SIXTEENTH CONGRESS OF THE FEDERATED STATES OF MICRONESIA

THIRD SPECIAL SESSION, 2010 C.B. NO. 16-97

A BILL FOR AN ACT

To further amend Title 54 of the Code of the Federated States of Micronesia, as amended, by adding a new Chapter 5 to establish the Net Profit Tax Act of 2010, and for other purposes.

BE IT ENACTED BY THE CONGRESS OF THE FEDERATED STATES OF MICRONESIA:

Section 1. Title 54 of the Code of the Federated States of Micronesia is hereby further amended by adding a new chapter 5 entitled "Taxation of Net Profits".

Section 2. Title 54 of the Code of the Federated States of Micronesia is hereby amended by adding a new subchapter I of Chapter 5 entitled "General Provisions."

Section 3. Title 54 of the Code of the Federated States of Micronesia is hereby further amended by adding a new section 511 to subchapter I of Chapter 5 to read as follows:

"Section 511. Short title. This chapter may be cited as the "Net Profit Tax Act of 2010".

Section 4. Title 54 of the Code of the Federated States of Micronesia is hereby further amended by adding a new section 512 to subchapter 1 of Chapter 5 to read as follows:

"Section 512. Definitions. In this chapter, except where otherwise specified, the following terms shall have the meanings stated below:

(1) "Associate" has the meaning in section 515.

(2) "Board" means the Board of Directors of the

Unified Revenue Authority as appointed under Section 712 of this Title.

(3) "Business" includes any profession, trade, manufacture, or other undertaking carried on for pecuniary profit, but not including employment.

(4) "Business asset" means an asset, whether of revenue or capital nature, used, available for use, or held in carrying on a business, including inventory, a depreciable asset, an intangible, or goodwill.

(5) "CEO" means the Chief Executive Officer appointed under section 731 of this Title.

(6) "Consideration received", in relation to a business asset, has the meaning attributed to it in section 553.

(7) "Cost", in relation to a business asset, has the meaning attributed to it in section 552.

(8) "Depreciable asset" means any tangible personal property or that portion of a structural improvement to real property that:

(a) has a useful life exceeding one year;

(b) is likely to lose value as a result of normal wear and tear, or obsolescence; and

(c) is used, available for use, or held solely to derive gross revenue.

(9) "Disposal", in relation to a business asset, has

the meaning in section 551.

(10) "Distribution", in relation to an entity, includes:

(a) a distribution of profits or entitlement to income by an entity to a member of the entity;

(b) an amount returned by an entity to a member of the entity in respect of a membership interest in the entity on a partial reduction in capital to the extent that the amount returned exceeds the amount by which the nominal value of the membership interest was reduced; or

(c) any amount distributed by an entity to a member of the entity on redemption or cancellation of a membership interest in the entity (including in liquidation or dissolution of the entity) to the extent the amount distributed exceeds the nominal value of the membership interest.

(11) "Employee" means any individual who, under the usual common law rules applicable in the FSM in determining an employer-employee relationship, has the status of an employee.

(12) "Employment" means an employer-employee relationship as determined under the usual common law rules applicable in the FSM and includes activities performed as the holder of an office.

<u>(13) “Entertainment” means the provision of food, beverages, tobacco, amusement, recreation, or hospitality of any kind.</u>

<u>(14) “Entity” means a company, corporation, partnership, unincorporated association or other business entity, trust, or estate.</u>

<u>(15) “Finance lease” means a lease that is treated under generally accepted accounting principles as a finance lease and is so accounted for by the lessor in its financial accounts.</u>

<u>(16) “FSM” means the Federated States of Micronesia.</u>

<u>(17) “Gross revenue” has the meaning attributed to it in section 532.</u>

<u>(18) “Industrial building” means a building that is a depreciable asset used, available for use, or held solely in carrying on:</u>

<u>(a) manufacturing operations;</u>

<u>(b) research and development into improved or new methods of manufacture;</u>

<u>(c) mining operations (other than an accommodation building); or</u>

<u>(d) a hotel business.</u>

<u>(19) “Intangible” means:</u>

<u>(a) a patent, invention, design or model, secret formula or process, trademark, copyright, or other</u>

like property or right;

(b) contractual rights (including arising as a result of a prepayment of expenses) with a benefit for a period of more than one year; or

(c) an expenditure that provides an advantage or benefit for a period of more than one year, other than expenditure incurred to acquire any tangible personal or real property, provided that the property, right, or expenditure is used solely to derive gross revenue.

(20) "Interest" means:

(a) an amount, whether described as interest, discount, premium, or otherwise, whether periodical or a lump sum, as consideration for the use of money or being given time to pay;

(b) an amount that is functionally equivalent to an amount referred to in paragraph (a);

(c) any amount treated as interest under section 546; or

(d) a commitment, guarantee, service, or similar fee payable in respect of a debt or other instrument or agreement giving rise to interest under subparagraphs (a), (b), or (c).

(21) "Inventory" means anything produced, manufactured, purchased, or otherwise acquired for sale or exchange, and includes livestock, or any raw materials, or

consumables used in a production or manufacturing process.

