

**Department of Revenue and Taxation
Gross Receipts Tax Exemptions**

**Performance Audit
October 1, 2010 through September 30, 2012**

**OPA Report No. 13-01
May 2013**



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EXECUTIVE SUMMARY
Department of Revenue and Taxation
Gross Receipts Tax Exemptions
OPA Report No. 13-01, May 2013

Our audit of the Department of Revenue and Taxation's (DRT) gross receipts tax (GRT) exemptions revealed that DRT has not processed GRT forms and assessed taxes and exemptions since March 2011. This occurred because of a breakdown in DRT's system and optical image scanner, along with the expiration/termination of the service agreement with the contracted vendor. As a result, the Government of Guam (GovGuam) is at risk of losing revenue due to possible non-reporting and under reporting of GRT. DRT has no system in place to track the number and amount of exemptions being claimed by Guam taxpayers; therefore, the financial impact on GovGuam revenue is unknown. GRT and exemption data is incomplete, possibly unreliable, and lacking necessary information for management and elected leaders to make sound decisions related to GRT. Without DRT effectively monitoring, reporting, and collecting GRT and reviewing exemptions claimed, there is no assurance that all GRT revenues are being collected and reported completely and accurately.

System Breakdown and Termination of Service Agreement

In March 2011, DRT was no longer able to utilize its optical scanner and system interface for processing GRT forms. As a result, for two years the Business Privilege Tax (BPT) branch did not scan or input GRT tax and exemptions data from tax forms into its system. Specifically, 24,694 GRT forms were not processed in calendar year (CY) 2011 and 55,006 GRT forms in CY 2012, a total of 79,700 for the two years. According to DRT Management, CY 2013 forms are being processed and GRT forms for CY 2011 and 2012 will be processed by May 2013.

Unprocessed Gross Receipts Tax Forms

DRT did not have contingency procedures for handling the system failure, and reverted to a manual recording process in the interim. The issue of DRT's inability to process and assess gross receipts taxes is an urgent matter that must be addressed by management and elected leaders. As stated in 11 GCA § 26102 (e), the limitation of time to assess these taxes is three (3) years after the return is filed. As of the date of this report, reliable information related to gross receipts taxes and exemptions is unavailable because of the backlog of tax processing. While information for CY 2006 through 2010 was subsequently provided, we did not test the completeness and reliability of this information. Without GRT and exemption data, we are unable to quantify GRT exemptions and determine its financial impact on Government of Guam revenue.

Compensating Controls at Department of Administration

Although DRT has not processed two years of GRT forms into its system, the Department of Administration (DOA) and the Treasurer of Guam (TOG) have compensating controls through the recording of GRT payments. Only GRT taxpayers who submit payments to the TOG are recorded at the point-of-sale and in the DOA AS400 system. However, non-cash transactions, zero-balance transactions, and electronic filing transactions are not recorded in DOA's AS400 system. Therefore, complete GRT data does not exist in any one system.

The TOG's point-of-sale system at one point was integrated into DRT's AS400 system; however when the lack of integration occurred between TOG and DRT is unknown. Both AS400 systems at DOA and

DRT are stand alone systems, independent of each other, and are not integrated or interface with each other.

Electronic Filing and Improved Financial Management System

The DRT Director stated that transitioning to electronic filing (e-filing) will improve efficiency and reliability of processing GRT forms. E-filing presents benefits such as efficient recording of data into DRT's system and does not rely on a system interface between TOG, DOA, and DRT.

GovGuam can no longer afford to operate with such old legacy systems¹ that are independent and not integrated. GovGuam should begin the process to move to a more efficient financial management system at both DRT and DOA that are fully integrated with technological software appropriate for the 21st century to include such aspects as online and e-filing capability.

Conclusion and Recommendations

Guam tax collection problems are not new, having been in existence for over two decades. The problems we found are similar to findings reported by the U.S. Department of Interior Office of Inspector General audit report on *Guam's Tax Collection Activities* issued in November 2008. The challenges noted in the OIG report include: 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. These challenges still remain with respect to DRT processing of gross receipts taxes.

By failing to address long standing tax collection deficiencies, GovGuam has allowed its tax system to fall into disrepair and has suffered tax revenue losses estimated in the millions of dollars annually. This deprives Guam of the revenues it desperately needs to fund public education, health, safety, and other programs for the people of Guam.

To improve the recording, reporting, collecting and monitoring of gross receipts tax and exemptions, we recommend the Governor, the Legislature, and DRT Director and DOA Director:

1. Establish a tax administration task force to develop an action plan for revitalizing DRT and ensuring complete filing and payment of all taxes due to Guam.
2. Establish a financial management task force to develop an action plan for the acquisition of updated financial management systems at both DRT and DOA.
3. Establish and meet a target date to fully transition to e-filing of GRT taxes and other related taxes.

DRT management did not disagree with OPA's audit findings. The Director further stated that: "(1) The inability for your office to test reliable data was already an issue that DRT has been trying to resolve since the discontinuance of the point of sale system previously maintained by the private vendor and (2) DRT currently is trying to resolve data integrity by updating and correctly posting to taxpayer accounts, all payments, credits and assessments. By the time the draft audit was discussed, DRT already made significant updates to GRT but was not included in the audit report."

This is the first OPA audit conducted of DRT. We appreciate the cooperation and assistance shown during the course of this audit by DRT, the Treasurer of Guam, and the DOA Division of Accounts.



Doris Flores Brooks, CPA, CGFM
Public Auditor

¹ DOA's accounting software system was originally acquired in the late 70s and early 80s known as BACIS (Budget Accounting Information System) which was developed by IBM for the city of Burbank, California. Over the years DOA and its primary consultant reprogrammed and modified the BACIS system.



Introduction

This report presents the results of our audit of the Department of Revenue and Taxation's (DRT) gross receipts tax (GRT) exemptions. The audit was conducted at the initiation of the Public Auditor and at the request of a senator in the 32nd Guam Legislature. Our objective was to quantify GRT exemptions and determine their impact on Government of Guam (GovGuam) revenues. The objective, scope, methodology, and prior audit coverage are detailed in Appendices 1 and 2.

Background

DRT exists to promote quality service to all taxpayers, increase voluntary compliance by helping taxpayers understand and meet their responsibilities by applying the tax law with integrity and fairness to all. DRT consists of five divisions: Regulatory Division, Motor Vehicle Division, Real Property Tax Division, Tax Enforcement Division and the Taxpayer Service Division. Within the Taxpayer Service Division lies the Business Privilege Tax (BPT) branch whose function is to conduct year-round taxpayer services in the administration and enforcement of the BPT law. Gross receipt taxes and exemptions claimed are monitored by the BPT Branch.

