Dear Governor Togiola,

We submit for your review the Economic Advisory Council (EAC) report on Policy Reform, covering issues and recommendations for your consideration.

Being mindful of the highly competitive global economy, American Samoa must ensure that our environment is commercially attractive and as friendly as possible; that potential investors will give us serious consideration and gain a level of comfort from our investment parameters, cultural requirements, statutes and codes that will assist them with making positive investment decisions in our favor.

It is the view of the EAC that such reforms are deemed necessary to encourage economic development and investment by non-US companies.

We look forward to the opportunity to discuss the contents of this report with you, and in due course, working with the relevant government entities, to addressing and implementing policy changes as they become necessary and appropriate.

Sincerely,

Oreta M. Togafau	**David Robinson**
Co-chair	Co-chair

REPORT ON POLICY REFORM
Economic Advisory Council
Pago Pago, American Samoa
June 2008

The concept of policy reform can be both simple and difficult. In its simple format, policy reform may entail no more than a simplification of procedures designed to make doing business with the American Samoa Government easier. For the purposes of this paper we are assuming the role of non-US overseas investors that intend to establish a manufacturing operation in American Samoa to service the US market. To ensure a balanced view of each issue, substantial discussions have been held with the various government departments and where practicable their comments have been incorporated in recommendations that have been made. Areas of concern are:

Business Licenses
As it currently stands it could take up to 6 months for new investors to navigate the cumbersome business license application process and that assumes that the investors have employed a competent person to guide them through this complex process.

Corporate Tax Policy
Serious investors will consider the tax environment that they will operate under and they will quickly identify that American Samoa tax rates are some of the highest in the world and by far the highest tax rates in the South Pacific. In addition they will be expected to pay; withholding tax on any dividend payments made to the parent company after payment of the high income tax; withholding tax on any interest payments on borrowings from non-US based banks and on any management fees paid to the parent, and; withholding tax on payments to any non-US based contractor or service provider. They will also be faced with high and inconsistent levels of Import Excise Tax on all fixed assets and raw materials sourced from off-shore. This can add up to an effective tax rate in excess of 65%. The investors may be told that they can apply for a Tax Exemption from the Tax Exemption Board; however this provides little comfort as it is not guaranteed and could change depending on the whim of politicians and/or a change of government.

Personal Tax Policy
This can be an issue for all taxpayers; however, as all workers will be subject to local tax policy it will appear unusual that the tax policy for employees was frozen in December 2000, therefore representing an older tax scale than that which currently applies in the USA. This may not be an issue, except when you consider the benefits that US taxpayers have enjoyed subsequently, none of which have been passed on to the American Samoan taxpayer, This is a major concern when attempting to employ mainland Americans.

Immigration Policy
Given the small population of American Samoa, it is inevitable that some specialized roles cannot be filled from existing resources, and in the case of lower paid jobs, such as tuna canneries, it has proven problematic, at best, to recruit from the local population. However, immigration reform should not favor expatriate workers over American Samoan workers. Immigration reform should seek to reform the guest worker renewal process, and modify the permit timeframes to match contract time periods. Small changes like these two recommendations can have big results in the area of immigration reform.

POLICY REFORM ISSUES AND RECOMMENDATIONS

1. Business Licenses

One of the major problems recognized by the private sector is that the process by which a business license application is reviewed and approved or disapproved is lengthy and cumbersome. This may discourage an applicant from establishing a small business, and possibly pose a threat to the individual’s livelihood and income. The average time for processing a business license in American Samoa is said to be at least six months. This cannot compete with other countries around the world where anything more than one week (provided all documents are in order) would be deemed poor service.

In addition, the current practice by ASG, as required by law, is that a license be obtained for any and all activity added to an already established business. This means that a business is unable to operate more than one business under the same corporation, without obtaining a further business license. One example is where an individual required a separate license to run a computer repair operation and a sewing machine repair operation. We propose that this provision be removed or an amendment be made to the statute, because it only makes the process longer and frustrating for both ASG and the applicant.

In reality, provided an investor is prepared to abide by the law and commit capital to establish a business, the process should be very simple. It is acknowledged that this concept does not extend to more regulated industries such as telecommunications insurance and banking where industry specific licenses are required.

As it stands, the Territorial Planning Commission (TPC) is the entity that gives the final call on a business license application before being forwarded to the Governor for approval/disapproval. Prior to the TPC, the application is required to obtain approvals and signatures from seven other agencies. The Council suggests that TPC statutes & rules be revisited to help alleviate the business licensing process and ensure fairness in decisions made.

