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NORTHERN MARIANA ISLANDS

Tax Information[1]

• *(Tax Year Begins January 1)* •

The Commonwealth of the Northern Mariana Islands ("CNMI") consists of the islands of Saipan, Rota and Tinian along with other islands. The other islands have few or no regular inhabitants. The islands lie almost due south of Japan at approximately 17 degrees north latitude in the Pacific Ocean. Since 1986 the CNMI has been in "Political Union with the United States of America." The income tax laws in force in the United States are applied in the CNMI as a separate tax, the Northern Marianas Territorial Income Tax ("NMTT"). Much of this chapter concerns the NMTIT, its relationship with the United States income tax, and which portions of the U.S. Internal Revenue Code apply directly to the CNMI as federal taxes as opposed to being "mirrored" into the NMTIT. The CNMI collects substantial revenues from the Wage and Salary Tax, Earnings Tax and Business Gross Revenue Tax. The other taxes imposed by the CNMI are also discussed.

SOURCE OF LAW

In view of the controversies that periodically arise around tax in the CNMI, a brief description of underlying law is provided.

Establishment of the Commonwealth

On February 15, 1975 the United States signed a Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States of America (the "Covenant").[2] The Covenant was approved by the Congress of the United States (hereafter "Congress") under Public Law 94-241, 48 USC 1801 and also approved by the Marianas District Legislature (established under the former United States Trusteeship for the Pacific Islands (of Micronesia) and in a vote held by the Northern Mariana Islands. Under the Covenant, a Constitution was adopted for the Commonwealth of the Northern Mariana Islands which came into effect January 9, 1978 (the "CNMI Constitution") The Covenant came into full effect and the Commonwealth was fully established effective November 4, 1986 as set out by Presidential Proclamation No. 5564 issued by President Regan November 3, 1986.

The income tax system in the CNMI is derived from Section 601 of the Covenant. However, the force of the Covenant is unclear. On the one hand it is part of 'the supreme law of the Northern Mariana Islands (Covenant Section 102). On the other hand the United States has agreed not to amend certain sections of the

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[2] The Covenant appears in 48 U.S.C.A. 1801 notes.

Covenant, not including Section 601, Section 105 of the Covenant. May the CNMI legislature unilaterally change the tax system set out in the Covenant? May Congress do so? With the ultimate source of law uncertain, practitioners should not place absolute reliance on either laws enacted by the CNMI legislature or regulations issued by the U.S. Treasury, especially when the two conflict.

Covenant

Section 601(a) of the Covenant provides "*The income tax laws in force in the United States will com into force in the Northern Mariana Islands as a local territorial income tax . . . in the same manner as those laws are in force in Guam.*" The Guam territorial income tax was enacted by Congress.[3] The basic concept behind these taxes is that the tax is identical to the tax in the United States from time to time, with changes enacted by Congress taking effect in Guam and the CNMI at the same they are effective in the United States. Revenue is collected and retained by the possessions, not by the U.S. Treasury. Individuals pay tax to a possession, or the United States, but not both, Covenant Section 601(b). References to the United States in the Internal Revenue Code become, where appropriate, references to the CNMI.[4] These regimes, along with a similar system for the United States Virgin Islands (hereinafter "USVI") are sometimes referred to as the "mirror codes."[5]

Commonwealth Code

The Commonwealth Code adopts essentially the same provisions as outlined above, but the legislature enacts them, thereby retaining the right to amend them, independently of Congress. The Governor of the CNMI (and his agents) may, in administering the tax, now named the Northern Marianas Territorial Income Tax, 4 CMC 1701(a)[6] "interpret, modify or suspend any provision of the NMTIT which is manifestly inapplicable or incompatible with the intent of" the Covenant and CNMI law, 4CMC 1701(h). The Governor may also change IRS regulations. 4 CMC 1702(d)(3). Jurisdiction to hear tax cases is vested in the local CNMI courts (comparable to state courts in the United States) rather than in federal courts, as in the case in the United States and Guam 4 CMC 1701(j). Assets take on fair market value as of January 1, 1985, which is viewed by the CNMI as the beginning of the NMTIT.[7] A number of deductions and credits provided in the Code may not be taken if they arise from non-CNMI investments. 4 CMC 1706

[3] 48 U.S.C. § 1421i.

[4] Covenant Section 601(c) and 48 U.S.C. 1421i(e).

[5] For more on the mirror codes see Karla Hoff, *U.S. Federal Tax Policy Towards the Territories: Past, Present and Future*, 37 TAX LAW REVIEW, Fall 1981; Lawrence Barusch & Marjorie R. Roberts, *Taxation of Individuals in United States Possessions*, BNA 33 TAX MANAGEMENT INTERNATIONAL JOURNAL, March 12, 2004, at 153; Lawrence Barusch, et al., *Is it a Partnership? Is it a Corporation? IRS Issues Regulations to Clarify Treatment of Entities by U.S. Possessions*, BNA 34 TAX MANAGEMENT INTERNATIONAL JOURNAL, November 11, 2005, at 629.

[6] Commonwealth Code of the Northern Mariana Islands ("CMC").

[7] For more information *see infra* Rebates p. 7.

and 1709 (It is not clear that these provisions have been enforced.) The most important change, however, involves the rebates discussed below.

INDIVIDUAL INCOME TAXES

In General

Under the mirror code an individual computes the NMTIT under the rules prevailing in the United States at the same time. For a discussion of United States income taxation see the Chapter on the United States in this treatise. This discussion focuses on those aspects of the NMTIT that either differ from the United States rules or require coordination with those rules. The most notable differences with the United States concern the rules for determining residency, the rules for determining source of income and the CNMI rebates on CNMI source income which are discussed below.

Residency

In most cases[8] an individual files an income tax return with the CNMI or the United States, but not both and is relieved of liability for income tax to the jurisdiction where he or she does not file.[9] Individuals filing under this system would treat the CNMI as including the United States (except where this is inappropriate as determined by the U.S. Treasury). Thus individuals resident in the CNMI would generally not be able to take a foreign earned income exclusion under Code Section 911 for income earned in the United states or a foreign and possessions income tax credit under Code 901 for taxes paid to the United States because for these purposes the United States is not treated as being foreign to or a possession of the CNMI.

Prior to enactment of the American Jobs Creation Act of 2004 P.L. 108-357 an individual filed based on residency at the end of his or her taxable year. The United States definition of residency is broad, so the mirrored definition of CNMI residency is also broad. Hence dual residency was fairly common, but could not be accommodated under the statute. No tie breaker rule (which is common in tax treaties) was provided. This led to controversy which was resolved by Congress creating a new kind of residency, "bona fide residency"[10] by adding Section 937 to the Code.

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[8] An individual not a citizen of the United States, nor resident in either the CNMI or the United States with income derived from both jurisdictions would usually file tax returns with both jurisdictions.

