Managerial Implications of the 2004 American Jobs Creation Act on Tax Incentives in U.S. Possessions

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There are currently five United States possessions that have their own independent tax authorities and offer tax planning opportunities. The United States Internal Revenue Code grants special tax benefits and advantages for these possessions. To attract investments, the possessions invariably offer much lower income tax rates. Thus, these possessions have become known as tax havens since a United States citizen or corporation who derives income in these possessions could save a great deal of income tax by establishing residency in these possessions. However, recently the U.S. Congress enacted the 2004 American Jobs Creation Act (AJCA) along with subsequent regulations which made sweeping changes to the determination of bona fide residency in these territories, including making the facts and circumstances test for residency irrelevant for tax years after 2004. Furthermore, the Act clarifies the rules surrounding the taxation of income. Since the U.S. possessions represent highly desirable jurisdictions from which to operate, these new rules represent significant challenges to international operators and now makes it difficult for U.S. source income or income effectively connected to a U.S. trade or business to be legitimately routed through a U.S. possession. This paper discusses some of the tax benefits of operating in the five U.S. possessions and delineates the new requirements imposed by the 2004 AJCA and their impact on operations and tax planning strategies in these possessions.

INTRODUCTION

The United States Internal Revenue Code grants special tax benefits and advantages for corporations as well as persons earning income in several of its U.S. possessions. It treats the taxes paid to the possessions by their residents as taxes paid to the United States, provided that the residents meet the residency test and income source test as well as other conditions. However, in response to concerns that the benefits afforded to citizens who operate in tax havens may be subject to abuse, the U.S. Congress enacted new regulations which imposed new rigorous tests related to residency and income source requirements aimed at deterring any possible abuse.

THE UNITED STATES POSSESSIONS

There are currently five United States possessions; namely Puerto Rico, the United States Virgin Islands, Guam, American Samoa and The Northern Mariana Islands that have their own independent tax authorities and offer tax planning opportunities. To attract investments, the possessions invariably offer much lower income tax rates. Thus, these possessions have become known as tax havens since a United States citizen who derives income in these possessions could save a great deal of income tax by establishing residency in these possessions. However, on October 22, 2004[i], the U.S. Congress enacted the American Jobs Creation Act (AJCA) of 2004 which imposed new requirements for tax incentives in U.S. possessions. These requirements curtailed many of the benefits afforded to citizens.

The AJCA imposed new requirements for the residents of U.S. possessions to qualify for special tax benefits. To this end, on February 27, 2006 the Internal Revenue Service (IRS) of the U.S. Treasury Department issued detailed regulations (Regulation §1.937-1(c)) for these new requirements[ii] which were later amended on November 14, 2006.[iii]

The new regulations issued by the Treasury and the IRS made sweeping changes to the determination of bona fide residency in the possessions, including making the facts and circumstances test for residency irrelevant for tax years after 2004. Furthermore, they clarify the rules surrounding the taxation of income. Since the U.S. possessions represent highly desirable jurisdictions from which to operate, these new rules present significant challenges to international operators and will make it difficult for U.S. source income or income effectively connected to a U.S. trade or business to be legitimately routed through a U.S. possession.

This paper discusses some of the tax benefits of operating in the five U.S. possessions and delineates the new requirements imposed by the 2004 AJCA and their impact on operations and tax planning strategies in these possessions.

THE USE OF TAX COMPETITION STRATEGY

Jeffers & Kleinfled (2007) note the importance of tax competition is a common strategy used by governments that offers differential tax treatment for a targeted economic development program that is aimed at attracting business firms, investment flows and needed skills in order to create additional jobs, spur investment and create economic growth.[iv] Tax competition can be aimed at a special country, a state in a union, a particular territory, or a certain group of consumers or sellers. Jeffers, Yang, Kleinfled & Linder (2006)[v] provide several examples of the use of tax competition as a strategy that is used throughout the world today. They show that it is a common practice for many developing countries to offer tax incentives to foreign investors for the purposes of luring their investment capital. They note that in 1991, China passed the ***"Foreign Investment Enterprise and Foreign Enterprise Income Tax Law"***[vi] that offered to reduce the foreign enterprise income tax rate from 30% to 15% if an enterprise engaged in production-oriented or advanced-technology activities in a tax-incentive zone. China further offered a tax holiday. Hence, the enterprise is completely exempt from tax liability for the first two years and is entitled to a 50% reduction for the next three years if the investment contract is for a minimum of ten years. This tax strategy has resulted in a tremendous economic boom in China. Currently, most of the foreign investors who are taking advantage of this incentive in China come from the United States and Europe and is an example of tax competition between China and the western industrialized countries.[vii]

