



U.S. Department of the Interior Office of Inspector General



Guam's Tax Collection Activities: Office of Insular Affairs Involvement Needed to Achieve Lasting Improvements

Report No. HI-EV-GUA-0002-2008

November 2008



United States Department of the Interior


Office of Inspector General

Washington, D.C. 20240

NOV 28 2008

Memorandum

To: Doug Domenech
Acting Deputy Assistant Secretary for Insular Affairs

From: Earl E. Devaney 
Inspector General

Subject: Final Evaluation Report *Guam's Tax Collection Activities: Office of Insular Affairs Involvement Needed to Achieve Lasting Improvements*
(Report No. HI-EV-GUA-0002-2008)

Our evaluation of the Government of Guam's (Guam) tax collection activities (Appendix 1) identified serious problems at Guam's Department of Revenue and Taxation (DRT) and significant challenges that Guam must meet if it is to significantly improve the effectiveness of its tax collection efforts. Our objective was to evaluate the current level of taxes owed to Guam and determine whether Guam was making reasonable efforts to collect these outstanding amounts. The problems we observed are not new, having been identified and reported on previously in a number of Office of Inspector General (OIG) reports dating back to 1989. We estimate that the persistent deficiencies in Guam's tax collection process are resulting in lost tax revenues of at least \$23.5 million each year. In his response to our draft report, the Governor stated that he is committed to resolving the resource constraints outlined in our report and to revitalizing Guam's tax collection and enforcement efforts. Given Guam's lack of success in dealing with these challenges in the past and its current financial situation, however, we believe that the Office of Insular Affairs' (OIA) active involvement and assistance will be required to promote sound financial management practices and to achieve lasting improvements in the future.

Guam's efforts to process and collect taxes are ineffective. DRT is hamstrung by the lack of adequate funding and staff, an inability to hire and retain qualified tax enforcement staff, an ever increasing workload, and reliance on manual processes and outdated equipment. We noted, for example, that DRT's Examination Branch (Examinations) was not performing any high-dollar, complex corporate audits because it has not employed any senior auditors capable of performing such audits since 2005. In addition, Examinations had not attempted to use its taxpayer database to identify potential non-filers for at least seven years. As a result, Examinations' audit productivity declined from \$10.5 million in fiscal year 2005 to just \$800,000 in fiscal year 2007. Between 2003 and 2004, Examinations hired eight new auditors but only three remained at the time of our review. We were told that Examinations cannot hire

and retain highly-qualified auditors because, under Guam's pay system, Examinations can only offer employees the same salary that was paid over 10 years ago. In addition, we were told that many of the employees that were hired left for higher paying jobs elsewhere after they received tax training.

We also noted that potential tax revenue is being lost as a result of ineffective tax collection efforts. At the time of our review, DRT's Collection Branch (Collections) had over 6,000 active cases and only 24 revenue officers; an average of over 200 cases per revenue officer. From our review of one revenue officer's \$13.5 million caseload, we determined that no recent effort had been made to collect on more than 50 percent of taxpayer liabilities reported to be active, and that over \$4.5 million was no longer collectable because the statute-of-limitations had been exceeded. Moreover, we concluded that Collections lacks an effective monitoring system to ensure that Revenue Officers are actively working on this huge caseload and that taxes are collected prior to expiration of the statute-of-limitations.

We found that DRT currently employs only three people in its Criminal Investigation Branch, none of which is a tax attorney. We were told that the lack of legal support undermines efforts to generate viable cases for prosecution by the Attorney General's office, with the result that only one case was referred for consideration in the last three years. The last time a criminal tax case was actually prosecuted in Guam was apparently sometime in the late 1990s, and we were told that the government lost that case.

We noted that Guam had established a process to combat tax evasion by requiring businesses to file their tax returns before they are issued business licenses. We found, however, that DRT employees were clearing flagged business licenses without evidence that related tax payments were made or contractually arranged.

Finally, we determined that DRT's Real Property Tax Division (Real Property) was not using current market values to develop tax assessments for privately owned real property. Periodic reappraisals of all real property on Guam required by law have not been performed since 1993, and Real Property does not update property records to reflect current value, even when the ownership of a piece of property is transferred or sold. Citing the research of a local real estate group, a local Guam newspaper recently reported that property values in Guam have increased by 71 percent since 2003. Based on this information, we estimate that DRT's failure to keep property tax records current results in lost property taxes of \$13.8 million a year.

Guam's tax collection problems are not new, having been in existence for nearly two decades. OIG reports describing systemic breakdowns in Guam's tax administration and enforcement activities and concomitant tax revenue losses date back to 1989 (See detailed discussion in Appendix 1). Each OIG audit report made recommendations to former Governors intended to ensure that shortcomings in Guam's tax collection efforts were addressed and corrected. Our reports included a total of 57 separate recommendations over the years, many of which dealt with the need to provide additional resources or to make better use of existing resources. Yet our current evaluation found the conditions at DRT to be little changed. In fact, in the last 10 years, staff and funding for DRT's tax collection activities have actually been reduced. By its failure to address its long-standing tax collection deficiencies, Guam has allowed

its tax system to fall into disrepair and has suffered tax revenue losses in the tens of millions of dollars annually.

Guam's failure to address its long-standing tax collection deficiencies is a contributing factor in its current dire financial situation. In its financial statements for the fiscal year ended September 30, 2006, Guam reported that it had accumulated a \$524 million general fund deficit, substantially more than the total amount of taxes and fees Guam collects in an entire year. Guam's Public Auditor recently stated "To address our financial woes, our Government should increase its revenues, reduce its spending, or a combination of both..." An increase in tax assessments may ultimately prove necessary. However, we believe that an even more critical first step is for Guam to step-up its tax collection and enforcement efforts. The current lack of substantial audits, proactive efforts to identify non-filers and under-reporters, vigorous collection and enforcement efforts, and accurate property values creates little incentive for voluntary tax compliance and deprives Guam of the revenues it desperately needs to fund health, safety, education, and other programs for the citizens of Guam.

