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OFFICE OF THE ATTORNEY GENERAL

July 30, 2013

LEGAL MEMORANDUM **Ref:** DRT 11-0408

TO: Director, Department of Revenue and Taxation

FROM: Chief Deputy Attorney General[1] P.J.T.

SUBJECT: **No Statutory Authority to Outsource Assessment and Collection of Business Privilege Tax**

The issuance of this memorandum stems from a recent meeting where the Office of the Attorney General met with Department of Revenue and Taxation ("DRT") officials to discuss an amendment to a contract between a local law firm and the Office of the Governor, to assist DRT with assessing and collecting outstanding local taxes, specifically the business privilege tax on a contingency fee basis.[2] As discussed below, absent legislative action, DRT is unable to hire an outside company to perform the actions of the Department.

LEGAL ANALYSIS

1. Relevant Statutory Language Does Not Authorize Outside Collectors:

The statutory requirement for DRT to collect business privilege tax is codified in Guam Code Annotated ("GCA") Title 11, Chapter 26. Pursuant to 11 GCA § 26102(b)(3), the DRT Director shall "be responsible for the acts of his assistants … and for the enforcement and collection of all taxes imposed by this Chapter." When authorizing the powers and duties of DRT and its Director regarding the collection of local taxes, the Legislature did not include a provision on outsourcing the task to the private sector.

The relevant statutes addressing collection and enforcement authority are 11 GCA § 1103, 11 GCA § 1106(c), and 11 GCA § 1107. Pursuant to 11 GCA § 1103 the Department "shall be charged with the enforcement of the tax laws of Guam and the collection of revenue," thereby creating authority to enforce and collect local taxes. In addition, 11 GCA § 1106(c) states, "the

[1] Attorney General Rapadas has voluntarily recused himself from involvement in the discussion and analysis of outsourcing tax assessment and collection to the specific law firm and has assigned the Chief Deputy Attorney General in his place.

[2] DRT had assumed that a mutual understanding had been reached between the OAG and the Office of the Governor regarding the issue of outsourcing for the assessment and collection of taxes and DRT was informed that such was not the case based on previous discussion with the Office of the Governor's representative.

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employee under his direction and supervision." 11 GCA § 1107 outlines the duties and powers of the DRT Director including, "(to) exercise and discharge the powers and duties of the Department through such divisions or other organizational units as he may establish pursuant to this title or otherwise provided by law(.)"

As a creature of statute for local tax purposes, DRT may only act within its powers as specifically granted by the Legislature.[3] Unlike other authorizing statutes of government agencies,[4] Title 11 does not provide detailed contracting authority to DRT. Therefore, without direct statutory reference for outsourcing,[5] the Legislature did not authorize DRT to hire private tax collectors to assist with the identification, assessment, and collection of local taxes.[6]

2. Other Considerations:

A. Existing Law Requires an Appropriation –

In Guam, all public expenditures require a requisite appropriation prior to entering into a contract.[7] The Guam Organic Act, at Section 1423j, expressly reserves the power to appropriate money with the Legislature.[8] The Legislature's plenary power of appropriation includes the power to impose conditions upon the expenditure of appropriated funds.[9] The policy behind this plenary power is for the legislative, and not the executive branch, to determine which social programs or objectives to pursue.[10]

In addition to Section 1423j(a), the Guam Supreme Court, in *Pangelinan v. Gutierrez,* analyzed local law, codified at 5 GCA § 22401, that prohibits an officer or employee of the government of Guam from "involv[ing] the government of Guam in any contract or obligation ... in advance of the appropriation made for such purpose."[11] The Supreme Court held, such a contract or obligation constitutes an "illegal expenditure."[12] In its analysis the Court reasoned:

> Certainly, we do not attempt to limit the executive branch's prerogative in administering the expenditure of funds which are appropriated. However, where