Jeffers, Yang, Kleinfeld & Linder (2006) further list many U.S. multinational corporations that have taken advantage of the tax shelter opportunities available in various countries. Such companies include Pfizer, Exxon Mobil, General Electric, I.B.M., Merck, Johnson & Johnson, Hewlett Packard, Proctor & Gamble, Eli Lilly, PepsiCo, Nabors Offshore, Wyeth, Schering Plough, AlliedSignal, Tyco International, and a host of other well-known companies. Many tax-haven countries offer very low income tax rates or no income tax at all to U.S. corporations as tax shelters. These tax-haven countries include Andorra, The Channel Islands, The Cook Islands, Gibraltar, Hong Kong, The Republic of Ireland, Liberia, Liechtenstein, Mauritius, Nauru, The Netherlands, Samoa, Switzerland and Vanuatu. It also includes many Caribbean countries such as Anguilla, Aruba, The Bahamas, Barbados, Bermuda, The British Virgin Islands, The Cayman Islands, The Netherlands Antilles, Nevis, Panama as well as the U.S. Possessions of Puerto Rico, the U.S. Virgin Islands, American Samoa and the Northern Mariana Islands.

If a U.S. corporation owns a foreign subsidiary corporation, the foreign earnings are not subject to United States income tax until cash dividends are repatriated back to the United States.[viii] Since one of the main objectives of the IRS is to maximize the collection of income taxes, it wishes to induce U.S. corporations to repatriate their foreign profits back to the United States as cash dividends and pay U.S. income taxes. To achieve this objective, the AJCA offers a one-time-only tax break. Thus, if the U.S. parent company repatriates the controlled foreign corporation's non-Subpart F income back to the United States, the cash dividend is given a temporary and elective 85% dividend received deduction. This reduces the tax rate from a maximum of 35% to only 5.25% (35% x 15%). Nonetheless, S corporations do not qualify for this deduction.[ix] Jeffers, Yang, Kleinfled & Linder describe this as an example of tax competition between the United States and the tax haven countries.

The use of the tax competition strategy is also evident within all fifty states of the United States which are in competition with each other. In order to attract consumers to purchase merchandise from their states, the states of Alaska, Oregon, Montana, New Hampshire and Delaware do not charge sales taxes. This has resulted in these states experiencing flourishing cross-border sales.

It is apparent that tax competition exists everywhere, domestically as well as internationally. The five U.S. possessions are also engaged in tax competition with the United States mainland. The 2004 American Jobs Creation Act enacted various new requirements that make it more difficult for corporations and individuals to qualify for these tax incentives.

UNITED STATES POSSESSIONS

The U.S. possessions can be categorized as 1) **incorporated territories,** 2) **unincorporated territories,** 3) **unorganized and unincorporated territories and** 4) **commonwealths**. Under the Tax Reform Act of 1986, five of the U.S. possessions were no longer required to follow the United States Internal Revenue Code. Instead, they were permitted to enact their own income tax laws. In response to this freedom, all five possessions launched "tax competition" with the United States.

Tax Incentives in Puerto Rico

Puerto Rico is a commonwealth which has a local constitution and the ability to govern its own internal affairs to a great extent. The tax incentive programs for Puerto Rico are promoted by The Puerto Rico Industrial Development Company (PRIDCO). Throughout the island of Puerto Rico, there are three foreign trade zones and sixteen sub-zones which involve manufacturing, warehousing and distribution, trans-shipment services of a wide variety of unfinished and/or finished goods. While in this economic zone, U.S. custom duties and excise tax payments on products shipped to the United States are deferred and products exported to foreign markets are not charged.

Operations that are deemed to have novel or innovative technology not utilized in Puerto Rico before January 1, 2000 and which are deemed to have a significant impact on the economy and development of Puerto Rico may qualify for income tax rates between zero and 2%.