Taxpayer Service Division

The Taxpayer Service Division is responsible for the administration of the business privilege tax laws on Guam. The division is charged with providing a comprehensive year-round taxpayer service program, which include counter services; processing of tax declarations; assessment of taxes due in a timely manner; identification of non-filers; maintenance of accounts receivables; tax compliance clearances; taxpayer education programs; and the maintenance and storage of all taxpayer records as mandated by Public Law (P.L.) 17-4 and Executive Order 83-15.

Business Privilege Tax Branch

The BPT Branch falls within the Taxpayer Service Division. The BPT Branch is responsible for conducting year-round taxpayer services in the administration and enforcement of the BPT laws. Gross receipts taxes and other business privilege taxes are assessed and collected monthly against persons on account of their businesses and other activities in Guam measured by the application of rates against values, gross proceeds of sales or gross income. Businesses are required to file a monthly GRT Form based on the period the income was received or accrued (depending on the accounting method selected). All business privilege taxes are filed through a GRT form.

Business Privilege Taxes and Exemptions

Business privilege taxes consist of five categories as contained in the Guam Code Annotated:

- Gross Receipts Tax – a tax is levied and shall be assessed and collected monthly against persons on account of their businesses operating within and without Guam measured by the application of rates against values, gross proceeds of sales or gross income. The tax rate applied is four percent (4%) of gross income or proceeds of sales related to business activities such as service businesses, professions, contractors, etc.
- Alcoholic Beverage Tax – a tax is imposed on alcoholic beverages (except those manufactured in Guam) sold in Guam by manufacturer, manufacturer’s agents, rectifiers or wholesalers or sellers of alcoholic beverages selling alcoholic beverages with respect to which no tax has been paid within areas of which the Federal government exercises jurisdiction on malted fermented, distilled, and vinous beverages. Tax rates vary by alcoholic beverage type.
- Liquid fuel tax - Any transfer in Guam of liquid fuel made by a distributor shall be taxed ten cents (\$0.10) per gallon on diesel fuel and eleven cents (\$0.11) per gallon on all other liquid fuel, except liquid fuel used for commercial aviation purposes which are taxed at four cents (\$0.04) per gallon.
- Tobacco tax - a tax shall be assessed and collected from every business engaged in the manufacturing or production in Guam, or importation into Guam, of any cigarettes, cigars at various sizes, and other tobacco products. Tax rates vary by tobacco product.
- Automotive surcharges – in addition to the liquid fuel tax levied, there is a tax imposed on automotive surcharges of four cents (\$0.04) per gallon on all liquid fuel taxed except for liquid fuel used for aviation purposes and a mass transit automotive surcharge of four cents (\$0.04) per gallon on diesel fuel.

GRT taxes make up the largest category of business privilege taxes paid into GovGuam representing approximately 89% in FY 2011. See Table below.

Table 1: FY 2011 Summary of BPT Revenues from FY 2011 Financial Audit

Tax Type	Amount	Percentage of BPT Revenue
Gross Receipts	\$ 200,047,641	89%
Liquid Fuel	\$ 9,478,586	4%
Tobacco	\$ 12,831,340	6%
Alcoholic Beverages	\$ 2,910,508	1%
	\$ 225,268,075	100%

GovGuam levies the GRT on a broad base of services and goods, including the sale of tangible personal property and the provision of professional services. However, certain entities and sales, including most wholesale businesses, governmental entities, charitable and community organizations, hospitals, most agricultural producers and fisheries, home industries, licensed childcare facilities and certain fuel sales, are exempt from the business privilege tax. Based on Title 11 §26203, there are 47 specific tax exemptions that are available to Guam taxpayers. However, the GRT form provides 43 tax exemptions that can be claimed by taxpayers. See Appendices 3 and 4 for complete listings.

Results of Audit

Our audit of the Department of Revenue and Taxation's gross receipts tax exemptions revealed that the number of exemptions being claimed by Guam taxpayers and its impact on GovGuam revenues is unknown. We found that DRT had not processed and recorded GRT returns for calendar years (CY) 2011 and 2012 because of a breakdown of the optical image scanner, system interface, and the expiration/termination of the service agreement with the contracted vendor. Therefore our audit results were based on the condition we found and our assessment of DRT's process deficiencies of GRT and efforts to correct these deficiencies.

DRT had not processed GRT forms and assessed gross receipts and other business privilege taxes since March 2011. A total of 79,700 forms remain unprocessed, 24,694 for CY 2011 and 55,006 for 2012. Management has stated that they are current in the processing of 2013 GRT forms. Management anticipates processing 2011 and 2012 forms by end of May 2013 as DRT staff has been working overtime. The BPT branch currently has a staff complement of six who all put in two hours of overtime daily, and eight hours of overtime on Saturdays to process the backlog of GRT forms. When GRT exemption data becomes available, the OPA will revisit our original audit objectives pertaining to GRT exemptions and their effect on GovGuam revenues.

Based on our current audit, GRT and exemption data is incomplete, possibly unreliable, and lacking necessary information for management and elected leaders to make sound decisions related to business privilege taxes. Without DRT effectively recording, monitoring, reporting, and collecting GRT and reviewing exemptions, GovGuam is at risk for losing revenue due to possible non-reporting and under reporting.

DRT continues to experience serious problems with tax collection activities. As evidenced in the U.S. Department of Interior Office of Inspector General (DOI OIG) audit report on *Guam's Tax Collection Activities* issued in November 2008, DRT has had challenges for the past 20 years. The poor conditions identified in this report still exist including reliance on manual processes and outdated equipment as well as an incomplete database that reduces the effectiveness of clearing business licenses and processing tax returns. See Appendix 6 for the full audit report.

Myriad of Challenges Processing GRT Forms

DRT has experienced many challenges and delays when processing GRT forms. The Department has transitioned from a manual process, to a quasi-automated system, and then back to a manual process. The timeline below is a summary of DRT processing:

DRT's Manual Processing of Gross Receipts Tax Forms

Prior to 2009: DRT utilized a manual process where tax filers submit a monthly form to the BPT Branch of the Taxpayer Service Division. These forms were manually processed into DRT's system for recordkeeping purposes by DRT BPT Branch staff.

In July 2007, P.L. 29-03 appropriated \$1.3 million (M) to fund computer system upgrades and hardware and software integration at DRT with funding coming from federal government tax reimbursements received by GovGuam.

In September 2007, General Services Agency (GSA) published an invitation for bid for an optical image scanner with the capability of reading and processing tax return information. With no bid submissions, GSA opted to sole source this procurement to the vendor recommended by the DRT Director. The optical image scanner was purchased in January 2008 for \$1.3M and installed later that year from the sole source vendor. This vendor for more than a decade has been the prime software consultant maintaining DRT's tax software programs.