[9] 26 U.S.C. § 935 (1986 as amended) (hereafter the "Code"). Section 935 was repealed by the Tax Reform Act of 1986, Pub. L. No. 99-514, but under Section 1277 of that Act repeal is effective "if (and so long as) an implementing agreement under Section 1271[of such act] is in effect between the U.S. and [the CNMI]. No such agreement has yet been signed by the CNMI. Section 935 also remains in effect with respect to Guam. Section 935 does not affect any other U.S. possessions.

[10] This concept had previously been used for the USVI, see Code Section 932, but had not been applied to Guam or the CNMI. In any event the 2004 legislation changed the definition, even for the USVI.

Bona fide is residency in the CNMI requires 1) presence; 2) not having a tax home outside of the CNMI; and 3) not having a closer connection to the United States or a foreign country than to the CNMI. The presence or absence from the CNMI of a member of the U.S. armed forces in compliance with military orders for a particular tax year will not change such individual's prior residency status.

Presence Test

To satisfy the presence test, the individual must 1) be present in the CNMI for at least 183 days during the tax year; 2) be present in the CNMI for at least 549 days during the 3-year period (current year and two preceding years), and be present in the CNMI for at least 60 days for the current year; 3) be present in the U.S. for no more than 90 days during the current year; 4) have had earned income in the U.S. of no more than $3,000 and be present for more days in the CNMI than in the U.S. during the current year; OR 5) have had no significant connection to the U.S. during the tax year.[11] These rules do not apply to nonresident aliens.[12]

Tax Home Test

The tax home test is satisfied if the individual did not have a tax home outside the CNMI during any part of the tax year. A tax home is the individual's regular or main place of business, employment, or post of duty regardless of where the family home is maintained. If there is no regular place of business then the tax home is the place where the individual regularly lives.

Closer Connection Test

The closer connection test is satisfied if there is not a closer connection to the U.S or a foreign country than to the CNMI. A closer connection is based on significant contacts. These include: 1) location of permanent home; 2) location of family; 3) location of personal belongings; 4) location of organizations with which the individual has a relationship; 5) location of routine personal banking; 6) location of business activities; 7) jurisdiction issuing a driver's license; 8) location in which the individual votes; 9) location of charitable organizations to which the individual contributes; 10) country of residence designated on forms; and 11) types of official forms and documents filed, such as Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for U.S. Tax Withholding, or Form W-9.

A closer connection to a different possession will not be treated as a closer connection to a foreign country.

Applicability to the CNMI

Section 937 as added by the 2004 legislation directly references the Northern Mariana Islands, so there can be no doubt Congress intended to use these tests to determine who was a bona fide resident of the CNMI. This clearly applies for

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[11] See Treas. Reg. § 1.937-1 for what constitutes a day of presence in the possession, what is a significant connection, and other elaboration.

[12] For a discussion of United States income taxation of individuals who are neither citizens of nor residents of the United States see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

purposes of Code Section 957(c) discussed below. The 2004 legislation also changed the test for Guam filing from "residence" to "bona fide residence." However, Section 935 only mentions Guam. Did Congress also intend to change the test from "residence" to "bona fide residence" for the CNMI? Recall Section 601(a) of the Covenant says U.S. income tax laws shall apply in the CNMI "in the same manner as those laws are in force in Guam."

However, Section 105 of the Covenant, a particularly hard bargained provision, states:

The United States may enact legislation in accordance with its constitutional processes which will be applicable to the Northern Mariana Islands, but if such legislation cannot also be made applicable to the several States the Northern Mariana Islands must be specifically named therein for it to become effective in the Northern Mariana Islands.

The thrust of the legislation is that if Congress changes special rules for Guam it must explicitly state it is changing the rules for the CNMI. Section 935 by its terms is not made applicable to the several states. It only mentions Guam. Can a change to Section 935 change the rules for the CNMI if the CNMI is not mentioned? Is mentioning the CNMI in Section 937 enough? If, as is sometimes the case, Congress passes a thousand page tax reform act and the CNMI is mentioned in one section, does that mean Congress has stated all sections are to apply to the CNMI? Can it be said that if Section 935 is not effective under the terms of Covenant Section 105, it is nevertheless effective in the United States, so that CNMI residents (who are not "bona fide residents") must still file in the U.S.? Was that the intent and effect of Covenant Section 105? The reader is left to reflect on these questions.

Source of Income

The source of income is important because only income treated by the CNMI as CNMI source qualifies for rebates. The U.S. source rules are generally mirrored for this purpose.[13] However, the rebates will not benefit a taxpayer if his income is also taxed in the United States. In that case, the CNMI rebates decrease the U.S. foreign tax credits available and result in a shift in the jurisdiction receiving the tax (from the CNMI to the United States) but would not decrease the tax. Therefore it is also important to determine whether the United States not just the CNMI) will treat the income as CNMI (or foreign) source.

Treasury Regulation 1.937-2 and 1.937-3 address this subject. These rules are issued under Code Section 937 Sources rules follow U.S. source rules with some exceptions. Three will be discussed here.

Appreciated Property

Gain from the sale of most personal property acquired by an individual before

[13] For a discussion of United States income tax rules for determining the source of income and income effectively connected with the conduct of a trade or business in the United States see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

such individual became a bona fide resident of the CNMI and within ten years of realizing the gain will not be recognized by the U.S. as CNMI source. There had been cases where U.S. citizens anticipating large capital gains (as from selling stock in a company) would establish residency in the CNMI. Under standard sourcing rules gain from the sale of stock is sourced to the residency of the seller, Code 865. The seller claimed a CNMI rebate on economic value that accrued while he was in the United States. This rule stops this practice, but is of broader effect. However, for those who have been residents in the CNMI for a time, a set of rules provides some relief so that appreciation during the CNMI residency is CNMI source. For marketable securities this is determined with respect to annual price fluctuations. For other property the gain is apportioned over time.

Certain Stock

Consider the U.S. citizen who moves to the CNMI holding an appreciated asset. He transfers the asset to a newly formed CNMI corporation, deferring gain recognition under Section 351 of the Code. The CNMI corporation then sells the asset, perhaps benefitting from a CNMI rebate, since the income could be CNMI source for this purpose. Under standard sourcing rules, dividends paid by this corporation would be CNMI Source. Code 861(a)(2). Thus the individual might avoid the rule on appreciated property discussed above. If the CNMI shareholder holds at least 10% of the stock of the CNMI corporation, the United States will look through the corporation to determine the source of the income of the corporation. When the dividend is paid, a portion of the dividend will be treated by the U.S. as U.S. source and taxable in the U.S. Again the rule has a reach that goes beyond merely remedying the perceived abuse and so must be carefully considered in applicable circumstances.

Effectively Connected Income

The USVI (but not the CNMI) has the right to rebate mirror tax on income effectively connected with the conduct of a trade or business in (in that case) the USVI, even if such income is not possessions source. Some income can be effectively connected to more than one jurisdiction. To limit the USVI rebate power the regulations provide that income from U.S. sources or effectively connected with a trade or business in the United States can never be effectively connected with any possession, including the CNMI. The author is unable to see how this could effect taxation in the CNMI, but more imaginative planners should be aware this rule exists.