OIA is charged with carrying out the Department of the Interior's responsibilities to coordinate federal policy in the U.S.-affiliated insular areas, including Guam. These responsibilities fall within DOI's Strategic Plan goal entitled "Serving Communities – Increase Economic Self-Sufficiency of Insular Areas." According to OIA's fiscal year 2009 budget justification, OIA will achieve its mission by "encouraging private sector economic development, promoting sound financial management practices in the insular governments, and increasing Federal responsiveness to the unique needs of island communities."

OIA has been providing assistance to Guam during the last few years with the intent of improving tax collection operations. We were told that OIA awarded three separate technical assistance grants in fiscal years 2005 and 2006, providing a total of almost \$300,000 for the training of DRT's tax collection staff. In addition, a \$290,000 grant was provided under OIA's Management Control Initiative to assist DRT and the Department of Administration in implementing new strategic goals in the 2005 Financial Management Improvement Project. Approximately \$96,000 of this grant was later reprogrammed to assist with the implementation of on-line tax filing at DRT.

The recommendations we made to the Governor for revitalizing DRT and restoring an effective and robust tax collection process cannot be accomplished without additional resources, assistance, and political resolve that, heretofore at least, have not been in evidence. We believe, however, that these commitments are absolutely imperative in order to maximize tax revenues needed to support Guam's services and programs, reduce its current financial deficit, and achieve long-term financial security for Guam and its residents. Given the breadth and duration of tax collection deficiencies discussed in this report, however, we conclude that Guam is unlikely to achieve success on its own. OIA's direct involvement and assistance will be a critical factor in determining whether Guam succeeds in implementing significant and lasting improvements in its tax collection process, or continues to be plagued by significant tax losses and financial deficits.

Recommendations

We recommend that OIA:

1. Facilitate and participate in the tax administration task force that we recommended to the Governor to develop an action plan for revitalizing DRT and ensuring the filing and payment of all taxes due Guam. This task force should include officials from tax collection authorities and tax experts from outside Guam, such as the Internal Revenue Service. Issues addressed should include streamlining and modernizing DRT's tax information systems, eliminating impediments to the hiring and retention of qualified tax enforcement staff, and establishing budget levels and staffing patterns for effective tax program performance.
2. Identify financial resources and/or management assistance that can be made available to Guam to implement fundamental financial management and systems improvements at DRT.

OIA Response and OIG Reply

In his undated response to our draft report (Appendix 2), the Acting Director for Insular Affairs concurred with our recommendation to facilitate and participate in a task force to develop an action plan for revitalizing DRT. He also agreed that OIA would serve as liaison with other Federal agencies that are able to provide necessary expertise to the Governor. The Acting Director generally concurred with our recommendation to identify financial resources and management assistance that can be made available to Guam to implement financial management and systems improvements.

We are encouraged that OIA recognizes the critical significance of our findings and the impact that an ineffective tax assessment and collection process is having on Guam's government. As OIA notes in its response, tax revenues are commonly 60 percent of Guam's total general revenues and the Government of Guam has been forced to seek ways to drastically reduce operating costs due to dwindling resources. But at the same time, we are concerned that OIA apparently does not intend to make any extraordinary efforts to address this critical problem. We noted, for example, that in agreeing to work with the Governor to facilitate the development of an action plan for revitalizing DRT, OIA committed to doing so only to the extent that its "resources permit." And while OIA generally concurred with our recommendation to identify financial resources and management assistance that can be made available to Guam to implement financial management and systems improvements at DRT, the only commitment OIA made was to ensure that the Governor includes DRT operations on his list of priorities for the next round of routine OIA technical assistance grant funding.

OIA's passive approach, in our opinion, will do little to ensure that Guam succeeds at revitalizing its tax collection and enforcement efforts. If the failures of the last 20 years prove anything, it is that good intentions and a "business as usual" approach are not sufficient to get a task as difficult as this done. By taking an aggressive stance and helping Guam to reinvigorate its tax collection and enforcement activities now, however, OIA can ensure that Guam is in

position to take advantage of the unique opportunity for significant tax revenue increases that should accompany the impending military build-up and construction boom on Guam.

Based on the Acting Director's response to the draft report, we consider Recommendations 1 and 2 resolved but not implemented. The status of the recommendations is shown in Appendix 3.

The legislation, as amended, creating the Office of Inspector General requires that we report to the U.S. Congress semiannually on all reports issued, actions taken to implement our recommendations, and recommendations that have not been implemented.

Please provide a written response to this final report by January 9, 2009. The response should supply the information requested in Appendix 3. We appreciate the cooperation shown by your staff during our evaluation. If you have any questions regarding this report, please call me at (202) 208-5745.

cc: Nikolao Pula, Director, Office of Insular Affairs, U.S. Department of the Interior
(MS 4328)
Marina Tinitali, Office of Insular Affairs, U.S. Department of the Interior (MS 4328)

Appendix 1 – Report to the Governor



U.S. Department of the Interior Office of Inspector General

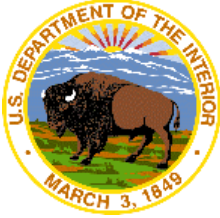


Tax Collection Activities ***Government of Guam***

Revitalized Tax Collection and Enforcement ***Effort Needed***

Report No. P-EV-GUA-0002-2008

November 2008



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL

Western Region Office
2800 Cottage Way, Suite E-2712
Sacramento, California 95825

NOV 26 2008

The Honorable Felix P. Camacho
Governor of Guam
P.O. Box 2950
Hagatna, Guam 96932

Re: Final Evaluation Report *Tax Collection Activities, Government of Guam, Revitalized Tax Collection and Enforcement Effort Needed*
(Report No. P-EV-GUA-0002-2008)

Dear Governor Camacho:

The enclosed final report details the results of our evaluation of the Government of Guam's (Guam) tax collection activities. Our objective was to evaluate the current level of taxes owed to Guam and determine whether Guam was making reasonable efforts to collect these outstanding amounts.

We found that Guam's Department of Revenue and Taxation (DRT) is hamstrung by the lack of adequate funding and staff, an inability to hire and retain qualified tax enforcement officers, an ever-increasing workload, and reliance on manual processes and outdated equipment. Our scope, methodology, and prior audit coverage are detailed in Appendices 1 and 2. We estimate that at least \$23.5 million of tax revenue is being lost each year because of the inefficiencies at DRT (See Appendix 3). Previous reports by the Office of Inspector General (OIG) have reported similar conditions going back almost 20 years, and as such, we believe that your direct intervention will be needed to achieve significant and lasting improvements. With the impending military build-up on Guam, we believe that your strong support for DRT revitalization, including an appropriate injection of resources, could significantly increase tax collections and improve Guam's financial condition now and in the future.

