



OFFICE OF
INSPECTOR GENERAL
U.S. DEPARTMENT OF THE INTERIOR

GUAM'S BUSINESS PRIVILEGE TAX



**OFFICE OF
INSPECTOR GENERAL**
U.S. DEPARTMENT OF THE INTERIOR

SEP 24 2014

The Honorable Eddie Baza Calvo
Governor of Guam
Ricardo J. Bordallo Governor's Complex
Adelup, Guam 96910

Subject: Final Evaluation Report – Guam's Business Privilege Tax
Report No. HI-EV-GUA-0001-2013

Dear Governor Calvo:

This report presents the results of our evaluation of the Government of Guam's Department of Revenue and Taxation's (DRT) process for collecting the Business Privilege Tax (BPT) from businesses that have contracts with the U.S. Federal Government, including the Department of Defense, for U.S. military projects on Guam. We found that DRT has an incomplete procedure for identifying contractors subject to the BPT and for collecting those taxes. DRT also uses an incomplete list of Federal contractors when identifying those subject to BPT.

We offered three recommendations to which we requested your response. While we appreciate your response to our draft report, we consider our recommendations unresolved. As the U.S. Department of the Interior's conduit for coordinating Federal policy and activities with insular area territories and government, the Office of Insular Affairs (OIA), monitors and tracks Guam's governance efforts, which would include resolution and implementation of the recommendations contained in the attached report. Accordingly, we have requested that OIA track Guam's progress in implementing and resolving these recommendations.

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, evaluation, and inspection reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented.

If you have any questions regarding this report, please contact Mr. Charles Haman, Regional Manager at 303-236-9243.

Sincerely,

Mary L. Kendall
Deputy Inspector General

Table of Contents

Results in Brief	1
Introduction.....	2
Objective	2
Background	2
The Government of Guam’s Tax Laws	2
The U.S. Military Buildup on Guam and Its Potential Impact on Taxes	4
Findings.....	5
Inadequate Procedures.....	5
Limited Identification of Contractors.....	6
Conclusion and Recommendations.....	8
Conclusion.....	8
Governor’s Response	8
Recommendations Summary.....	9
Appendix 1: Scope and Methodology.....	10
Scope	10
Methodology	10
Appendix 2: Guam’s Department of Revenue and Taxation Policy.....	11
Appendix 3: Schedule of Monetary Impact	12
Appendix 4: Prior Reports	13
Appendix 5: Status of Recommendations.....	14

Results in Brief

The Government of Guam's (GovGuam) Department of Revenue and Taxation (DRT) collects tax revenues, which account for more than half of GovGuam's revenue sources. The Business Privilege Tax (BPT), which applies to all persons or contractors on Guam as well as contractors not located on the island but who conduct business on the island, made up 35 percent of Guam's tax revenue in fiscal year 2012. Any business that has contracts with the Federal Government for U.S. military projects on Guam is subject to the tax. This includes the U.S. Department of Defense (DOD), which awards hundreds of contracts per year for projects on Guam. With more than 6,000 U.S. Marines and their dependents relocating to the island, the number of contracts for projects may increase in order to build the infrastructure necessary to accommodate this increased U.S. military presence.

We evaluated DRT to determine its ability to collect the BPT from Federal contractors. We found that DRT's procedure (the Federal Contractors Task Force document) for identifying those contractors that are subject to the BPT and for collecting the taxes from those contractors is inadequate. Because DRT does not have a complete policy for identifying Federal contractors who are subject to the BPT, GovGuam may not be collecting taxes that it is owed. In addition, DRT does not use a complete list of Federal contractors when identifying who is subject to the BPT, nor does it follow through with established processes, adding to GovGuam's problem of possible lost revenue. To provide programs and services to its people, it is important for Guam to identify and collect all the taxes due.