Companies operating in areas identified as "eligible business" by the Capital Tax Incentives Act of 1998 can qualify for a low corporate tax rate with additional tax credits, exemptions and special deductions. Depending on the location, companies may benefit from income and property tax reductions for periods ranging from 10 to 25 years. Eligible businesses include manufacturing, export services, scientific research and development, products produced from recycled materials collected in Puerto Rico, production of energy from local renewable services and hydroponics cultivation and aquaculture. Thus, eligible businesses which are starting up or expanding their operations in Puerto Rico may benefit from additional tax and other incentives. The incentives are as follows:

1. Income tax benefit at a 7% maximum rate with some companies qualifying for an even lower rate.
2. No tax on dividend distributions.
3. A 200% deduction for R&D expenses and job training costs. Additionally, there is an immediate expense reduction for investments in office and factory buildings and for equipment and machinery not previously used in Puerto Rico.
4. Tax incentives for agriculture and tourism available from the Puerto Rico Department of agriculture and the tourism industry.
5. A 100% exemption from excise taxes on raw materials, municipal license taxes, real and personal taxes (during initial construction and the first year of operation), taxes on passive income derived from eligible Puerto Rican investments and any property tax on intangible assets such as patents and production licenses.

Tax Incentives in the U.S. Virgin Islands

The U.S. Virgin Islands (USVI) is an unincorporated territory and is controlled by the executive branch of the U.S. Government. Under the Naval Appropriations Act of 1922, the income tax laws of the United States, as amended were held to be "likewise in force in the Virgin Islands", except that the proceeds of the income taxes were paid into the Treasury of the Virgin Islands. The Courts interpreted this provision to establish what is known as the "mirror system" of taxation in the Virgin Islands. To this end, for income tax purposes, the Internal Revenue Code applied in the USVI but with the words "the U.S. Virgin Islands" substituted for 'the United States' wherever the latter applied.

During the consideration of the Tax Reform Act of 1986, the Virgin Islands took a proactive stand far more than the other U.S. possessions. Consequently, the provisions relating to the U.S. Virgin Islands are substantially different from those that are applied to the other territories. To assist in the coordination of its tax systems with the U.S., the USVI government wanted the "mirror system" to continue as the territory's tax system for corporate purposes but not necessarily for individual purposes. As a result, the Tax Reform Act of 1986 contained three major changes relating to the Virgin Islands as follows:

1. The loophole closing the provisions regarding the “inhabitant corporation”;
2. A new Code section substantially eliminating the adverse effects of the mirror system on individuals while retaining the mirror system generally; and
3. A provision reiterating the ability of the U.S. Virgin Islands exempt company.[x]

Tax Incentives in Guam

Guam is also an unincorporated territory located in the Asian-Pacific region. The Government of Guam, through the Guam Economic Development Authority is authorized by law to allow rebates to qualified investors. Qualifying Certificates for tax incentives are granted on the basis of investment commitment as well as the potential for creating new employment and expanding the base of the island’s industry. These incentives are aimed primarily at manufacturers, insurance companies, commercial fishing companies, corporate headquarters, specialized medical facilities, high technology, agriculture and development firms. Qualified firms may be granted up to 100% income tax rebate for a maximum of 20 years; up to 100% abatement on real property up to a maximum of 10 years; up to 75% rebate on dividends up to a maximum of 5 years; and an abatement of the gross receipts tax on petroleum and alcoholic beverages made in Guam for a maximum of 10 years. Guam based trusts can also enjoy similar benefits.

These incentives have proven to be extremely attractive particularly to insurance issuers and Guam-based trusts. If the headquarters of these companies are located in Guam, then re-insurers, commercial insurers or captive insurers may be able to enjoy many benefits such as tax incentives and rebates.[xi] Furthermore, the importance of tax incentives has been highlighted by the Guam Foreign Investment Equity Act which was passed by Congress and signed by President Bush on August 23, 2002. Under the Equity Act, the government of Guam is required to apply to certain Guam-source income of a foreign person, the same reduced income tax rates or exemptions that would apply under an applicable U.S. Income Tax Treaty as if Guam were a part of the United States.