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[3] *Carlson v. Guam Telephone Authority*, 2002 Guam 15, ¶ 9.
[4] DPW – 5 GCA Chapter 50, Chamorro Affairs – 5 GCA § 87103 and § 87104, Guam Solid Waste – 10 GCA § 51A104(e), EMS – 10 GCA § 84105, OPA – 7 GCA § 3112(1), GEPA – 10 GCA § 51103(c)(3), Child Support – 5 GCA § 34113, Mayors Council – 5 GCA § 40113(c), GHURA – 12 GCA § 5104, Port Authority 12 GCA § 10105, Guam Airport – 12 GCA § 1105, DLM – 21 GCA § 60502, GEDCA – 12 GCA § 51105, GVB – 12 GCA § 9105, Restoration of Hagatna – 21 GCA § 79303, GWA – 12 GCA § 14104, and GPA – 12 GCA § 14104.
[5] Similar to 26 USC § 6306, which authorizes assistance with collection activities but does not allow an outside contractor to investigate, assess, or compromise debt.
[6] It should be noted 26 USC § 6306, which authorizes assistance with collection activities of Guam Territorial Income Taxes, does not allow an outside Contractor to assess or compromise debt.
[7] *Pangelinan v. Gutierrez*, 2003 Guam 13 at ¶16.
[8] 48 USC § 1423j(a).
[9] *In re Request of Gutierrez*, 2002 Guam 1 at ¶ 44. However, see ¶ 45 stating, "(T)he Legislature may not set conditions to appropriations which impinge on the executive's power to allocate staff and resources for the proper fulfillment of its duty to execute the laws. (citation omitted)"
[10] *Id.*
[11] *Pangelinan v. Gutierrez*, 2003 Guam 13 at ¶ 15-17.
[12] *Id* at ¶ 23-25.

> the Governor involves the Government in a contract for the payment of money, without the requisite legislative approval for such contract, the Governor acts so without authority. See *Cray Research, Inc. v. United States,* 44 Fed. Cl. 327, 333 (1999) (finding that the contracting officer was without authority to contract in advance of appropriations).[13]

In the *Gutierrez* case, a violation of Section 1423j(a) of the Organic Act or 5 GCA § 22401 voided the offending contract.[14]

Guam law requires additional steps be taken when requesting certain types of appropriations. For instance, new projects need to be separately stated from annual budgets.[15] As such, 5 GCA § 4111 requires any outsourcing of tax functions to be separately stated in its initial budgetary request.

B. Existing Law Prohibits Outsourcing –

Public Law 31-233, Chapter XII, Section 16 prohibits the use of independent contractors to provide services typically performed by classified and unclassified employees. Since government of Guam employees actively participate in the assessment and collection of local taxes, Public Law 31-233 prohibits hiring outside parties from conducting this activity. As such, entering into a contract for the assessment and collection of local taxes would violate existing law.

C. Existing Law Requires Approval by the Legislature for Outsourcing Initiatives –

1 GCA § 1800, Requirement of Approval by Legislation for Privatization, provides:

> No office, department, agency, [or] institution, ... of the government of Guam may privatize any function or transfer any real property of the government of Guam without the approval of I Liheslatura [the Legislature]. Any plan or action taken by an office, ... purporting to privatize any function or transfer any real property of the government of Guam shall be transmitted to I Liheslatura [the Legislature] which, by statute, may amend, approve, or disapprove the plan or the action taken within forty-five (45) days or said plan or action shall be deemed approved.

The applicability of 1 GCA § 1800 needs further review. Neither 1 GCA § 1800 nor Chapter 18 defines "privatize." Generally, courts look to the plain meaning of a term if there is no definition provided within the statute.[16] Typically, the ordinary meaning may be ascertained by a dictionary.[17] Black's Law Dictionary defines privatization as, "the act or process of converting a business or industry from governmental ownership or control to private enterprise."[18] DRT's contemplated outsourcing initiative would not trigger the notice requirements of 1 GCA § 1800.

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[13] *Id.*
[14] *Id.*
[15] 5 GCA § 4111.
[16] *See generally* Statutory Interpretation: General Principals and recent Trends, a CRS Report for Congress (2008).
[17] *Id.*
[18] Black's Law Dictionary (8th Edition, 2005).

However, a court may look beyond the ordinary meaning when interpreting the statute.[19] Instead, a court may as easily look to the stated purpose of legislation to resolve statutory ambiguities.[20] The Legislative Findings and Intent of Public Law 27-34, which amended 1 GCA § 1800, state:

> The Legislature finds that certain existing provisions of the Guam Code annotated governing 'reorganization' of the government of Guam are restrictive of the privatization and outsourcing mandates required by the current financial and economic circumstances of the government of Guam. Thus, the Legislature finds it necessary to amend specific provisions that will facilitate implementation of such measures.[21]

Since a court may interpret 1 GCA § 1800 based on a plain meaning or legislative intent, any action undertaken by DRT should take the legislative intent of the statute into consideration[22] by providing notice to the Legislature prior to undertaking any initiative.