(22) "Liaison office" means an office the sole activity of which is representation.

(23) "Management fee" means an amount as consideration for the rendering of a managerial service, but does not include salary or wages.

(24) "Member", in relation to an entity, means a shareholder in a company, partner in a partnership, beneficiary of a trust, or any other person with a membership interest in the entity.

(25) "Membership interest", in relation to an entity, means a share in a company, the interest of a partner in a partnership, the interest of a beneficiary in a trust, and any other ownership interest in the entity.

(26) "Natural resource amount" means:

(a) an amount (including a premium or like amount) as consideration for the right to take minerals or a living or non-living resource from land or sea; or

(b) an amount calculated in whole or part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea.

(27) "Net profit" has the meaning in section 531.

(28) "Net profit tax" means a tax imposed under subchapter II.

(29) "Non-resident person" means a person that is not a resident person.

(30) "Permanent establishment" means a fixed place of business through which the business of a person is wholly or partly carried on, and includes:

(a) a place of management, branch, office (other than a liaison office), factory, warehouse, or workshop;

(b) a mine, oil or gas well, quarry, or other place of extraction of natural resources;

(c) a building site, or a construction, assembly or installation project, or supervisory activities connected with such site or project, but only if the site, project or activities continue for more than ninety days;

(d) the furnishing of services by the person, including consultancy services, through employees or other personnel engaged by the person for such purpose, but only if activities of that nature continue for the same or a connected project for a period or periods aggregating more than ninety days within any twelve-month period;

(e) a person (referred to as an "agent") acting on behalf of another person (referred to as the "principal"), if the agent:

(i) has and habitually exercises an

authority to conclude contracts on behalf of the principal; or

(ii) habitually maintains a stock of inventory from which the agent regularly delivers inventory on behalf of the principal, but does not include an agent of independent status; or

(f) any substantial equipment used by a person.

(31) "Person" means an individual, company, corporation, partnership, unincorporated association or other business entity, trust, estate, a government, a political subdivision of a government, or a public international organization.

(32) "Prescribed" means set forth by the Secretary in regulations.

(33) "President" means the President of the FSM.

(34) "Relative" in relation to an individual, means:

(a) an ancestor, a descendant of any of the grandparents, or an adopted child, of the individual;

(b) an ancestor, a descendant of any of the grandparents, or an adopted child of a spouse of the individual; or

(c) a spouse of the individual or any person specified in paragraph (a) or (b).

(35) "Resident person" means:

(a) in the case of an individual, an individual who:

(i) has his or her home in the FSM; or

(ii) is present in the FSM for a period of, or periods amounting in aggregate to, one hundred eighty-three days or more in any twelve month period that commences or ends during a tax year; or

(iii) is an employee of the National or a State Government of the FSM posted abroad at any time during the year; or

(b) in the case of any other person, the person is incorporated, formed, organized, or otherwise established in the FSM.

(36) "Royalty" means an amount, however described, whether periodical or a lump sum, as consideration for:

(a) the use of, or right to use any patent, invention, design or model, secret formula or process, trademark, or other like property or right;

(b) the use of, or right to use any copyright of a literary, artistic, or scientific work (including films or video tapes for use in connection with television or tapes in connection with radio broadcasting);

(c) the receipt of, or right to receive, any visual images or sounds, or both, transmitted by satellite, cable, optic fiber, or similar technology in connection with television, radio, or internet broadcasting;

(d) the supply of any technical, industrial, commercial, or scientific knowledge, experience, or skill;

(e) the use of or right to use any industrial, commercial, or scientific equipment; or

(f) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any property or right referred to in paragraphs (a) through (e).

(37) "Secretary" means the Secretary of the Department of Finance of the FSM National Government.

(38) "Small business" means a business that is carried on by a person that is not registered for the VAT because the business is below the VAT registration threshold.

(39) "State" means a State of the FSM.

(40) "Structural improvement", in relation to real property, includes any building, road, driveway, car park, pipeline, bridge, tunnel, airport runway, canal, dock, wharf, retaining wall, fence, power lines, water or sewerage pipes, drainage, landscaping, or dam.

(41) "Tax year" mean:

(a) in the case of a corporation, the period of twelve months ending on the date of the annual balance of its accounts; or

(b) in any other case, the period of twelve months ending on December 31.

(42) "URA" means the Unified Revenue Authority established pursuant to Chapter 7 of this Title.

(43) "VAT" means the value added tax imposed pursuant to applicable revenue laws.

(44) "VAT Law" means the Value Added Tax Act of a State."

Section 5. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 513 to subchapter 1 of chapter 5 to read as follows:

"Section 513. Source of Income.

(1) An amount derived by a resident person in carrying on a business is derived from sources in the FSM except to the extent that it is attributable to a business carried on through a permanent establishment of the person outside the FSM is considered a source of income for that resident person.

(2) An amount derived by a non-resident person in carrying on a business is derived from sources in the FSM to the extent that it is attributable to a business carried on through a permanent establishment of the

person in the FSM is considered a source of income for that non-resident person.