Tax Incentives in American Samoa

American Samoa is an unincorporated U.S. territory located in the South Pacific. The U.S. Constitution does not explicitly extend to all matters in the territory. Hence, the local Samoan Government has the ability to create and administer its own immigration and taxation laws rather than being subject to Immigration and Naturalization Service (INS) or the Internal Revenue Service (IRS) regulations. Furthermore, it also controls the sale of its land to local and foreign businesses and has the right to govern the licensing of offshore businesses in any way it deems appropriate. This privilege affords several businesses the opportunity to derive special tax and licensing concessions generally unavailable in most U.S. states and other nations in the region. The residents of American Samoa are considered U.S. nationals and are effectively eligible for all rights and privileges that U.S. citizens enjoy except the right to vote in Presidential elections. The independent wage rate laws allow America Samoa to set its own minimum wage levels by industry classification and offer a very attractive employment market for talented foreign nationals from the region in conjunction with focused immigration.

Essentially, American Samoa has the same tax structure as the United States. There are no gross receipts, property, export or value added taxes. Moreover, tax exemptions can be granted by the Governor of American Samoa on some or all taxes except for individual income tax for up to 10 years for the establishment or expansion of qualifying industrial or business enterprises under the Industrial Incentives Act. Also, tax exemptions may be extended for additional periods to encourage new types of businesses or for significant expansion of an existing business.

In American Samoa, there are no restrictions on their repatriation of funds, earnings, profits or dividends. Dividends paid by several wholly-owned subsidiaries of U.S. parent companies operating in American Samoa are not taxed. Additionally, approved industries are granted the option for a tax holiday or an investment tax credit on taxable income for the value of capital investment made in the operation. American Samoa has direct access to the United States market, thus avoiding any duty or excise tax. Specifically, products manufactured, produced or assembled in American Samoa are eligible for duty-free entry into the customs territory of the United States provided that 30% of the value of the finished product is added in American Samoa (excluding tuna products). An added benefit is that products manufactured in American Samoa can be labeled "Made in the U.S.A." Additionally, American Samoa is eligible for favorable duty treatment under the generalized table of preferences of Australia, New Zealand, Japan and the United States.

A possession-exclusion is applied to certain income for bona fide residents of American Samoa for an entire tax year. If a taxpayer has a calendar year as his tax year, then he must be a bona fide resident from January 1 through December 31. If a taxpayer qualifies, then the taxpayer can exclude income from sources in American Samoa, Guam or the Commonwealth of the Northern Mariana Islands and income effectively connected with the taxpayer's trade or business in these possessions such as wages, dividends, interest, and gains from sale of securities.

Tax Incentives in the Northern Mariana Islands

The Northern Mariana Islands, located in the Northwestern Pacific Ocean and became a self-governing territory of the United States under its own constitution in 1978. It became a commonwealth of the United States in 1986 and is similar to Puerto Rico. The Commonwealth of the Mariana Islands can control and regulate its own immigration policy in lieu of specific U.S. regulations. This unique advantage allows the Marianas to benefit from an inflow of human capital and resources that have made it possible to establish its successful garment manufacturing industry. The travel industry has also benefited greatly from the Mariana's own immigration control since it allows inbound tourists from the neighboring countries of China and Russia to obtain tourist visas.[xii]

The tax system in the Mariana Islands is based on the U.S. Internal Revenue Code but taxes are significantly lower than in the United States. There are no sales taxes or city, state or county taxes. The present tax system is designed to provide business incentives by giving tax rebates. Thus, taxes on wages are capped at 9% and every person subject to the territorial income tax is entitled to a rebate ranging from 50 to 90%. In the Mariana Islands, a territorial tax of up to 5% is generally paid by businesses on their gross income. This tax is paid on the net equal to that which might have been imposed by the Internal Revenue Code. The amount of gross business revenue tax paid is then credited against the territorial income tax and a portion of the territorial income tax paid is then rebated to the taxpayer.