Image 1: DRT's Optical Image Scanner procured in July 2007

Processing of GRT Forms Utilizing OCR Scanner

From 2009 through 2010: DRT implemented an optical character recognition (OCR) scanner that would scan and process tax information. In order for the scanning to work, the GRT form that was used for manual processing was updated by the vendor and divided into four forms, one of which was a form exclusive for tax exemptions. Utilizing one of the four forms, tax filers would submit their monthly GRT form to the BPT Branch of the Taxpayer Services Division. If taxes were owed, tax filers would pay their business privilege taxes at the Treasurer of Guam or DRT's Collection Branch. All tax filings were then batched and sent to the Scanning Room for processing. As part of the processing, the forms were scanned and fields were meta-tagged, processed, and taxes were assessed. Forms were then returned to the BPT Branch for storage, corrections, classification, or other.

Ideally, the scanner was supposed to read the GRT forms and post the line items into the proper accounts in DRT's system. According to DRT officials, the scanner was able to scan tax forms; however, the scanner and the system interface had difficulty in processing the information on the forms and distributing the information to the departments in need of the information. DRT also had a service contract with the sole source vendor who provided support with on-site employees. The vendor's on-site employees were primarily scanning and processing GRT forms. Few DRT employees were involved in the scanning process.

System Breakdown and Termination of Service Contract

From 2011 through 2012: The specific date for system failure is unknown; however, DRT officials claim that by March 2011, they were no longer able to utilize their optical scanner and system interface. The OCR scanner was no longer in service and processing of GRT forms ceased because of maintenance issues and the expiration/termination of the service agreement with the sole source vendor. The on-site staff employees provided by the vendor were no longer at DRT. The BPT branch employees could not scan or input GRT and other BPT tax and

exemptions data into its system causing the department to be at a standstill in providing data to management and other interested parties. Specifically, 24,694 GRT forms were not processed in CY 2011 and 55,006 GRT forms were not processed in 2012. We were informed that 2013 GRT forms are being processed. As of the date of this report, complete and reliable information related to GRT and exemptions is unavailable because of the backlog of GRT processing.

Table 1: Unprocessed GRT Returns

Year	Income	Zero	Amended	Mail	Total Unprocessed
2011	14,655	9,190	106	743	24,694
2012	32,511	18,656	2,024	1,815	55,006
Total					79,700

According to DRT officials, employees were not familiar with the scanner’s programming; therefore, when the vendor ceased operations, DRT employees were unable to process GRT forms. Staff at the BPT branch preferred **not** to have the scanner in place for processing tax forms as it appeared to be more problematic than beneficial due to the high rejection rate and the inability of the scanner to read all data correctly. It is also unclear if staff were trained to use the scanner and its program once the vendor’s on-site employees left. This method of processing GRT forms ceased upon the expiration/termination of the contract with the sole source vendor. Further, the contract did not specify liability of the vendor for any breakdown in the system outside the contracted period. Reverting to manually processing GRT forms was not possible because the program was taken offline and could not be found.

Amount of Gross Receipts Tax Exemptions Claimed Unknown

We were unable to quantify the amount of GRT exemptions taken between CY 2011 and 2012 because DRT has not completely processed such information. Information for CY 2009 and 2010 was provided in March 2013 and CY 2006 – 2008 tax information provided in April 2013, however, we did not test the reliability and completeness of this data. See Appendix 5 for details. As a result of DRT’s inability to provide timely and reliable data relating to GRT exemptions, we were unable to complete our initial audit objective pertaining to amount of GRT exemptions claimed.

Business Privilege Tax Challenges

The issue of DRT’s inability to process and assess GRT is an urgent matter that needs to be addressed by management and elected leaders. Otherwise as stated in 11 GCA § 26102 (e), the limitation of time to assess these taxes is three (3) years after the return is filed. DRT has been challenged with a lack of funding, system upgrades, and has limited staff dedicated to processing GRT forms. These challenges are further impacted by the ever-increasing workload and a reliance on manual processing. The challenges we encountered have been identified in previous DOI OIG audits and most recently in the November 2008 audit. Based on our observations, minimal progress in improving tax collections has been made from 2008.

As a result, GRT information is not being processed timely, tax audits are not productive as they lack information, and there are few effective tools and information to assist tax examiners. Minimal efforts are being made to identify non-filers. There are significant challenges to collect taxes in a fair and expeditious manner. We recommend the Governor, Legislature and DRT

Director to establish a tax administration task force and develop an action plan for revitalizing DRT and ensuring the filing and payment of all taxes due to Guam.

Compensating Controls at Department of Administration

Although DRT has not processed GRT forms since March 2011, the Department of Administration (DOA) and the Treasurer of Guam (TOG) have compensating controls through the inputting of GRT forms that involve payments. Such payments are recorded into TOG's point-of-sale (POS) system² and DOA's AS400 Financial Management system.

TOG's POS system was integrated and interfaced with DRT's AS400 system, but was scheduled to expire in November 2011. In anticipation of the expiration date, DOA together with GSA issued a request for proposal for a new POS system. This procurement encountered various problems during negotiations and subsequently resulted in an appeal (OPA-PA-12-007) to the Public Auditor in April 2012. During the appeal hearings, we learned of the expiration/termination of the POS agreement between DOA, DRT, and the vendor, and that DOA developed a bridged system to capture tax payments at the TOG and to allow DOA to record all tax collected in the right categories in the AS400 system. To date, this bridge system is in effect. The TOG bridge system is not integrated with DRT, but is recorded in DOA's AS400 system through additional manual input by DOA's Division of Accounts.

After several exhaustive hearings involving numerous hours of witness testimony and related matters including settlement talks with the Governor's office and the intervention of the Governor's legal counsel over the Attorney General's representation, the appellant withdrew its appeal in December 2012.

TOG's POS system and DOA's AS400 system continue to be independent of DRT. The AS400 systems at DRT and DOA are stand alone systems and are not integrated or interfaced with each other. However, the vendor who assists DRT with its AS400 is the same vendor that assists DOA and its AS400. DOA began limited processing of GRT tax information when GRT forms were changed due to the implementation of the optical scanner that did not function as intended.

Only taxpayers who file GRT and make payments are captured by the TOG. Payments can be made at any TOG cashier offices located at DRT, the Department of Public Works, and the DOA building in Hagatna. Upon receiving tax payments, the TOG cashiers input certain information into the POS system and generate sales receipts that include the taxpayer's employee identification numbers, GRT account numbers, and taxes paid. The posting done by TOG began when the GRT forms were changed and DRT was experiencing difficulty with the OCR scanner not being able to recognize tax information written on the forms.

Once TOG completes its postings, GRT forms are then batched for delivery to the DOA Division of Accounts for a secondary review and limited data entry of GRT payments into DOA's AS400. DOA staff only record tax information with payments that have been processed by the TOG. Tax forms with zero-balances as well as those who may file online are not captured in the DOA AS400 system. DOA staff do not post GRT exemptions claimed on the forms. Once GRT forms

² Point-of-Sale System: refers to the application software utilized by the TOG for accounting and receipt of GRT payments.

are verified and amounts paid are entered into the DOA AS400 system, they are boxed and delivered to DRT. DRT employees will then again manually input GRT information into DRT's AS400 system.