Introduction

Objective

We examined the Government of Guam's (GovGuam) Department of Revenue and Taxation (DRT) to determine whether it has a process in place for identifying and collecting Business Privilege Taxes (BPT) from businesses that have contracts with the Federal Government, including the U.S. Department of Defense (DOD), for U.S. military projects on Guam (see Appendix 1 for scope and methodology).

Background

The Government of Guam's Tax Laws

In 1950, the U.S. Government enacted the Guam Organic Act, which gave U.S. citizenship to the people of Guam, established local self-government, and assigned administrative responsibility for Guam to the Secretary of the Interior. In regard to income tax law, the Act mirrors the U.S. Internal Revenue Code, substituting references to the "U.S. Government" with "Guam" where necessary and removing any inapplicable provisions.

DRT enforces Guam's tax laws and collects all tax revenues, as well as revenues from other sources, such as business licensing and vehicle registration. DRT's stated mission is to promote quality service to all taxpayers, increase voluntary compliance by helping taxpayers understand and meet their responsibilities, and apply the tax law with integrity and fairness.

In fiscal year (FY) 2012, taxes comprised 57 percent of GovGuam's total revenue, as detailed in Figure 1.

Fiscal Year 2012 Government of Guam Revenue Sources

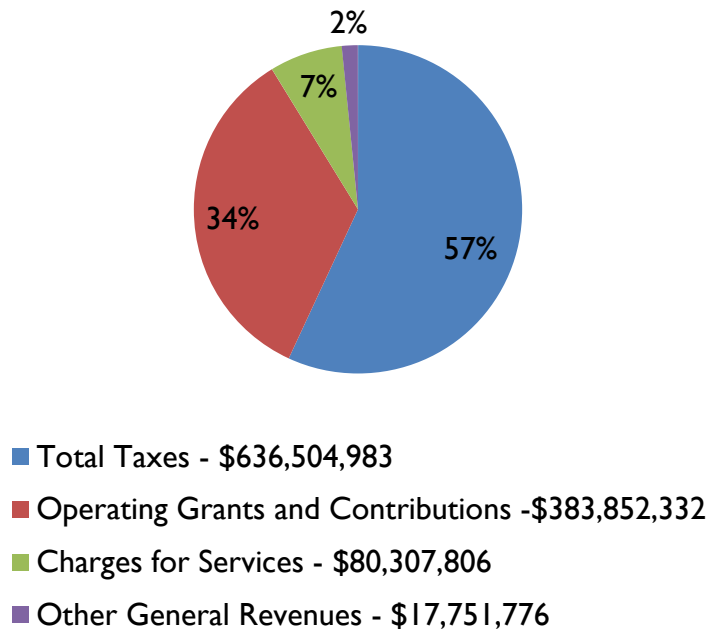


Figure I. The Independent Auditor's Report for FY 2012 reported GovGuam's revenues from governmental activities, including local revenues, totaled \$1.1 billion in FY 2012.

In addition to income taxes and various other taxes, Guam imposed the BPT in 2007, which is assessed and collected in accordance with Title 11 Chapter 26 of the Guam Code. The Guam Code states that the BPT tax rate to be levied, assessed, and collected on contractors is 4 percent of the contractor's gross income for goods and services performed.¹

The BPT applies to all persons or contractors doing work on Guam, whether or not their business is located on the island. This includes Federal contractors doing work for the U.S. military on Guam. The Guam Code does provide for exemptions; however, the onus is on the contractor to provide support for such an exemption.

Until 2011, DRT collected the BPT from not only the prime contractor — the contractor who received the contract— but also any subcontractor working on the project. On March 1, 2011, Public Law 30-230 went into effect, which placed the burden of paying the BPT solely on the prime contractor. Under the new law, prime contractors are now responsible for

¹ 11 Guam Code Annotated § 26202.

paying their subcontractors' BPT. This change should make it easier for DRT to track and collect taxes.

In FY 2012, the BPT represented 35 percent of Guam's total tax revenues, as shown in Figure 2.