The report contains two recommendations that represent a holistic approach for revitalizing DRT, restoring an effective and robust tax collection process, and generating the tax revenues needed to support Guam's services and programs. In your September 22, 2008 response to our draft report (Appendix 4), you concurred with our recommendations and identified certain actions taken or in process to address some of our concerns. Based on your response, we consider Recommendations 1 and 2 to be resolved but not implemented (Appendix 5).

The legislation, as amended, creating the Office of Inspector General, requires that we report to Congress semiannually on all reports issued, the monetary effect of findings, actions taken to implement our recommendations, and recommendations that have not been implemented. The monetary impact of the findings in this report is shown in Appendix 3.

Please provide a response to this report by January 9, 2009. The response should provide the information requested in Appendix 5 and be addressed to Mr. Michael P. Colombo, Regional Manager, Office of Inspector General, Western Region Office, 2800 Cottage Way, Suite E2712, Sacramento, California 95825. We appreciate the cooperation shown by government staff during our evaluation. Should you have any questions about this report, please do not hesitate to contact me at (916) 978-5653.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael P. Colombo". The signature is stylized with a large, looped initial "M" and a trailing flourish.

Michael P. Colombo
Regional Manager

Enclosure

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INTRODUCTION

GOVERNMENT, ECONOMY, AND REVENUES

Guam is located 3,700 miles west-southwest of Honolulu, Hawaii, and 1,500 miles south-southeast of Tokyo, Japan. In 1950, the U.S. Government enacted the Guam Organic Act conferring U.S. citizenship on the people of Guam, establishing local self-government, and assigning administrative responsibility for Guam to the Secretary of the Interior. The Guam Organic Act provides for a republican form of government with locally elected executive and legislative branches and an appointed judicial branch. Guam also has an elected representative to Congress.

In fiscal year 2006, Guam's revenues totaled about \$683 million, of which approximately \$417 million was from taxes and fees as shown in figure 1 below.

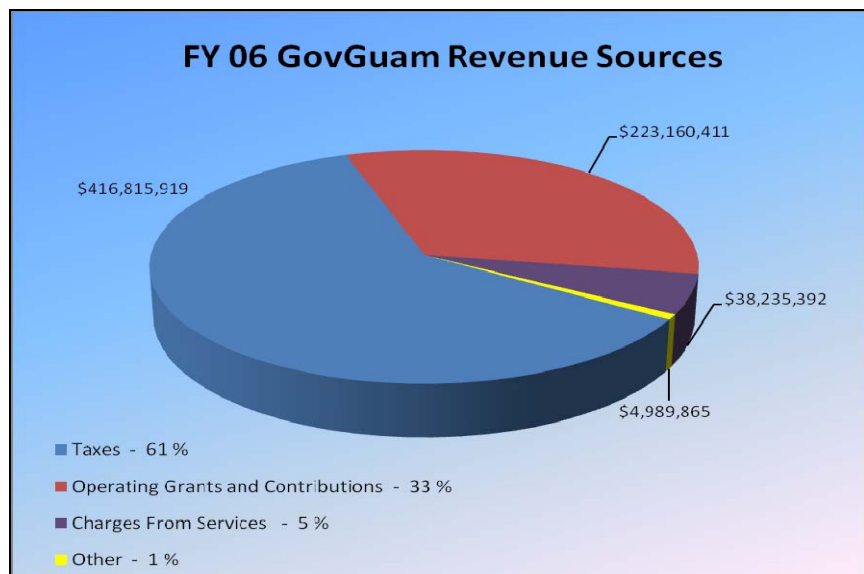


Figure 1

Guam's income tax system generally mirrors the Federal tax system. Section 31 of the Organic Act provides that the income tax laws in force in the United States shall be the income tax laws of Guam, substituting Guam for the United States where necessary and omitting any inapplicable or incompatible provisions. The U.S. Internal Revenue Code with appropriate changes therefore constitutes the Guam Territorial Income Tax Law. Taxes imposed by Guam include business privilege taxes and real property taxes and are assessed and collected in accordance with Title 11 of the Guam Code Annotated. Income taxes and business privilege taxes

represented 84 percent of Guam's total tax revenues in FY 2006 as shown in figure 2.

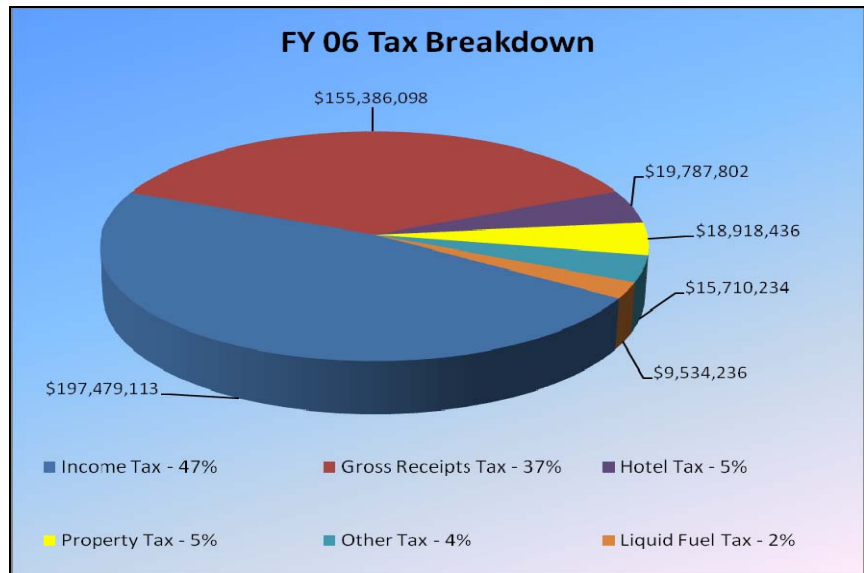


Figure 2

Guam's Department of Revenue and Taxation (DRT) is responsible for enforcing the income and general tax laws of Guam and for collecting tax revenues, as well as revenues from other sources such as licensing and 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 to all. To accomplish this, DRT reports that it has instituted aggressive collection efforts to reduce tax receivables, identified and initiated industry and professional audits, and aggressively pursued fraud and non-filer cases to enhance public awareness.

