 1939 [and 1986], shall be read so as to substitute "Guam" for "United States", "Governor or his delegate" for "Secretary or his delegate", "Governor or his delegate" for "Commissioner of Internal Revenue and "Collector of Internal Revenue" ... and with other changes in nomenclature and other language, including the omission of inapplicable language, where necessary to effect the intent of this section." 48 USC §1421i(e). [Emphasis Added].

Subtitle A of the 1986 IRC incorporates the income tax laws of the U.S. including the EITC, IRC §32. Since Subtitle A is generally

applicable in Guam, the EITC must be mirrored in Guam unless the EITC is "manifestly inapplicable or incompatible with the intent of" the GTIT, is "manifestly otherwise required" or its language must be omitted "to effect the intent of" the GTIT.

3. Conflicting Purposes of GTIT and EITC.

When the purposes of the GTIT and the EITC are compared, it is apparent that the EITC is "manifestly inapplicable or incompatible with the intent" of the GTIT, is "manifestly otherwise required" and its language must be omitted "to effect the intent" of the GTIT.

The GTIT and the EITC serve conflicting purposes. The GTIT was enacted to provide GovGuam with a source of locally generated revenue to be used to fund governmental operations free of the need for appropriations from the U.S. Treasury. The EITC, on the other hand, is a social welfare program and not a tax program. Although it operates through the income tax system, it was designed to redistribute income tax revenue and not to collect income tax revenue. It was adopted to help the working poor by shifting income tax revenue to them.

To date, large amounts of GovGuam revenue has been applied to individuals claiming the EITC. These amounts have exceeded the amounts of GTIT that the EITC claimants have paid to GovGuam. Instead of enhancing GovGuam revenues, which was Congress' purpose for enacting the GTIT, the EITC has resulted in a loss of tax revenue to Guam.

Congress carefully crafted the EITC and has amended it numerous times over the past 20 years to reflect Congress' aims in the area of social welfare. The legislative history of the EITC indicates that Congress had U.S. economic, social and demographic conditions in mind when it enacted and amended the EITC. No where in the legislative history is there any mention of the economic, social and demographic conditions of Guam or of any of the other U.S. possessions, and no indication is given in the legislative history that Congress intended the EITC to be mirrored by GovGuam or by the governments of the two other U.S. mirror-code possessions, the CNMI and the Virgin Islands. See: Leg. Hist., P.L. 94-12, §204, U.S. Code, Cong. & Admin. News, 94th Cong., 1st Sess., 1975, Vol. 1, pgs. 63, 64, 85 & 86; Leg. Hist., P.L. 95-600, §103 - §105, U.S. Code, Cong. & Admin. News, 95th Cong., 2nd Sess., 1978, Vol. 6, pgs. 6815 & 6816; Leg. Hist., P.L. 99-514, §111, U.S. Code, Cong. & Admin. News, 99th Cong., 2nd Sess., 1986, Vol. 5, pgs. 4100 & 4101; Leg. Hist., P.L. 101-508, §11111 - §11116, U.S. Code, Cong. & Admin. News, 101st Cong., 2nd Sess., 1990, Vols. 5 & 6, pgs. 2242, 2280 - 2281, 2740 - 2746; Leg. Hist., P.L. 103-66, §13131, U.S. Code, Cong. & Admin. News, 103rd Cong., 1st Sess., 1993, Vols. 2 & 3, pgs. 839 - 841 & 1223 - 1226.

4. Mirror Code vs. Non-Mirror Code Possessions.

The EITC is not applied by Puerto Rico or American Samoa because they do not mirror the IRC. See Rev. Rul. 78-400, 1987-2 C.B. 7. Thus, the social welfare benefits of the EITC are not available in those two U.S. possessions although, theoretically, the social welfare benefits of the EITC are available in Guam, the CNMI and the Virgin Islands because they mirror the IRC. Would Congress have intended such a disparate result in the application of a major U.S. social welfare program if Congress had intended that the EITC would apply at all in the U.S. possessions?

In the mirror code and non-mirror code possessions alike, income tax revenues collected by the possession governments are deposited into the local treasuries and are not deposited into the U.S. Treasury. Since IRC §32 does not provide for U.S. funding of the EITC in the mirror code possessions, the EITC is payable from local tax revenues to the extent the EITC is actually applied in the mirror code possessions. The EITC is not payable from U.S. tax revenues. Based on this state of affairs, it would not have made sense for Congress to establish as the dividing line for extending the EITC to the U.S. possessions the factor that a particular possession mirrors or does not mirror the IRC. U.S. social welfare policy would not be enhanced by extending the EITC to mirror code possessions but not to non-mirror code possessions when U.S. funding is not involved. Residents of non-mirror code possessions have similar social welfare needs to residents of mirror code possessions.