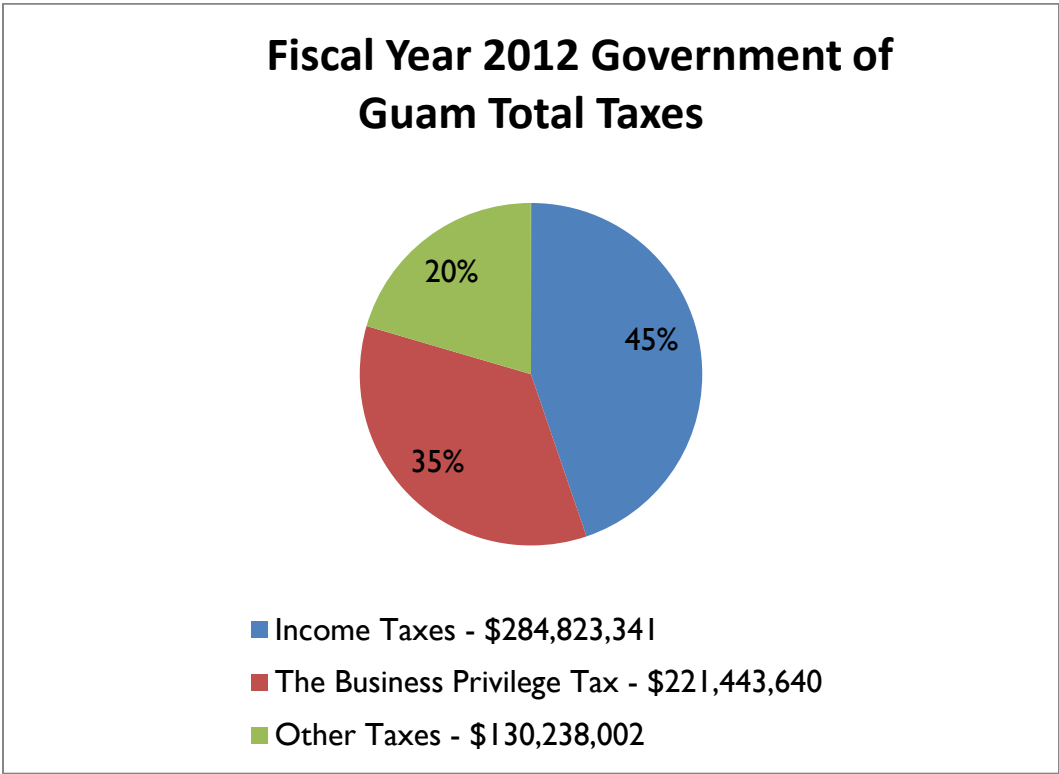


Figure 2. The Business Privilege Tax amounted to 35 percent of its total taxes.

The U.S. Military Buildup on Guam and Its Potential Impact on Taxes

In 2006, the United States and Japan agreed to reduce the U.S. military presence in Japan by relocating units to other areas in the Pacific region, including Guam. Because of this relocation, OIG began a series of evaluations to look at how the impending population increase would affect GovGuam's ability to operate.

DOD currently plans to relocate approximately 5,000 Marines and 1,300 dependents in the first half of 2020. The military buildup will require necessary changes to infrastructure to respond to the increased population, which will likely increase the number of DOD contractors subject to BPT and further increase tax revenue due to GovGuam.

Findings

DRT enforces Guam's tax laws and collects tax revenues, including the BPT from Federal contractors who conduct business for the U.S. military on Guam. We found, however, that DRT has an inadequate procedure for identifying all Federal contractors and for subsequently collecting the BPT from those contractors. In addition, DRT is relying on an incomplete list of Federal contractors to identify contractors that could be subject to the BPT.