Under the revised U.S. tariff schedules, articles grown, manufactured or produced in the Mariana Islands may be imported into the United States free of duty if 70% or less of the value of the product is derived from foreign materials. Clothing manufactured in the Marianas is not subject to any of the import quotas or tariffs that apply to garments manufactured in other countries. This provision allows importing garments into the United States a 17.25% cost advantage over comparable products produced worldwide. In addition, there are no quota restrictions. Under the World Trade Organization Agreement on textile and clothing, all textile and garment quotas were scheduled to be phased out between member countries. Nevertheless, tariff protection continues, but is subject to a 2.5% reduction.

THE 2004 AMERICAN JOBS CREATION ACT

The final regulations issued by the IRS of the U. S. Treasury Department and the IRS on February 27, 2006 and as later amended on November 14, 2006 under the American Jobs Creation Act of 2004 issued detailed regulations (Regulation §1.937-1(c)) that impact tax incentives in the U.S. possessions.[xiii] These new regulations focused on various areas concerning the provision of incentives for businesses and individuals involved in international operations as well as the determination of residency status of individuals in the U.S. possessions of Puerto Rico, the United States Virgin Islands, American Samoa, Guam and the Northern Mariana Islands.

Overview of the New Regulations

The new regulations issued by the Treasury and the IRS clarify the rules surrounding the taxation of income. These new laws enact more stringent residency requirements in order for persons involved in international operations to qualify for the 90%, 95% or 100% tax exemptions as well as eligibility for the generous tax rebates.

Bona Fide Residency of A U.S. Possession

The general rule to establish "bona fide residency" is that an individual is a "bona fide resident" of a U.S. possession if that individual meets a presence test, tax home test, and a closer connection test. Under the general rule, an individual who is not present in the possession for at least 183 days may still meet the presence test under one of the three alternatives. These are exclusive tests and are as follows:

a. The individual spends no more than 90 days in the United Stated during the taxable year;
b. The individual spends more days in the possession than in the United States and has no earned income in the United States; or
c. The individual has no permanent connection to the United States.

It may be noted that despite the fact that Congress gave the IRS authority to provide sufficient flexibility and to adopt appropriate to exceptions to the 183 day rule[xiv], the alternatives provided by the regulations are still, in fact, quite rigid. For years prior to 2004, a determination of residency was made solely upon the individual facts and circumstances of the taxpayer, using among other things the section 871 regulations. Thus, an individual who is a bona fide U.S. possession resident on the last day of the tax year, or who filed a joint return for the tax year with an individual who is a bona fide U.S. possession on the last day of the tax year, was required to file a return for that year only with the possession's Bureau if Internal Revenue and pays tax only to the Bureau with respect to his income.[xv]

For the period following the enactment of the 2004 American Jobs Act was enacted and the issuance of the two sets of Regulations, taxpayers had several alternative ways of meeting residency. Starting with the tax year 2005, an individual was required to meet the tax home and closer connection tests, as well as an objective physical presence test. Physical presence can be achieved by meeting one of the following:

1. **183-Day Test**: An individual can satisfy the strict 183-day rule codified in Code section 937, that is, spend at least 183 days a year in a possession including days of travel to and from a possession as long as part of the day of travel is spent in a possession.
2. **No More Than 90 Day Test:** An individual can satisfy the physical presence test by spending no more than 90 days in the United States each year.
3. **More Time in a Possession and Earned Income Not Exceeding $3,000 Test**: An individual can satisfy the physical presence test by spending more days in a possession than in the United States and having earned income in the United States not exceeding $3,000.
4. **No Significant Connection to the United States Test**: An individual can satisfy the physical presence test by having no significant connection to the United States. However, this exception may not encompass any individual who has full-time access to any residence in the United States even if the residence has never been the individual's tax home, such as a vacation home.

For taxable years ending after January 31, 2006, Treasury Regulation §1.937-1(c), as amended on November 14, 2006, provides that a U.S. citizen or resident alien satisfies the physical presence test if he or she meets one of four alternative tests listed above, or a newly added weighted average test which requires a taxpayer by being present in a possession for at least 549 days during a three-year period consisting of the current taxable year and the two immediately preceding taxable years, provided that the individual is also present in the possession for at least 60 days during each taxable year of the three-year period. In other words, this alternative to the physical presence test requires an individual to be present in a possession for a simple non-weighted three-year average of 183 days per year so long as a minimum of 60 days of presence is met in each of those three years.