To conclude that Congress intended to extend the social welfare benefits of the EITC to eligible residents of Guam, the CNMI and the Virgin Islands but not to residents of Puerto Rico and American Samoa would mean that Congress intended to discriminate against residents of Puerto Rico and American Samoa solely because Puerto Rico and American Samoa do not mirror the IRC. Since Congress can not be presumed to have intended to discriminate between the U.S. possessions insofar as this particular social welfare program is concerned, it must be assumed that by not enacting special EITC legislation for the non-mirror code possessions of Puerto Rico and American Samoa, Congress did not intend to extend the EITC to the mirror code possessions of Guam, the CNMI and the Virgin Islands.

This conclusion is fortified by the fact that Congress gave the mirror code possessions the power in 1986 to delink from the mirror code. U.S. Public Law 99-514, §1271(a) & §1277(b). If the EITC were an important social welfare program that Congress intended to extend to the mirror code possessions but not to the non-mirror code possessions, would Congress have given the mirror code possessions the power to eliminate the EITC by delinking from the mirror code? To date, none of the mirror code possessions have delinked from the mirror code.

5. CNMI and Virgin Islands.

The CNMI has taken a middle ground. It has not strictly mirrored the EITC under its Northern Marianas Territorial Income Tax ("NMTIT"). Until recently, the CNMI imposed a local tax in the amount of any EITC credit in excess of the amount of tax paid by the EITC claimant to the CNMI treasury. 4 CMC §1710; CNMI Public Law 4-24, §2. The imposition of the local tax had the effect of converting a refundable credit under IRC §32 into a non-refundable credit. Thus, the EITC could only be used to reduce an EITC claimant's tax liability to zero. The EITC could not be used to create an overpayment of tax refundable in cash.

In January 1995, the CNMI Legislature modified the local tax imposed on the excess amount of EITC. The tax is now imposed on only eligible individuals having no qualifying child. It is not imposed on eligible individuals having one qualifying child or on eligible individuals having two or more qualifying children. 4 CMC §1709; CNMI Public Law 9-22. Thus, it is now possible for eligible individuals having one or more qualifying children to receive cash refunds for the amount that their EITC exceeds the amount of income taxes paid into the CNMI treasury and to receive cash refunds in such amounts.

The CNMI's treatment of the EITC is significant because the NMTIT is based on the Guam Territorial Income Tax ("GTIT"). Under Section 601 of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America, U.S. Public Law 94-241, the CNMI is required to apply as its NMTIT the same laws that comprise the GTIT and to apply them in the same manner as does Guam. Based on its understanding of the mirroring rules applicable in Guam, the CNMI has concluded that it is not required to strictly apply the EITC but, instead, has the option to tailor the EITC to the CNMI's particular needs.

The Virgin Islands, on the other hand, has chosen to mirror the EITC without any apparent limitations. In 1976, the Virgin Islands obtained a special one-time only appropriation from Congress to assist the Virgin Islands for the cost of the EITC and for other revenue shortfalls in 1975. The appropriation was made necessary by adverse economic conditions that prevailed in the Virgin Islands during that time and by the loss of revenue caused by a reduction in U.S. tax rates and an increase in the standard deduction as mirrored in the Virgin Islands. U.S. Public Law 94-392, §4; Leg. Hist., U.S. Code, Cong. & Admin. News, 94th Cong., 2nd Sess., 1976, Vol. 3, pgs. 2099 - 2104. The legislative history discussing the reasons for the appropriation gave no indication that Congress had intended to extend the EITC to the Virgin Islands or to any other mirror code possession.

The different reactions of the CNMI and the Virgin Islands to the EITC suggests that the EITC has been treated as a matter of local option in the two mirror code possessions other than Guam.

6. Unfunded Mandate.

The EITC would clearly constitute an unfunded mandate imposed by the U.S. on Guam if Congress had intended that Guam should mirror the EITC. GovGuam would be required to expend its own locally raised tax revenues to support a U.S. social welfare program in Guam. Local tax revenues that could otherwise be used to support GovGuam operations would have to be devoted to financing the EITC. Congress can not be deemed to have intended such a result as it would mean that Congress intended to alter its original purpose in enacting the GTIT, i.e., that GovGuam should be self-supporting and should not rely on Federal resources to fund GovGuam operations.