From an audit perspective, the external independent financial auditors have concluded that all GRT payment information has been recorded into DOA's AS400 system. What is not available is the amount of taxes owed by taxpayers as the DOA system only records actual payments made.

Old Legacy Software Systems formerly BACIS now Firm 400

From the process above, we noted that GRT tax information is handled and processed manually by three different sections, the TOG upon receipt of tax payments, DOA Division of Accounts to ensure the recording of revenues collected, and DRT staff for manual data entry of GRT tax information.

A fully integrated system with an updated financial management system would minimize the handling and manual processing of tax information. DOA's old legacy accounting system was originally acquired in the late 70s and early 80s known as the BACIS system. BACIS was developed by IBM for the city of Burbank, California. Over the years DOA and its primary consultant reprogrammed and modified the BACIS system. Collectively these program changes evolved into what DOA now uses. In the late 1990s with the advent of Y2K, DOA attempted to move toward a new financial management system known as Oracle. The Oracle system was installed for a short time between 2000 and 2001, but there were significant implementation problems. As a result, the Governor made the decision to remove Oracle and revert back to the BACIS system. However, BACIS was no longer in existence. Therefore the contracted vendor installed its own propriety software program known as Firm 400 which had the look and feel of the BACIS system. The Firm 400 system is the DOA accounting software that is used today.

Efforts to implement a modern tax collection system at DRT have been stymied due to lack of funding. GovGuam can no longer operate with old legacy accounting systems and should begin the process to move to a more efficient financial management system at both DRT and DOA. Accordingly, we recommend the Governor together with the Legislature establish a task force to develop an action plan for the acquisition of an updated financial management system at both DRT and DOA.

Move toward Electronic Filing

The DRT Director stated that the best approach to improve efficiency and reliability of processing GRT forms is to transition to e-filing. The e-filing would drop rejection rates because it forces taxpayers to input the correct data at the onset of filing, and would reduce the redundancy of scanning documents, and re-inputting on template forms.

Based on a GRT Statistical Report for a three month period in 2013, 16,905 forms or 29% were filed electronically through DRT's website. We were unable to verify the validity and accuracy of this information.

E-filing presents benefits such as efficient recording of data into DRT's system and does not rely on system interfacing between TOG and DOA. E-filing would be a major organizational change

not only for Guam's taxpayers, but also for DRT personnel. For an effective e-filing system to be in place, systems and processes must be in integrated, policies and procedures documented, staff adequately trained with ongoing technical and IT support, and educational assistance available to taxpayers.

For DRT to become more efficient in its tax collection responsibilities, it must make technological improvements such as e-filing that would enhance productivity and efficiency. However, electronic filing is just one aspect of an overall integrated tax collection system. Accordingly, we recommend that DRT establish and meet a specific target date for the transition to full e-filing of GRT forms including online payments.

Conclusion and Recommendations

Gross receipts tax forms (a total of 79,700) have not been completely processed for CY 2011 and 2012 due to a breakdown of the optical image scanner, system interface, and the expiration/termination of the service agreement with the contracted vendor. Information for CY 2009 and 2010 was provided in March 2013 and the CY 2006-2008 information was provided in April 2013. However, we did not test the completeness, accuracy, and reliability of this data.

DRT had experienced a myriad of challenges processing GRT forms. GRT and exemption data is incomplete, possibly unreliable, and lacking necessary information for management and elected leaders to make sound decisions related to GRT. DRT is not effectively recording, monitoring, reporting and collecting GRT, and there is a high potential for loss revenues due to possible non-reporting and under reporting of gross receipts. The amount of accounts receivable owed by taxpayers who have not filed is also unknown. Without GRT and exemption data, we were unable to quantify GRT exemptions and determine their financial impact on GovGuam revenues.

DRT continues to experience serious problems with tax collection activities as evidenced by the U.S. DOI OIG audit report on *Guam's Tax Collection Activities* issued in November 2008. The challenges noted in the OIG report include 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. These challenges have existed for the past 20 years and still remain. As stated in the OIG's report, "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."

While DOA has developed compensating controls for GRT information, it too is saddled with an old antiquated legacy system BACIS/Firm400, originally designed in the early 1980s. As of FY 2011, revenues collected by the Government of Guam General Fund, and related Funds; exclusive of Autonomous agencies have grown to over a billion dollars. To properly and regularly account for this information, DRT together with DOA must move toward a fully integrated financial management system.

To improve the recording, reporting, collecting and monitoring of DRT's business privilege tax and exemptions, we recommend the Governor, the Legislature, the DRT Director, and the DOA Director:

1. Establish a tax administration task force to develop an action plan for revitalizing DRT and ensuring complete filing and payment of all taxes due to Guam.
2. Establish a financial management task force to develop an action plan for the acquisition of updated financial management systems at both DRT and DOA.
3. Establish and meet a target date to fully transition to e-filing of GRT forms and other related taxes.

Management's Response & OPA Reply

A draft report was transmitted to DRT in April 2013 for their official response. The OPA met with DRT officials that same month to discuss the audit findings and recommendations. DRT management did not disagree with the audit findings in their official response of April 30, 2013. The Director pointed out the following: “(1) the inability for your office to test reliable data was already an issue that DRT has been trying to resolve since the discontinuance of the point of sale system previously maintained by the private vendor; (2) DRT currently is trying to resolve data integrity by updating and correctly posting to taxpayer accounts, all payments, credits and assessments. By the time the draft audit was discussed, DRT already made significant updates to GRT, but was not included in the audit report; and (3) DRT is presently looking at implementing a Transaction Processing System (TPS) that should allow for the interfacing of all tax assessment and payments to replace the POS system that integrated DRT and DOA.” See Appendix 7 for DRT’s management response.

The legislation creating OPA requires agencies to prepare a corrective action plan to implement audit recommendations, to document the progress in implementing the recommendations, and to endeavor to have implementation completed no later than the beginning of the next fiscal year. Accordingly, we will be contacting DRT to provide target dates and title of the official(s) responsible for implementing the recommendations.

This is the first audit the OPA has conducted on DRT. DRT management has been open, accommodating and responsive to all OPA staff. We appreciate the cooperation and assistance shown during the course of this audit by DRT, the Treasurer of Guam, and the DOA Division of Accounts.

OFFICE OF PUBLIC ACCOUNTABILITY



Doris Flores Brooks, CPA, CGFM
Public Auditor

Appendix 1:**Objective, Scope, and Methodology**

Our initial audit objectives were to quantify the business privilege tax exemptions and determine their impact on Government of Guam revenues. The scope of this engagement was originally from fiscal years 2010 to 2012. Due to the lack of more recent tax information, the scope was expanded to include CY 2006 to 2010. When tax data was not made available until March 2013, the audit was refocused to assess deficiencies in DRT's processes and controls as they pertain to GRT exemptions. There was a scope limitation on data availability for the most current years which prevented data testing.