Finally, 5 GCA § 11103[23] requires legislative approval for reorganizations. The statutory definition of "reorganization" includes:

> (5) The authorization of any non-elective officer to appoint any individual to perform any of his functions; ... or
> (8) The use of a person under contract to perform functions which regularly are performed or budgeted to be performed by employees appointed under the merit system.

Outsourcing core functions of DRT triggers notification to the Legislature as any future agreement would 1) appoint an individual or firm to perform functions of the DRT Director (investigation, assessment, and collection) and 2) use a person under contract to perform functions regularly performed by employees. To remain compliant with 5 GCA § 11103, any outsourcing initiative requires approval by the Legislature prior to execution.

D. Use of a Private Collector May Compromise a Court Proceeding –

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[19] *See* Statutory Interpretation: General Principals and recent Trends, a CRS Report for Congress (2008) quoting Judge Learned Hand in his *Cabell v. Markham*, 148 F.2d 737, 739 (2d Cir. 1945) decision, "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary; but to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning."

[20] *See* Statutory Interpretation: General Principals and recent Trends, a CRS Report for Congress (2008) citing *United States v. Turkette*, 452 U.S. 576, 588-90 (1981) and citing *Rice v. Rehner*, 463 U.S. 713, 732 (1983) when the court held a canon of construction should not be followed, "when application would be tantamount to a formalistic disregard of congressional intent."

[21] Public Law 27-34 (2003).

[22] Failing to do otherwise may lead to adverse consequences. For example, if a Court determines notice and approval were necessary and the agency failed to obtain said requirements, then any subsequent contract for services would likely be cancelled leaving the government potentially responsible for significant costs. Additionally, under Guam law any procurement needs an appropriate appropriation (failure to obtain may result in a taxpayer lawsuit against the individual pursuant to5 GCA, Chapter 7 or voiding of the contact / imposing a criminal charge under P.L. 31-77).

[23] This Statute may conflict with § 1422c(c) of the Guam Organic Act which grants the Governor the authority to reorganize the executive branch.

In its Policy Statement on Contingency Fee Audit Arrangements, the Tax Executives Institute, Inc. raised concerns regarding the use of a transfer pricing auditor, compensated on a contingency fee basis, to provide expert testimony as a means to substantiate the validity of the transfer pricing assessments. Tax Executives Institute, Inc. believes the process violates certain state ethics rules. By way of example, the policy statement referred to comment three to Rule 3.4(b) of the American Bar Association Model Rules of Professional Conduct, which states, "it is improper to pay an expert witness a contingent fee."[24] Therefore, the use of an expert paid on a contingency fee basis may compromise future litigation efforts.

E. Policy Considerations –

Since tax collection requires fair and impartial assessments, the government must be free of any outside influence. When a contingency fee agreement is in place there is a potential erosion of the government's neutrality as the individual or firm making the decisions will not be paid unless there is a substantial monetary recovery. In this situation, tax collection may not be guided by what is best for the general welfare.[25] The major risk a contingency fee agreement poses to the assessment and collection of taxes is that public confidence will be eroded by the perception that government action is being steered solely by profit-seeking rather than public policy. Emphasizing this point, the following organizations provided statements or resolutions advocating for the prohibition of contingency fee agreements for tax audits: American Institute for Certified Public Accountant's, Tax Executives Institute, Inc., Taxation Section of the Michigan State Bar, and the National Conference of State Legislators.

CONCLUSION

For these reasons, absent express statutory authority to outsource local tax functions, DRT should not enter into any contracts or other agreements for the assessment and collection of the business privilege tax.

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[24] See Model Rules of Professional Conduct Rule 3.4, Comment 3.

[25] *See Sears, Roebuck and Co. v. Parsons*, 260 Ga. 824 (1991) wherein the Georgia Supreme Court invalidated a contingency fee agreement for property tax returns based on public policy grounds.