Rebates

Under Section 601 of the Covenant the mirror tax should have become effective January 1, 1979. However, the CNMI legislature used its rebate power under Section 602 to rebate 100% of the tax prior to collection, rendering Section 601 moot. Congress was not amused.[14] Eventually Congress agreed to postponement

[14] See the historical and statutory notes to Pub. L. No. 96-805 as twice amended found at 48 U.S.C. § 1843. While Congress appears to have insisted the CNMI collect the NMTIT before

of the effective date of the NMTIT to January 1, 1985, and the CNMI agreed not to rebate the full NMTIT.

The currently effective rebates begin with a computation of the "rebate base." This is the NMTIT imposed on income derived from less CNMI less certain credits. All of the tax levied on (a) wages and salaries under 4 CMC 1201, (b) on earnings under 4 CMC 1202 (c) on gross revenue under 4 CMC 1301, (d) the Customs Service Certification Fee imposed under 4 CMC 1421 and (e) the tax imposed on duty free concessions at the commercial port and airport imposed under 4 CMC 2202(h) are creditable. These taxes are discussed under transaction taxes. The effect is that taxpayers whose taxes under these local tax levies exceed the NMTIT pay no NMTIT. If the NMTIT is larger, the total tax burden of all taxes is, in effect, the NMTIT.

It is sometimes said a taxpayer pays one set of taxes or the other, but not both. This may be true in an economic sense, but may lead to misunderstanding and non-compliance if applied too crudely. The better description is that in the preceding paragraph.

Similar credits available for these items are also discussed under transfer taxes.

For individuals the amount rebated is 90% of the first $20,000 of rebate base, 70% of the next $80,000 and 50% of the balance.

To illustrate the mechanics of this, consider the tax on an additional $100,000 of earnings to an individual already in the top tax and rebate brackets. (For simplicity, assume the taxpayer already had $1,000,000 of earnings). The tentative NMTT would be 35% or $35,000 for 2010. The earnings tax would be 9% or $9,000. The rebate base would be $26,000 ($35,000 - 9,000). The rebate (we assume the higher rebate brackets have been exhausted) would be $13,000 (50% of $26,000). The NMTIT due would be $13,000 ($35,000 - $9,000, - $13,000). The combined NMTIT and earnings tax would be $22,000 ($13,000 + $9,000). Thus the top marginal rate on earnings in the CNMI after computing both taxes is 22% for individuals.

Please see the section on corporate tax for rebates for corporate taxpayers.

CORPORATE INCOME TAXES

In General

Under the mirror code a corporation computes the NMTIT under the rules prevailing in the United States at the same time.[15] The most notable points concern withholding on dividends, interest and other fixed or determinable annual or periodic income, branch profits tax, sourcing and rebates which are discussed

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rebating it, current 4 CMC 1708(a) permits taxpayers to apply the rebate to reduce tax obligations, even if those taxes have not been paid.

[15] For a discussion of United States income taxation of corporations see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

below. Note that corporations unlike individuals do not have a single filing rule. A corporation owing tax to both the CNMI and the United States will file and pay tax in both jurisdictions, although the foreign and possessions tax credit under Section 901 of the Code provides a measure of relief under certain circumstances.

FDAP

The United States imposes a 30-% tax on foreign corporations with respect to gross income consisting of interest, dividends, rents, salaries, wages and other fixed or determinable annual or periodic income "FDAP") received from sources within the United States.[16] This Section is generally mirrored into the NMTIT. Thus without more U.S. corporations receiving FDAP from the CNMI would owe NMTIT (and CNMI corporations receiving FDAP from the United States would owe federal income tax). Code 881(b) provides that in certain circumstances U.S. corporations will not be considered foreign for NMTIT FDAP purposes (and CNMI corporations will not be considered foreign for federal income tax purposes, but the rules are <u>not</u> symmetrical). The current text of Code 881(b) was added by the Tax Reform Act of 1986 but is not effective pending the effectiveness of an implementing agreement between the CNMI and the United States.[17] It is therefore necessary to refer to the prior version of 881(b) as enacted by the Deficit Reduction Act of 1984. This is not easy to understand. The General Explanation of the Revenue Provisions of the Tax Reform Act of 1984 prepared by the staff of the Joint Committee on Taxation (the "1984 Blue Book") discusses a new rule under which FDAP paid to CNMI corporations may be subject to tax depending upon ownership and source of income. The report then states that payments from FDAP to U.S. corporations "from sources in Guam and the Marianas will remain free of tax in those possessions regardless of the U.S. corporation's owners or the source of its other income."[18]

Branch Profits Tax

The branch profits tax imposed under the United States Internal Revenue Code is "mirrored" into the NMTIT. However, it is not imposed on United States corporations. The Branch Profits Tax was added to the Internal Revenue Code by the Tax Reform Act of 1986. The same legislation amended Section 881(b) to provide that a CNMI corporation meeting certain qualifications (the "1986 qualifications") would not be considered foreign for purposes of the federal Branch Profits tax and (by mirroring) a U.S. corporation would not be foreign for purposes of the NMTIT. In general the 1986 amendments with respect to the CNMI are not effective. However, in 1988 Section 1277 of the Tax Reform Act of 1986 was amended by adding subsection (f) to provide that the provision exempting U.S. corporations from the NMTIT branch profits act would be unconditionally effective. In order to receive the exemption from the NMTIT

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[16] Code § 881(a).

[17] This is the same provision that retains Section 935 in the Code. *See supra* note 9.

[18] General Explanation of the Revenue Provisions of the Tax Reform Act of 1984 prepared by the staff of the Joint committee on Taxation, p. 419.

branch profits tax must the U.S corporation satisfy the mirrored 1986 qualifications? In TD 9194 issued in 2005 page 12 of the preamble the U.S. Treasury said the 1986 requirements do apply. (Foreign ownership must be less than 25%, 65% of gross income must come from sources in the United States or the possession and no substantial part of the income can be used to satisfy obligations held by foreign persons.) However, the preamble to TD 9194 is confused about the relationship of the 1984 and 1986 legislation. Regulation 1.881-5(a) states that paragraph (g) "provides special rules for the application of sections 881 *and 884* to corporations organized in the United States. Subparagraph g does *not* impose the 1986 qualifications on U.S. corporations, but subsection (g) by its terms applies only to section 881, not 884. The author does not believe the U.S. Treasury meant to impose the 1986 qualifications on U.S. corporations for branch profits purposes (until an implementing agreement becomes effective), but the issue will be decided in the possessions where tax administrators will have an incentive to see matters differently.

Source of Income Rules

The special regulations issued under Section 937 concerning source of income and effectively connected income discussed above with respect to individuals likewise apply to corporations.

Controlled Foreign Corporations

In general the United States does not tax the foreign source income of foreign corporations until it is brought back to the United States. However, under a portion of the Code known as "Subpart F" every U.S. shareholder of a controlled foreign corporation includes certain types of income ("Subpart F income") in the shareholder's income as earned by the controlled foreign corporation, even though it may not have been distributed. A corporation is a controlled foreign corporation if more than 50% of it is owned by U.S. persons (including U.S. citizens) wherever resident.