The positive changes to the regulation to make them workable are limited. One important element not considered by the IRS is medical treatment under the presence test. A temporary stay in the U.S. for certain undocumented medical treatment of the individual, or a parent, spouse or child whom the individual accompanies to the treatment provided it is on a full-time basis will not count as days spent in the U.S. irrespective of where the medical condition arose. Such a temporary stay outside the possession, whether in the U.S., another U.S. possession or a foreign country will count as days of presence in the U.S. possession.

Another positive change occurred in part in recognition of the hurricanes and other disasters of the recent past. Thus, if a person leaves or is unable to return to a relevant possession during a) a two-week period within which an officially declared major disaster in the relevant possession occurs, or b) the period in which a mandatory evacuation order applies, then the individual will not count any day occurring within that period as a day of presence in the U.S., even though the individual has evacuated to or is otherwise present in the U.S.

With regard to the connection test, the IRS seems to prefer to use a "significant" connection test rather than a "permanent" connection test. The IRS believes the new term "significant test" to be more precise and accurate even though they recognize the permanent connection test is "fundamentally an objective standard."

If a person has a permanent home in the U.S. he can rely on the significant connections for the presence test. However, two exceptions apply in the following cases:

1. The individual has an estranged spouse and a child of a non-custodial parent or a child living in the U.S. for educational purposes.
2. The individual has rental property in the U.S.

Another exception has been added and provides an alternative to the 183 days test. This exception is made in the case of income earned under the more days in a U.S. possession than in the U.S. test. This exception is available if no more than $3,000 is earned in the U.S.

A critical determination is the recognition of when an individual actually moves to a U.S. possession. If an individual moves to the U.S. possession during the taxable year, then the tax home test of the individual is satisfied provided that the individual does not have a tax home outside that possession during any part of the last 183 days of that taxable year. In this case, the individual must be a resident for the next three years. The effective date of the residency rule is for the taxable year ending after January 31, 2006. Taxpayers may elect to use the new residency rule for calendar year 2005 and forward.

The individuals claiming to become, or cease to be residents of a U.S. possession are required to file notice of such a claim with the IRS and supply such information that establishes their residency.

CLARIFICATION OF EFFECTIVELY CONNECTED INCOME & SOURCES

The IRS pronouncement of January 30, 2006 entitled "AJCA - New Rules Regarding U.S. Possessions"[xvi] clarifies and makes a distinction between USVI source income and income effectively connected with a trade or business in the USVI. The pronouncement further states that the rules for determining U.S. source income and income effectively connected with a trade or business in the U.S. apply to all possessions. It further states that the U.S. source income and income effectively connected with a trade or business in the U.S. are not treated as a possession source income or income effectively connected with a trade or business in the possession.

Income effectively connected with a USVI trade or business qualifies for tax benefits of the USVI while the USVI source income does not qualify. Thus, to be qualified, there must be employees or independent contractors in the USVI that trigger income to the USVI that is based on services provided in the USVI which leads to income effectively connected to a trade or business in the USVI. Further, the U.S. source income and income effectively connected with a trade or business in the U.S. are not treated as USVI source income or income effectively connected with a trade or business in the USVI. Therefore, the source of such qualified USVI income cannot be the U.S. mainland or USVI source income, i.e., the income should be from sources outside of the mainland U.S. and the USVI. These regulations are generally effective for income earned after October 22, 2004. The U.S. income rule is effective for income earned after December 31, 2004. It may be noted that the regulations, however, provide for three exceptions.[xvii] These are:

a) The regulations preserve the existing treatment of income from the sale of goods manufactured in a possession, which provide for the allocation of this income between U.S. and possessions source.

b) The regulations provide rules to prevent U.S. citizens and residents from avoiding U.S. tax on appreciated property by becoming resident in a possession prior to the property's disposition in certain instances.
c) The regulations also provide certain anti-abuse rules for determining the source of dividends and interest from possession corporations.[xviii]

MANAGERIAL IMPLICATIONS

Since tax is a real economic cost which can be minimized and, in some cases, even avoided, it is imperative that the proper steps are taken to ensure that all of the new requirements are satisfied. By legitimately minimizing tax liability, an individual or a corporation can have a significant impact on the amount of income that the taxpayer is allowed to keep and on the bottom line of the company.