The Department of Commerce was recently awarded a Technical Assistant Grant by the U.S. Department of Interior to set up a “One-Stop Shop” type of system for permitting and business licensing in American Samoa. The Council is in full support of this effort and wishes that the needs of the private sector be considered and met when designing this project. This “One-Stop Shop” system will ease up the permitting and business licensing process, and will encourage entrepreneurs and outside investors to establish and conduct business in the Territory. This will most definitely be beneficial to the local economy.

2. View of the Department of Commerce (DOC)

Discussions held with DOC generally supported the recommendations made here and the Council was delighted to hear that the “One-Stop Shop” concept remains a focus of DOC moving forward. The procurement process on this project has started in which the project will be carried out in two phases. First phase will be the e-permitting and computerizing of basic information and the second part will be connecting all involved agencies.

3 Business License Recommendations

The Council makes the following recommendations in regard to Business License applications:

- Revise the existing TPC Statutes and Rules with a strong view to simplification.
- Ensure only one agency is required to approve an application or at most two agencies where special requirements exist (e.g. Department of Health, in the case of Food Vendors).
- Enable only be one business license in instances where multiple but similar operations exist. e.g., only one license should be issued for a retailer, not separate licenses depending on what is being retailed.
- Establish a maximum acceptable time frame for completion of the process and implement the required change to ensure this standard is met. This Council recommends one week as the standard to be reduced to one day over time.
- Pursue the One-Stop Shop concept as a matter of urgency.

4 Tax Reform

Tax reform, and all its connotations, is the largest and most complex of the issues dealt with in this paper and it is acknowledged that wholesale changes to the tax act as it currently applies can be a difficult matter. Nevertheless, the Council considers the current tax structure to be the largest single deterrent to foreign investment and for that reason alone, it deserves to be addressed immediately. Whether the canneries stay or go, foreign investment is vital to the economic future of American Samoa and all efforts should be directed towards welcoming investors.

The taxation issues faced by our theoretical foreign investor are complex, cumbersome and negative. They include:

Corporate Tax Rate

The current tax rates are:

Up to and including $50,000	15%
$50,001 - $75,000	25%
$75,001 - $650,000	34%
Greater than $650,000	44%

These are among the highest corporate tax rates in the world and are well in excess of tax rates that apply to neighboring countries, for example:

Samoa	29%
Asia Pacific region average	30%
Guam	35%
New Zealand	33%
CNMI	18%

It may be seen as a necessary evil by the Government, as corporate taxes are a substantial contributor to local revenue (19%); however in countries where taxes are lower, corporate taxes contribute much more than this, as corporations are less worried about minimizing tax and more concerned about making money.

Corporate Withholding Tax
Current contentious withholding tax rates are:

• Dividend Withholding Tax – payable on all dividends paid to non-US parent companies	30%
• Interest Withholding Tax – payable on all interest payments to non – US financiers (e.g. parent)	30%
• Management Fee Withholding Tax – payable on all management fees, royalties etc. paid to either parent entities or franchisees or similar.	30%
• Service Fee Withholding Tax – payable whenever non-US service providers provide services in American Samoa (e.g. off-island auditors)	30%

The concept of withholding tax in its simple form is to tax revenue that is not captured under the normal tax collection process; however, in the first two of these instances that is not the case:

Dividends are only paid from after tax income, meaning the company has already paid tax on net profit and is then asked to pay tax again as the profit is distributed to the company owners. Interest paid on money borrowed from a local or US bank or financier/parent does not attract this tax. In both cases the expense remains a tax deduction; however, the source of the borrowing should have no impact on the tax paid. It appears that this is designed to tax the revenue of the financier; however, it is not the financier who is paying the withholding tax; it is the borrower, as a deduction of 30% withholding tax from any interest payment would inevitably result in a monetary default under the loan agreement. The end result, assuming a 100% dividend repatriation, can be an effective tax rate of over 60%. This is very restrictive and only applies to non-US companies whereas the USA only applies withholding taxes in these instances of between 0 – 5% depending on the tax treaty negotiated with the country of ownership.

Import Excise Tax
In the absence of a Sales Tax, Goods and Services Tax or Value Added Tax, Import Excise Tax (IET) can be a suitable alternative provided that rates applied are both fair for all concerned and evenly charged.