If A, B and C own equal interests in MCo, a corporation organized in the CNMI, and A,B, and C are U.S citizens resident in the CNMI, then MCo is a controlled foreign corporation for U.S. income tax purposes. If MCo is a plain vanilla company doing business in the CNMI this seems a strange result. If MCo is merely engaged in an ordinary business in the CNMI it will have no subpart F income, so this won't manner. However, if MCo has passive income (interest, dividends, rents, royalties) or certain other kinds of income, it will have subpart F income. Even if it does, there is no problem if A, B and C are bona fide residents of the CNMI, because they only file and pay taxes under the NMTIT and under the NMTIT MCO is domestic. However, if A ceases to be a bona fide resident of the CNMI he will be taxed in the United States on his share of MCo's subpart F income.

Prior to the Tax Reform Act of 1986 there was certain relief for residents of the

possessions. The Tax Reform Act of 1986 repealed that provision,[19] which is now fully effective, and substituted other relief (Section 1273) which will not become effective until an implementing agreement is effective. So it is best to avoid these situations, as technically there is no relief. If a taxpayer cannot avoid the situation, the taxpayer might argue that he or she should get the benefit of current Section 957(c)(2). In that case if 80% of the gross income for a three year period is CNMI source (determined under the new treasury regulation 1.937-2) and 50% of the income was from the active conduct of a trade or business in the CNMI then bona fide residents of the CNMI are not treated as United States persons for the control requirement.

Alternately, and more logically (but not likely to win acceptance from the Treasury) the taxpayer could try to apply the pre-1986 rule. In that case a CNMI corporation satisfying the 80% and 50% rules set forth above is not a controlled foreign corporation, no matter who owns it.

Rebates

The rules on rebates discussed for individuals above generally apply to corporations. Typically a corporation would take a credit against NMTIT for the gross revenue tax paid. The rates of rebate on the rebate base for corporations are currently the same as for individuals, although from time to time proposals to change the corporate rebate rates arise.

PARTNERSHIP TAXATION

Partnerships are intended to be flexible business entities that are not themselves subject to income taxation. The partners of the partnership will incur the taxation of the income of the partnership at their respective individual levels regardless of whether the income is actually distributed. The U.S. rules on partnership taxation are again mirrored into the NMTIT.[20]

Note that a partnership with a foreign partner receiving income effectively connected with the CNMI is required to withhold on that partners share at the highest rate imposed (35% at this writing). This requirement, imposed under Section 1446 applies if the foreign corporation is a U.S. corporation, because Section 1446 does not have the relief for U.SA. corporations found in 1442 for FDAP type income paid directly to foreign corporations.

EMPLOYMENT TAXES

FICA

Under Section 607 of the Covenant, the United States social security system generally came into effect in the CNMI with the Covenant. This includes the

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[19] Section 1224 of the Tax Reform Act of 1986.

[20] For a discussion of United States income taxation of partnerships see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

Federal Insurance Contributions Act ("FICA") tax.[21] FICA, unlike the NMTIT, is reported and paid directly to the United States, not the CNMI government. Special rules arising because reporters of FICA in the CNMI generally do not pay U.S. income tax (instead they pay the NMTIT) are described in Publication 80, Federal Tax Guide for Employers in the U.S. Virgin Islands, Guan, American Samoa and the Commonwealth of the Northern Mariana Islands, available at www.irs.gov. For 2011 employers pay 6.2% and employees pay 4.2% on the first $106,800 of gross wages (not interest income, dividends, etc.) with the ceiling adjusted each year based on average national wages. For 2012 the employee rate is scheduled to return to 6.2%.The employee and the employer both pay 1.45% of gross income for Medicare with no ceiling. The healthcare legislation passed in 2010 also imposes an additional 0.9% on income over $200,000 for individuals and $250,000 for couples filing jointly starting in 2013. Under the new health care legislation in 2013 an equivalent of the medicare tax (3.8% =1.45%x2 + 0.9)) will be applied to passive income. Whether this will be part of the NMTIT or to the United States income tax is not clear as of this writing. Probably the best guess is that such tax would be collected by the United States in a manner similar to current collection of the self employment tax.

Employers provide form W-2CM (not form W-2) to their employees and the United States social security administration and file form 941-SS (FICA return) with the United States IRS (not the CNMI).

Self-employed individuals are responsible for the entire 15.3% (12.4% for social security and 2.9% for Medicare), on 92.35% of net earnings from self-employment. A deduction is allowed for half of the self-employment tax.[22] Again these rules are the same as in the United States, but residents in the CNMI report and pay their self-employment tax on Form 1040-SS filed with the IRS.[23]

FUTA

The Federal Unemployment Tax Act ("FUTA") is not applicable in the CNMI.

ESTATE TAXES

CNMI Taxes

The CNMI imposes a "pick-up" tax on estates in the amount of the credit allowed by the United States against federal estate taxes. Currently the United States does not allow any credit, so this CNMI tax is inapplicable. Otherwise, the CNMI does not impose estate, gift, inheritance, generation skipping transfer or other death related taxes. Probate is often necessary and the current filing fee for opening a probate in the Superior Court of the CNMI is the same as for any other civil action, $150. However, some jurisdictions (see Guam in this treatise) impose probate fees based on the value of the estate, which has the economic effect of a

[21] For a discussion of FICA see the Chapter on the United States in this treatise.

[22] IRC §§ 1401–03.

[23] See IRS Publication 54.

tax. The CNMI could convert to such a system without legislative action.

Federal Estate and Gift Taxes

Residents of the CNMI who are not citizens of the United States pay U.S. estate, gift and generation skipping transfer taxes on certain U.S. related property.[24] Residents of the CNMI who are U.S. citizens, deriving that status from being born within the 50 states or the District of Columbia pay tax as U.S. residents.

The federal estate tax system has been in flux because of the expiration of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). For 2011 and 2012 there is a five million dollar exemption, with the excess taxable estate taxed at 35%. In 2014 the estate tax is scheduled to return to an exemption amount of $1 million with rates up to 55%. Current thinking is the current (2011) system will be extended, but no assurance can be granted.

CNMI resident decedents and donors who acquired U.S. citizenship solely by reason or birth or residence within a U.S. possession are taxed as noncitizens of the United States. Those who acquired U.S. citizenship as a result of the Covenant coming into effect, or who were born in the CNMI after the Covenant was fully effective, or who were naturalized in the CNMI after the Covenant became effective based on their residence in the CNMI would fall in this category. Because of changes in U.S. naturalization law over the years there are a number of possibilities for acquiring citizenship other than those just named. Specialized inquiry is required to determine how those residents are treated.