Inadequate Procedures

We found that DRT's Federal Contractors Task Force document does not have a complete set of procedures for identifying Federal contractors who complete projects for the U.S. military on Guam or for collecting the BPT from those contractors. DRT's procedure is a short, 1-page document that defines DRT's responsibilities (see Appendix 2). The document describes the process for identifying Federal contractors and determining if they have paid the BPT. If the contractor has not paid the tax, DRT sends up to two notices of unfiled taxes to the contractor.

The document, however, does not include specific procedures for pursuing delinquent taxes. For example, there are no timeframes for sending notices of unfiled taxes or guidance as to when DRT should take further actions to ensure that the contractor has paid its taxes. In addition, the document does not contain a prescribed method for monitoring and recording follow-through on delinquent taxes or parameters for when DRT should report delinquencies to Guam's Attorney General for legal action, if warranted.

Without a complete procedure to identify and maintain a record of Federal contractors subject to the BPT and to collect the BPT from those contractors, GovGuam could be losing much needed revenue. In a sample of 40 contracts totaling \$117 million from the 2010 Contract Award document, we found that DRT did not collect taxes from six contracts.² None of these contractors supplied documentation to prove they were exempt from the BPT. If DRT had collected the 4 percent BPT on these contracts, DRT would have collected an additional \$414,414 in revenue (see Appendix 3).

In addition, Guam may not have collected this potential revenue because it did not follow through on the BPT process to validate whether contractors were exempt. GovGuam's policy states: "a special task force is assigned to contact contractors on the list to ensure they are meeting the required filing...." OIG was informed, however, that DRT had only one person assigned part time to implement the present procedure. When we began our review in March 2013, DRT staff had not

² The 2010 Contract Award document contained a list of 633 DOD contracts for projects on Guam, totaling about \$957.6 million.

yet performed any work toward identifying or collecting FY 2012 taxes. In addition, while notices were issued to the contractors for FY 2011, there was no follow-up with contractors that did not respond.

Recommendations

We recommend that GovGuam:

1. Resolve whether Guam is owed the \$414,414 in taxes.
2. Develop and implement a BPT collection procedure for all contractors conducting projects for the U.S. Government on Guam with specific control elements including, but not limited to—
 - a. a tracking mechanism that identifies all Federal contractors;
 - b. defined timeframes for notices of unfiled taxes;
 - c. requirements to monitor and record actions on delinquent taxes; and
 - d. parameters for when to report delinquencies to the Attorney General.

Limited Identification of Contractors

We found that DRT does not use a complete list of contractors for identifying those that could be subject to the BPT. Instead, it relies on a Military Contracts Awards Report supplied by the Guam Economic Development Authority. This report only lists contracts from the U.S. Department of the Navy and Air Force. In contrast, the USASpending report lists all Federal awards, including awards from other agencies that may be subject to the BPT. This report can be generated at no cost to DRT from a searchable website established by the U.S. Office of Management and Budget (OMB). Current information such as the entity receiving an award, the amount of an award, and the location of the entity receiving the award are easily accessible.

The purpose of the Federal Contractors Task Force is to ensure that Federal contractors, among others, are meeting “Full Compliance” requirements when filing certain tax documents. In our USASpending report sample of 54 contractors from FY 2010, we found 47 Federal contractors who conducted business on Guam that were not listed on the Military Contracts Award Report that may have been subject to BPT.

Recommendation

We recommend that GovGuam:

3. Expand data sources to include, but not limited to, USASpending to identify all contractors that may be subject to the BPT.

Conclusion and Recommendations

Conclusion

GovGuam currently operates with an annual fiscal deficit and owes more than \$1 billion in long-term debt. While FYs 2011 and 2012 have seen an increase in overall total revenue collected for the general fund, GovGuam needs to collect all taxes that it is owed to pay down the deficit. We have reported on Guam's inability to collect taxes in previous reports (see Appendix 4), and we have found that deficiencies at DRT persist. By failing to address long-standing tax collection deficiencies, such as the case with BPT, Guam has been deprived of the revenues it desperately needs to fund public education, health, safety, and other programs for its people. Based on the response from the Governor of Guam, we consider our three recommendations unresolved.