On two occasions, Congress has appropriated funds to GovGuam to compensate Guam for the loss of tax revenues arising from the reduction of U.S. income tax rates and the increase in the standard deduction as mirrored in Guam. Congress also authorized Guam to impose a local 10% surtax on GTIT liabilities for the same purpose. See: U.S. Public Law 95-30, §407; Leg. Hist., U.S. Code, Cong. & Admin. News, 95th Cong., 1st Sess., 1977 Vol. 1, pgs. 217 & 218; U.S. Public Law 95-134, §203(c) & §402; Leg. Hist., U.S. Code, Cong. & Admin. News, 95th Cong., 1st Sess., 1977, Vol. 3, pgs. 3000, 3004, 3006, 3007, 3013 & 3014. The appropriations were one-time transfers and were not continuing appropriations. They were not intended to compensate GovGuam for the loss of revenue connected with the EITC. Congress has never appropriated any funds to GovGuam for that purpose.

It is noteworthy that two other social welfare programs expressly adopted by Congress to operate through the IRC are not mirrored by Guam. The Federal Employment Contributions Act ("FICA") and the Self-Employment Tax, from which social security benefits are funded, are not mirrored by Guam. 48 USC §1421i(d); IRC §3401 et seq; IRC §1401 et seq. The same is true of the Federal Unemployment Tax Act ("FUTA") which contributes to the funding of unemployment compensation. 48 USC §1421i(d); IRC §3301 et seq. The taxes for these social welfare programs are collected by the U.S. Internal Revenue Service and the resultant revenues are used by other U.S. government agencies to administer the programs.

7. Elimination of 1954 IRC §931 from the EITC.

The EITC originally incorporated Section 931 of the 1954 IRC. 1954 IRC §43(c)(1)(B); U.S. Public Law 94-12, §101; 1954 IRC §32(c)(1)(B); U.S. Public Law 98-369, §471(c)(1). Individuals having income derived from a U.S. possession described in Section 931 were not eligible to receive the EITC. Section 931 excluded from taxation in the U.S. the possessions source income of individuals residing in U.S. possessions other than Puerto Rico, the Virgin Islands, the CNMI and Guam. 1954 IRC §931(c); 48 USC §1421i(d). Thus, Section 931 applied only to individual residents of American Samoa. The coordination of the U.S. income tax and the territorial income taxes of Puerto Rico, the Virgin Islands, the CNMI and Guam with respect to individual income taxpayers was governed by other provisions of the 1954 IRC. See: 1954 IRC §932, §933 & §935.

Section 931 of the 1954 Code was eliminated from the EITC in the Tax Reform Act of 1986. It was eliminated because Section 931 was amended to include residents of Guam and the CNMI in addition to residents of America Samoa. However, 1986 IRC §931 does not apply to residents of Guam and the CNMI unless and until Guam and the CNMI delink from the mirror code, which Guam and the CNMI have not yet done. Accordingly, the U.S. income tax and the Guam and CNMI territorial income taxes continue to be coordinated under IRC §935 insofar as individual income taxpayers are concerned. U.S. Public Law 99-514, §1271(a), §1272(d)(4) & §1277(b); 1986 IRC §32(c)(D). The status of the EITC in Guam and the CNMI remains the same as before the passage of the Tax Reform Act of 1986.

8. Court Decisions.

The courts have decided a number of cases under the GTIT involving the mirroring rules. The issues in all of these cases were technical in nature and related to the procedural and substantive aspects of determining income tax liabilities under the GTIT, i.e., whether a particular tax rule of the IRC applicable in the U.S. should be mirrored in Guam for the purpose of determining a taxpayer's income tax liability to GovGuam. None of these cases dealt with the issue of whether a U.S. social welfare program such as the EITC should be mirrored in Guam, should be administered by DRT and should be financed from GovGuam tax revenues to the detriment of Guam's tax base.

In Laguana v. Ansell, supra, Phelan v. Taitano, supra, Wilson v. Kennedy, supra, and Lamkin v. Brown and Root, Inc., supra, the U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit") held that Sections 30 and 31 of the Organic Act of Guam, 48 USC §1421h & §1421i, established a separate territorial income tax in Guam based on the IRC but administered by GovGuam, and that the IRC must be mirrored in Guam so as to provide Guam with its own independent source of tax revenue free from direct appropriations from Congress.

In Murray v. Ingling, 190 F.Supp. 427 (D.C. Guam 1961), and Jones v. Ingling, 190 F. Supp. 428 (D.C. Guam 1961), the District Court of Guam ("District Court") held that 1954 IRC §6212 & §6213, authorizing GovGuam to assess income tax deficiencies against a taxpayer if the taxpayer fails to file a tax court petition for redetermination of the deficiency within 90 days after the petition is mailed to the taxpayer, must be mirrored in Guam. Consequently, the District Court dismissed the petitions of the taxpayers because they failed to file them within 90 days after the notices of deficiency were mailed.