(3) Notwithstanding subsections (1) and (2), the following amounts are considered derived from sources in the FSM:

(a) a fee for services performed in the FSM;

(b) rental from the lease of real property in the FSM;

(c) interest, a royalty, or a management fee:

(i) paid by a resident person, other than as an expense of a business carried on through a permanent establishment of the person outside the FSM; or

(ii) paid by a non-resident person as an expense of a business carried on through a permanent establishment of the person in the FSM;

(d) a natural resource amount in respect of a natural resource taken in the FSM or

(e) an insurance premium in respect of the insurance of a risk in the FSM."

Section 6. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 514 to subchapter 1 of chapter 5 to read as follows:

"Section 514. Fair Market Value

(1) The fair market value of an asset, property, service, or benefit at a particular time is the ordinary

open market value of the asset, property, service, or benefit at that time.

(2) If it is not possible to determine the fair market value of an asset, property, service, or benefit at a particular time under subsection (1), the fair market value is the consideration a similar asset, property, service, or benefit would ordinarily fetch in the open market at that time, adjusted to take account of the differences between the similar asset, property, service, or benefit and the actual asset, property, service, or benefit.

(3) If the fair market value of an asset, property, service, or benefit cannot be determined under subsection (1) or (2), the fair market value is the amount determined by the CEO."

Section 7. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 515 to subchapter I of subchapter 5 to read as follows:

"Section 515. Associate

(1) Subject to subsection (2), two persons are associates if the relationship between them is such that one may reasonably be expected to act in accordance with the intentions of the other, or both persons may reasonably be expected to act in accordance with the intentions of a third person.

(2) Two persons are not associates solely by reason of the fact that one person is an employee of the other or both persons are employees of a third person.

(3) Without limiting the generality of subsection (1), the following are treated as associates:

(a) an individual and a relative of the individual, except if the CEO is satisfied that neither person may reasonably be expected to act in accordance with the intentions of the other;

(b) a partner in a partnership and the partnership, if the partner, either alone or together with an associate or associates under another application of this section, controls fifty per cent or more of the rights to income or capital of the partnership;

(c) a trust and a person who benefits or may benefit under the trust;

(d) a shareholder in a company and the company, if the shareholder, either alone or together with an associate or associates under another application of this section, controls either directly or through one or more interposed persons:

(i) fifty percent or more of the voting power in the company;

(ii) fifty per cent or more of the rights to dividends; or

(iii) fifty percent or more of the rights to capital, and

(e) two companies, if a person, either alone or together with an associate or associates under another application of this section, controls either directly or through one or more interposed persons:

(i) fifty per cent or more of the voting power in both companies,

(ii) fifty per cent or more of the rights to dividends in both companies, or

(iii) fifty per cent or more of the rights to capital in both companies.

(4) In applying subsection (3)(b), (d), or (e) holdings that are attributable to a person from an associate are not reattributed to another associate."

Section 8. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter II to chapter 5 to be entitled "Imposition of Tax".

Section 9. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 521 to subchapter II of Chapter 5 to read as follows:

"Section 521. Imposition of Net Profit Tax

Net profit tax is imposed for each tax year at the rate of 25% on the net profit for the tax year of every business."

Section 10. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 522 to subchapter II of Chapter 5 to read as follows:

"Section 522. Imposition of Presumptive Tax

A presumptive tax of Eighty Dollars ($80) per tax year is imposed on a business if the gross revenue of the business for the tax year does not exceed Ten Thousand Dollars ($10,000.)"

Section 11. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 523 to subchapter II of chapter 5 to read as follows:

"Section 523. General Provisions Applicable to Net Profit Tax and Presumptive Tax.

(1) Net profit tax or presumptive tax is payable by the person or persons carrying on the business. If a person carries on more than one business, the net profit tax or presumptive tax payable is computed and reported separately for each business. For this purpose, if a business has operations in more than one State, the operations in each State are treated as a separate business.

(2) No net profit tax or presumptive tax is payable if the gross revenue of a business for a tax year does not exceed Two Thousand Dollars ($2,000).

(3) Notwithstanding subsection 1of this section, in determining whether the gross revenue of a business carried on by a person does not exceed $10,000 for the purposes of section 522 or $2,000 for the purposes of subsection (2) of this section, account is taken of the gross revenue of all businesses carried on by the person or by associates of the person in the FSM."

Section 12. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 524 to subchapter II of chapter 5 to read as follows:

"Section 524. Imposition of Tax on Transportation or Insurance Income of Non-resident Person

(1) Tax is imposed at the rate of 3% on:

(a) the gross amount derived by a non-resident person without a permanent establishment operating a ship or aircraft for the carriage of passengers, livestock, mail, merchandise, or goods embarked in the FSM; or

(b) the gross amount of an insurance premium derived by a non-resident person for the insurance of risks in the FSM.

(2) Subsection (1)(b) does not apply to an insurance premium that is attributable to a business carried on by the non-resident person through a permanent establishment in the FSM and, in that case, the premium

is taxable under section 521.

(3) Tax payable under this section shall be payable by the non-resident person deriving the amount subject to tax. The tax payable under subsection (1)(a) shall be discharged if the tax has been paid in accordance with section 575 or 576, as the case may be, and the tax payable under subsection (1)(b) shall be discharged if the tax has been paid in accordance with section 581."

