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BY THE U.S. GENERAL ACCOUNTING OFFICE

## Report To The Governor Of Guam

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# Followup Of Guam's Administration Of Its Income Tax Program

In 1979, GAO first reported on how effectively Guam enforced its territorial income tax and concluded that problems in administering the income tax program were resulting in millions of dollars of lost revenue.

Although improvements have been made since the 1979 review, problems continue to exist which are aggravating Guam's financial condition. This report discusses these problems as well as the actions GAO believes are necessary to resolve them.



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UNITED STATES GENERAL ACCOUNTING OFFICE  
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT  
DIVISION

B-194332

The Honorable Ricardo J. Bordallo  
Governor of Guam

Dear Governor Bordallo:

As you know, we reported in 1979<sup>1/</sup> on how effectively the Government of Guam enforced the territorial income tax. At that time, we concluded that Guam's chronic problems in administering the territorial income tax were resulting in millions of dollars of lost tax revenue and suggested that Guam

- improve its procedures for collecting delinquent accounts, identifying nonfilers, and selecting returns for audit; and
- automate the system for administering its tax program.

This report presents the results of our followup review of Guam's progress in improving the administration of its income tax program.

Our current review showed that although Guam has attempted corrective action in areas noted in our prior report, problems still exist. For example, identifying nonfilers remains a problem and automation of the tax program remains incomplete. We therefore believe that Guam could further improve the administration of its tax programs by

- establishing an interim manual matching program to identify and take appropriate action against those who fail to file a tax return;
- taking aggressive collection actions against delinquent taxpayers by using authority to seize property more frequently and filing notices of liens and levies in a timely manner;
- monitoring all firms having government service contracts for tax compliance;

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<sup>1/</sup>"The Government of Guam's Administration of Its Income Tax Program" (GGD-80-3, Oct. 3, 1979).

- requiring employers who are chronically delinquent in paying withholding taxes to file monthly, rather than quarterly, returns; and
- establishing an effective management system for monitoring and controlling agents workloads.

It appeared to us that one of the primary reasons why Guam did not fully adopt the suggestions contained in our prior report was because Guam lacked the financial resources to fully implement the needed improvements--on September 30, 1979, Guam's General Fund deficit was \$35.4 million. Moreover, the latest report issued by the U.S. Government Comptroller for Guam, dated August 1982, showed that the deficit had risen to \$83.2 million by September 30, 1981, and estimated that it would further increase to \$90 million by the end of fiscal year 1982. This increase occurred despite an austerity program which began in fiscal year 1981 and continued into fiscal year 1982. This program called for such measures as reducing personnel costs by postponing recruitment and reclassification actions and by closely monitoring overtime costs and encouraging reductions in the cost of goods, services, and travel.

The deficiencies in tax administration disclosed by our current review should be corrected because they are aggravating Guam's financial problems and because changes would help to promote tax administration equity. However, additional funds may be needed to make the improvements and it is not likely that the revenue the improvements will generate would significantly reduce Guam's General Fund deficit. Therefore, if Guam is to achieve self-sufficiency status additional or alternative revenue raising approaches or further budget cuts will probably have to be developed.

#### OBJECTIVES, SCOPE, AND METHODOLOGY

Our objectives were to (1) identify Guam's efforts to correct problems addressed in our prior report and (2) assess their effectiveness.

During our review, we interviewed Guam's Director and Deputy Commissioner of the Department of Revenue and Taxation and other appropriate Guam officials involved in the tax program to determine what had been done to correct the problems. We also met with appropriate Federal officials from the Departments of the Interior and the Treasury, including the U.S. Internal Revenue Service, to discuss their relationship with Guam and to determine what, if any, assistance they had given or could give Guam's Department of Revenue and Taxation.

To evaluate the effectiveness of the actions taken, we reviewed revised procedures, correspondence, and statistical data related to delinquent accounts receivable, nonfilers, audit cases, and automation. We reviewed random samples of delinquent accounts receivable cases and cases selected for audit. Also, to identify potential nonfilers we performed some manual matching of lists of professionals, government employees, elected officials, and business owners against the Department's listing of over 25,000 taxpayers who had filed 1980 tax returns. We did not verify the accuracy of these lists. The audit, which was conducted between January 1982 and July 1982, was performed in accordance with generally accepted government auditing standards.

Appendix I contains details of our findings. By letter dated August 2, 1983, the Department of Interior informed us that it agrees with our finding that more aggressive steps need to be taken to improve the efficiency of Guam's tax administration and to increase tax revenue. The Department's comments have been incorporated in this report and are included as appendix II.

We requested comments from the Government of Guam but were informed that it would not be providing comments on the report.