In Bromberg v. Ingling, 300 F.2d 859 (9th Cir. 1964), the Ninth Circuit held that the notice of deficiency and assessment restriction requirements of 1954 IRC §6212 & §6213 must be mirrored in Guam by GovGuam in the same manner as they are applied by the U.S. Internal Revenue Service even though the District Court had no tax court jurisdiction at that time.

In Government of Guam v. Koster, 362 F.2d 248 (9th Cir. 1966), the Ninth Circuit held that tax regulations adopted by GovGuam, defining the term "gross income" so as to exclude income not derived from or earned in Guam and permitting deductions for only those items directly attributable to Guam taxable income, were invalid because they were contrary to 1939 IRC §22(a) and 1954 IRC §61 which GovGuam was required to mirror.

In Sayre & Company v. Riddell, supra, the Ninth Circuit held that 1954 IRC §881(a), imposing a 30% withholding tax on certain types of income received by foreign corporations from sources within the U.S., must be mirrored in Guam. Thus, interest and commission income paid by a Guam sole proprietorship to a Hawaii corporation from Guam sources was subject to the 30% withholding tax which the Guam sole proprietorship was required to deduct, withhold and pay over to the Treasurer of Guam.

In Flores v. Government of Guam, supra, the Ninth Circuit held that 1954 IRC §932(a), which treated individuals who became U.S. citizens under the Organic Act of Guam as being non-resident aliens of the U.S. for U.S. tax purposes, could not be mirrored in Guam for purposes of the GTIT. Hence, a Guamanian who became a naturalized U.S. citizen while residing in the U.S. before the Organic Act of Guam was enacted could not be treated as a non-resident alien of Guam for purposes of the GTIT and could not be denied the right under 1954 IRC §932(a) to file a joint income tax return with his wife, a U.S. citizen under the Organic Act, and to claim itemized deductions on the joint return.

In Manning v. Blaz, 479 F.2d 333 (9th Cir. 1973), the Ninth Circuit reaffirmed that 1954 IRC §932(a) can not be mirrored in Guam for purposes of the GTIT and held that a non-Guamanian U.S. citizen, not a resident of Guam, could not be denied the right to file a Guam joint income tax return with his wife to report his share of Guam source income earned by a Guam Subchapter S corporation.

In Bank of America v. Chaco ("Chaco I"), supra, the Ninth Circuit held that the IRC, as mirrored in Guam, is a U.S. law imposed on Guam by Congress although administered by GovGuam, and is not a law imposed on Guam by the Guam Legislature. Thus, the Guam 4% business privilege tax imposed by the Guam Legislature on banks doing business in Guam is not a "second tax" imposed by Congress on banks in violation of 12 USC §548.

In Bank of America v. Chaco ("Chaco II"), 423 F.Supp. 409 (D.C. Guam 1976), the District Court held that 1954 IRC §864(c)(4), which treats certain types of foreign source income of a foreign corporation as being effectively connected with the conduct of a trade or business in the U.S., can not be mirrored in Guam insofar as a U.S. corporation doing business in Guam is concerned. Consequently, the Bank of America, which had several branches in Guam, could not be taxed by Guam on certain U.S. source interest earned on government obligations pledged as collateral to secure GovGuam deposits with the Bank of America in Guam.

In Holmes v. Director of Revenue and Taxation ("Holmes I"), 827 F.2d 1243 (9th Cir. 1987), the Ninth Circuit held that the mirroring rules of Guam, when applied in conjunction with the mirroring rules of the CNMI, required Guam to treat a CNMI corporation as a domestic corporation of Guam for Subchapter S corporation purposes and that a Guam shareholder of the CNMI corporation was entitled to deduct on his Guam income tax return the losses incurred by the CNMI corporation from its business activities in the CNMI.

In Holmes v. Director of Revenue and Taxation ("Holmes II"), 937 F.2d 481 (9th Cir. 1991), the Ninth Circuit held that the statute of limitations for asserting an income tax deficiency against a Guam shareholder of a CNMI Subchapter S corporation began to run when the CNMI corporation filed its NMTIT return in the CNMI and that this result was required by the mirroring rules.

Clearly, all of the decided cases have dealt with the procedural and substantive aspects of determining income tax liabilities under the GTIT. None of the decided cases have held that Guam is required to mirror, administer and fund a U.S. social welfare program such as the EITC to the detriment of Guam's tax base. The purpose of Congress in enacting the EITC was to ensure that Guam had a local, independent source of tax revenue from which to conduct GovGuam operations free of the need to receive direct Congressional appropriations from the U.S. Treasury.