RESULTS OF EVALUATION

OVERVIEW

DRT is hamstrung by the lack of adequate funding and staff, an inability to hire and retain qualified tax enforcement officers, an ever-increasing workload, and reliance on manual processes and outdated equipment. As a result, tax information is not being processed timely, tax audits are not productive, no efforts are being made to identify non-filers, tax liabilities are not collected in a fair and expeditious manner, and criminal prosecutions are essentially non-existent. In addition, we found that a business license clearance process implemented by DRT was not being used to its fullest extent and that substantial property tax losses were occurring because tax assessments were not based on the current market values. While the total amount of tax losses associated with these problems cannot be determined, we concluded that at least \$23.5 million is being lost each year.

The tax collection problems observed have existed for at least two decades and have been reported on in five separate reports by the OIG. Our prior reports (Appendix 2) included 57 recommendations to former Governors intended to ensure that shortcomings in Guam's tax collection efforts were addressed and corrected. Many of these recommendations dealt with the need to provide additional resources or to make better use of existing resources.

TAX COLLECTION EFFORTS IMPEDED BY RESOURCE CONSTRAINTS

DRT has been confronted with several obstacles that have resulted in ineffective enforcement of Guam's tax laws and the loss of significant revenues for the government.

Funding. Funding levels for DRT have not kept pace with the overall level of government spending. Information provided by DRT showed that funding for its operations declined by 42 percent from 1996 to 2003 before rebounding slightly in the last few years. Total reported government expenditures held relatively stable or increased during the same period.

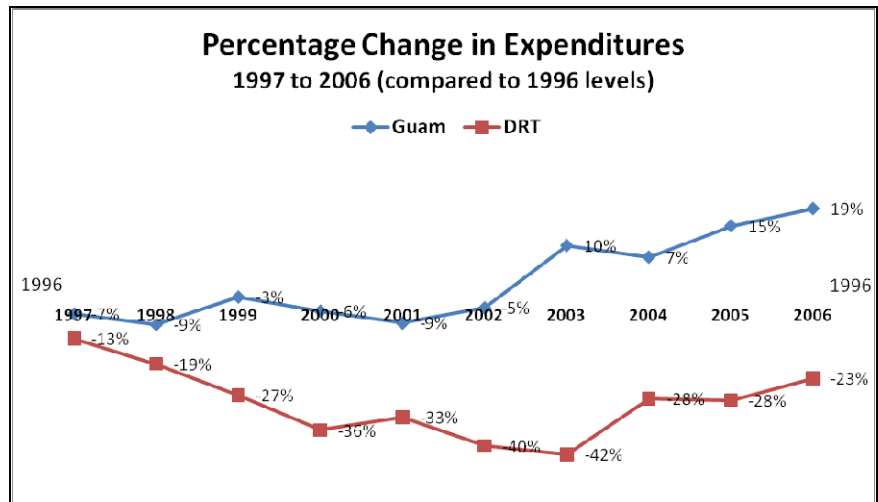


Figure 3

Staffing. DRT’s authorized staffing levels have dropped significantly over the past 10 years. DRT officials and staff told us they do not have enough staff to review past and current returns and to adjust those needing correction. In addition, DRT staff told us that they are continually faced with “special projects” such as court ordered refund claim processing, prior year refund tax notifications, and tax amnesty work that pull them away from their normal jobs. Our review of the timesheets for four DRT auditors confirmed that only 57 percent of their recorded time in calendar year 2007 was spent on actual casework.



Figure 4

Hiring and Retention. DRT cannot offer competitive salaries to attract and retain highly qualified employees. Under Guam’s pay system, DRT pays the same salary that it paid more than 10 years ago. A DRT official told us that because of the limit on the amount of compensation that can be offered, DRT has been unable to recruit graduates from the University of Guam. In addition, we

were told that once DRT provided specialized tax training to the employees it is able to hire, many leave for higher paying jobs elsewhere. Between 2003 and 2004, 8 new auditors were hired for DRT's Examination Branch, but only 3 remained at the time of our review.

Workload. DRT's workload continues to grow while its funding and staffing shrink. Guam's population increased by approximately 18 percent during the past 10 years, thus increasing the number of tax returns that must be processed. In addition, changes in federal tax laws, including the Internal Revenue Service Restructuring and Reform Act of 1998, focused on customer service and expanded taxpayer rights, thus increasing the amount of work that DRT must perform to collect taxes.

Equipment. DRT's computers, software, and related equipment are old and antiquated. Most tax data is still manually entered into DRT's tax information system. This involves tens of thousands of tax documents a year that have to be entered, including personal and corporate income tax returns, quarterly W-1s, annual employer-supplied W-2s and W-3s, annual 1099s, and monthly Business Privilege Tax returns. Historically, some large firms provided their tax information on magnetic tape with DRT using tape readers to enter tax information into the computer system for reconciliation with filed tax returns. However, the tape readers no longer work, and the last reconciliation was done about 3 or 4 years ago.

**TAX INFORMATION
NOT PROCESSED
TIMELY**

Because of the lack of adequate resources, DRT has accumulated a backlog of documents to be processed over the past several years. This backlog, and the fact that DRT's taxpayer database is not current and complete, results in DRT being unable to perform real-time verifications, such as comparing employer W-2 data with W-1 employer taxes paid data to ensure that reported withholding taxes have in fact been paid to the government. In addition, the incomplete database reduces the effectiveness of the tax clearance process for business licenses and makes it harder to process tax returns and respond to taxpayer inquiries.



Bins of tax documents from previous months wait to be processed at DRT (OIG Photo)

Subsequent to the completion of our last site visit, DRT began working diligently to eliminate at least a portion of the backlog in order to take advantage of funding being provided by the Department of the Treasury under The Economic Stimulus Act enacted by Congress in February 2008. Since rebates to Guam's citizens are based on 2007 income tax returns, DRT staff has been working overtime to process these returns as well as the backlog of tax returns from prior years. While this will be an improvement over the conditions we observed, additional time and resources will be required to eliminate the remainder of the backlog.