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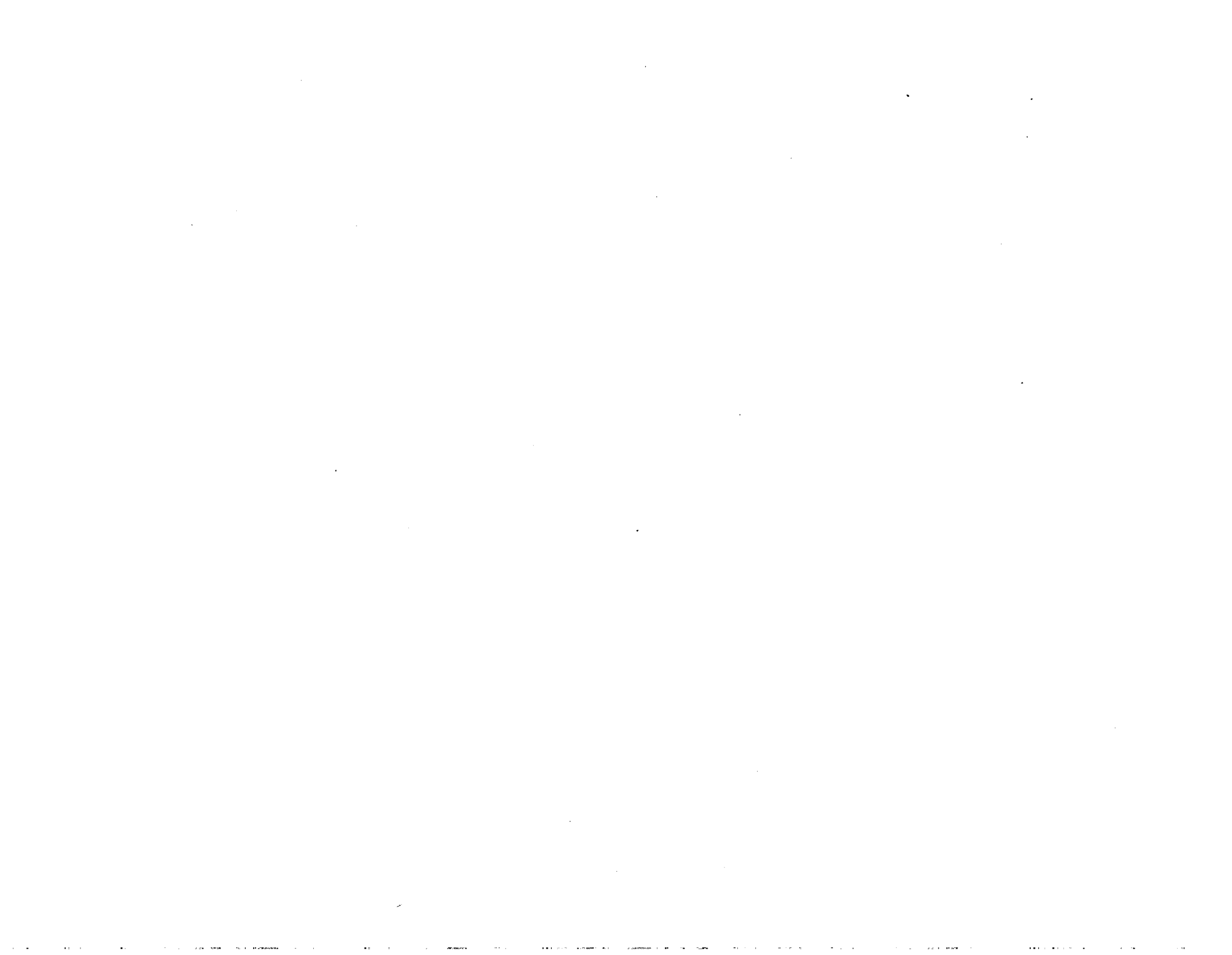
Copies of this report are being sent to the Director, Department of Revenue and Taxation and other interested parties.

We appreciate the assistance provided to us by the Government of Guam's staff. They were extremely cooperative during the course of this review.

Sincerely yours,



William J. Anderson  
Director



FOLLOWUP OF GUAM'S ADMINISTRATION  
OF ITS INCOME TAX PROGRAM

In 1979, we reported on how effectively Guam enforced the territorial income tax. We concluded, at that time, that Guam's chronic problems in administering the territorial income tax were resulting in millions of dollars of lost tax revenue and suggested that Guam

- improve its procedures for collecting delinquent accounts, identifying nonfilers, and selecting returns for audit; and
- automate the system used to administer its tax program.

The objectives of this followup review were to determine what actions, if any, had been taken to correct these problems and to assess their effectiveness.

BACKGROUND

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

The territorial income tax, Guam's major tax, provided over 60 percent of the locally collected taxes for fiscal years 1979 through 1981. In addition to the territorial income tax authorized under Federal law, Guam has imposed and collects other local taxes such as gross receipts taxes and property taxes and administers several regulatory activities under its own laws. Guam's Department of Revenue and Taxation administers all of the activities described above. The table on the following page shows Guam's locally collected tax revenues for fiscal years 1979 through 1981.