Unfortunately, IET has become a simple source of Government funding for various projects and has seen IET increased on an ad hoc basis, such as the unpopular soda tax or alcohol tax. In isolation these may not matter much; however, potential investors can be confused by the complexity and worried about the potential of IET increasing on goods they import.

Most successful economies have effectively removed IET and relied more on a sales based tax, despite the difficulties involved in policing this. It is the view of this Council that this should be pursued further, despite the apparent complexities in policing. It may well be appropriate to employ additional tax officers to enforce collection which will be funded from the increased revenue that it attracts.

Personal Tax Rates

It is expected that an investor will need employees and while it is expected most would be local, often foreign labor is required for specialized roles. These employees will no doubt need to compare taxation rates with those currently paid to ensure they are earning an equivalent or better salary. As a result of the freezing of the American Samoa tax code to mirror the US tax code of December 31, 2000, benefits that have subsequently been enjoyed within the USA, such as reduced tax rates and family allowances, have not been passed on locally.

In addition, a more attractive personal tax code would benefit S-Corporations and sole/joint proprietors that all pay effective tax at the personal rates.

Tax Exemption Board

When faced with such a complex tax regime, the potential investor may take comfort in the Tax Exemption process; however, traditionally, investors are not in favor of exemptions as they are often temporary by nature, can be dependent on the whim of politicians or altered as a result of a change of a government.

These concerns are only heightened in American Samoa. Applying for an exemption can be a time consuming and frustrating process as exemptions are not granted evenly or easily, despite promises that may have been made during initial discussions with government representatives. The worry of existing exemptions being overturned in the future exist as well as uneven playing fields being created should competitors obtain more attractive exemptions, particularly IET exemptions.

Most investors would prefer to see a fair, reasonable and consistently applied corporate and personal tax system that will provide comfort without the reliance on government support.

The key factors potential investors look for in the tax structures are: fair and reasonable tax rates; consistent application of tax with penalties for non-compliance; no exemption process, particularly one that is not consistently applied; competitive tax rates, particularly with neighboring areas; and, simplicity.

One of the many reasons that Hong Kong became a major financial center, despite no real natural resources, was a very simple tax code and a reasonable rate of 18% that was fairly applied.

5 View of Tax Office

Meetings were held with Tax Office representatives in American Samoa during the preparation of this report, together with the newly appointed ASG Treasurer. It is fair to say that the Tax Office supports tax reform in essence; however, it expresses concerns regarding the change process and the ability of the existing Tax Office employees' structure to police any changes. These concerns stem, in part, from the existing frustrations experienced with policing the existing tax code, such as:

Cash & Off-Shore Payments

While sympathy was held for the plight of the foreign investor in regard to withholding tax, this does not extend to the recipients of the cash economy, particularly as it relates to non-American Samoa corporations that are contracted to provide a service to American Samoa (e.g. a construction project). Inevitably the payments for this project are made either direct to the country of origin of the contractor or in cash. As a result no local tax is often paid on revenue earned in the Territory.

Frustrations were voiced regarding the propensity of this to occur as well as the inability of the Tax Office to police this. In other countries this problem is enforced by either a robust and well policed Goods & Service Tax (GST) or by a requirement for only locally registered contractors to contract for such jobs, requiring also that being a locally registered entity, they must file a tax return and pay appropriate taxes.

Non Filers

Frustrations were raised regarding the lack of resources available to the Tax Office to police non-filers. Detailed statistics are not available; however, based on known numbers of registered corporations as advised by the DOC, less than 40% are actually lodging tax returns. The Council believes all businesses should pay their correct tax by filing a tax return and supports any efforts in policing non-filers.

This can be a further deterrent to new investment if it is deemed un-penalized common practice not to file, as investors like to operate in level playing fields.

Compliance

Frustrations were raised regarding the lack of skilled resources in the Tax Office and the impact this has on tax revenue.

Withholding Tax Payments

Despite the negativity that this tax causes for potential investors, the reality is that many companies are not paying it, either out of: a lack of understanding of the tax act, a willful avoidance of the tax or, in the case of the dividend withholding tax, by not striking a dividend. Based on estimates only for the 2007 tax year, approximately $7million was raised from withholding tax, although it was stressed that the vast majority of this was paid by very few corporations and mainly related to tax on royalties, which is potentially more acceptable as these are tax deductible expenses and therefore not taxed by other means.

Based on this rough analysis, removal of the withholding tax on dividends and off-shore interest only will have minimal negative impact on tax revenue and a very positive impact on foreign investment.