**TAX AUDITS ARE
UNPRODUCTIVE AND
NON-FILER
IDENTIFICATION
PROGRAMS DO NOT
EXIST**

At DRT's Examination Branch (Examinations), we found that no high-dollar value or complex corporate audits were being performed. We were told that these audits are not performed because Examinations has not been able to hire or retain any senior auditors capable of performing such audits since 2005. In 2005, Examinations' four senior auditors identified \$9.6 million of additional revenues, 91 percent of Examinations' productivity for the year. These senior auditors subsequently left Examinations and production declined by \$9.7 million as shown in the following graph.

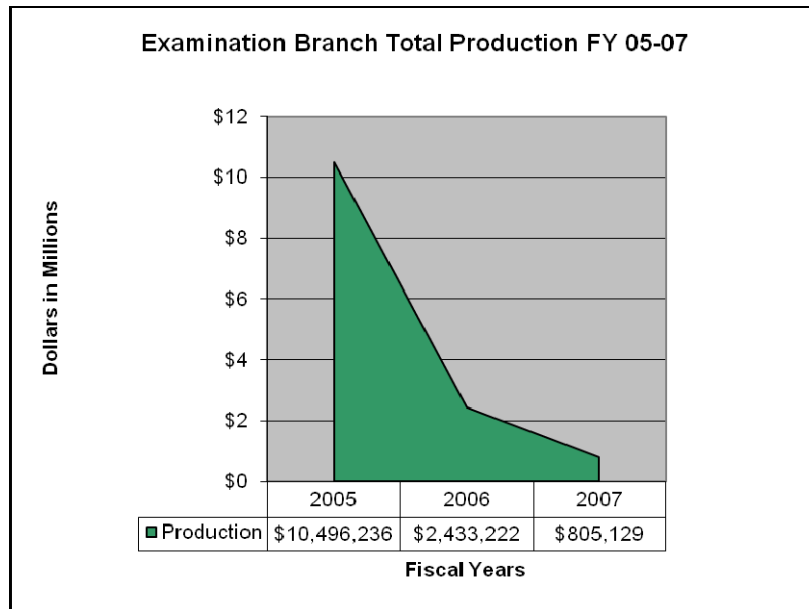


Figure 5

In addition, we found that Examinations was not attempting to identify taxpayers that fail to file returns. An Examinations' official told us he thought the last time such an effort was made was sometime around FY 2000. Although DRT's taxpayer database is not current and complete, it contains older information that could be used to identify potential non-filers. In this regard, we asked DRT to generate data from 2003 on W-2 filings submitted by employers and identify any individuals that did not file an income tax return. Our review of the data identified 756 individuals that had taxable wages in excess of \$15,600, the filing requirement for married filing jointly in 2003. In total, these individuals had \$29.1 million in taxable income. While it would be preferable to have a complete and current database and perform automated matches on this data, Examinations should be using the information that is available to identify and examine instances of unreported income.

**TAXES ARE NOT
COLLECTED AND
MONITORING
SYSTEMS ARE
INEFFECTIVE**

DRT's Collection Branch (Collections) was not collecting tax liabilities in a fair and expeditious manner, resulting in an undetermined amount of lost revenue and an overstatement of tax receivables by millions of dollars. We found that Collections had over 6,000 active cases and only 24 revenue officers; an average of over 200 cases per revenue officer. According to the Collection Supervisor, Revenue Agents are required to either collect, abate, or inactivate delinquent taxes. However, in reviewing one revenue

officer's \$13.5 million caseload, we determined that no recent collection efforts had been made on more than 50 percent of taxpayer liabilities reported to be active. Over \$4.4 million of the receivables were from cases that were so old the statute-of-limitations had been exceeded and the debts were no longer collectable.

One factor contributing to lack of timely tax collection efforts is that Collections does not have an effective monitoring system. For the year ending 2007, Collections reported nearly \$90 million of active receivable cases. The Collection Supervisor's methodology for tracking and monitoring the status of these cases is to print a nearly 600-page report from the tax information system using a standardized template that provides no ability to extract, sort or manipulate data. Sections of the report are then distributed to each revenue officer with instructions to pencil in case status for their areas of responsibility. Although this manual process theoretically allows a high level of review by the Collection Supervisor, we found it to be ineffective as it required valuable staff-hours to produce and allowed Revenue Officers to leave inactive and uncollectible cases open. A better system is needed that ensures the Supervisor is notified when Revenue Officers fail to actively work cases, and taxes are in danger of being lost due to the expiration of the statute-of-limitations.

**CRIMINAL
INVESTIGATIONS
UNDER GUAM'S TAX
LAWS ARE
SEVERELY
HAMPERED**

DRT's Criminal Investigation Branch (Investigations) is significantly hampered by the lack of personnel. There are currently only three employees to investigate criminal violations of Guam's tax laws, such as willful failure to file returns or pay taxes, tax evasion, fraud and false statements, and internal violations. DRT does not employ a tax attorney, and Investigations staff stated that the lack of legal support undermines their effectiveness in generating viable cases for prosecution by the Attorney General's office. Only one case was referred to the Attorney General's office in the last 3 years. We were also told that cases referred to the Attorney General's office have not been prosecuted because that office lacks the resources to handle these types of cases. Rather than prosecute, the Attorney General's office reportedly forwards criminal tax cases to the civil court to try and obtain a civil settlement. The last time a criminal tax case was prosecuted in Guam was apparently sometime in the late 1990s, and the government lost that case.

**BUSINESS LICENSE
CLEARANCE
PROCESS
INEFFECTIVELY
IMPLEMENTED**

To its credit, Guam has established a process to combat tax evasion by requiring businesses to file their tax returns before they are issued business licenses. We found, however, that DRT employees were clearing flagged business licenses for reasons not authorized by statute. Based on limited testing of DRT's accounts receivable listing, we determined that DRT's Collection Branch cleared accounts receivable flags for one of the five businesses tested even though the business had not paid, or made contractual arrangements to pay, all taxes owed. In a separate test of 10 business licenses, we found that the Business Privilege Tax flag on one license was cleared because Business Privilege Tax returns were filed, but there was no evidence to document that the related tax payments were actually made.