When the special rule for certain U.S. citizens resident in possessions was enacted half a century ago, it was a clear advantage to be treated as a nonresident alien, because the U.S. does not subject to estate and gift taxation property sufficiently removed from its jurisdiction, such as CNMI real property and stock in CNMI corporations. However, the exemption for nonresident aliens with U.S. property remains at $60,000 (or up to $130,000 for CNMI U.S. citizens in certain cases). Stock in U.S. corporations and interests in most retirement plans sponsored by U.S. employers are treated as U.S. property. Thus for CNMI residents with estates as small as $70,000, there may be a disadvantage to being classed as a nonresident alien. Determining the correct classification, therefore, is important. A U.S. citizen otherwise taxable as a nonresident alien can become taxable as a "regular" U. S. resident eligible for at least a $1,000,000 exemption, and possibly a higher exemption (depending on what Congress does) by establishing his or her domicile in one of the 50 States, the District of Columbia or any foreign country, so long as it is not classified as a possession of the U.S.

Federal Generation Skipping Transfer Taxes

The treatment of CNMI residents who are U.S. citizens but treated as nonresident aliens under the estate and gift tax and their beneficiaries for purposes of the U.S. generation skipping transfer tax is complex and should be separately investigated on a case by case basis.

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[24] For a discussion of United States estate, gift and generation skipping transfer taxes see the chapter on the United States in this treatise.

TAXATION OF TRUSTS

Single Filing Rule does not apply to Trusts

The U.S. income tax rules for trusts are mirrored into the NMTIT. In 1972, when Code Section 935 providing for single filing for individuals was first enacted it was believed—quite possibly by the sponsors of the legislation—that it would apply to trustees because Regulation 1.871-2(a) treats nonresident alien fiduciaries' (including trustees) as nonresident alien individuals.[25] However, the current treasury position is just the opposite. Only natural persons can be bona fide residents for purposes of Section 935 (Regulation 1.937-1(b)(3)).

Foreign Trusts

A trust administered exclusively in the CNMI will, for United States income tax purposes be treated as foreign because no CNMI court is treated as a United States court for purposes of satisfying the requirement that a domestic trust must be supervised by a United States court. Treasury Regulation 301.7701-7(c)(3)(ii). Therefore it would not be a surprise if the CNMI took the position a trust *not* subject to CNMI judicial supervision would be foreign for NMTIT purposes. Perhaps CNMI authorities could be persuaded otherwise, but absent authority from the CNMI grantors and beneficiaries subject to the NMTIT should consider that U.S. trusts may be treated as foreign. For some consequences of this, see the next paragraph.

Section 679

Section 679 of the Code, as applicable under the NMTIT provides that if a NMTIT person transfers property to a foreign trust with a CNMI beneficiary, even if the transfer would otherwise be respected (the trust is irrevocable, only limited powers are retained by the grantor) the income will continue to be taxed to the grantor. As discussed in the prior paragraph, U.S. trusts may be viewed as foreign for this purpose.

Forms 3520 and 3520-A

The United States requires United States citizens (even those deriving such citizenship solely by reason of birth or residence in the CNMI) to report transfers to foreign trusts and to assure that such foreign trusts file returns with the United States. Although there has been discussion of relaxing this requirement with respect to trusts in the possessions, no pronouncement has been made and the unofficial treasury recommendation is to file. The potential penalties for failure to file may be draconian. For example the penalty for failure to report a transfer of property to a foreign trust is 35% of the value of the property transferred. CNMI trusts are foreign for this U.S. requirement. Thus, in principle, if a U.S. citizen born and resident in the CNMI transfers property to a standard estate planning revocable trust and fails to file Form 3520 reporting such transfer, the U.S. could take 35% of the property transferred.

[25] See RT 81-0282 issued by the Attorney General of Guam August 20, 1981, and CRT Ruling 81-2 issued by the Director of Revenue and Taxation of Guam August 31, 1981. The latter is the Guam equivalent of a published Revenue Ruling from the IRS.

Grantor Trusts

A grantor trust is a type of trust that allows the creator of the trust to control the assets in the trust and recognize any income that is generated from the trust. If the grantor of the trust is also the trustee, a separate income tax return may not be necessary for the trust. The grantor will be taxed on the grantor's trust foreign source income as if the funds were received directly.[26] Only U.S. citizens, residents, or domestic corporations can be taxed as an owner of a trust under the grantor trust rules.[27] See prior discussion for complications arising from U.S. tax treatment of CNMI trusts.

If the grantor makes gifts from the trust assets during the grantor's lifetime the gifts will be considered as made from the grantor. Therefore, there may be gift tax consequences.

Once the grantor dies, the assets of a grantor trust are included in the grantor's estate, and are therefore subject to the estate tax.

Non-Grantor Trusts

A non-grantor trust is a trust where the grantor has given up (nearly) all rights and interest in the property funding the trust. The grantor does not have the power to terminate a non-grantor trust, only the trustee. The grantor may not be the trustee, beneficiary, or remainderman. All grantor trusts at the grantor's death become non-grantor trusts.

Non-grantor trusts are required to have Tax Identification Numbers and file a Form 1041 with the CNMI if there is $600 or more in income or the trust has a non-resident alien as a beneficiary. A Schedule K-1 must be prepared for the non-grantor trust beneficiaries.

A trust receives deductions for distributions to its beneficiaries, as long as the distributions carry out the trust's "distributable net income" for the year. DNI will retain its character when distributed to the recipient beneficiaries, and will be taxed to the beneficiaries. Any amount distributed to a beneficiary of a domestic trust that is above the DNI will be a non-taxable distribution of capital.[28]

The tax rates in 2011 for irrevocable trusts are:

Irrevocable Trust Income	Marginal Rate
0–$2,300	15%
$2,300–$5,450	25%
$5,450–$8,300	28%
$8,300–$11,350	33%
Over $11,350	35%

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[26] Treas. Reg.§ 1.671-2 (c).

[27] IRC § 672 (f).

[28] IRC § 643.

A domestic trust pays NMTIT on worldwide income and capital, like CNMI residents. Gains when capital assets are sold or exchanged after being held for more than 12 months are taxed at long-term capital gains. If the asset is held less than 12 months then the ordinary income tax rate applies.

Foreign Trusts (U.S. Rules)

The United States rules for taxing trusts foreign to the U.S. are mirrored into the NMTIT for taxing trusts foreign to the CNMI.[29] Be aware that U.S. trusts may be treated as foreign for CNMI purposes.

TAXATION OF PROPERTY

Capital Gains and Losses

The sale of capital assets carry special tax consequences when there is a gain or a loss. A capital asset is an item that is owned for investment or a personal purpose. The main examples include stocks, bonds and houses. Assets used in a business and inventory are not capital assets.