Section 13. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 525 to subchapter II of chapter 5 to read as follows:

"Section 525. Tax on Certain Payments to Non-resident Persons

(1) Tax is imposed at the rate specified in subsection (2) on the gross amount of interest, a royalty, natural resource amount, insurance premium, or management fee derived by a non-resident person from sources in the FSM.

(2) The rate of tax imposed under subsection (1) is:

(a) 5% of the gross amount of the insurance premium; or

(b) 15% of the gross amount of the interest, royalty, natural resource amount, or management fee.

(3) Subsection (1) does not apply to:

(a) an amount that is exempt income; or

(b) interest, a royalty, natural resource amount, insurance premium, or management fee that is attributable to a business carried on by the non-resident person through a permanent establishment of the person in the FSM and, in that case, the interest, royalty, natural resource amount, insurance premium, or management fee is taxable under section 521.

(4) The tax payable under subsection (1) is discharged if the tax has been paid in accordance with section 581."

Section 14. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter III to chapter 5 to be entitled "Computation of Net Profit".

Section 15. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 531 to subchapter III of chapter 5, to read as follows:

"Section 531. Net Profit

The net profit of a business for a tax year is the gross revenue of the business for the year reduced by the total amount of deductions allowed to the business for the year."

Section 16. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 532 to subchapter III of chapter 5 to read as follows:

"Section 532. Gross Revenue

The gross revenue of a business for a tax year is the sum of the following amounts (other than an amount that is exempt income) derived by the business during the year from sources in the FSM:

(a) the gross receipts from the carrying on of the business, including the gross proceeds from the disposal of inventory and the gross fees for the provision of services;

(b) the gross receipts from the employment of the capital of the business, including interest, royalties, and rentals;

(c) the net gain on disposal of a business asset (other than inventory);

(d) the net gain on satisfaction or cancellation of a debt of the business; and

(e) the amount of an expense, loss, or bad debt previously allowed as a deduction that has been reimbursed or recovered by the business.

(2) For the purposes of subsection (1)(c), the net gainon disposal of a business asset is the consideration received on disposal of the asset less the cost of the asset at the time of disposal.

(3) The gross revenue of a business does not include any amount subject to tax under section 522, 524, or 525."

Section 17. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 533 to subchapter III of chapter 5 to read as follows:

"Section 533. Exempt Income

(1) The following amounts are exempt income:

(a) a distribution by an entity; and

(b) interest paid by a resident company to a non-resident person in respect of debentures if the following conditions are satisfied:

(i) the debentures were issued by the company outside the FSM for the purpose of raising a loan outside the FSM;

(ii) the debentures were issued with a view to public subscription or other wide distribution;

(iii) the debentures were issued for the purpose of raising funds for use by the company in a business carried on in the FSM; and

(iv) the interest is paid outside the FSM.

(2) A provision in another law providing that an amount is exempt income does not have legal effect unless also provided for in this Act."

Section 18. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 534 to subchapter III of chapter 5 to read as follows:

"Section 534. Deductions

(1) Subject to this Act, the total amount of deductions allowed to a business for a tax year is the sum of:

(a) subject to section 535, the expenses incurred during the year solely in deriving amounts included in the gross revenue of the business;

(b) the cost of inventory acquired during the year as determined under section 544;

(c) the total amount, as determined under section 536, by which the value of the depreciable assets of the business have declined during the year by reason of wear and tear from use in deriving amounts included in the gross revenue of the business;

(d) the total amount, as determined under section 537, by which the value of the intangibles of the business have declined in value during the year from use in deriving amounts included in the gross revenue of the business; and

(e) the net loss on disposal of a business asset (other than inventory) during the year.

(2) For the purposes of subsection (1)(e), the net loss on disposal of a business asset is the cost of the asset at the time of disposal less the consideration received on disposal of the asset."

Section 19. Title 54 of the Code of the Federated States of

Micronesia, is hereby further amended by adding a new section 535 to subchapter III of chapter 5 to read as follows:

"<u>Section 535</u>. <u>Non-deductible Expenses</u>

<u>(1) No deduction is allowed for:</u>

<u>(a) a distribution by an entity or capital withdrawn from a business;</u>

<u>(b) an expense or loss of a capital nature except as provided in section 534(1)(c), (d), or (e);</u>

<u>(c) an amount placed in a reserve fund, a provision for expected expenses or losses, or an amount capitalized in any way;</u>

<u>(d) an expense or loss to the extent recoverable under a policy of insurance or contract of indemnity;</u>

<u>(e) an expense incurred in providing entertainment except:</u>

<u>(i) if the entertainment was provided in the ordinary course of a business carried on to provide the entertainment and the entertainment was not provided to an employee or an associate of the person carrying on the business; or</u>

<u>(ii) if the entertainment was provided to an employee, it was provided while the employee is traveling on business in course of the employee's employment;</u>

<u>(f) interest payable to an associate other than</u>

that interest included in the gross revenue of a business carried on by the associate or taxable under section 525;

(g) the net profit tax, including any penalty or interest payable in respect of net profit tax payable;

(h) a fine or penalty imposed for violation of any law, rule, or regulation; or

(i) a bribe, kickback, or other expense incurred to accomplish an illegal transaction or activity.