The revised audit objectives were established to:

- (1) Determine the completeness and reliability of CY 2006-2010 information as it pertains to GRT.
- (2) Determine why GRT forms were not processed in recent years, specifically CY 2011 and 2012.
- (3) Determine what can be done to ensure DRT management overcomes long term barriers that hinder tax processing.

Scope Limitation

Based on our interviews with DRT senior management, GRT forms have not been completely processed for CY 2011 and 2012. While information for CY 2009 and 2010 was provided in March 2013 and CY 2006 – 2008 information was provided in April 2013, we did not test the accuracy, completeness, and reliability of this data. See Appendix 5 for details. The lack of information presented a scope limitation for our audit of GRT exemptions for the five year period 2006 through 2010. Accordingly, we did not test tax information pertaining to GRT tax exemptions.

Audit Methodology

Our audit methodology included a review of laws, policies, procedures, prior audit findings, hotline tips, and other information pertinent to DRT's business privilege tax exemptions. We also performed the following:

- Interviewed key officials from the DRT, DOA, and TOG.
- Performed walkthroughs and physical observations to gain an understanding of the business privilege tax and exemptions processes at DRT.
- Analyzed procurement-related documents related to the content manager, OCR programming and technical services.

We conducted this audit in accordance with the standards for performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. These standards require that we plan our audit objectives and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.

Appendix 2:
Prior Audit Coverage

DOI-OIG Guam's Tax Collection Activities (2008)

In November 2008, the U.S. Department of Interior (DOI) Office of Inspector General issued an audit report on Guam's Tax Collection Activities. This report identified the poor conditions at DRT for the past 20 years which include the agency's reliance on manual processes and outdated equipment as well as an incomplete database that reduces the effectiveness of clearing business licenses and processing tax returns. In response to the general findings and recommendations of the report, the Governor of Guam stated that he believes DOI's concerns will be resolved through the implementation of a computer scanner that is capable of reading tax return information resulting in efficient processing of returns for audit and tax collection.

Appendix 3: Summary of Gross Receipts Tax Exemption Code Listing

DEPARTMENT OF REVENUE AND TAXATION
GOVERNMENT OF GUAM
EXEMPTION CODE LISTING

Code	Exemption Reason
E01	AIR COMMERCE EXEMPTION
E02	BOS CONTRACTING SERVICES
E03	BR20 RENTAL
E04	BR20 USE
E05	26203(21) LFT SALE VESSEL-COMMRCL FISHNG
E06	26404(A) LFT TRFR VESSEL-COMMRCL FISHING
E07	CONTRACTOR LICENSE
E08	WHOLESALERS TO LICENSE CONTRACTOR
E09	RETAIL TO LICENSE CONTRACTOR
E10	DAVE SANTOS AMENDMENT
E11	TOBACCO EXPORT
E12	GEDA CERTIFICATE
E13	RETAIL SALES TO GOVERNMENT OF GUAM
E14	LFT TRF TO VESSELS IN COMMERCIAL FISHING
E15	LFT TRF TO U.S. GOVERNMENT OR ANY AGENCY
E16	LFT TRF FOR AVIATION/USED IN AIRCRAFT
E17	LFT TRF BY A DISTRIBUTOR TO ANOTHER DIST
E18	LFT TRF TO GOVGUAM OR INSTRUMENTALITIES
E19	OFF ISLAND SALES
E20	26203K(31)(I) 50% OF LOCAL PRODUCE
E21	P.L. 26-149 EXEMPTION ON SUBCONT AMOUNTS

Code	Exemption Reason
E22	AGRICULTURAL PRODUCERS AND FISHERIES
E23	USE TAX EXEMPTION OR DEDUCTION
E24	WHOLESALE EXEMPTION
E25	EXEMPTION FOR INSURANCE PREMIUM
E26	BOS CONTRACTOR EXEMPTION
E27	PEALS BOARD
E28	MANUFACTURER EXEMPTIONS
E29	SUBSECTION 26202 I
E30	TOUR AGENCIES
E31	HOME INDUSTRY EXEMPTION OR HAND MANU.
E32	ALCOHOLIC BEV TO WHICH EXCISE TAX N/A
E33	RATE INCREASE FROM 4% TO 6%
E34	26203(K)(34)
E35	VISIBLE GRT
E36	GRT ROLLBACK FROM 6% TO 4%
E37	DECREASE OF EXEMPTION TO \$40,000.00
E38	HOSPITALS, INFIRMARIES AND SANITARIUM
E39	HOTEL OCCUPANCY
E40	OTHERS (GOVGUAM/FEDGOV)
E41	WASTEWATER MANAGEMENT
E42	PUBLIC LAW 30-230
E43	PUBLIC LAW 31-127

GRTEP1 (DEC2011)

Business Privilege Tax Exemptions 11 GCA §26203

The following business privilege tax exemptions are outlined in 11 GCA §26117:

(1)	The government of Guam, the government of the United States, the government of any foreign sovereignty, or any agency or instrumentality of any of the foregoing governments in regard to any activity or function engaged in.
(2)	Fraternal benefit societies, orders or associations, operating under the lodge system, or for the exclusive benefit of the members of the fraternity itself which provide for the payment of death, sick, accident or other benefits to the members of such fraternity and their dependents.
(3)	Corporations, associations or societies organized and operated exclusively for religious, charitable, scientific or educational purposes, or the preservation of the culture historically indigenous to Guam.
(4)	Business leagues, chambers of commerce, boards of trade, civic leagues, public schools, and organizations operated exclusively for the benefit of the community and for the promotion of social welfare, provided that no profit accrues to the benefit of the private stockholder or individual.
(5)	Hospitals, infirmaries and sanitariums.
(6)	Totally blind, with respect to the first Three Thousand Dollars (\$3,000.00) of gross income for each tax year.
(7)	Agricultural producers and fisheries.
(8)	Manufacturers, producers or importers, who shall have paid the taxes levied by Articles 3 or 6 of this Chapter on the manufacture, production or importation of alcoholic beverages, and tobacco; provided that any such taxpayer claiming exemption under this Section may claim it only to the extent of the gross proceeds of sales accruing to him from the sale to a wholesaler or retailer of the product taxes under such other sections; provided further, that a person claiming exemption under this Section shall keep accounts of such sales separately and support them by sales receipts for each separate transaction which is taxable under Articles 3 or 6 of this Chapter.
(9)	Any person doing business as home industry and holding a business license issued pursuant to § 16114 of the Government Code.
(10)	The exemption of § 26203(b), (c), (d) and (e), shall apply only to the gross income of any person included in any such subsection received: <ul style="list-style-type: none"> a. from the regular activities of such person, or b. from a lottery authorized under 9 GCA, Chapter 64, or c. from a carnival, fiesta, dance, athletic performance, or other similar entertainment, sponsored by such person, the profits of which are to be used exclusively for, or in furtherance of, the regular activities of such person, and shall not accrue in whole or in part to the benefit of any private stockholder or individual. Such exemptions shall be allowed only upon application to the Tax Commissioner in accordance with § 26117. The within Subsection (j) shall not be construed to exempt from the taxes levied by this Article any person having a concession or contract from an exempt person for the furnishing or sale of any tangible property, or the furnishing of any service, from which gross income accrues to such person.