Capital gains are separated into two categories: short term capital gain (capital asset held for one year or less) ("STCG's") and long term capital gains (capital asset held for more than one year) ("LTCG's"). STCG's have no preferential tax treatment, and the gains are taxed at ordinary tax rates. The rules applicable in the United States are "mirrored" into the NMTIT.[30]

Nontaxable Exchanges

Section 1031 as mirrored into the NMTIT allows for no gain or loss to be recognized on the exchange of property held for productive use in a trade or business or for investment if the property is exchanged solely for property of a like kind which is to be held for productive use in a trade or business or for investment.[31] This allows for the deferral of tax until the sale of the second property. Section 1031(h) prevents exchanging U.S. property for property "outside the United States" on a tax free basis. Not withstanding this rule, individuals may treat the U.S. as including the CNMI and exchanges of property otherwise coming within Section 1031 will qualify.[32] However, corporations may not exchange U.S. and CNMI property tax free. This issue is not resolved for individuals who would otherwise report gain as the result of a pass through entity ("S" corporation, partnership or trust).[33]

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[29] For a discussion of United States income taxation of trusts see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[30] For a discussion of United States income taxation of gain and loss from the sale or exchange of capital assets see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[31] IRC § 1031.

[32] Treas. Reg. § 1.935-1(c)((1)(ii)(E).

[33] For a discussion of United States income taxation of like kind exchanges see the Chapter on

Real Property Taxes

Unlike Guam, the CNMI does not impose a real property tax.

Depreciation and Depletion

The rules for depreciation, depletion and amortization of assets for income tax purposes under the United States Internal Revenue Code are mirrored into the NMTIT.[34] Note that corporations (but not individuals) will treat assets in the United States as foreign under the NMTIT for these purposes.

Non-Resident Tax Treatment

Non-resident aliens are subject to a 30% withholding tax on rental income. See the discussion below for the effect of tax treaties. United States corporations are generally not considered foreign for this purpose, but certain restrictions apply.[35]

TRANSACTION TAXES

Excise Taxes

"Duty" and Use Tax Like Levies:

The CNMI imposes excise taxes for the privilege of first sale, use, manufacture, lease or rental in the Commonwealth for business purposes or for personal use exceeding the personal exemptions. The excise taxes are imposed as follows:

(1) Soft drinks, one-half of one cent ($0.005) per fluid ounce or fractional equivalent thereof;

(2) Foodstuffs, one percent ad valorem;

(3) Commodities used in the production of agricultural products, including fertilizers, seed, animal feeds, pesticides and herbicides, agricultural equipment, machinery, tools, irrigation equipment and accessories intended specifically for agricultural use, one percent ad valorem;

(4) Perfumery, articles of perfumery including cologne and other fragrances whether in sachets or otherwise, 23 percent ad valorem;

(5) Cosmetics, including all preparations used as applications to the hair or skin, lipsticks, eye shadows, mascara, pomades, powders, makeup and other preparations not having medicinal properties or hygienic purposes, 17.25 percent ad valorem;

(6) Hygiene products and toiletries, one percent ad valorem;

(7) Prescription drugs and medicines, one percent ad valorem;

(8) Construction equipment, construction materials, and construction ma-

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the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[34] For a discussion of United States income taxation of depreciation, depletion and amortization see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[35] Code § 881(b).

chinery, three percent ad valorem;

(9) Leather goods or related products, 5.75 percent ad valorem;

(10) Jewelry, 5.75 percent ad valorem;

(11) Precious metals, precious or semiprecious stones or related commodities, 5.75 percent ad valorem;

(12) Passenger vehicle having a value not exceeding $30,000 per unit, five percent ad valorem;

(13) Passenger vehicle having a value in excess of $30,000 per unit, 5.75 percent ad valorem;

(14) Boats and yachts, whether capable of being powered by sail or motor, and having a value in excess of $500,000 per unit, 5.75 percent ad valorem;

(15) Goods, commodities, resources, or merchandise manufactured grown or entirely derived from sources within the Commonwealth, one percent of retail price, unless otherwise specified within this chapter.

(16) Cigarettes, one dollar and seventy-five cents per every twenty cigarettes, or fractional equivalent thereof, for eight years after December 13, 2002; thereafter, two dollars per every twenty cigarettes or fractional equivalent thereof;

(17) Tobacco or tobacco substitute or chewable tobacco product, or other smokable or snuffable substance, material or product, other than cigarettes, sixty percent of the invoice price;

(18) Beer and malt beverages, 2 cents per fluid ounce or fractional equivalent thereof;

(19) Distilled alcoholic beverages, 18 cents per fluid ounce or fractional equivalent thereof;

(20) Wine and sake, 5 cents per fluid ounce or fractional equivalent thereof;

(21) All other goods, commodities, resources, or merchandise not otherwise provided by law, five percent ad valorem.

Exemptions are available for those arriving in the CNMI for (1) 30 packs of cigarettes of up to 20 cigarettes each; (2) one pound of tobacco (other than cigarettes) (3) 77 ounces of distilled spirits; (4) 288 ounces of beer, and (5) 128 ounces of wine and sake. A total of $1,000 of other goods may be brought in (but this does not extend the duty free quotas on alcohol and tobacco.) Alternate energy and Energy Star certified devices may be brought in free of excise taxes if for personal use.

There are multiple exemptions for importation of goods for personal use, with emphasis on items used in Free Trade Zones and items that produce goods for export.

Departing passengers can purchase goods duty free at licensed duty free stores and at the commercial port and airport.

Liquid Fuel other than aviation fuel is taxed at $0.15 per gallon. Aviation fuel is taxed at 3% ad valorem. Exemptions may be available for sales to the Commonwealth Utility Corporation (for power generation), aviation fuel (for commercial airlines) and diesel fuel for fishing boats. These exemptions have a discretionary element. Taxpayers planning to claim these exemptions should confirm the current extent of the exemption with the government.

Containers of soft drinks, beer, ale or malt are taxed at $0.05 per container (e.g. can).

These taxes may be refunded if the goods involved are exported.

In addition, an Environmental Beautification Tax (to fund solid waste disposal) of 0.42% as valorem is assessed on "consumer goods", a detailed notion but aimed principally at vehicles, retail products, garment material, construction material and packaged goods Consumer goods does not include foodstuffs and medicine.

3.7% Customs Service Certification

At one time the CNMI had a flourishing garment industry. Partially assembled items from China and elsewhere would be imported into the CNMI where enough additional value would be added to qualify for subsequent duty free entry into the United States under "Headnote 3a". Entry into the U.S. was conditioned on certification of additional value added. The CNMI raised revenue by charging for certification. Changes in U.S. trade policies have reduced (or perhaps eliminated) these operations. This charge is creditable against NMTIT in the same manner as the wage and BGRT taxes are.

Miscellaneous Excise Taxes

The "bar tax" imposes a 10% tax on alcoholic beverages sold for consumption on the premises.

The rental of lodging for less than ninety consecutive days is subject to a 10% hotel tax.

Amusement machines (video games, pin ball, pool) where the prize is limited to additional use are subject to an annual license fee of $150. Machines that pay out (slot machines, poker machines) not situated in casinos are subject to an annual license fee of $6,000. Fees for casino concessions are determined outside of tax law. Jackpots are, in addition, subject to a 30% tax.

Developer Tax

Developers pay a tax of 2% of the cost of new development projects.