(2) A person required to withhold tax under Subchapter VII in respect of an amount paid to a non-resident person is not allowed a deduction for the amount paid until the withheld tax has been paid to the CEO."

Section 20. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 536 to subchapter III of chapter 5 to read as follows:

"Section 536. Depreciable Assets

(1) A business is allowed a deduction for a tax year for the amount by which the value of the depreciable assets of a business has declined in value during the year.

(2) The decline in value of a depreciable asset of a business for a tax year is computed by applying the rate specified in subsection (3) against the cost of the asset.

(3) The rate of depreciation is:

(a) in the case of motor vehicles, buses and minibuses, goods vehicles, trucks, tractors, trailers, and trailer-mounted containers, computers and data handling equipment, construction equipment and earthmoving equipment, and plant and machinery used in manufacturing, mining, or farming operations, [50%];

(b) in the case of industrial buildings, [10%];

(c) in the case of any other structural improvement, [5%]; or

(d) in the case of any other depreciable asset,[33$^{1}/_{3}$%].

(4) If a depreciable asset of a business is not used, available for use, or held in carrying on the business for the whole of the year, the amount computed under subsection (2) is reduced by the proportion of the year that the asset was not so used.

(5) The total decline in value allowed as a deduction under section 534(1)(c) for a depreciable asset for the current tax year and all previous tax years must not exceed the cost of the asset."

Section 21. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 537 to subchapter III of chapter 5 to read as follows:

"Section 537. Intangibles

(1) A business is allowed a deduction for a tax year for the amount by which the value of the intangibles of a business has declined in value during the year.

(2) The decline in value of an intangible of a business for a tax year is computed by dividing the cost of the intangible by its useful life.

(3) An intangible:

(a) with a useful life of more than ten years; or

(b) that does not have an ascertainable useful life, is treated as having a useful life of ten years.

(4) If an intangible of a business is not used, available for use, or held in carrying on the business for the whole of the year, the amount computed under subsection (2) is reduced by the proportion of the year that the intangible was not so used.

(5) The total decline in value allowed as a deduction under section 534(1)(d) for an intangible for the current tax year and all previous tax years must not exceed the cost of the intangible.

(6) In this section, "cost" means:

(a) in relation to an intangible referred to in paragraph (a) or (b) of the definition of "intangible" in section 512, the total expenditure incurred in acquiring, creating, improving, or renewing the intangible; or

(b) in relation to an intangible referred to in paragraph (c) of the definition of "intangible" in section 512, the amount of the expenditure."

Section 22. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 538 to subchapter III of chapter 5 to read as follows:

"Section 538. Net Loss Carry Forward

(1) If the total amount of deductions of a business allowed for a tax year exceeds the gross revenue of the business for the year, the amount of the excess is the net loss of the business for the year.

(2) If a business has a net loss for a tax year, the amount of the loss is carried forward to the following tax year and allowed as a deduction in computing the net profit of the business for that following year.

(3) If a net loss is not wholly deducted under subsection (2), the amount not deducted is carried forward to the next following tax year and applied as specified in subsection (2) in that year, and so on until the loss is fully deducted, but no loss can be carried forward for more than three tax years after the year in which the loss was incurred.

(4) If a person has a net loss carried forward under this section for more than one tax year, the loss of the earliest year is deducted first.

(5) If a person carries on more than one business, this section applies separately to each business."

Section 23. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 539 to subchapter III of chapter 5 to read as follows:

"Section 539. Currency Translation

(1) An amount taken into account under this Chapter must be expressed in United States dollars.

(2) Subject to subsection (3), if an amount is in a currency other than United States dollars, the amount must be translated to United States dollars at the United States Federal Reserve exchange rate applying between the foreign currency and United States dollars on the date the amount is taken into account for the purposes of this Chapter.

(3) With the prior written permission of the CEO, amounts taken into account in computing the net profit or net loss of a business for a tax year may be translated to United States dollars at the average mid-exchange rate for the tax year between the foreign currency and United States dollars."

Section 24. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 540 to subchapter III of chapter 5 to read as follows:

"Section 540. Interest Expense

(1) Subject to section 535(1)(f) and subsection (2) of this section, a business is allowed a deduction for any interest expense incurred by the business during a tax year to the extent to which the business has used the proceeds or benefit of the debt or other instrument or agreement giving rise to the interest to derive income included in the gross revenue of the business.

(2) The total amount of interest allowed to a business as a deduction under this section for a tax year must not exceed the amount computed according to the following formula:

A + (50% x (B – C))

Where:

A is the total interest income derived by the business during the year;

B is the total gross income of the business for the year, other than interest income; and

C is the total amount of deductions allowed to the business for the year, other than for interest incurred.

(3) If an amount of interest is not deducted in a tax year as a result of subsection (2), the undeducted amount of the interest is carried forward and treated as interest incurred by the business in the next following tax year and deducted in accordance with this section in that year, and so on until the interest is fully

deducted.