Government of Guam  
Locally Collected Tax  
Revenues for Fiscal Years  
1979 through 1981

<u>Type of tax</u>	<u>1979</u> <u>(note a)</u>	<u>1980</u>	<u>1981</u>	<u>Total</u>	<u>Percentage of total taxes collected</u>
----- (thousands) -----					
Income	\$ 80,218	\$ 62,971	\$ 69,618	\$212,807	62
Gross receipts	36,636	32,260	40,339	109,235	32
Other (including property)	6,597	6,121	6,978	19,696	6
Total	<u>\$123,451</u>	<u>\$101,352</u>	<u>\$116,935</u>	<u>\$341,738</u>	<u>100</u>

a/For 15-month period ending September 30, 1979.

During fiscal year 1981 the Department processed 79,817 tax returns of which 29,476 were income tax returns. The remaining returns were for gross receipts taxes. The Department's annual budget exceeds \$3 million.

The subsequent sections of this appendix discuss improvements and problems relating to Guam's administration of its territorial income tax laws and their impact on Guam's financial condition.

FURTHER IMPROVEMENTS NEEDED  
IN THE GOVERNMENT OF GUAM'S  
ADMINISTRATION OF ITS INCOME  
TAX PROGRAM

Our followup review of the Government of Guam's administration of its income tax program showed that although improvements have been made since our 1979 review, problems continue to exist. Improved procedures and programs are needed for identifying nonfilers, collecting delinquent taxes, and auditing tax returns if Guam is to maximize its tax revenue. One major improvement that would help in this regard is automation of the tax system.

Guam should make better use  
of available information on  
nonfilers

Our 1979 report concluded that the Government of Guam needed procedures for identifying individuals and businesses that did not file income tax returns. That report estimated



that nearly 20 percent of Guam's elected officials and Government employees and over 25 percent of all businesses and certain groups of licensed professionals in Guam may not have filed 1977 returns. However, because the Department of Revenue and Taxation's records were incomplete, we could not determine precisely how many returns had not been filed.

Although our 1979 report contained no specific suggestions to Guam officials for correcting its nonfiler problems, several actions were informally discussed with Department officials at the completion of that review. We mentioned the need to improve security over tax documents and to develop programs to identify nonfilers. At that time Department officials agreed that nonfilers were a problem and that they would take further actions.

Since 1979 the Department has made significant strides in safeguarding and processing tax return and taxpayer information by

- limiting access to the processing branch to authorized personnel only;
- constructing a vault for storing returns;
- microfilming all returns and taxpayer information filed for safekeeping; and
- entering into the computer all information contained on page 1 of the 1040A and pages 1 and 2 of the 1040 tax return forms.

Although we observed some areas needing improvement in the Department's implementation of these changes, we believe these actions represent a creditable first step in determining whether a tax return has been filed.

Department officials also outlined to us their long-range plans for developing a totally automated nonfiler identification program. For example, according to Department officials, their goal is to match, by computer, the master list of all individuals who filed a return against information documents such as wage statements (Forms W-2) submitted by employers and interest statements (Forms 1099) submitted by financial institutions. The Department also plans to compare listings of all individuals who filed returns in one year against the previous year's list of filers. However, according to these Department officials, it is uncertain when the Department's tax return records will be completely automated. The automation of the tax program is discussed in greater detail on page 11.

Because the tax program had not been automated, we used a manual approach to determine the extent of the nonfiler problem and to determine if such an approach would be feasible for identifying potential nonfilers until the operation becomes totally automated. We manually matched lists of all physicians, dentists, attorneys, and accountants, as well as, all elected officials and government employees earning \$8 or more an hour against the Department's listing of over 25,000 taxpayers who had filed 1980 tax returns. To the extent that these lists were complete, the number of potential nonfilers identified represented the universe for each of these groups. We also matched a random sample of sole proprietors against the Department's listing. Because this was not a scientific random sample, the results cannot be projected.

In all, we identified 70 individuals who appeared to be nonfilers from the 938 names we matched against the Department records of taxpayers who filed 1980 tax returns. For the 70 potential nonfilers, we reviewed Department records of requests for filing date extensions and also checked to see if these individuals had filed a tax form or a request for an extension for 1981. We were unable to locate either a filed 1981 return or a request for a filing date extension for 42 of the 70 individuals.

We are unable to state whether our test results represent an improvement in the nonfiler problem since our previous audit in 1979. At that time we reported that because of the inadequacy of the Department's records, it was impossible to determine precisely how many returns had not been filed. However, as previously stated, the Department has improved its security and controls over the storage and accessibility of tax returns since our 1979 report. As a result of these changes, we believe the following table now more precisely portrays Guam's nonfiler problem.