Business Gross Revenue Tax; Earnings Tax; Wages Tax

The two major revenue sources for the CNMI are the NMTIT discussed above and the three related taxes discussed here. Income that is not treated as CNMI source for income tax purposes is not included in the measure of these taxes.

Wages and salaries and other earnings are taxed at the following rates:

If the total yearly wages or total yearly earnings are:	*The tax on the total yearly wages and salaries or total yearly earnings is:*
(a) $0 to $1,000	No tax.
(b) $1,001 to $5,000	Two percent of the amount over $0.
(c) $5,001 to $7,000	Three percent of the amount over $0.
(d) $7,001 to $15,000	Four percent of the amount over $0.
(e) $15,001 to $22,000	Five percent of the amount over $0.
(f) $22,001 to $30,000	Six percent of the amount over $0.
(g) $30,001 to $40,000	Seven percent of the amount over $0.
(h) $40,001 to $50,000	Eight percent of the amount over $0.
(i) Over $50,000	Nine percent of the amount over $0.

Note this table involves “cliff” rates rather than the “stair step” rates familiar from income taxation. Thus an employee making exactly $40,000 will pay $2,800 under this tax, but an employee making $40,001 will pay $3,200.08.

Wages do not include pay of those on active duty in the military, per diem and travel allowances not in excess of those allowed employees of the Commonwealth government, free or reduced rent on residences or housing allowances, medical care, retirement plans, scholarships and student aid and social security. Notice that several items taxable in whole or on part for NMTIT purposes are excluded from taxable wages for purposes of the wages and salaries tax.

Earnings include gain (in the income tax sense) from sale of personal property not taxed under the BGRT (see below) and half the gain from sale and half the income from leasing CNMI real property. Generally only payments from qualified retirement plans, alimony, unemployment compensation benefits and social security benefits are exempt. Otherwise income taxable for NMTIT purposes (but not taxed under the BGRT) is taxed, except that distributive shares from “S” corporation and partnerships (already subject to BGRT) are not subject to the earnings tax. Since the maximum BGRT rate is 5% but the earnings tax maximum is 9% there is an advantage to conducting personal service businesses through entities. Losses do not reduce earning.

The gross revenue tax, often referred to as the “Business Gross Revenue Tax” or “BGRT”, is imposed at the following rates:

If the yearly total gross revenue is between:	*The tax on the yearly total gross revenue is:*
(1) $0 to $5,000	No tax.
(2) $5,001 to $50,000	1.5 percent of the amount over $0.
(3) $50,001 to $100,000	Two percent of the amount over $0.
(4) $100,001 to $250,000	2.5 percent of the amount over $0.
(5) $250,001 to $500,000	Three percent of the amount over $0.
(6) $500,001 to $750,000	Four percent of the amount over $0.
(7) $750,001 and over	Five percent of the amount over $0.

Again note these are “cliff rates” as explained with respect to the wage and salary

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tax. The tax is imposed on "gross revenue" from business" defined broadly to pick up income earned in or related to activities in the CNMI.

Taxes are imposed on farmers and fishermen at a reduced rate: 1% of the amount in excess of $20,000. Manufacturer's tax tops out at 2% when revenue exceeds $50,000. Formerly, banks and similar institutions paid 5% on net revenue (as defined by the statute) or 3% of gross revenue, but now banks pay regular GRT.

Several exemptions are available, including for goods exported from the CNMI, diesel fuel for use outside territorial waters, and income earned by Foreign Sales corporations and off-shore banks.

Duty free retail concessions at the commercial port (cruise ships) and airport are subject to a 4% GRT.[36]

A credit against all of these taxes of up to $5,000 is allowed for cash contribution to public and qualifying private schools, and certain other institutions, but the taxpayer may not then take a charitable deduction against his NMTIT.

All of these taxes may be taken as non-refundable credits against the NMTIT as discussed above under rebates.

Unlike Guam, the CNMI does not impose a use tax, per se, but see excise taxes listed above which reach use. The typical excise rate of 5% on ordinary items matches the BGRT maximum rate.

Business License Fees

The Department of Finance of the CNMI collects the following license fees at the time of issuance or renewal of business licenses:

(1) Banks, $500;

(2) Offshore banking corporations, $1,000;

(3) Securities dealers, $300;

(4) Insurance companies, $300;

(5) Insurance brokers, $100;

(6) Insurance agents, $75;

(7) Public utilities, $300;

(8) Manufacturers, $50;

(9) Wholesalers, $50;

(10) Roadside vendors selling local agricultural and fishery products, $5;

(11) Scuba instruction and scuba diving tour operations, $100;

(12) General business license covering all other businesses unless otherwise provided by this act, $50, per separate line of business.

[36] 4 CMC 2202(h).

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Free Trade Zones

CNMI law provides for establishment of Free Trade Zones at the Commercial Port, Airport and elsewhere. Goods not destined for CNMI markets may move freely in and out of such zones. Public land within the zones may be leased at favorable rates to appropriate candidates. A special license is required. This program has had relatively little development to date, but the CNMI may be eager to implement it in appropriate circumstances. It may be possible to negotiate a new zone in appropriate circumstances.

INVESTMENT ACCOUNTS

Retirement Accounts

The rules for individual retirement accounts, including Roth IRAs under the United States Internal Revenue Code are mirrored into the NMTIT.[37]

There are complications if an employer plan is subject to regulation both in the United States and the CNMI. Questions include whether a deduction is allowed under the NMTIT for payments to a U.S. trust, whether income earned by a CNMI employees' trust from U.S. sources is subject to U.S. withholding, whether payments to beneficiaries from a trust are subject to U.S. or CNMI withholding (or both) and what portions are subject to withholding, and how trust assets are taxed in the estate of a CNMI decedent acquiring his citizenship by birth or residence in the CNMI. Many of these issues are unresolved and in any event cannot be satisfactorily explained without assuming detailed understanding of U.S. taxation of deferred employee compensation. The reader should seek advice from counsel.

College Savings Plans

Individuals can generally take advantage of college savings plans established under Section 529 in the United States.[38]

DIVIDENDS

Taxation of Dividends from CNMI Source

Dividends from domestic CNMI companies are generally considered CNMI source income. Dividends from foreign corporations, including domestic U.S. companies generally are considered foreign source income. The United States has issued special rules regarding determining CNMI source income for U.S. income tax purposes. Treasury Regulations 1.937-2 and -3. This section discusses sourcing rules for NMTIT purposes. Part of a dividend received from a foreign

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[37] For a discussion of United States income taxation of IRAs and other investment accounts see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[38] For a discussion of United States income taxation of "529 Plans" and other college savings incentives see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

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corporation is CNMI source income if 25% or more of the total gross income for the 3-year period was effectively connected with a trade or business in the CNMI. If the corporation was formed within 3 years prior to the declaration of a dividend, then the total gross income from the time the corporation was formed will be used. The CNMI source income will be determined by multiplying the dividend by the following fraction:[39]

$$\frac{\text{Foreign corporation's gross income connected with a CNMI trade or business for a 3-year period}}{\text{Foreign corporation's gross income from all sources for that period}}$$

Dividends when paid are generally included in the shareholder's gross income in the year of receipt, unless there is a constructive receipt of the dividends at an earlier date.[40]

Under the "Jobs and Growth Tax Relief Reconciliation Act" of 2003 a new category of taxable income was created with "qualified dividend income." Qualified dividend income is treated as net capital gain and is subject to lower tax rates. Non-qualifying dividends are still taxed at ordinary income tax rates (as all dividends were prior to this legislation).