In addition, our review found that DRT's implementation of the tax clearance process was hobbled by the backlog of unprocessed tax returns. DRT established flag dates for each type of tax return based on processing status information provided by the various DRT branches. These dates are entered into the computer system so that the system can automatically flag potential instances of noncompliance with tax return filing and payment requirements. But we were told by DRT personnel that the processing of tax returns was so far behind that, in 2007, DRT eliminated the flag dates for income tax withholding returns and stopped checking the more recent years' income tax and business privilege returns. Therefore, the tests for delinquent taxes were at best incomplete and at worst non-existent.

**PROPERTY TAXES
LOST**

The Real Property Tax Division (Real Property) is not using current market values to develop tax assessments for privately owned real property, resulting in significant lost tax revenues. Guam's tax code mandates that all real property be reappraised every five years¹ to ensure that values are current. However, the required periodic reappraisal has not been performed since 1993. We were told that the appraisal was not done due to the lack of staff to perform the work in-house and the high cost of contracting for such an appraisal. In addition, Real Property currently does not update property records to reflect current value when the ownership of a piece of property is transferred or sold. We were told that updating property values during an ownership transfer would not be difficult, but it was felt that doing so would unjustly burden the new owners whose taxes would be grossly disproportionate to the taxes for comparable properties not reappraised since 1993.

¹ Until 2007, the law required reappraisals to be completed every three years.

Citing the research of a local real estate group, which Real Property officials agreed was probably accurate, a local Guam newspaper recently reported that property values in Guam have increased by 71 percent just since 2003. Using the 2005 real property assessment of \$19.5 million (that was primarily based on 1993 land values), we estimate that property taxes will be under assessed by at least \$13.8 million this year. The actual loss may be more or less considering that our estimate does not account for property value changes between 1993 and 2003.

RECOMMENDATIONS

TO THE GOVERNOR OF GUAM

We recommend that the Governor of Guam:

1. Lead a tax administration task force in the development of an action plan for revitalizing DRT and ensuring the filing and payment of all taxes due Guam. This task force should be established in cooperation with the Legislature and include officials from tax collection authorities and tax experts outside Guam, such as the Internal Revenue Service. Issues addressed should include establishing budget and staffing levels concomitant with an effective tax collection program, eliminating impediments to the hiring and retention of qualified tax enforcement staff, and streamlining and modernizing DRT's tax information systems.
2. Coordinate with the Office of Insular Affairs (OIA) for financial and/or management assistance to implement fundamental financial management and systems improvements at DRT.

GOVERNOR'S RESPONSE AND OIG REPLY

In his September 22, 2008 response to our draft report (Appendix 4), the Governor of Guam concurred with our recommendations. In acknowledging our findings and recognizing the root problems identified in the report, the Governor stated he is committed to resolving the resource constraints outlined in our report and to revitalizing Guam's tax collection and enforcement efforts. The Governor stated that he believes our concerns will be resolved upon full implementation of a newly acquired computer scanner capable of reading tax return information resulting in efficient processing of returns for audit and tax collection purposes. He also stated that his management team is addressing procedural matters raised by our report, including conducting a government-wide pay study and issuing a Request for Proposals for a "Computer Assisted Mass Appraisal Program" targeted for full implementation by March 2009. Finally, the Governor stated that he has directed his Chief of Staff to assemble a tax administration task force involving the Internal Revenue Service to develop an action plan to ensure revitalization of Guam's tax collection efforts, and has also directed the Chief of Staff to initiate dialogue with OIA to obtain any available assistance.

We are pleased that the Governor concurred with our recommendations and has taken the first steps toward building a

healthier and more vital tax collection process. Full implementation of the newly acquired computer scanner has the potential to substantially increase DRT's tax return processing productivity. It also carries the promise that DRT's taxpayer database might someday be made current and complete, although this goal cannot be achieved without substantial additional work to fill gaps and correct errors in the data from previous years. And while we agree that increased automation is a key component of DRT revitalization, the purchase and implementation of the newly acquired computer scanner is not a panacea for the multitude of long-standing problems besetting DRT. Repairing damage done to Guam's tax collection apparatus by 20 years of neglect will undoubtedly prove to be a long and difficult task. We believe, however, that the financial rewards that Guam can gain from this effort are well worth the investment of time, effort, and resources.

While it will be for the Governor's task force to identify a specific action plan for revitalizing DRT, we believe that time is of the essence. For example, once the computer assisted mass appraisal program is up and running, DRT should be in a position to begin collecting millions of dollars of additional property tax revenues. If in turn these revenues were reinvested in the hiring and training of additional tax enforcement and collection officers, DRT could once again participate in proactive tax enforcement activities such as non-filer identification programs and field investigations. Such activities should yield substantial additional income tax collections from taxpayers and businesses that currently do not pay taxes or that pay less than they should, as well as from the many new contractors that the Department of the Defense will employ to complete the impending military build-up on Guam.

Based on the Governor's response, we consider Recommendations 1 and 2 resolved but not implemented. The status of the recommendations is shown in Appendix 5.

Appendix 1 - Evaluation Scope and Methodology

The objective of our evaluation was to identify the current level of taxes and fees owed to Guam and determine if Guam was making reasonable efforts to collect these outstanding amounts.

We performed our evaluation work from November 2007 through June 2008.

To accomplish our objective, we reviewed Guam's tax laws and interviewed officials from DRT and other branches of the government of Guam. We reviewed tax forms, tax payment records, computerized tax information, collection history files, tax clearance letters, and annual tax bills.

Our evaluation was conducted in accordance with the January 2005 *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency and included limited testing of records. As part of the evaluation, we assessed DRT's tax assessment and collection policies and procedures to the extent we considered necessary to accomplish our objective.