	<u>Individuals</u>	<u>Individuals not required to file 1980 return</u>	<u>Individuals required to file 1980 returns</u>	<u>Potential 1980 nonfilers</u>	<u>Percent</u>	<u>1980 Potential nonfilers who did not file 1981 returns or extensions as of July 2, 1982</u>
Dentists	50	17	33	6	18	6
Physicians	116	38	78	2	3	1
Attorneys	125	10	115	13	11	11
Accountants	<u>32</u>	<u>6</u>	<u>26</u>	<u>3</u>	<u>12</u>	<u>1</u>
Total Professionals	<u>323</u>	<u>71</u>	<u>252</u>	<u>24</u>	<u>10</u>	19
Sole proprietors	58	0	58	7	12	4
Selected ranks of Guam's government employees and elected officials (note a)	<u>557</u>	<u>20</u>	<u>537</u>	<u>39</u>	<u>7</u>	<u>19</u>
Total	<u>938</u>	<u>91</u>	<u>847</u>	<u>70</u>	<u>8</u>	<u>42</u>

a/We reviewed master lists of government employees earning over \$8 per hour. The list contained some duplication of individuals which we attempted to eliminate. Department of Revenue and Taxation officials believe our revised list represented a reasonable estimate of this population.

It would be difficult to determine the increased revenues that would become available if Guam confronted the nonfiler problem immediately and took action against those individuals we identified as potential nonfilers. However, we do not believe that revenue considerations should be the sole factor in determining whether to pursue nonfilers. A filed return can be checked for errors, omissions, or fraud, but a nonfiler gives no such leads. To be fair to those taxpayers in Guam who continue to voluntarily assess their own tax liabilities, file returns, and pay taxes on time, the Department should take action against nonfilers.

We agree with Department officials that identifying nonfilers will continue to be a problem until the tax system is totally automated. However, because it is uncertain when the Department's tax return records will be completely automated, the Department should attack the nonfiler problem with the resources currently available, e.g., by manually matching master lists of filers, on a sample basis, against other income information documents, such as lists of licensed professionals, government officials, etc. On the basis of our test to identify nonfilers, we believe such a program would require limited staff time and could be established at minimal cost.

More could be done to  
collect delinquent taxes

In our 1979 report we concluded that the lack of timely and aggressive actions in collecting delinquent accounts had caused substantial revenue losses for Guam. In discussing those findings, we suggested that (1) accounts receivable be chronologically documented according to the date of assessment, (2) procedures be established to monitor how effectively revenue officers used their work time, (3) a consistent policy for use of seizures, liens, and levies be established, and (4) an offset procedure be established for delinquent taxpayers who are due money from government contracts. In commenting on a draft of that report, Guam recognized its past problems with collections and added that it has been working in these areas.

Since 1979, we found the collections branch has made some procedural changes on the basis of our suggestions; however, we also observed that collection personnel were not making as much use as possible of the procedures. Unless the Department uses these new procedures effectively and aggressively, there will be no marked improvement in its ability to collect delinquent taxes.

The Department has prepared a list, by date of assessment, of all delinquent accounts. With this list, revenue officers should be able to keep track of older accounts and take action

before the 6-year statute of limitations on collections expires. Also, changes have been made in monitoring revenue officers' workloads and activities. Daily activity sheets are now used to record revenue officers' collection activities, and revenue officers are now assigned smaller workloads. At the time of our review, all but one revenue officer was assigned less than 200 delinquent accounts, down from 300 in 1978.

Despite these improvements, Guam continues to have difficulty collecting delinquent taxes. The Department still rarely seizes property as a means of collection, and revenue officers do not contact delinquent taxpayers or file notices of liens and levies as quickly as they could. In addition, records of actions taken against delinquent taxpayers are often incomplete making it difficult for supervisors to monitor or reassign cases.

Seizure of property can be effective in collecting delinquent taxes. However, the Department has initiated only six seizure actions since our 1979 review and none since April 1980. In 1979, a collection branch supervisor compiled a list of 36 taxpayer accounts that he felt could be recommended for seizure action. These taxpayers collectively owed \$1.49 million in delinquent taxes. The Department initiated seizure action in only three of these cases totaling \$91,375 in delinquent taxes.

When we asked Department officials about this list, they suggested that the collections statute of limitations had probably expired on many of the accounts and that the Department therefore could not take action. Using the names on this list, we reviewed the accounts and found that as of March 31, 1982, 25 of these taxpayers still owed Guam a total of over \$1 million in delinquent taxes. Over \$700,000 of the \$1 million involved represented amounts that had been assessed since January 1979. Less than 10 percent of the total represented assessments for which the statute of limitations had expired at the time of our work.

The collection branch has not improved its ability to act on delinquent accounts within the time frames established by IRS regulations (which the Department has adopted) or the branch's own written procedures. According to Department regulations, a revenue officer must decide whether or not to file a notice of lien against the taxpayer's property within 30 days after receiving the delinquent account and must explain in writing the reason for not filing or for delays in filing. A taxpayer's property may be seized by levy 10 days after the taxpayer is notified of the delinquency. In reviewing 60 accounts received by the collections branch, we found that 48 accounts had been received more than 30 days before our review yet none of these

accounts had liens filed nor were there any written explanations as required by the regulations. In fact, 28 of these 48 accounts were older than 90 days.