Lost Revenue from Tax Reform

There is little doubt that any tax reform that is beneficial to foreign investment will result in reduced taxation revenue. The Council believes that such a reduction will be temporary in nature as it will be off-set in due course by increased investment, resulting in increased tax revenue, even though there will no doubt be a dip in revenue that will need to be managed or financed.

In addition, the Tax Office advised that the tax revenue for 2007 was stronger than recent years and that the Tax Office is doing all it can to maximize tax collection in the future in an attempt to fund a government that struggles fiscally. Any proposed reduction in revenue will not be welcome and would need to be carefully managed. This should also be considered in light of the current economic climate. As minimum wage hikes seem to be continuing, canneries continue to struggle to recruit employees and threaten to leave the territory and the US economy enters a recession, the likelihood that tax revenues will reduce over the ensuing years as businesses struggle to maintain previous levels of profitability is real.

Despite all of this, there was reasonable support from Tax Office for a gradual reduction in the top corporate tax rate. At the moment only a handful of companies are paying the top corporate tax rate of 44%; however, the tax paid by these companies is approximately $10 million, compared to approximately $20 million from other forms of taxation including IET. As a result, these corporations are paying a disproportionate contribution. Names were not provided; however, it is expected that these few companies are representative of the larger employers in the Territory. It should also be stressed that the $10 million paid by the few also includes tax paid at the lower scales also. It is estimated that a reduction in the top corporate tax rate from 44% to 35% for example, may only result in a reduction in tax paid of $1.5 – 2.5million.

Specific details of the sources of tax revenue were sought from the Tax Office but were not provided due to disclosure issues.

Discussion was held around privatization as a means to fund any potential shortfall in tax collection; however, this was not something that the Tax Office was comfortable discussing.

In addition they did not want to see tax treaties form part of this paper as the USA has spent many years negotiating its existing treaties and they were not comfortable that American Samoa was in a position to unilaterally adopt similar treaties.

Tax Recommendations

The Council recommends the following in regard to tax reform:

- **An initial reduction in the corporate tax rates**:
  An initial reduction in the corporate tax rates from 44% to perhaps 35%, with a subsequent review to progressively reduce them further in possibly 3 – 4 years when the impact of the initial reduction is known. It is the view of this Council that the corporate tax rate should more closely mirror that of personal taxpayers as well as being competitive within the South Pacific region. This should entail a reduction in the corporate tax rate to below 30% and this Council recommends 25% as a reasonable target. This would ensure competitiveness as well be seen as a reasonable rate by taxpayers in turn leading to improved tax ethics.
- **Removal of the unpopular dividend withholding tax**:
  It is a double taxation, being paid after payment of corporate taxes; it is not providing much revenue in any event and is a major negative for foreign investment.
- **Removal of the interest withholding tax:**
  Similarly, it is not providing much revenue (if any); however, it restricts the ability of non-US based corporations to raise money in a cost effective manner for the purposes of foreign investment here. Bearing in mind that it can be difficult for foreign investors to raise debt from the local banks as they do not usually have a proven track record and / or a sound collateral base from which to secure debt. The intent, being to tax the recipient of the interest, is not being achieved as the lender will not allow withholding tax to be deducted without calling a monetary default on the borrower.
  Removal of the Tax Exemption Board (preferable):

This includes cancellation of all existing exemptions provided, or a substantial revision of the tax exemption process. It is acknowledged that exemption removals may need to be progressively introduced as some corporations are only able to remain competitive as a result of incentives currently in place; however, for this reason alone, the board should be disbanded as level playing fields should be encouraged at all times.

Should a revision of the tax exemption process be considered, then it should include extremely clear guidelines that must be met before an exemption is provided, such as:

- required levels of investment or equity
- required local employment levels
- a clearly defined and non-competitive market. This is essential to ensure that existing market players are not suddenly disadvantaged due to a new entrant with an attractive tax exemption.
- clear evidence of economic benefit, or
- clear evidence of an uneven playing field with the tax exemption request designed to rectify the anomaly.
- **Personal Tax rates should be aligned to US tax rates at a maximum, possibly even lower**

The difficulties of this are acknowledged by this Council as the US tax code is very complex and difficult to administer, which is probably the reason why the code was frozen in December 2000. Nevertheless, the American Samoan taxpayer is paying a rate higher than mainland USA and higher than neighboring countries.