When the purposes of the GTIT and the EITC are compared, it is apparent that the EITC is "manifestly inapplicable or incompatible with the intent" of the GTIT, is "manifestly otherwise required" and its language must be omitted "to effect the intent" of the GTIT. 48 USC §1421i(d) & (e). Accordingly, it is hereby ruled that DRT is not required to mirror and administer the EITC in Guam and DRT is not required to certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns.

9. This Ruling is not Affected by DRT's Prior Administrative Practices Regarding the EITC or by the Prior Legal Opinion Issued by the AG Concerning the EITC.

This ruling is not affected by the fact that heretofore the EITC has been applied in Guam, that the EITC has been administered by DRT and that DRT has certified to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns. DRT has the power and right to change its erroneous legal interpretation and administrative practices concerning the EITC and DRT is not estopped from so doing. Taxpayers do not have a vested right to insist that DRT should continue to follow a legal interpretation and administrative practices that are erroneous. Automobile Club of Michigan v. Commissioner of Internal Revenue, 353 U.S. 180, 77 S.Ct. 707, 550 AFTR 1967 (1957); Dixon v. United States, 85 S.Ct. 1301, 15 AFTR 2d 842 (1965); Dickman v. Commissioner of Internal Revenue, 104 S.Ct. 1086, 53 AFTR 2d 84-1608 (1984).

This ruling is also not affected by the fact that the AG previously issued a legal opinion concluding that the EITC applies in Guam. Insofar as the GTIT is concerned, the Director of DRT has the exclusive administrative authority to interpret the EITC. 48 USC §1421i(c); 1986 IRC §7805(a); 11 GCA §1102(a), §1103, §1104(a), §1106(a), §1107(a) & (d). An Attorney General's opinion is only advisory and does not have the weight of law. See: AG Office Procedure Manual, pg. VI.6. In exercising his responsibility, the Director has concluded that the Attorney General's opinion is erroneous.

B. DRT Can Not Lawfully Certify to DOA for Payment the Amounts of EITC Cash Refunds Reported by Guam Taxpayers on their Guam Individual Income Tax Returns to the Extent Such Refunds Exceed the Amounts of The Income Tax Liabilities Appearing on the Returns Because the Guam Legislature Has Not Appropriated Funds to DOA for this Purpose.

Section 20 of the Organic Act of Guam requires the Guam Legislature to appropriate funds before they can be expended. 48 USC §1423j. The Guam Legislature has provided by statute that no officer or employee of GovGuam shall make or authorize any expenditure of Guam funds unless the expenditure has been appropriated by the Legislature. 5 GCA §22401. Anyone who willfully violates this prohibition shall be guilty of a misdemeanor. 5 GCA §22401(c). See 63A Am. Jur.2d, Public Funds, §37.

The Guam Legislature has created a private cause of action whereby any taxpayer who is a resident of Guam shall have standing to sue GovGuam and any employee or officer of the Executive Branch to enjoin the expending of GovGuam funds without proper appropriation and to recover for GovGuam any funds which have been expended without proper appropriation. 5 GCA, Div. 1, Chptr. 7; Guam Public Law 18-09.

The Guam Legislature has never appropriated funds to DOA to cover payment of EITC cash refunds in excess of tax liabilities reported by Guam taxpayers on their Guam individual income tax returns. No such appropriation appears in the 1996 fiscal year budget recently passed by the Legislature and approved by the Governor. Guam Public Law 23-45. Since EITC cash refunds in Guam have been paid from GovGuam revenues and not from U.S. revenues appropriated to Guam by Congress, the Guam Legislature is not absolved from making such appropriations. Wong v. Camina, 2 Guam Reports - No. 1, pgs. 132 - 135 (D.C. Guam, Civ. No. 78-001, Jan. 23, 1978).

Significantly, Congress appropriates funds to the U.S. Treasury Department to cover EITC cash refunds of U.S. taxpayers in excess of income tax liabilities. To alleviate the need to appropriate money for this purpose every year, Congress has made it subject to a continuing appropriation. 31 USC §1324; U.S. Public Law 101-503, §11116.

Assuming, arguendo, that the EITC applies in Guam and DRT is required to administer the EITC, DRT could not lawfully certify to

DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns to the extent such refunds exceed the amounts of the income tax liabilities appearing on the returns unless the Guam Legislature appropriates funds to cover such refunds. The Attorney General's contrary opinion, DOA 89-0750, is erroneous. Similarly, DRT's administrative practice of certifying payment of these amounts to DOA is erroneous. See ¶A(8) above, pgs. 12 & 13, supra.