We also found that the timeliness of collection efforts is often hindered by the revenue officers' failure to record actions taken and decisions made on delinquent taxpayer cases. If revenue officers do not maintain adequate records, supervisors cannot review cases to determine if appropriate actions have been taken. For example, a collection branch supervisor told us that in November 1981, over 200 accounts were found in the vacated desk of an employee. The supervisor stated some of the accounts could be closed, but action on the remaining 198 accounts valued at over \$600,000 had been delayed because the accounts were not adequately documented as to prior actions taken by the revenue officer. In fact, none of the 198 accounts had any recorded actions since September 30, 1979.

Another major problem identified during our 1979 review was employee withholding taxes collected by businesses but not turned over to the government. The problem still receives no special emphasis even though these taxes alone accounted for nearly 30 percent of the total delinquent taxes.

The Department has not adopted any measures that would help prevent employers from using these taxes for their own benefit. In fact, some delinquent taxpayers with large withholding amounts outstanding presently do not turn over currently due quarterly withholding taxes to the government even after collection action has begun on delinquent taxes from previous quarters. For example, 5 of the 41 corporate taxpayer accounts we reviewed had delinquent withholding taxes amounting to over \$700,000 as of December 31, 1981. These five corporations also failed to remit an additional \$219,000 in withholding taxes to the government which was due subsequent to December 31, 1981.

The Department could take several measures to control the delinquent tax problem. It could, for example, use its authority under the Territorial Income Tax Code to require chronic delinquents to file monthly rather than quarterly returns. In addition, the Guam legislature could enact legislation requiring businesses to pay their delinquent employee withholding taxes before receiving renewed business licenses. A current statute requires that businesses pay their delinquent local taxes before licenses are renewed; however, this law does not apply to employee withholding taxes.

The Department could also monitor all government service contracts to determine if the contractors paid all of their withholding taxes to the government. In a May 1981 memorandum,

the Governor of Guam notified his department heads that some contractors and consultants had completed projects for the government without securing business licenses, filing tax returns, or paying delinquent taxes. At that time the Governor asked government department and agency heads to send copies of all service contracts to the Department of Revenue and Taxation. The Department was supposed to review these contracts for compliance with Guam tax and regulatory provisions. According to Department officials, the Department received copies of some contracts at the time the memorandum was circulated but has not received or followed up on any since that time. The Department of the Interior informed us that since we completed our work in Guam, the Government of Guam has reduced delinquent tax receivables from \$20 million to \$3.5 million.

Guam's approach to auditing tax returns needs to be re-evaluated

Our 1979 report concluded that the Department needed comprehensive standards and guidelines to ensure an effective and unbiased selection of tax returns for audit. In addition, the Department needed to develop procedures to ensure uniformity in examining returns.

Since 1979 the Department has taken several actions to improve its procedures for selecting and examining returns. For example, the Tax Audit Branch has

- established criteria for selecting returns for audit,
- obtained copies of the IRS audit manual,
- rewritten parts of the manual to cover situations unique to Guam,
- sent eight revenue agents to IRS audit training courses,
- appointed one agent as training coordinator, and
- conducted a 10-week, in-house training course for its agents between January and March 1981.

Although the Department has taken these actions, we found that (1) its criteria for selecting returns is rarely followed, (2) a reduction in staffing levels has significantly reduced the number of audits performed, and (3) the Department still does not effectively monitor and control returns selected for audit.

Our review showed that subsequent to our 1979 report, the Government of Guam initiated two programs which have substantially affected the number and/or types of returns being audited. The first program is the Governor's austerity program.

One aspect of the austerity program is not to fill vacancies created in departments and agencies. According to the Tax Audit Branch supervisor this program has hindered his branch's efforts to effectively audit returns. For instance, the branch is authorized 29 professional positions, however, at the time of our review only 19 positions were filled.

The other program which has affected the types of returns being audited is the prerefund audit program--audits of returns claiming large refunds. Department officials stated that this program, which started in fiscal year 1981, has provided some revenue and has eliminated the difficulties of auditing and collecting additional taxes after the taxpayer has received a refund check. However, as shown below, this approach has resulted in an increase in the percentage of individual audits being performed and a reduction in the percentage of corporate audits. For example, the percentage of individual audits increased from 75 percent in fiscal year 1980 to 95 percent in 1981. Conversely, the percentage of corporate audits decreased from 23 percent in fiscal year 1980 to 5 percent in 1981. This increase in individual audits may have had an adverse impact on the amount of potential revenue generated from auditing corporate returns because, of the 1,058 completed audits in fiscal year 1981, the average corporate audit resulted in a recommendation for additional taxes of over \$8,000 while an individual audit resulted in a recommendation for additional taxes of about \$800.