Traditionally lower salary levels relate to lower taxation and this is not occurring in American Samoa at present. Ideally, a simplified tax code is adopted, similar to other Pacific Island countries; however, this has not been researched in any great detail in the preparation of this report, as it is deemed out of scope.

6. Immigration Policy

Attracting new and possibly foreign investment dollars will necessitate a review of our current immigration practices to see how new investors in our community can cope with a process that will be proactive in assisting to employ the expatriate or guest workers who may be needed. It should be stressed here that the intent of any immigration reform should not favor expatriate workers over American Samoan workers and existing policy that requires evidence that the role could not be filled from existing American Samoan resources as part of an Entry Permit application is encouraged and should be retained.

There, then, needs to be a method of matching the immigration term with the term of the asset invested. For example, in the case of the manufacturing investors, it is likely they will see this asset as a 10 year plus asset, yet they will face the existing arrangement of one year entry permits for both the investor and the managers of the investment that must be renewed each year. One suggestion is to provide “investment entry permits” that will allow the investor to remain in the territory for either the term of the employment contract or the perceived term of the investment (depending on the level of the investment), on the proviso that the applicant maintains a clean criminal record.

This and other areas where improvement is needed in the immigration process was detailed in the 2006 American Samoa Private Sector Assessment prepared by the Department of The Interior Office of Insular Affairs and the Council believes that these areas are still those most in need of urgent attention. They include:

The Attorney General should delegate the administrative task of reviewing applications to an administrator within the Department of Immigration with the idea of expeditiously moving applications forward, provided all required criteria are met.

As the Immigration Board consists of political appointees, assigning a legal specialist, an immigration specialist, and a private sector representative to the Immigration Board to support the Board in moving forward on applications should assist in streamlining the process.

Changing the present practice of one year renewals for workers who are in American Samoa in connection with their employment contract. Work permission should be granted for 2 or 3 years instead of the current 1-year practice. This is a major issue for expatriates who often need to bring families with them, yet can obtain no more than a one year work permit.

Even if 2 – 3 year entry permits are made available, the process of obtaining a renewal should be simplified. The existing process of obtaining a renewal is cumbersome, time consuming and necessitates time off work and school to attend hearings and renewal arrangements. Provided the applicant has a clean criminal record and intends working for the same corporation, renewal should be a simple matter and should extend to the term of the employment contract. This is not to say that American Samoan employment should not be protected where possible; however, in instances where foreign employment is inevitable, then a simplified process is in order. The USA recognizes this and offers visa terms in excess of three years in certain circumstances.

Clearly the community's need for economic development must be addressed in a way to be sensitive to our culture and laws. The Council recommends working towards immigration processes that are fair, transparent and efficient.

Another aspect of immigration policy should be to review our educational system to see what is being done to promote vocational education to have more American Samoans skilled in the trades like electricians, plumbers, diesel mechanics, refrigeration technicians and other trades which the local business community is currently employing from beyond American Samoa.

The existing Guest Worker program is a step in the right direction; however, based on discussions with both canneries, it does not appear to have solved the problem, with both canneries experiencing difficulty in attracting labor.

7 Immigration Recommendations

The Council believes there are two specific areas that should be targeted in relation to immigration reform:

- Streamlining the Immigration Renewal Process
- Delegating the task of renewal applications and simplifying the process by excluding involvement of senior immigration officials other than for more complex issues.
- Assigning a legal/immigration specialist to the immigration board to support the board.
- Simplifying the process. The existing process is very detailed and requires multiple visits to the immigration office. Provided all documentation is in order this should not be necessary.
- Review the existing sponsorship program. Currently it is seen as an income generating exercise for many, Employees should have more ability to sponsor workers.
- If an immigrant has a steady job and a clean police record, then renewal should be a simple process.

Revise Existing Immigration Policy

• For investors who are committing capital for the benefit of the economy of American Samoa, Entry Permit terms that are reflective of the life of the asset invested should be pursued. For example, a building company under a specific contract should have an Entry Permit for the life of the contract, whereas a manufacturing investor that is building a factory should receive a longer term Entry Permit – say 5 – 10 years.

• For contract employees, the Entry Permit should reflect the term of their contracts (and be sponsored by the employer).

In both instances above, a process could be established where an annual confirmation certificate is provided which states that the conditions of entry remain and that a clean police record is held. If that is the case, then the file is noted with no need for renewal to occur. If that is not the case, the immigration status could be revoked.