Business Privilege Tax Exemptions 11 GCA § 26203

(11)	The provisions of this Article and the taxes levied hereunder, shall not apply to the following gross income or gross proceeds of sale: Amounts received under life insurance policies and contracts paid by reason of the death of the insured.
(12)	Amounts received (other than amounts paid by reasons of death of the insured) under life insurance, endowment or annuity, or upon surrender of the contract.
(13)	Amounts received by any persons under any accident insurance or health insurance policy or contract, or under worker’s compensation acts or employer’s liability acts, as compensation for personal injuries, death or sickness, including also the amount of any damages or other compensation received, whether as a result of action or by private agreement between the parties on account of such personal injuries, death or sickness.
(14)	The value of all property of every kind and sort acquired by any person by gift, bequest or devise, and the value of all property acquired by any person by descent or inheritance.
(15)	Amounts received by any person as compensatory damages for any tort injury to him, or to his character or reputation, or received by any person as compensatory damages for any tort injury to or destruction of property, whether as the result of action or by private agreement between the parties; provided, however, that amounts received by any person as punitive damages for tort injury or breach of contract injury shall be included in gross income.
(16)	Amounts received as salaries or wages for services, rendered by an employee to an employer.
(17)	Amounts received as alimony and other similar payments and settlements.
(18)	Amounts received by a distributor from the sale of liquid fuel when the tax levied by Article 4 of this Chapter has been paid thereon by the distributor. A distributor for purposes of this Section excludes all retailing activities of any business entity. This exemption shall not apply to the sale by a retailer or a retailing subdivision of a distributor of any liquid fuel on which a tax is levied under Article 4 of this Chapter.
(19)	The first Forty Thousand Dollars (\$40,000) earned or received per taxable year by any person as rental income from real property whose gross annual rental income from real property is less than Fifty Thousand Dollars (\$50,000) during the most recent tax year. The exemption shall apply annually, commencing at the first day of the month of the new tax year, based on the gross annual rental income of a person during the most recent year, and shall end on the last day of the last month of the same tax year.
(20)	All of the gross proceeds received by contractors for the construction of residential buildings developed, owned, and operated by non-profit corporations or associations, which construction is pursuant to a program approved by the Secretary of Housing and Urban Development pursuant to § 221 (d)(3) of the Housing Act, as amended.
(21)	The amounts collected by persons required to collect taxes imposed under Chapter 30.
(22)	All the gross proceeds received by those persons selling goods, arts or crafts in the Guam and Micronesian Cultural Village established by 12 GCA § 9302 of the Government Code of Guam for a period of ten (10) years commencing on the date that any business privilege tax would otherwise be required to be paid to the government of Guam.

Business Privilege Tax Exemptions 11 GCA § 26203

(23)	Amounts received from the sales of liquid fuel to the United States of America, to the government of Guam or for commercial aviation purposes.
(24)	Amounts received from the sale of residual fuel for marine purposes. As used in this Subsection, residual fuel means that liquid which is the heaviest grade petroleum product used in marine oil-burning boilers. It consists of the residue of certain crude oils after the lighter fractions such as benzine, kerosene, gas-oils and lubricating oils have been removed by distillation.
(25)	Amounts received from the sales of personal property to the government of Guam.
(26)	Amounts received as contributions or received from fund raising activities by political candidates, committees, parties, corporations, associations, organizations or funds and which are expended for political campaign purposes and reported to the Election Commission pursuant to the laws of Guam.
(27)	<ul style="list-style-type: none"> • Amounts received from the sale or resale of products processed or manufactured at the Guam Rehabilitation Workshop Center by registered clients of the Center, or certified as disabled worker products, and products processed and manufactured independently by registered clients of the Center where fifty percent (50%) of the value of the product is added by the client. • The Director of the Department of Vocational Rehabilitation shall certify that such products were processed or manufactured at the Guam Rehabilitation Workshop Center by registered clients of the Center, or certified as disabled worker products, or else processed and manufactured independently by registered clients of the Center where fifty percent (50%) of the value of the product is added by the client.
(28)	Export Trading companies as defined by § 26101(d) of this Title and goods and services exported by them.
(29)	All of the foreign trade income of a FSC, as defined in 12 GCA § 60101 (b).
(30)	All of the investment income of a FSC as defined in 12 GCA § 60101(f) and carrying charges as defined in 12 GCA § 60101(g).
(31)	Amounts received from the sale of liquid fuel to vessels engaged in commercial fishing.
(32)	<p>Amounts received from engaging or continuing in business as a wholesaler, except that if such persons are, in addition, engaging or continuing in business as a retailer, the provisions of this Subchapter and the taxes levied thereunder shall apply to that part of the businesses of such persons that involve retail.</p> <p style="padding-left: 40px;">a. Amounts received from engaging or continuing in business as a wholesaler shall include the sales of tangible personal property to contractors.</p>
(33)	The amount of winnings, payouts or malfunction refunds reported pursuant to § 26110(g) of this Title.
(34)	Amounts paid by the contractor out of the contract gross proceeds to individual clients or to the rehabilitation center or workshop pursuant to the provisions of 17 GCA § 41106.

Business Privilege Tax Exemptions 11 GCA § 26203

(35)	Amounts received by a participant in the Guam Micronesia Island Fair from sales of goods or services at the Fair.
(36)	Amounts received from the sale of betelnut (pugua), pepper tree leaf (pupulu), and lime (afok) for use with pugua.
(37)	All of the gross income of a Foreign Sales Corporation (FSC) from sources without Guam, as determined under 12 GCA § 60102(c).
(38)	<p>The first Forty Thousand Dollars (\$40,000) earned or received per taxable year by any person as income from retailing whose gross annual retail income is less than Fifty Thousand Dollars (\$50,000) during the most recent tax year. The exemption shall apply annually, commencing at the first day of the month of the new tax year, subject to the gross annual retail income of a person during the most recent year, and shall end on the last day of the last month of the same tax year.</p> <ul style="list-style-type: none"> a. Fifty percent (50%) of the amounts received from the retail sale of local produce, as defined in this Subdivision. b. Local produce as used in this Subdivision shall mean the following: locally produced crops, including, but not limited to, plants and plant products collectively grown or cared for and used for food and other useful purposes; locally raised livestock, including but not limited to, cattle, carabao, swine, sheep, goats, equine and poultry raised for food or other purposes; and locally caught fish to include any aquatic animal life, including, but not limited to, oysters, clams, mollusks, mussels, crustaceans and other shellfish
(39)	The first Forty Thousand Dollars (\$40,000) earned or received per taxable year by any person as income service, which includes, but is not limited to, legal; medical; dental; accounting; consulting and engineering fees; commissions on real estate sales or property management; fees charged by barbershops, beauty parlors, shoe shining parlors, dry cleaning and laundry establishments; and automobile, appliance, electronics and computer repair shops, whose gross annual service income is less than Fifty Thousand Dollars (\$50,000.00) during the most recent tax year. This exemption shall apply annually, commencing at the first day of the month of the new tax year, subject to the gross annual service income of the person during the most recent tax year, and shall end on the last day of the month of the same tax year.
(40)	The first Forty Thousand Dollars (\$40,000) earned or received per taxable year by person as rental income whose gross annual rental income is less than Fifty Thousand Dollars (\$50,000.00) during the most recent tax year. This exemption shall apply annually, commencing at the first day of the month of the new tax year, based on the gross annual rental income of a person during the most recent year, and shall end on the last day of the last month of the same tax year.
(41)	The first Forty Thousand Dollars (\$40,000.00) earned or received per taxable year by a person, partnership or corporation as commission income whose gross annual commission income is less than Fifty Thousand Dollars (\$50,000.00) during the most recent tax year. This exemption shall apply annually, commencing at the first day of the month of the new tax year, subject to the gross annual income of the person during the most recent tax year, and shall end on the last day of the month of the same tax year.