For the above reasons, it is hereby ruled that DRT can not legally certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns to the extent such refunds exceed the amounts of the income tax liabilities appearing on the returns because funds for this purpose have not been appropriated by the Guam Legislature to DOA.


C. DRT Will Not Audit and Adjust the Income Tax Returns of Individuals Claiming the EITC for Calendar Years Ending before January 1, 1995 and DRT Will Not Seek to Recover from Such Individuals Any EITC Cash Refunds Received from DOA for Calendar Years Ending before January 1, 1995.

The Director of DRT is vested with the discretion to determine whether a ruling shall have retroactive or prospective effect. 1986 IRC §7805(b); Treas. Reg. 301.7805-1(b). The Director's decision will not be overturned except for an abuse of discretion. Automobile Club of Michigan v. Commissioner of Internal Revenue, supra; Dixon v. United States, supra.

In ruling that the EITC does not apply in Guam, that the EITC should not be administered by DRT and that DRT should not certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns, the Director of DRT is cognizant that DRT has in fact done the foregoing for many years. The Director is also cognizant that in 1989 the AG issued a legal opinion concluding that the EITC applies in Guam and that the Guam Legislature is not required to appropriate funds to DOA to cover EITC cash refunds.

Based on the above factors, the Director has concluded that he should exercise his discretion in a manner that will not harm taxpayers who have heretofore claimed the EITC on their Guam individual income tax returns and who have also have received EITC cash refunds. Consequently, it is hereby ruled that this ruling shall be applied only to calendar years beginning after December 31, 1994. DRT will not audit and adjust the income tax returns of individuals claiming the EITC for calendar years ending before January 1, 1995 and DRT will not seek to recover from such individuals any EITC cash refunds received from DOA for calendar years ending before January 1, 1995.

ISSUED THIS 4 DAY OF JAN., 1996.


JOSEPH T. DUENAS
Director



GOVERNMENT OF GUAM
AGANA GUAM 96910

January 4, 1996

MEMORANDUM (Opinion) - Ref: DRT/DOA 96-001

To: Director of Revenue and Taxation
Director of Administration

From: Attorney General

Subject: Revocation of Attorney General Opinion DOA 89-0750
Regarding Earned Income Tax Credit

Buenas yan Hafa Adai!

We have received from the Director of Revenue and Taxation (DRT) his Revenue Ruling 96-001, dated January 4, 1996. In light of our contrary Attorney General's Opinion DOA 89-0750, issued by this office to the Director, Department of Administration (DOA) on June 23, 1989, the following Attorney General's Opinion is hereby issued.

ISSUE: Should Attorney General Opinion DOA 89-0750 be revoked and should the Director of Revenue and Taxation's Revenue Ruling 96-001 be adopted in its place?

ANSWER: Yes.

FACTS

In 1989, DOA requested a legal opinion from this office interpreting the applicability of the Earned Income Tax Credit in Guam. Specifically, DOA sought answers to the following two issues:

- (1) Is the Territory obligated to pay amounts qualified for the Earned Income Credit, specifically the sums in excess of actual taxes withheld? - and,
- (2) If the answer to 1) is yes, must the amounts so paid be appropriated by the Legislature?

On June 23, 1989, this office issued legal opinion DOA 89-0750. We determined that (a) the EITC applies in Guam under the Guam Territorial Income Tax ("GTIT") and (b) the Guam Legislature is not required to appropriate funds to cover sums payable by DOA for EITC cash



refunds, i.e., refundable amounts in excess of the amounts of actual taxes paid to the Government of Guam ("GovGuam") by or for these taxpayers. A copy of AG opinion DOA 89-0750 is attached hereto as Exhibit "1".

On January 4, 1996, the Director of DRT issued Revenue Ruling 96-001. It rules that the EITC does not apply in Guam and that the EITC should not be administered by DRT. It also rules that DRT is not required to certify to DOA for payment the amounts of EITC cash refunds reported by Guam taxpayers on their Guam individual income tax returns because (a) the EITC is not applicable in Guam and (b) the Guam Legislature has not appropriated funds to DOA for this purpose. A copy of Rev. Rul. 96-001 is attached hereto as Exhibit "2". This is the first ruling by the Director of DRT on this subject. The Director's ruling is contrary to our opinion.

DISCUSSION

The Director of DRT is charged with the exclusive administrative responsibility under the Guam Territorial Income Tax ("GTIT") and Guam law to interpret and administer the GTIT. 48 USC §1421i(c); 1986 IRC §7805(a); 11 GCA §1102(a), §1103, §1104(a), §1106(a), §1107(a) & (d). The applicability of the EITC in Guam comes within the scope of this responsibility as the EITC is part of the U.S. Internal Revenue Code.