Completed Income Tax Audits  
For Fiscal Years 1978-81

<u>Type of Return</u>	<u>FY 78</u>	<u>FY 79</u>	<u>FY 80</u>	<u>FY 81</u>
Individual	1480	1303	947	1009
Corporate	228	227	296	45
Partnerships/Other	0	7	25	4
Total income tax audits	<u>1708</u>	<u>1537</u>	<u>1268</u>	<u>1058</u>
Percent of audits to total				
Individual	87%	84%	75%	95%
Corporate	13%	15%	23%	5%
Partnership/Other	--	--	2%	--



We also found that the Department does not effectively monitor and control returns selected for audit. For example, the audit branch lacked procedures and guidelines to ensure that returns selected for audit are promptly assigned or reassigned, tax agents' workloads are monitored, and cases are closed on time. As a result, management does not have essential information on the status of active audit cases and, therefore, can not determine why an agent has not acted on particular cases.

We randomly selected 25 active cases in the Tax Audit Branch to determine whether the supervisor had sufficient control over agents' case inventories and whether adequate documentation was being maintained. In over 50 percent of the active audit cases we reviewed, the taxpayer had been notified that his/her return would be audited, but as of April 15, 1982, the assigned agent had not taken any further action. In several cases no additional action had been taken for over a year after the taxpayer had been notified. Department officials stated the problem resulted because the agents were assigned more audits than they could reasonably handle.

The audit branch has also failed to reassign audit cases of agents who have left the branch. Our active case sample and discussions with audit officials revealed that the cases of two agents who left the branch during 1981 were never reassigned to other agents. As a result of our review, the supervisor of the audit branch stated that the cases of those agents would be identified and reassigned to other agents to complete the audits.

Finally, agents do not keep adequate records to document the status and progress of audit cases assigned to them. The audit branch supervisor agreed that each audit case we reviewed lacked the documentation necessary for accurately determining the status of the audit case. As we suggested, the supervisor said he would implement guidelines to establish a case activity record so that he could monitor the progress of each case. Such documentation should allow any other agent to complete the audit without duplicating the prior agent's efforts.

#### Increased support and better planning of automation project needed

Our 1979 report concluded that automation of the tax system would enable the Department of Revenue and Taxation to increase revenues, increase voluntary compliance with tax laws, and provide a more effective management information system. We urged the Government of Guam to automate its operations and provide a major commitment of funds and resources for such a project. In commenting on our 1979 report, Guam indicated there were budget

restrictions in the past; however, it was fully committed "to an all out effort to computerize the Department of Revenue and Taxation."

Since 1979, the Department has made progress in automating its tax system. According to Department officials, starting with 1981 tax returns, it now has automated control of all income tax returns filed in Guam. This automated data base now includes not only the identity of the taxpayer but also the specific amounts of various types of income, deductions, credits, and other significant dollar amounts on returns.

The Department is developing plans for inputting information from employers withholding tax returns as well as information on Form 1099's from banks, other financial institutions, corporations, and other business entities on payments of interest, dividends, rentals, royalties, and other types of investment income subject to the reporting requirements of the tax law. In addition, information from listings of government employees, officials, and professional and business people, as well as, information contained in business privilege tax returns will be inputted into the computer.

For the past 4 years, a systems accountant employed by the Department of the Interior has been assigned as a technical adviser to the Government of Guam. Since October 1981, this accountant and a systems analyst, also from the Department of the Interior, have been the only staff assigned to the automation project. They have developed several programs since the project began; however, they have not spent much time preparing documentation for them. Thus, complete documentation is not available for all the programs in operation.

Compounding this situation is the fact that the Department has not provided technical training to any of its employees or assigned anyone to work with Interior's technical advisers. As a result, if the advisers must leave (their tenure is not permanent), there will be no one trained to continue the work or to evaluate and solve problems that may arise with the automated systems and procedures already in place.

Continuation of this project will require further commitments, both technical and financial, on the part of the Department of the Interior and the Government of Guam. In order to ensure the commitment of both parties, the Chief, Guam Office for Technical Assistance, drafted a memorandum of understanding in December 1981 to be signed by the Governor of Guam and Interior's Assistant Secretary for Territorial and International Affairs. The memorandum delineated the proposed responsibilities of both parties. As of July 1982, however, this memorandum had not been finalized. Although Guam has expressed support for

the project, the effect that Guam's deteriorating financial condition and its accompanying austerity program might have on its continuing support for the program is unknown.

### Conclusions

Since 1979, Guam has acted to improve its administration of the territorial income tax. Included in the actions taken were such items as the safeguarding and processing of tax returns and taxpayer information, the sequencing of delinquent accounts by date of assessment, monitoring of revenue officers' workloads and activities, improving procedures for selecting and examining returns, and automating the tax system.