Business Privilege Tax Exemptions 11 GCA § 26203

(42)	The first Forty Thousand Dollars (\$40,000) earned or received per taxable year by a licensed insurance company as insurance premium income whose gross annual insurance premium income is less than Fifty Thousand Dollars (\$50,000.00) during the most recent tax year. This exemption shall apply annually, commencing at the first day of the month of the new tax year, subject to the gross annual income of the person during the most recent tax year, and shall end on the last day of the month of the same tax year.
(43)	Any amounts received by businesses participating in the Performance of BOS Activities, defined in 12 GCA § 58128.7, as a BOS Contractor, or Subcontractors of the BOS Contractor, provided that such business is a ‘Guam-based Contractor or Guam-based Subcontractor’ for purposes of 12 GCA § 58128.7.
(44)	Any amounts received by a private water contractor having a joint operating agreement with the Guam Waterworks Authority to operate a community-wide water production and distribution system, or a wastewater disposal system, or both such systems.
(45)	Amounts received from the sale of telecommunication services including telephony, internet, data transmission line, wired/wireless/cable television and satellite service, two-way radios, paging and wired and wireless data communications and related services to customers outside of Guam.
(46)	All the gross proceeds received by child care facilities and group care homes which are duly licensed pursuant to Article 4 – Child Welfare Services Act, of Chapter 2, Division 1 of Title 10, Guam Code Annotated, for a period of five (5) years commencing on the date that any business privilege tax would otherwise be required to be paid to the government of Guam.
(47)	The amounts collected on behalf of the government as tipping fees imposed under Chapter 51 of Title 10 of the Guam Code Annotated.

Appendix 5: Business Privilege Tax Revenues³

LOCAL TAX REVENUES for Calendar Year 2009

<u>Line No.</u>	<u>Activity</u>	<u>Gross Receipts</u>	<u>Exemption</u>	<u>Taxable</u>	<u>Tax Due</u>	<u>Count</u>
<u>A. Gross Receipts Taxes:</u>						
1	Wholesaling	837,683,789	779,325,912	58,357,878	2,334,315	1,423
2	Retailing	2,246,688,211	300,585,503	1,944,857,945	77,794,318	3,523
3	Service	1,326,467,739	107,790,803	1,197,500,743	47,900,029	6,020
4	Rental - Real Property	277,450,704	53,963,539	223,479,515	8,939,180	5,483
5	Rental - Others	85,757,316	5,136,749	80,580,205	3,223,208	1,413
6	Profession	100,361,462	7,449,193	92,912,269	3,716,491	555
7	Commission	96,298,501	4,686,120	91,612,431	3,664,497	1,383
8	Insurance Premium	305,563,937	39,204,639	266,367,662	10,654,706	427
9	Contracting (Local)	803,101,873	213,580,376	590,446,094	23,617,843	982
10	Contracting (US)	40,446,395	6,398,443	34,187,952	1,367,518	334
11	Interest	10,197,693	218,155	9,979,323	399,173	429
12	Amusement	17,730,981	0	17,730,981	709,239	243
13	Others	102,771,648	39,719,925	62,931,817	2,517,273	947
	Sub-Total	6,250,520,249	1,558,059,357	4,670,944,814	186,837,789	23,162
<u>B. Use Tax:</u>						
15	Importation	6,474,424	1,742,546	4,732,201	189,288	585
16	Local Purchases	138,103	-	138,103	5,524	389
17	Inventory	333,223	-	333,223	13,329	486
	Sub-Total	6,945,749	1,742,546	5,203,527	208,141	1,460
<u>C. Hotel Occupancy Tax</u>						
19	Hotel/Motel	176,948,546	352,199	176,596,030	19,425,563	629
20	Other (Lodging)	1,828,053	800	1,827,252	182,725	787
	Sub-Total	178,776,600	352,999	178,423,282	19,608,288	1,416
<u>D. Liquid Fuel Tax / Automotive Surcharge</u>						
<u>Line No.</u>	<u>Activity</u>	<u>Gross Quantity</u>	<u>Exemption</u>	<u>Net Quantity</u>	<u>Tax Due</u>	<u>Count</u>
22	Diesel Fuel	112,105,167	103,144,351	8,960,816	896,082	79
23	Diesel Fuel - Surcharge	31,821,742	22,866,811	8,954,931	358,197	79
24	Gasoline	58,970,806	16,223,076	42,747,730	4,702,250	77
25	Gasoline - Surcharge	58,968,589	16,223,076	42,745,513	1,709,821	77
26	Other - Liquid Fuel	41	-	41	5	1
27	Other - Liquid Fuel Surcharge					
28	Commercial Aviation	41,022,127	5,761,342	35,260,785	1,410,431	75
	Sub-Total	302,888,473	164,218,656	138,669,817	9,076,786	232
<u>E. Tobacco Tax</u>						
30	Cigarettes	152,386,316	6,120,502	146,265,812	7,313,291	93
31	Cigars - Mini	600	-	600	120	87
32	Cigars - Standard	754	-	754	166	88
33	Cigars - Large	300	-	300	75	88
34	Cigars - Others	-	-	-	-	88
35	Cigars - Prior to 3/24/2000	-	-	-	-	88
36	Others - Other Tobacco Product:	139,280	8,463	130,823	45,788	89
	Sub-Total	152,527,251	6,128,965	146,398,289	7,359,440	621
<u>F. Alcohol Tax</u>						
38	Distilled Spirits	59,637	6,459	43,838	789,092	92
39	Vinous Beverages	128,513	42,128	89,574	443,391	92
40	Malted Fermented	28,903,649	1,663,358	27,240,291	1,906,821	90
	Sub-Total	29,091,799	1,711,945	27,373,703	3,139,304	274
					<u>226,229,748</u>	

³ Use tax and hotel occupancy tax are not listed under the business privilege tax law, but are included in GRT forms.