(4) Subsection (2) does not apply to a financial institution."

Section 25. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter IV to chapter 5 to be entitled "Tax Accounting".

Section 26. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 541 to subchapter IV of chapter 5 to read as follows:

"Section 541. Simplified Tax Accounting for Small Business

The net profit of a small business is computed in accordance with generally accepted accounting principles subject to the following modifications:

(a) the revenues and expenses of the business are accounted for on a cash basis under which an amount of revenue is derived when it is received and an expense is incurred when it is paid;

(b) no deduction is allowed for an amount specified in section 535;

(c) subject to paragraph (e), the amount allowed for the depreciation of depreciable assets or the amortization of intangibles is computed in accordance with sections 536 and 537;

(d) the amount allowed as a deduction under section

534(1)(b) for a tax year is the total amount paid by the business for the cost of inventory acquired during the year and section 544 does not apply; and

(e) an intangible that is a prepayment of a business expense is deductible in the tax year in which it is paid."

Section 27. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 542 to subchapter IV of chapter 5 to read as follows:

"Section 542. Tax Accounting for Businesses Other Than Small Businesses

(1) The net profit of a business (other than a small business) is computed in accordance with generally accepted accounting principles subject to the following modifications:

(a) the revenues and expenses of the business are accounted for on an accrual basis under which an amount of revenue is derived when it is due and an expense is incurred when it is payable;

(b) no deduction is allowed for any amount specified in section 535;

(c) the amount allowed for the depreciation of depreciable assets or the amortization of intangibles is computed in accordance with sections 536 and 537;

(d) the deduction allowed for inventory is computed in accordance with section 544;

(e) the gross revenues and expenses arising under a long-term contract are determined under section 545;

(f) a finance lease is treated as the equivalent of a sale and purchase of the leased asset in accordance with section 546; and

(g) a deduction for a bad debt is allowed in accordance with section 547.

(2) For the purposes of subsection (1)(a):

(a) an amount is due when the business is entitled to receive it even if the time for discharge of the entitlement is postponed or the amount is payable by installments; and

(b) an amount is payable when all the events that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy, but not before economic performance occurs.

(3) For the purposes of subsection (2), economic performance occurs:

(a) in the case of the acquisition of services or assets, at the time the services are provided or assets delivered;

(b) in the case of the use of assets, at the time assets are used; and

(c) in any other case, at the time payment is made in full satisfaction of the liability."

Section 28. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 543 to subchapter IV of chapter 5 to read as follows:

"Section 543. Change in Tax Accounting Method

(1) If a business that is a small business ceases to be a small business or a business that is not a small business becomes a small business, the business shall apply, in writing, to the CEO for a change in the method of accounting used by the business in computing the net profit of the person's business and the CEO shall in writing, approve or disapprove the application.

(2) If the method of accounting used by a business in computing the net profit of a business changes, adjustments must be made in the tax year of change to items of revenue, deduction, or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once."

Section 29. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 544 to subchapter IV of chapter 5 to read as follows:

"Section 544. Inventory

(1) The amount allowed as a deduction under section 534(1)(b) for a tax year to a business accounting for net profits tax on an accrual basis for the cost of

inventory is the cost of inventory disposed of during the year as computed under this section.

(2) The cost of inventory disposed of by a business during a tax year is computed in accordance with the following formula:

(A + B) – C

Where:

A is the opening value of the inventory for the tax year;

B is the cost of inventory acquired during the tax year; and

C is the closing value of inventory for the tax year.

(3) The opening value of inventory for a tax year:

(a) is the cost of inventory on hand at the end of the previous tax year; or

(b) if the business commenced during the year, the cost of inventory (if any) acquired by the owner of the business prior to commencement of the business.

(4) The closing value of inventory for a tax year is the lower of cost or fair market value of inventory on hand at the end of the tax year.

(5) The cost of inventory on hand at the end of a tax year is computed under the absorption-cost method. The absorption-cost method is the generally accepted accounting principle under which the cost of an item of inventory is the sum of direct material costs, direct

labor costs, and factory overhead costs. Direct material costs are the cost of materials that become an integral part of the inventory manufactured or produced, or which are consumed in the manufacturing or production process. Direct labor costs are the labor costs directly related to the manufacture or production of inventory. Factory overhead costs are the total costs of manufacturing or producing inventory, other than direct labor and direct material costs.

(6) If particular items of inventory are not readily identifiable, the cost of inventory on hand at the end of a tax year may be accounted for on the first-in-first-out method. The first-in-first-out method is the generally accepted accounting principle under which the valuation of inventory is based on the assumption that inventory is sold in the order of its acquisition."

Section 30. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 545 to subchapter IV of chapter 5 to read as follows:

"Section 545. Long-term Contracts

(1) A business accounting for net profit tax on an accrual basis must compute the net profit arising under a long-term contract during a tax year under the percentage of completion method. The percentage of completion method is the generally accepted accounting

principle under which revenues and expenditures arising under a long-term contract are recognized by reference to the stage of completion of the contract.