Despite these improvements, our current review showed that Guam is not (1) identifying and pursuing nonfilers, (2) using all available tools to collect delinquent taxes, and (3) selecting returns for audit based on established criteria which places emphasis on those tax returns which appear to offer the greatest potential for change.

In addition, Guam's commitment to the automation of its tax system does not appear to be sufficient to ensure continued success of that effort.

Making the needed improvements may require the expenditure of additional funds that will be difficult to secure because of Guam's financial condition. However, we believe the deficiencies should be corrected because they are aggravating Guam's financial situation and because making such changes would help to promote equity in Guam's tax administration.

### Suggestions

To ensure that all taxpayers are treated fairly and to encourage voluntary compliance, we suggest that the Director of Revenue and Taxation:

- Obtain tax returns, if warranted, from those individuals we identified as potential nonfilers during this review.
- Establish an interim manual matching program to identify and take appropriate action against those who fail to file a tax return. The program should include, but not be limited to, matching returns filed against (1) documentation already received from independent sources, such as interest statements from financial institutions, (2) licenses for professional practices and businesses, and (3) listings of government employees.

- Include the above steps in its automated nonfiler identification program when the tax operation is totally automated.

We suggest that the Director of Revenue and Taxation improve the collection of delinquent taxes by:

- Taking aggressive collection actions against delinquent taxpayers by using authority to seize property more frequently and filing notices of liens and levies in a timely manner.
- Requiring employees to document actions taken to collect delinquent taxes in sufficient detail to enable supervisors to monitor the progress on each account.

We also suggest that the Director of Revenue and Taxation strengthen the Department's efforts to collect delinquent employee withholding taxes. Measures should include:

- Monitoring all firms having government service contracts for tax compliance.
- Requiring employers who are chronically delinquent in paying withholding taxes to file monthly, rather than quarterly, returns.

We further suggest that the Governor propose to the Guam legislature legislation that would require businesses to clear delinquent employee withholding taxes before obtaining business license renewals.

To improve audit operations we suggest that the Director of Revenue and Taxation:

- De-emphasize its prerefund audit program and place priority on selecting returns which appear to offer the greatest potential for change.
- Establish an effective management system for monitoring and controlling agents' workloads. The system should include such procedures as (1) requiring the supervisor to conduct and document periodic workload reviews of active and completed cases of each agent; (2) requiring agents to maintain adequate records in order to document the status of each case in their inventory; (3) implementing safeguards over tax returns and return information assigned to agents to ensure that such information is not lost; and (4) reassigning audit cases when agents are terminated or transferred elsewhere within the Department.

To ensure that automation of the tax system is completed and implemented in the most efficient and cost-effective manner, we suggest that the Director of Revenue and Taxation:

- Develop a plan, on the basis of automation needs, costs, and benefits, which should be used to ensure effective and efficient automation of the tax administration program.
- Assign and train a Department staff to work closely with Interior's technical advisers, if the project is continued.

ADDITIONAL MEASURES MAY BE NEEDED  
FOR GUAM TO ACHIEVE SELF SUFFICIENCY

Our 1979 report concluded that Guam's problems in administering the territorial income tax were contributing to its inability to generate adequate revenues to meet its financial obligations and continue current levels of operations. Guam's financial position continues to deteriorate as annual expenditures continue to exceed income generated by the tax system. The government's General Fund deficit as of September 30, 1979, was \$35.4 million. The latest report issued by the U.S. Government Comptroller for Guam, dated August 1982, showed that this deficit had escalated to \$83.2 million by September 30, 1981, and estimated that the deficit would reach \$90 million by the end of fiscal year 1982.

The General Fund deficit alone does not tell the whole story of the financial problems Guam has experienced. Since fiscal year 1977 special Federal assistance to Guam has amounted to over \$115 million. Of this \$115 million, Guam has received approximately \$18.2 million from the Federal Government to cover "shortfalls" in income tax collections resulting from the Federal Tax Reduction Act of 1975 and the Tax Reform Act of 1976. These shortfalls result because Guam's tax system mirrors the Federal Internal Revenue Code. Thus, any reductions in Federal income taxes, in theory, reduce tax revenue available to Guam. In addition to covering "shortfalls", the Federal Government has forgiven loans and canceled interest due on loans to Guam. Without this additional assistance, the General Fund deficit would be much larger.

Although Guam's continuing difficulties in assessing and collecting the territorial income tax still contribute to its poor financial condition, it is unlikely, given the size of the deficits being incurred, that an effective and totally automated tax administration program would have a significant impact in

resolving its financial problems. Even so, we believe that Guam needs to continue its progress in improving its system for tax administration in order to increase its revenues thereby decreasing its need for Federal assistance. Therefore, Guam should implement those further suggestions outlined in the prior section of this report.