Appendix 5: Business Privilege Tax Revenues⁴

LOCAL TAX REVENUES for Calendar Year 2010

Line No.	Activity	Gross Receipts	Exemption	Taxable	Tax Due	Count
A. Gross Receipts Taxes:						
1	Wholesaling	935,338,096	874,997,779	60,340,320	2,413,613	1,210
2	Retailing	2,569,976,653	459,882,318	2,110,094,334	84,403,773	3,323
3	Service	1,327,205,499	79,499,035	1,247,706,468	49,908,258	5,746
4	Rental - Real Property	309,918,567	52,165,417	257,753,145	10,310,125	5,305
5	Rental - Others	109,659,636	4,598,032	105,064,089	4,202,563	1,251
6	Profession	115,162,155	5,081,928	110,080,236	4,403,209	501
7	Commission	98,306,253	5,111,070	93,195,198	3,727,808	1,241
8	Insurance Premium	366,937,351	68,513,325	298,424,026	11,936,961	377
9	Contracting (Local)	889,226,488	246,915,874	643,662,439	25,746,497	942
10	Contracting (US)	74,978,993	9,932,386	65,104,430	2,604,177	273
11	Interest	7,664,028	192,703	7,471,325	298,853	341
12	Amusement	19,339,545	5	19,339,545	773,582	191
13	Others	102,133,845	45,208,375	56,925,470	2,277,019	729
	Sub-Total	6,925,847,109	1,852,098,245	5,075,161,026	203,006,438	21,430
B. Use Tax:						
15	Importation	4,546,668	289,665	4,257,084	170,283	424
16	Local Purchases	4,609,284	63	4,609,231	184,369	264
17	Inventory	318,519	26	318,515	12,741	364
	Sub-Total	9,474,472	289,754	9,184,830	367,393	1,052
C. Hotel Occupancy Tax						
19	Hotel/Motel	205,231,018	924,706	202,768,566	22,304,542	464
20	Other (Lodging)	77,495	7	77,495	7,750	611
	Sub-Total	205,308,513	924,713	202,846,061	22,312,292	1,075
D. Liquid Fuel Tax / Automotive Surcharge						
Line No.	Activity	Gross Quantity	Exemption	Net Quantity	Tax Due	Count
22	Diesel Fuel	151,930,086	142,977,124	8,952,961	895,296	85
23	Diesel Fuel - Surcharge	33,635,662	24,690,839	8,944,822	357,793	84
24	Gasoline	62,834,577	17,783,670	45,050,907	4,955,600	82
25	Gasoline - Surcharge	62,832,601	17,783,670	54,678,931	2,187,157	81
26	Other - Liquid Fuel	16,509	16,499	10	1	84
27	Other - Liquid Fuel Surcharge	16,499	16,499	-	-	84
28	Commercial Aviation	55,245,670	10,307,652	44,938,017	1,797,521	80
	Sub-Total	366,511,604	213,575,955	162,565,648	10,193,368	580
E. Tobacco Tax						
30	Cigarettes	133,371,407	19,811,822	113,559,585	6,452,624	93
31	Cigars - Mini	1,895	-	1,895	630	85
32	Cigars - Standard	1,753	-	1,753	727	85
33	Cigars - Large	596	-	596	149	85
34	Cigars - Others	-	-	-	-	85
35	Cigars - Prior to 3/24/2000	-	-	-	-	84
36	Others - Other Tobacco Products	47,179	2,262	44,917	393,458	86
	Sub-Total	133,422,830	19,814,084	113,608,746	6,847,588	603
F. Alcohol Tax						
38	Distilled Spirits	50,318	14,987	35,331	635,966	93
39	Vinous Beverages	83,599	27,133	56,464	279,499	93
40	Malted Fermented	34,164,790	4,551,810	29,581,394	2,070,698	94
	Sub-Total	34,298,707	4,593,931	29,673,190	2,986,162	280
					245,713,242	

⁴ Use tax and hotel occupancy tax are not listed under the business privilege tax law, but are included in GRT forms.



**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

Appendix 6:
DOI OIG Audit on Guam's Tax Collection Activities

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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)



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April 30, 2013

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RE: Management Response – Audit Report on the Department of Revenue & Taxation's Gross Receipts Tax (GRT) Exemptions

Buenas Yan Saludas:

The Department of Revenue & Taxation (DRT) hereby submits management responses regarding the findings and conclusions as detailed in your audit report. DRT does not disagree with the audit findings; however, we would like to point out the following:

- 1) The inability for your office to test reliable data was already an issue that DRT has been trying to resolve since the discontinuance of the point of sale system previously maintained by a private vendor.
- 2) DRT currently is trying to resolve data integrity by updating and correctly posting to taxpayer accounts, all payments, credits and assessments. By the time the draft audit was discussed, DRT already made significant updates to GRT but was not included in the audit report.
- 3) DRT has never discontinued electronic filing for GRT, however, taxpayers who e-file are no longer able to make online payments after filing an online return since no interface is currently available.
- 4) DRT is presently looking at implementing a Transaction Processing System (TPS) that should allow for the interfacing of all tax assessments and payments to replace the POS system that integrated DRT and DOA.
- 5) The IBML OCR /ICR Scanner can be invaluable to the department. Although this technology will reduce processing time and will be more efficient; it can only be successful if the DRT staff and taxpayers perform the necessary due diligence as required.
- 6) DRT would like to implement all recommendations in this report but also requests that monies be appropriated accordingly to insure success for any plans already in place or determined by task force.

Should you have any concerns on this matter, feel free to contact me at 635-1815.

Senseramente,


JOHN P. CAMACHO
Director



Department of Revenue and Taxation Gross Receipts Tax Exemptions
Report No. 13-01, May 2013

ACKNOWLEDGEMENTS

Key contributions to this report were made by:
Franklin Cooper-Nurse, Audit Supervisor
Rachel Field, Auditor in Charge
Doris Flores Brooks, CPA, CGFM, Public Auditor

MISSION STATEMENT

**To improve the public trust,
we audit, assess, analyze, and make recommendations
for accountability, transparency,
effectiveness, efficiency, and economy of the government of Guam
independently, impartially, and with integrity.**

VISION

Guam is the model for good governance in the Pacific.

CORE VALUES

Integrity	Independence	Impartiality
Accountability	Transparency	

REPORTING FRAUD, WASTE, AND ABUSE

- Call our HOTLINE at 47AUDIT (472-8348)
- Visit our website at www.guamopa.org
- Call our office at 475-0390
- Fax our office at 472-7951
- Or visit us at Suite 401, DNA Building in Hagåtña;

All information will be held in strict confidence.