(2) In this section, "long-term contract" means a contract for manufacture, installation, or construction, or, in relation to each, the performance of related services, that is not completed within the tax year in which work under the contract commenced, other than a contract estimated to be completed within six months of the date on which work under the contract commenced."

Section 31. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 546 to subchapter IV of chapter 5 to read as follows:

"Section 546. Finance Leases

(1) If a business has entered into a finance lease, the net profit of the business is computed on the basis that:

(a) the lessee is the owner of the asset;

(b) the lessee acquired the asset at the commencement of the lease, except in cases when the lessee already was the owner of the asset; and

(c) the lessor has made a blended loan to the lessee at the commencement of the lease and each lease payment is in part repayment of principal and in part payment of interest under that loan.

(2) The cost of an asset treated as owned by the lessee under subsection (1)(a) is:

(a) if the lessor and lessee are not associates and an amount is stated as the cost or value of the asset in the lease agreement, that amount; or

(b) in any other case, the fair market value of the asset at the commencement of the lease.

(3) The amount of the loan referred to in subsection (1)(c) is the amount determined under subsection (2) as the cost of the asset.

(4) The interest part of each payment made under the loan is computed by reference to the interest rate implicit in the lease agreement.

(5) In this section, a blended loan is a loan under which payments by the borrower represent in part a payment of interest and in part a repayment of principal when the interest part is calculated on the principal outstanding at the time of each payment."

Section 32. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 547 to subchapter IV of chapter 5 to read as follows:

"Section 547. Bad Debts

(1) A deduction is allowed for a tax year for a bad debt of a business if the following conditions are satisfied:

(a) the amount of the debt:

(i) was previously included in the gross revenue of the business; or

(ii) is money lent by the business in the normal course of carrying on a business of money lending;

(b) the debt or part of the debt is written off in the accounts of the business in the tax year; and

(c) there are reasonable grounds for believing that the debt is irrecoverable.

(2) The amount of the deduction allowed under this section for a tax year must not exceed the amount of the debt written off in the accounts of the business for that year."

Section 33. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter V to chapter 5 to be entitled "Business Assets".

Section 34. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by enacting a new section 551 to subchapter V of chapter 5 to read as follows:

"Section 551. Disposal and Acquisition of Business Assets.

(1) Except as otherwise provided in this Chapter, this section establishes when a business asset is disposed of

<u>or acquired for the purposes of this Chapter.</u>

<u>(2) A business is treated as having made a disposal of an asset at the time the business parts with the ownership of the asset, including when the asset is:</u>

<u>(a) sold, exchanged, transferred, or distributed; or</u>

<u>(b) cancelled, redeemed, relinquished, destroyed, lost, expired, or surrendered.</u>

<u>(3) A disposal includes the disposal of a part of an asset.</u>

<u>(4) The transmission of an asset by succession or under a will is treated as a disposal of the asset by the deceased at the time the asset is transmitted.</u>

<u>(5) The application of a business asset to personal or domestic use is treated as a disposal of the asset by the owner at the time the asset is so applied.</u>

<u>(6) A business acquires an asset at the time the owner of the business begins to own the asset, including at the time the owner is granted any right.</u>

<u>(7) The application of a personal asset to business use is treated as an acquisition of the asset by the owner at the time the asset is so used.</u>

<u>(8) In this section, "personal asset" means an asset held wholly for personal or domestic use."</u>

Section 35. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 552

to subchapter V of chapter 5, to read as follows:

"Section 552. Cost.

(1) Except as otherwise provided in this Chapter, this section establishes the cost of a business asset for the purposes of this Chapter.

(2) Subject to this Chapter, the cost of a business asset is the sum of the following amounts:

(a) the total consideration given by a business for the asset, including the fair market value of any consideration in kind determined at the time the asset is acquired and, if the asset is constructed or developed, the cost of construction or development;

(b) any incidental expenditure incurred by the business in acquiring or disposing of the asset; or

(c) any expenditure incurred by the business to install, alter, renew, reconstruct, or improve the asset.

(3) The cost of a business asset is reduced by the amount of any deduction allowed to the business in respect of amounts included in the cost of the asset, including a deduction allowed under section 535 or 536.

(4) If a business disposes of a part of a business asset, the cost of the asset is apportioned between the part of the asset retained and the part disposed of in accordance with their respective fair market values

<u>determined at the time the business acquired the asset.</u>

<u>(5) The cost of a business asset does not include the amount of any grant, subsidy, rebate, commission, or other assistance received or receivable by a business in respect of the acquisition or holding of the asset, except to the extent to which the amount is included in the gross revenue of the business. The reference to "other assistance" in this subsection does not include a loan repayable with or without interest.</u>

<u>(6) The cost of a business asset treated as acquired under section 551(7) is the fair market value of the asset determined at the date it is applied to business use.</u>

<u>(7) If the acquisition of a business asset is the derivation of an amount included in gross revenue of a business, the cost of the asset is the amount so included plus any amount paid by the business for the asset.</u>

<u>(8) If the acquisition of a business asset is the derivation of exempt income, the cost of the asset is the exempt amount plus any amount paid by the business for the asset."</u>

Section 36. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 553 to subchapter V of chapter 5, to read as follows:

"Section 553. Consideration Received.