For qualified dividend income taxpayers in the 25% income tax bracket and higher pay a 15% tax from 2003–2012. Taxpayers in the 10% and 15% tax brackets the tax rate on qualified dividend income is reduced to 5% from 2003–2007 and 0% from 2008–2012. Starting in 2013 these provisions sunset and dividends will be treated as ordinary income once again, this is of course unless Congress enacts an extension of these rates.

Definition of "Qualified Dividend Income"

Qualified dividend income is dividends received from domestic corporations and "qualified foreign corporations." Although the mirror language is unclear, it is anticipated that a qualified foreign corporation includes a corporation incorporated in the US or one of the states. Other rules follow those for the United States.[41]

Non-Resident Alien Dividend Tax

Dividend income that is from a CNMI source and paid to is neither resident in the US nor the CNMI and is not a citizen of either is subject to a withholding tax of 30% or a lesser applicable tax treaty rate.

CAPITAL TAXES

Capital Taxes

There are no CNMI capital taxes (except to the extent capital gains are taxed as discussed above).

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[39] See IRS Publication 519 (2009).

[40] IRC § 61; Treas. Reg. §§ 1.61–9.

[41] For a discussion of United States income taxation of dividends see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

Treatment of "SWAP" Contracts; foreign Currency Transactions

The rules of the Internal Revenue Code for "SWAP" contracts and foreign currency transactions are mirrored into the NMTIT.[42] The currency of the CNMI is the U.S. dollar, so in general there are no special issues between the U.S. and the CNMI on these contracts. However, it is possible for both jurisdictions to exercise taxing jurisdiction. See discussion of the foreign and possessions tax credit above.

REVENUE TAXES

The CNMI has no import duties as such and therefore styles itself a "duty-free destination." However, see above for excise, business gross receipts and uses taxes than function like duties.

MISCELLANEOUS TAX

Health Care Taxes

The "Patient Protection and Affordable Care Act" and the "Health Care and Education Reconciliation Act of 2010" passed in 2010 added several new tax provisions in the United States. It is generally believed these taxes will be directly applicable to the CNMI. That is they will be imposed by and collected by the federal government.[43]

Nevertheless it is possible some of these taxes (such as the tax on net investment income) could be "mirrored", that is imposed by and collected by the CNMI. It may even be some of these taxes will not be collected in the CNMI. These issues have not been resolved at this writing.

Stamp Duties

There are no stamp duties in the CNMI.

Excise Tax on Payments by Military to Foreign Providers

On January 2, 2011 President Obama signed P.L. 111-347 to provide health benefits to 9/11 rescue workers. This expenditure is financed by a new tax on foreign procurement payments under new Section 5000C of the Internal Revenue Code. As this is not an income tax it would not be mirrored into the NMTIT but could be collected directly by the United States. Under U.S. laws CNMI corporations and multi-member LLCs are foreign. They would be subject to tax on procurement payments made by the U.S. military if the CNMI is a "countr[y] not a party to an international procurement agreement." The CNMI is not a party to any such agreement. Informal and non-binding guidance from the Treasury indicates "country" means "foreign country" for this purpose. In the context of the

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[42] For a discussion of United States income taxation of "SWAP" contracts and foreign currency exchange see the Chapter on the United States in this treatise. For the reasons United States income tax law is significant in the CNMI see Section II A of this Chapter.

[43] For a discussion of new United States taxes relating to and funding health care see the Chapter on the United States in this treatise.

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foreign earned income exclusion it has been held that possessions are not foreign countries. Thus current thinking is that this excise tax will not be collected in the CNMI.

TAX TREATIES

Under Section 104 of the Covenant, treaty making authority lies with the United States rather than the CNMI so there are no direct treaties. However, 48 USC 1421i(e)(3) made applicable to the CNMI by Section 601 of the Covenant provides that a person eligible for tax rate reductions in the United States under a tax treaty between the United States and such person's country is be eligible for comparable rate reductions under the NMTIT.[44] The effect of this provision is greatly limited in the CNMI because treaty rate reductions do not apply if there is a CNMI rebate. The CNMI rebates, as discussed above generally apply to CNMI source income. Hence treaty rate reductions would usually be applicable only to income that is not CNMI source including U.S. source income.[45] There is a complex and not necessarily consistent interaction with U.S. rules for determining CNMI source income, CNMI rules for determining CNMI source income for rebate purposes and the applicability of treaty rate reductions against the NMTIT.

INVESTMENT INCENTIVES

The CNMI will rebate some or all of the NMTIT (possibly the taxpayer must pay the tax and then seek a refund) and abate some or all of all other taxes for projects providing economic benefit to the CNMI. The details of qualification depend on the project but the following table may be helpful.

Activity	New Investment	Expansion of Investment	Nonrefundable Application Fee
1. Franchise Restaurant	$1,000,000	$500,000	$5,000
2. Water Park	$1,000,000	$500,000	$5,000
3. Aquarium	$1,000,000	$500,000	$5,000
4. Cultural Center	$1,000,000	$500,000	$5,000
5. Theme Park	$10,000,000	$5,000,000	$10,000
6. New Expansion, Resort Hotel or Condominium	$5,000,000	$2,500,000	$10,000
7.Golf Course	$10,000,000	$5,000,000	$10,000
8. Convention Center	$1,000,000	$500,000	$5,000

[44] For a list of countries having tax treaties with the United States see the Chapter on the United States in this treatise.

[45] Treas. Reg. § 1.937-2 discusses what income is CNMI source for purposes of federal income taxation.

0025 [ST: 1] [ED: 100000] [REL: 499] Composed: Thu Oct 20 16:23:46 EDT 2011
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VER: [SC_00304-Local:16 Mar 11 14:29][MX-SECNDARY: 07 Oct 11 20:57][TT-: 23 Sep 11 07:01 loc=usa unit=00290-chnomarisl] 0

9. Dinner Theater	$1,000,000	$500,000	$5,000
10. Special Event	$500,000	$250,000	$2,500
11. CNMI-based Airlines or Other Aviation-Related Activity	$1,000,000	$500,000	$5,000
12. Manufacturing or Processing of High Technology Product	$1,000,000	$500,000	$10,000
13. Internet-Related Businesses and/or Businesses Engaged in Internet Commerce	$100,000	$50,000	$2,500
14. Any Development or Project Not Listed Above That is Approved	$1,000,000	$500,000	$2,500

The foregoing applies to the island of Saipan. For the islands of Rota and Tinian, the minimum capital investment, including public benefit contributions and application fees, is sixty percent of the corresponding figures listed above.