The Director of DRT has determined that a definitive ruling interpreting the applicability of the EITC in Guam is necessary at this time because GovGuam has experienced large amounts of lost revenue and cash outlays under the EITC. See Exhibit "B" attached to Rev. Rul. 96-001.

In Rev. Rul. 96-001, the Director of DRT has concluded that the opinion of this office in DOA 89-0750 is erroneous. He has also concluded that the administrative practices of DRT with respect to the EITC have similarly been erroneous. The Director of DRT clearly has the power and right to change an erroneous legal interpretation and erroneous administrative practices concerning the EITC and he is not estopped from so doing. Taxpayers do not have a vested right to insist that DRT should continue to follow a legal interpretation and administrative practices that are erroneous. Automobile Club of Michigan v. Commissioner of Internal Revenue, 353 U.S. 180, 77 S.Ct. 707, 550 AFTR 1967 (1957); Dixon v. United States, 85 S.Ct. 1301, 15 AFTR 2d 842 (1965); Dickman v. Commissioner of Internal Revenue, 104 S.Ct. 1086, 53 AFTR 2d 84-1608 (1984).

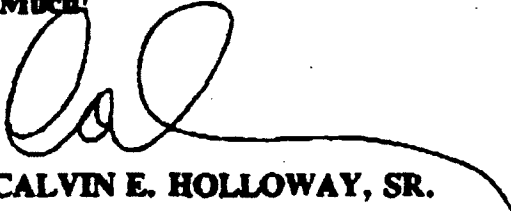
Since the Director of DRT has the exclusive administrative responsibility to interpret the GTIT and he has done so in Rev. Rul. 96-001, we defer to the Director's ruling in this matter. Opinions of this office are only advisory and do not have the weight of law. See: AG Office Procedure Manual, pg. VI.6. In any event, this office has concluded from its own analysis of the matter that the Director's ruling is correct in all respects.

Accordingly, Attorney General Opinion DOA 89-0750 is hereby revoked and Rev. Rul. 96-001 is adopted in its place as an opinion of this office.

This memorandum is issued as an opinion of the Attorney General.

For a faster response to any inquiry about this memorandum, please use the reference number shown above.

Dangkolo Na Agradesimo - Thank You Very Much!



CALVIN E. HOLLOWAY, SR.

Attachment

cc: Legal Counsel
Office of the Governor

Deputy, Solicitors Division

Compiler of Laws

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CEH/nd

GOVERNMENT OF GUAM
AGENCI GOVERNMENT

June 23, 1989

Memorandum (Opinion)

Ref: DOA 89-0750

To: Director, Department of Administration

From: Attorney General *EAD*

Subject: Earned Income Credit

We have received your memorandum dated June 5, 1989 requesting a legal opinion concerning the following:

REQUEST NO. 1: Is the Territory obligated to pay amounts qualified for the Earned Income Credit, specifically the sums in excess of actual taxes withheld?

ANSWER: Yes, unless we amend our tax law so that we no longer follow the Internal Revenue Code exactly.

REQUEST NO. 2: Must the amounts so paid be appropriated by the Legislature?

ANSWER: No. We believe they should be paid from General Fund revenues prior to appropriation from the Legislature.

STATEMENT OF FACTS:

The following information was provided to us in your memorandum. As the result of the Department of Administration reviewing certain reports prepared by the Department of Revenue and Taxation, and a preliminary review the Internal Revenue Code of 1954, as amended, numerous taxpayers filing income tax returns on Guam appear to be taking advantage of the earned income credit.

The purpose of this tax credit is to provide tax relief for individuals who have children and are working. The structure of the tax credit is such that people may and do receive credits (and hence refunds) which are in excess of the actual taxes withhold from the taxpayer. Whereas in 1986, the earned income ceiling for the credit was \$6,000, this increased to \$10,000 in 1987. For 1988, the ceiling exceeds \$18,000. As of 1988, as many as 60% of all taxpayers on Guam fall within the ceiling.

EXHIBIT 1

Although Social Security Taxes fall under the Internal Revenue Code, Guam does not refund to any taxpayer any claim for refund on excess social security taxes paid; taxpayers in the United States may apply for the refund directly on the income tax return unlike Guam's taxpayers. Guam residents must file separately for a refund with the IRS. This practice is reasonable since the Territory does not receive any social security taxes.

The concept of the Earned Income Credit (EIC) could not have been contemplated by the drafters of the Organic Act of Guam, as the Organic Act predates the EIC by 25 years. The EIC was effective for tax years beginning after December 31, 1974. The authority of Guam to collect the "federal" income tax was granted ostensibly to finance public services on Guam, which the Territory could hardly do if a "negative" tax collection occurred, by paying out more refunds than taxes collected.