Appendix 2 – Prior Audit Coverage

Over the past 20 years, we have performed numerous audits and evaluations of various aspects of Guam's tax collection process. Common to each of these reports are deficiencies that collectively demonstrate a systemic breakdown in tax administration and enforcement, which undermines public confidence in the fair administration of Guam's tax laws. Our reports in these areas include the following:

- July 1998, *Assessment and Collection of Gross Receipts Taxes, Department of Revenue and Taxation, Government of Guam* (No. 98-I-570). DRT did not ensure that delinquent gross receipts taxes (GRT) were collected and did not use available sources of information to identify businesses that had not filed GRT returns. This occurred because collections staff were transferred to other divisions, non-filer identification programs were not established, and tax information was not entered into the automated tax system. The report made 5 recommendations to the Governor to correct the conditions noted.
- June 1991, *Processing and Collection of Income Taxes, Department of Revenue and Taxation, Government of Guam* (No. 91-I-969). DRT did not ensure that potential non-filers identified through non-filer identification programs actually filed tax returns, did not utilize available resources to identify and locate other non-filers, and did not take timely actions to collect from delinquent taxpayers. This occurred because DRT had not: (1) assigned staff and a program coordinator to investigate and manage non-filer cases, (2) developed a non-filer program plan, (3) developed desk procedures to ensure that collection actions were taken timely on delinquent accounts, (4) developed procedures concerning the waiver of interest and penalties on delinquent taxes, and (5) reconciled tax receivable cases at the Collection Branch with official accounting records. The report made 16 recommendations to the Governor to correct the conditions noted.
- April 1991, *Assessment of Income Taxes, Department of Revenue and Taxation, Government of Guam* (No. 91-I-687). DRT did not ensure that income taxes were properly assessed, violators were prosecuted, and penalties and interest were properly assessed and collected. This occurred because DRT had not: (1) provided the necessary resources and guidance to the Investigation and Examination Branches, (2) developed

written procedures or provided adequate training to staff, (3) designated a fraud coordinator, (4) required written statements to support reductions in tax deficiencies proposed by the Examination Branch, (5) developed procedures and a monitoring system to ensure that tax cases were processed prior to the expiration of the statute-of-limitations, and (6) developed annual examination plans to guide the selection of tax returns for audit. The report made 14 recommendations to the Governor to correct the conditions noted.

- June 1990, *Assessment and Collection of Property Taxes, Department of Revenue and Taxation, Government of Guam* (No. 90-72). DRT did not ensure that property taxes were properly assessed and collected. In particular, DRT did not complete the required triennial reappraisal of Guam real property in a timely manner, did not enforce the collection of delinquent property taxes, and did not maintain accurate property records. This occurred because DRT delayed a decision on how to conduct the 1990 reappraisal and then did not provide sufficient funds to perform the reappraisal work in-house. In addition, DRT elected not to auction tax-deeded property to ensure that delinquent property taxes were collected and did not develop controls to ensure that accounts receivable and property ownership records were accurate. The report made 9 recommendations to the Governor to correct the conditions noted.
- May 1989, *Gross Receipts Tax Billing and Collection Practices, Department of Revenue and Taxation, Government of Guam* (No. 89-70). DRT did not adequately verify taxes reported, control delinquent accounts, perform comprehensive searches for delinquent taxpayers' assets, effectively use its enforcement options, and investigate potential tax violators and non-filers. This occurred because DRT did not adhere to existing procedures and apply its enforcement authority, and procedures did not include provisions for effective and timely execution and control of assessment, collection, and enforcement activities. The report made 13 recommendations to the Governor to correct the conditions noted.

Appendix 3 – Monetary Impact

FINDING AREA	UNCOLLECTED REVENUES (IN MILLIONS)
Examination Branch Productivity Losses (annual)	\$ 9.7
Real Property Taxes Lost (annual)	\$13.8
Total	\$23.5

Appendix 4 – Governor of Guam's Response



Office of the Governor of Guam

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Felix P. Camacho
Governor

Michael W. Cruz, M.D.
Lieutenant Governor

Mr. Michael P. Columbo
Regional Manager
U.S. Department of Interior
Office of Inspector General
Western Region Office
2800 Cottage Way, Suite E2712
Sacramento, California 95825

SEP 22 2008

Dear Mr. Columbo,

Hafa Adai! Thank you for your draft report dated August 13, 2008. In consultation with Mr. Artemio B. Ilagan, Director of Guam Revenue and Taxation (DRT) regarding the proposed findings of your evaluation of the Government of Guam's (Guam) tax collections activities we have reviewed your draft report and humbly submit this response. DRT acknowledges the findings and recognizes the root problems identified in your report stem from the lack of properly funding DRT, the inability to provide them with the necessary skilled staffing due to budgetary constraints and outdated compensation plans to attract and retain highly skilled employees, outdated computer equipment and software to efficiently process local, income and property tax information in a timely manner. I am committed to resolve the resource constraints outlined in the DOI report and believe this will be the impetus to revitalizing Guam's tax collection and enforcement efforts.

With regards to many of your findings, DRT is committed to addressing the concerns outlined in your report and we are confident that they will be resolved upon full implementation, targeted by this calendar year end, of their newly acquired computer scanner capable of reading tax return information resulting in efficient processing of returns for audit and collection purposes.

Other procedural matters are being addressed by his management team to include effective case inventory management in both Collections and Examination Branches, automated non-filer programs, timely processing of returns for referral to collections, the cross checking of current information with business license records, and the procurement of an automated real property tax system that would interface with our Department of Land Management records and the Department of Public Works Building Permits Division. The Request for Proposals for a "Computer Assisted Mass Appraisal Program" is targeted for full implementation by March 2009 thereby making the revaluation of

property taxes more efficient and based on current values. Concurrently, the Government of Guam is also conducting a government-wide pay study which has been long overdue. These actions already initiated demonstrate DRT's commitment to addressing your concerns.

With the impending military buildup, we estimate that we lost over \$40 million in taxes (corporate, business privilege taxes and employee withholding taxes) simply because the Federal Government does not have a provision in its contracts that all companies doing business in Guam require them to obtain Guam business licenses and pay the requisite taxes.

It would be extremely helpful if the Inspector General of the Department of Interior brought this to the attention of the Department of Defense. Since all your recommendations require funding and financial support, this is one clear way of obtaining these funds.