In addition, Guam needs to develop additional or alternative revenue raising approaches. One possible approach would be to impose a "state type" local income tax. The Omnibus Territories Act of 1977 (Public Law 95-134) authorized the Guam legislature to approve a separate tax of up to 10 percent of an individual's income tax obligation due the territorial government. The separate taxing authority was to provide the territorial legislature income tax powers it lacked to obtain additional sources of revenue to meet rising program costs. Thus, the act enables Guam to impose an additional tax on its citizens similar to a State income tax.

Given the size of the Guam tax base, this action alone would not raise sufficient revenue to cover the annual deficits Guam is experiencing. However, it would serve to demonstrate Guam's willingness to take actions which would reduce its reliance on Federal assistance.

Although Guam officials agree that additional revenues are needed to reduce its deficit, these officials told us that enacting a separate local tax was politically not feasible.

### Conclusion

Given the amount of the General Fund deficit, it is unlikely that improved tax administration alone would enable Guam to achieve self-sufficiency. Therefore, additional revenue raising approaches or further budget cuts are needed if Guam is to become less reliant on Federal assistance.

### AGENCY COMMENTS AND OUR EVALUATION

By letter dated August 2, 1983, the Department of the Interior concurred with our findings.

The Department stated that it had

--granted a \$30,000 technical assistance grant to the Government of Guam for the training of local revenue officers, in addition to the \$100,000 in technical assistance granted to Guam to assist in computerizing its system; and

--requested the Office of Inspector General, Department of Interior, to conduct a compliance audit of Guam's Department of Revenue and Taxation.

It further stated that since we completed our review work, the Government of Guam has taken several steps to enhance its revenue posture and improve its collection systems, including (1) submitting proposed tax legislation in the Guam Legislature, (2) intensifying collection efforts on withholding, business privilege and real property taxes, and (3) reducing delinquent tax receivables from \$20 million to \$3.5 million.

These actions are consistent with our suggestions.



## United States Department of the Interior

OFFICE OF THE SECRETARY  
WASHINGTON, D.C. 20240

AUG 2 1983

Mr. Brian P. Crowley  
Senior Associate Director  
U.S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Crowley:

This responds to your letter requesting our comments on a General Accounting Office draft report, "Follow-up Review of the Government of Guam's Administration of Its Income Tax Program."

In reviewing the draft report, we share GAO's findings that although the Government of Guam has made certain substantive improvements in the administration and collection of tax revenues, more aggressive steps must still be undertaken to improve efficiency and increase tax revenue.

Attached are our specific comments on the draft report.

Sincerely,

Richard T. Montoya  
Deputy Assistant Secretary  
Territorial and International Affairs

Enclosure



COMMENTS

We concur with the findings of the General Accounting Office in its follow-up review of the Government of Guam's administration of its income tax program, to wit:

1. Although there are indications of improvements in tax administration since the initial review was conducted in 1979, more aggressive steps must be undertaken to improve efficiency and increase tax revenue.
2. More efforts should be taken to identify and take appropriate action against non-filers.
3. More aggressive actions should be taken against delinquent taxpayers, including utilization of the government's authority to seize property, impose liens and levies.
4. Monitor all firms with government service contracts to insure compliance with all tax laws and regulations.
5. Require employers who are chronically delinquent in paying withholding taxes to file monthly returns rather than quarterly.
6. Develop an effective management system for monitoring revenue agents' workloads.
7. Pursue full implementation of an automated system.

The worsening deficit financial condition of the Government of Guam--- from \$35.4 million in September 30, 1979, to \$83.2 million as of September 30, 1982---is, needless to say, a very serious problem.

Improvements in tax administration will not likely resolve the deficit situation but would be a step in the right direction. Other alternatives would be: (a) tax increases or (b) budget cuts.

This office has granted a \$30,000 technical assistance grant to the Government of Guam for the training of local revenue officers, such training to be provided by the U.S. Internal Revenue Service. The sum of \$100,000 in technical assistance was previously granted to Guam by the Department of Interior to assist in computerizing its system.

I have also requested the Office of Inspector General, Department of Interior, to conduct a comprehensive audit of Guam's Department of Revenue and Taxation. Among areas to be probed are:

1. Loss of revenue as a consequence of bankruptcies, non-enforcement of tax laws and regulations, expiration of statute of limitation, etc.
2. Administrative costs in relation to certain types of taxes (i.e., real property and user taxes).

3. Negative impact of tax rebates and other tax concessions.
4. Recommend whether or not local tax system should be overhauled for the purpose of increasing potential revenues.

It should be pointed out that since the second GAO review, the government of Guam has taken several positive steps to enhance its revenue posture and improve its collection system in general, including (a) submission of proposed tax legislation in the Guam Legislature (among which is the imposition of a 10 percent surcharge on annual income), (b) intensification of collection efforts on withholding, business privilege and real property taxes, and (c) reduction of delinquent tax receivables from \$20 million to \$3.5 million.



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