In today's global environment, the role of the manager in any organization is undergoing major changes. Notwithstanding this, the role of the manager is decision-making, planning and control. A major part of these functions is to adapt to changes and undertake initiatives that are in the best interest of the company and which result in a positive impact on the operations of the company. By minimizing the company's tax liability and maximizing the net income, the major is fulfilling a major part of his objective.

Due to the rigorous new residency requirements in order to qualify for the lucrative special tax incentives and other benefits available in the five U.S. possessions of Puerto Rico, the United States Virgin Islands, Guam, American Samoa and the Northern Mariana Islands, it is important that individual U.S. citizens and managers of multinational corporations doing business in U.S. possessions take the necessary steps to ensure that all of the income and residency qualifications and requirements are met. In the case of the individual, these include taking the necessary steps such as obtaining employment contracts, securing driver's and other licenses, registering to vote, joining business and professional organizations as well as undertaking other initiatives aimed at establishing and documenting his residency and ensuring that he complies with all of the new requirements.

CONCLUSION

The United States Internal Revenue Code grants special tax benefits and advantages for several of its U.S. possessions. To qualify for these special tax considerations and benefits, it is necessary for a taxpayer to meet the rigorous residency, income and other requirements in a U.S. possession. It is apparent that the changes resulting from the new regulations will present significant challenges to persons involved in international operations. Since the U.S. possessions represent highly desirable jurisdictions from which to operate, these new rules makes it difficult for U.S. source income or income effectively connected to a U.S. trade or business to be legitimately routed through a U.S. possession. Despite the reductions, these incentives still present attractive opportunities and indirectly reinforce the legitimacy of tax incentive programs in the U.S. possessions.

ENDNOTES

[i] Public Law 108-357, October 22, 2004.
[ii] Internal Revenue Bulletin: 2006-9, February 27, 2006.
[iii] U.S. Treasury Regulation § 937 – 1(c) as amended on Nov. 14, 2006.
[iv] Jeffers, A.E. & Kleinfled, D. (2007), Financial Planning Utilizing the U.S. Virgin Islands. Journal of International Taxation, 18 (8), August, 40-49, 63.
[v] Jeffers, A. E., Yang, J. G. S., Kleinfeld, D., Linder, C. (2006), New Requirements for Tax Incentives in U.S. Possessions. International Tax Journal, 32 (4), Fall, 29-37.
[vi] Passed by the National People's Congress of China on April 9, 1991.
[vii] Jeffers, A.E., Yang, J. G.S., Kleinfeld, D. & Linder, C., (2006), New Requirements for Tax Incentives in U.S. Possessions. International Tax Journal, 32 (4), Fall, 29-37.
[viii] Internal Revenue Code §941(a)(1).
[ix] American Jobs Creation Act of 2004, §422.
[x] Jeffers, A. E., & Kleinfled, D. (2007), Financial Planning Using the U.S. Virgin Islands. Journal of International Taxation, 18 (8), August, 40-49.
[xi] Jeffers, A. E., Yang, J. G. S., Kleinfled. D. & Linder, C., (2006), New Requirements for Tax Incentives in U.S. Possessions. International Tax Journal, 32 (4), Fall, 29-37.
[xii] Ibid.
[xiii] Internal Revenue Bulletin: 2006-9, February 27, 2006.
[xiv] To qualify for possession exclusion, except as provided in regulations taxpayer must be present in the possession for at least 183 days during the tax year for tax years after October 22, 2004. For calendar year taxpayer, the rule applies to tax returns for 2005 and later years.
[xv] Jeffers, A.E., & Kleinfled, D., (2007), Financial Planning Using the U.S. Virgin Islands. Journal of International Taxation, 18 (8), August, 40-49.
[xvi] Refer to Internal Revenue Code §937.
[xvii] It may be noted that IIRS Code Section 6688 imposes penalty for failure to file the required notice is $1000 for each failure.
[xviii] Jeffers, A. E., Yang, J. G. S., Kleinfeld, D., & Linder, C., (2006), New Requirements for Tax Incentives in U.S. Possessions. International Tax Journal, 32 (4), Fall, 29-37.