Furthermore, in response to your recommendations, I have directed my Chief of Staff, Mr. George Bamba to assemble a tax administration task force immediately to begin the development of an action plan along with DRT and the Internal Revenue Service to ensure the revitalization of Guam's tax collection efforts in accordance with concerns mentioned in your report. I have also directed Mr. Bamba to initiate dialogue with the U.S. Department of Interior Office of Insular Affairs to provide any assistance on these matters.

Sinseru yan Magâhet,



FELIX P. CAMACHO
I Maga' lâhen Guðhan
Governor of Guam

Appendix 5 – Status of Recommendations

Finding/ Recommendation	Status	Action Required
1	Resolved, Not Implemented.	We look forward to receiving the tax administration task force's action plan for revitalizing DRT and evidence of actions taken by Guam to implement the action plan.
2	Resolved, Not Implemented.	We look forward to receiving evidence of Guam's efforts to coordinate with OIA for financial and/or management assistance to implement fundamental financial management and systems improvements at DRT.

Appendix 2 – Office of Insular Affairs Response



United States Department of the Interior
OFFICE OF THE SECRETARY
Washington, DC 20240



MEMORANDUM

To: Earl E. Devaney
Inspector General

From: Tom Bussanich
Acting Director for Insular Affairs

Subject: Evaluation Report (Draft) of Guam's Tax Collection Activities
Assignment No. HI-EV-GUA-0002-2008

The Office of Insular Affairs has reviewed the Office of the Inspector General's Draft Evaluation Report, "*Guam's Tax Collection Activities: Office of Insular Affairs Involvement Needed to Achieve Lasting Improvements*". OIA finds that the Report clearly identifies issues that need to be addressed by the Government of Guam, especially in light of the reported material amount of losses in local annual tax revenues ("at least \$23.5 million annually").

OIA has been assisting the Government of Guam, and each of the other six Insular Areas for which the Department of the Interior has oversight responsibilities, to improve accounting processes and produce more timely and accurate financial data and reports. As a result, the Government's accountability over the use of funds has improved and, for the first time, the Government of Guam received an unqualified opinion on its audited financial statements (fiscal year ended 2007). OIA will continue to assist Guam in improving its accountability to its citizens, the Federal government and other interested parties.

With the availability of more timely and accurate financial data, the Government of Guam should be able to review its revenue sources and amounts, and allocate funds to offices in a manner that enables its offices to operate effectively. Appropriate local personnel will also have data available to help determine if revenue projections are achievable. Included in this analysis would be whether tax revenues are properly estimated for budgetary purposes and expected targets are being collected. If experienced staff determine that realistic projections are not being achieved, the Government of Guam will be able to look into the matter and take corrective actions. This is especially important for the Guam Department of Tax and Revenue as tax revenues are commonly 60% of total general revenues, and the Government of Guam has been forced to seek ways to drastically reduce operating costs due to dwindling resources.

The Report identifies that over the past 20 years, OIG reviews of Guam's tax collections operations resulted in numerous recommendations to the Governor of Guam to provide additional resources to its Department of Revenue and Tax (DRT) and to make better use

of existing resources. Moreover, the Report identifies that, currently, DRT is hamstrung by the lack of adequate funding and staff, inefficient tax collection processes, inability to hire and retain qualified tax enforcement staff, and reliance on manual processes and outdated equipment. The Report concludes that, "[G]iven Guam's lack of success in dealing with these challenges in the past and its current financial situation, we believe that the Office of Insular Affairs' (OIA) active involvement and assistance will be required to promote sound financial management practices and to achieve lasting improvements in the future."

OIA notes that it is the Insular Area Government's responsibility to ensure that its offices are allocated sufficient resources to operate efficiently and achieve their objectives. To assist in the Government's efforts, OIA has provided financial assistance for government operations to each of the seven Insular Areas based upon 1) requests by the Government for such assistance, and 2) the availability of program funds. Moreover, OIA has recently implemented a process for each of the seven Insular Areas to identify its priorities for OIA technical assistance, and OIA will discuss the identified priorities, in relation to the Department's oversight responsibilities and strategic goals, with each of the respective Governors and Presidents.

The Report recommends that OIA:

Report Recommendation 1: "Facilitate and participate in the tax administration task force that has been recommended to the Governor to develop an action plan for revitalizing DRT and ensuring the filling and payment of all taxes due Guam. This task force should include officials from tax collection authorities and tax experts from outside of Guam, such as the Internal Revenue Service. Issues addressed should include streamlining and modernizing DRT's tax information systems, eliminating impediments to the hiring and retention of qualified tax enforcement staff, and establishing budgets levels and staffing patterns for effective tax program performance.

OIA Response: Concurrence. As resources permit, OIA will assist the Governor's task force to achieve the goals set by the Governor. Also, in partnership with the Government of Guam, OIA will liaison with other Federal agencies to help ensure that available expertise is provided to the Governor. Upon OIA's review of the Governor's response to this Report, OIA will meet with appropriate Government of Guam personnel to identify actions OIA may take to assist.

Report Recommendation 2: Identify financial resources and/or management assistance that can be made available to Guam to implement fundamental financial management and systems improvements at DRT.

OIA Response: Generally concur. As previously mentioned, OIA has limited financial assistance programs that are made available to each of the seven Insular Areas and are allocated based upon the priorities identified by each Government leader. OIA will meet with the Governor of Guam, and other officials, to discuss the importance of addressing the deficiencies identified in the Report, and to help ensure that effective operations of

DRT are included in the Governor's listing of priorities for OIA technical assistance program funds.

If you have any questions or require additional information, please do not hesitate to contact me at 202-208-4736. Or you or your staff may contact Marina Tinitali, OIA's Accountability Policy Specialist and Audit Liaison Officer, at (202) 208-5920.

Appendix 3 – Status of Recommendations

Finding/ Recommendation	Status	Action Required
1	Resolved, Not Implemented.	Identify the actions taken and resources committed by OIA to assist the Governor's tax administration task force in developing an action plan for revitalizing DRT.
2	Resolved, Not Implemented.	Identify financial resources and management assistance, other than the resources already described in this report, that OIA actually provides to Guam to implement fundamental financial management and systems improvements at DRT.

Report Fraud, Waste, Abuse And Mismanagement



Fraud, waste, and abuse in government concerns everyone: Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or Insular area programs and operations. You can report allegations to us in several ways.



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