We commend GovGuam's efforts and improvements cited in the response. While we understand the context of the Governor's response, we still feel that it is important to address our recommendations so that GovGuam can collect potential lost revenue.

Governor's Response

The Governor of Guam agrees that taxes due should be collected in full from companies with liabilities and those gaps must be closed. Guam has made significant progress in the collection of taxes. In addition, the Governor has introduced legislation to hire counsel to pursue companies not paying taxes.

The Governor believes that certain achievements and works in progress have resulted in a significantly higher rate of return than the Federal Contractors Task Force. Among the projects were a real property computer system, a real property revaluation, availability of computers for customer use, the reconciliation process of Section 30 and on-line scheduling for driver's licenses. He stated that DRT has been constrained by both manpower and time to complete these tasks that GovGuam prioritized.

Finally, with regard to the BPT, additional instructions were included in the "Instructions to the Bidders" for the Military Installations, which outline the contractor's tax obligations. DRT was also instrumental in amending the local statute, resulting in up front collection of the BPT by the prime contractor.

Recommendations Summary

We recommend that GovGuam:

1. Resolve whether Guam is owed the \$414,414 in taxes.
2. Develop and implement a BPT collection procedure for all contractors conducting projects for the U.S. Government on Guam with specific control elements including, but not limited to—
 - a. a tracking mechanism that identifies all contractors;
 - b. defined timeframes for notices of unfiled taxes;
 - c. requirements to monitor and record actions on delinquent taxes; and
 - d. parameters for when to report delinquencies to the Attorney General.
3. Expand data sources to include, but not limited to USASpending, to identify all contractors that may be subject to the BPT.

We request that Guam provide DOI Office of Insular Affairs with the actions taken to address the recommendations, which we identify in Appendix 5.

Appendix I: Scope and Methodology

Scope

Our evaluation focused on the Guam Department of Revenue and Taxation (DRT) and its collection of the Business Privilege Tax for Federal contractors. We conducted our evaluation from March 11, 2013, to May 2, 2013. As part of our review, we relied on the work of several internally generated reports, as well as the report and assessment, listed in Appendix 4.

We performed our evaluation in accordance with the Quality Standards for Inspection and Evaluation as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

Methodology

We interviewed officials and staff from DRT and the Guam Public Accountability Office. In addition, we reviewed—

- applicable laws, regulations, policies and other criteria;
- information from DRT websites, publications, and reports; and
- various studies, assessment reports, and financial information.

We visited—

- Guam’s Department of Revenue and Taxation in Barrigada, Guam;
- Guam’s Economic Development Authority in Tamuning, Guam;
- Guam’s Bureau of Statistics Planner in Adelup, Guam; and
- Naval Facilities Engineering Command Marianas in Guam.

Appendix 2: Guam's Department of Revenue and Taxation Policy

FEDERAL CONTRACTORS TASK FORCE

The purpose of this Task Force is ensure that Corporations/Federal Contractors/Taxpayers are meeting Full Compliance requirements on certain tax returns obligated of them to file.

The Department of Revenue and Taxation shall be responsible to make sure Foreign Corporations dealing with the military on Guam follow the proper procedures for admission to transact business activity on Guam. These Corporations must contact the General Business Licensing Branch to obtain the necessary information and documents required.

The Department of Revenue and Taxation Tax Enforcement Division obtains a listing of Federal Contractors awarded to exclusively contract business with the military on Guam. A special task force is assigned to contact Contractors on the list to ensure they are meeting the required filing of certain tax returns as well as payment on the return. A FULL COMPLIANCE check is completed on each Corporation listed before any action to contact is done. If no information can be found on the Corporation, it is possible they are not registered and must do so provided they will not seek contracts locally.