The EIC appears not to be a matter of tax policy, but rather a social policy of the United States of America. In substance, the United States appears to have established public assistance for working people with low income and with families (children) who should receive assistance through its (the Federal Government's) revenue system rather than risking any perceived stigma of having qualified persons applying directly for public assistance. Qualified taxpayers receive the benefit using the confidentiality of income tax returns.

The Internal Revenue Service, U.S. Department of the Treasury, has adopted in its regulations a practice of recording the EIC in two different ways. When the EIC refunded is still less than the total withholdings taxes paid, the EIC is classified as a tax expenditure. The EIC, when it exceeds the amount of taxes withheld, is classified as a tax outlay. A review of the annual budget of the U.S. Government (FY'1989) discloses a statement that it is the Treasury department's responsibility to pay all tax outlays. The total outlay for the fiscal year may exceed \$2 million.

DISCUSSION:

Guam currently uses a mirror image of the Internal Revenue Codes as its basis for collecting income taxes. Some time ago, the Territory received the permission of Congress to enact its own tax code in the 1986 Tax Reform Act. By Executive Order, we have established the Guam Tax Reform Commission to determine and recommend how we will delink from the IRC. The Earned Income Credit (EIC) and its applicability to Guam is one of the issues currently before the Commission. We have been informed that Guam had previously received an annual reimbursement from the federal government amounting to several million dollars, but that the practice was halted during the administration of President Carter.

It appears that because we have the authority to delink from IRC, and yet choose not to do so (if only by our inaction), that we are in a position of being responsible for any shortfall resulting from following federal tax policies which are entirely discretionary upon us. We might be able to attempt to seek reimbursement for the estimated or actual shortfall caused by Earned Income Credit. However, the response of Congress is likely to be that we merely have to rewrite our local tax code to remove this burden. Of course, we have the authority under Section 31(a) of the Organic Act of Guam, as amended, to place a 10% surcharge on our income taxes, which we haven't done. This would offset some of the impact upon us in following the EIC portion of the tax code.

The refunds, or shortfall, in our opinion, should be made up in the same manner as we make up for refunds of overpaid taxes. In other words the shortfall should be made up from the General Fund; specifically from the same deposit account where other income tax revenue is placed.

We recommend that the issue be raised with the Guam Tax Reform Commission, which is in the process of reviewing the substantive portions of the Territorial Income Tax laws.

This memorandum is issued as an opinion of the Attorney General. For a faster response to any inquiry about this memorandum, please use the reference number shown.

OFFICE OF THE ATTORNEY GENERAL

By: 
for ROBERT G.P. CRUZ
Assistant Attorney General

cc: Director, Department of
Revenue & Taxation

TWENTY-THIRD GUAM LEGISLATURE
1995 (FIRST) Regular Session

JAN 29 1996

Bill No. 481 (LS)
Introduced by:

F.P. Camacho



**AN ACT TO MAKE THE EARNED INCOME TAX CREDIT
APPLICABLE TO GUAM.**

1 BE IT ENACTED ON BY THE PEOPLE OF THE TERRITORY OF GUAM:

2
3
4 **Section 1.** The legislature hereby disagrees with the legal analysis and policy conclusions
5 enumerated by the Director of Revenue and Taxation in Revenue Ruling 96-001, a ruling which
6 has been approved by the Attorney General of Guam.

7 The legislature intends to make the Earned Income Tax Credit (EIC) available to the
8 taxpayers of Guam both as a matter of tax policy and social policy.

9 **Section 2.** A new section 4108 is added to Title 11, GCA, to read as follows:

10 “Section 4108. Earned Income Tax Credit Applicable to Guam. (a) Title 26 U.S.C. Section 32,
11 also known as Section 32 of the Internal Revenue Code, all related federal tax statutes and
12 regulations necessary for the enforcement of that statute and the Earned Income Tax Credit which
13 it creates, are hereby made applicable to Guam. The Department of Revenue and Taxation shall
14 make the Earned Income Tax Credit (EIC) available to Guam taxpayers to the full extent
15 permitted by federal law.

16 (b) The Department of Revenue and Taxation shall certify to the Department of Administration

1 every year the amounts necessary to pay such sums as are required by this statute to be paid to
2 Guam taxpayers.

3 (c) There is hereby appropriated from the General Fund, on a continuing basis, such funds as are
4 necessary to give this statute its full force and effect.”

5 **Section 3.** This Act will take effect immediately after its enactment.