A "FIRST NOTICE" is sent to these Contractors identifying unfiled returns such as 1120-F, W-1, GRT etc. and the specific tax periods of each type. A period of 30 days is given to them to respond to the "FIRST NOTICE".

If there is no response to the "FIRST NOTICE", a "SECOND NOTICE" is sent. This notice explains the different types of returns that their Corporation may be obligated to file with the Government of Guam, Department of Revenue and Taxation to report their Guam Sourced Income.

If the Corporation or Contractor responds saying they are not obligated to pay taxes to the Government of Guam; the Department of Revenue and Taxation will respond by stating if they are servicing craft by virtue of a contract and that contract is home-ported on Guam and the work or repairs is not actually performed on Guam, then the Corporation/Taxpayer must cite the authority/law that bars them from filing on Guam.

If a response from the Corporation/Taxpayer is that they have no representation on Guam, (office space and employees), Revenue and Taxation will respond saying "their Corporation/Contractor has been identified on a Federal Contractors listing and although they may not be liable for any Guam taxes, an inquiry will be made to the military installations on Guam as to the nature of their business activities as it relates to Guam. We will contact them if subsequent information permits.

Once communication has been established with the Corporation/Contractor/Taxpayer, the members of the Task Force will follow through to ensure Full Compliance is met.

Appendix 3: Schedule of Monetary Impact

Company	Contract Amount	Potentially Underpaid Revenues (4% of Contract Amount)	Remarks
Contractor A	\$989,800.00	\$39,592.00	No Record
Contractor B	\$119,608.00	\$4,784.32	No Record
Contractor C	\$5,301,544.00	\$212,061.76	No Record
Contractor D	\$2,000,000.00	\$80,000.00	No Record
Contractor E	\$228,655.00	\$9,146.20	No Record
Contractor F	\$1,720,740.00	\$68,829.60	No Record
Total	\$10,360,347.00	\$414,413.88*	

*This total represents the taxes that Guam would have collected if the contracts were subject to the 4 percent BPT. DRT received no feedback from these companies to document their exemption from the tax.

Appendix 4: Prior Reports

Applicable reports issued by the U.S. Department of the Interior (DOI) Office of Inspector General (OIG).

“Tax Collection Activities Report,” P-EV-GUA-0002-2008. We reported that Guam’s Department of Revenue and Taxation (DRT) continued to be challenged by inadequate funding, an inability to hire and retain qualified tax enforcement officers, an ever-increasing workload, and reliance on manual processes and outdated equipment. At that time, we estimated that at least \$23.5 million in tax revenue was being lost each year because of the inefficiencies at DRT. We noted that our previous reports identified similar conditions going back almost 20 years.

Appendix 5: Status of Recommendations

Recommendation	Status	Action Required
1	Unresolved	Resolve whether Guam is owed the \$414,414 in taxes.
2	Unresolved	Develop and implement a BPT collection procedure for all contractors conducting projects for the U.S. Government on Guam with specific control elements including, but not limited to: a tracking mechanism that identifies all contractors; defined timeframes for notices of unfiled taxes; requirements to monitor and record actions on delinquent taxes; and parameters for when to report delinquencies to the Attorney General.
3	Unresolved	Expand data sources to include but not limited to USASpending, to identify all contractors that may be subject to the BPT.

Report Fraud, Waste, and Mismanagement



Fraud, waste, and mismanagement in Government concern everyone: Office of Inspector General staff, departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and mismanagement related to departmental or Insular Area programs and operations. You can report allegations to us in several ways.



By Internet: www.doi.gov/oig/index.cfm

By Phone: 24-Hour Toll Free: 800-424-5081
Washington Metro Area: 202-208-5300

By Fax: 703-487-5402

By Mail: U.S. Department of the Interior
Office of Inspector General
Mail Stop 4428 MIB
1849 C Street, NW.
Washington, DC 20240