(1) Except as otherwise provided in this Chapter, this section establishes the amount of consideration received on disposal of a business asset for the purposes of this Chapter.

(2) The consideration received by a business on disposal of a business asset is the total amount received by the business for the asset, including the fair market value of any consideration received in kind determined at the time of disposal.

(3) If a business asset has been lost or destroyed, the consideration received by a business for the asset includes any compensation, indemnity, or damages received by the business as a result of the loss or destruction, including amounts received as a consequence of:

(a) an insurance policy, indemnity, or other agreement;

(b) a settlement; or

(c) a judicial decision.

(4) The consideration received for a business asset treated as disposed of under section 551(5) is the fair market value of the asset determined at the time it is applied to personal or domestic use.

(5) If two or more business assets are disposed of by

a business in a single transaction and the consideration received for each asset is not specified, the total consideration received by the business is apportioned among the assets disposed of in proportion to their respective fair market values determined at the time of the transaction."

Section 37. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 554 to subchapter V of chapter 5, to read as follows:

"Section 554. Non-arm's Length Transaction.

For the purposes of this Act, if a business asset is disposed of in a non-arm's length transaction:

(a) the business disposing of the asset is treated as having received consideration equal to the fair market value of the asset determined at the time the asset is disposed of; and

(b) the business acquiring the asset is treated as having a cost equal to the amount determined under paragraph (a)."

Section 38. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 555 to subchapter V of chapter 5, to read as follows:

"Section 555. Gain or Loss Not Recognized.

(1) For the purposes of this Chapter and subject to subsection (2), no gain or loss is taken to arise on the

disposal of a business asset:

(a) between spouses as part of a divorce settlement or under an agreement to live apart;

(b) by reason of the transmission of the asset on the death of a person to an executor or beneficiary; or

(c) by reason of the compulsory acquisition of the asset under any law if the consideration received for the disposal is reinvested by the recipient in an asset of a like kind (referred to as a "replacement asset") within one year of the disposal.

(2) Subsection (1) does not apply if the person acquiring the asset (including a replacement asset) is a non-resident person at the time of the acquisition.

(3) If subsection (1)(a) or (b) applies, the person acquiring the asset is treated as acquiring an asset of the same character as the person disposing of the asset for an amount equal to the cost of the asset for the person disposing of the asset at the time of the disposal.

(4) A person's cost of a replacement asset or intangible referred to in subsection (1)(c) is the cost of the asset or intangible at the time it is compulsorily acquired plus the amount by which any consideration given by the person for the replacement asset exceeds the consideration received by the person

for the asset or intangible compulsorily acquired."

Section 39. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter VI to chapter 5 to be entitled "Anti Avoidance".

Section 40. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 561 to subchapter VI of chapter 5, to read as follows:

"Section 561. Transfer Pricing.

(1) The CEO may, in respect of:

(a) a transaction between businesses carried on by persons who are associates; or

(b) a transaction between businesses carried on by the same person, distribute, apportion, or allocate revenue and expenses between the businesses as is necessary to reflect the outcome that would have arisen in a transaction between independent persons dealing with each other at arm's length.

(2) In applying subsection (1), the CEO may be guided by international standards, case law, and guidelines on transfer pricing issued by international organizations concerned with taxation."

Section 41. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 562 to subchapter V of subchapter 5, to read as follows:

"Section 562. General Anti-avoidance Provision.

(1) In this section, "tax avoidance scheme" means any transaction or arrangement where one of the main purposes of a person in entering into the transaction or arrangement is the avoidance or reduction of the tax liability of a business under this Chapter.

(2) For the purposes of determining the tax liability of a business under this Chapter, the CEO may:

(a) determine the character of a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;

(b) disregard a transaction that does not have substantial economic effect;

(c) determine the character of a transaction if the form of the transaction does not reflect the substance; or

(d) treat separate businesses carried on by the same person as a single business if business activity has been fragmented under a tax avoidance scheme."

Section 42. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter VII to chapter 5 to be entitled "Procedure".

Section 43. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 571 to subchapter VII of chapter 5 to read as follows:

"Section 571. Filing of Tax Return.

(1) A business liable for tax under section 521 must file a net profit tax return for each tax year within three months after the end of the tax year.

(2) A business liable for tax under section 522 must file a presumptive tax return for each tax year within three months after the end of the tax year.

(3) A tax return must be in the prescribed form and filed in the prescribed manner."

Section 44. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 572 to subchapter VII of chapter 5, to read as follows:

"Section 572. Self-assessment of Net Profit Tax or Presumptive Tax Due.

(1) A business that files a net profit tax return for a tax year is treated as having made a self-assessment of:

(a) if the business has a net profit for the year, the amount of the net profit of the business and the net profit tax payable thereon as specified in the return; or

(b) if the business has made a net loss for the year, the amount of the net loss of the business as specified in the return.

(2) A business that files a presumptive tax return for a tax year is treated as having made a self-assessment

of the presumptive tax payable for the year as specified in the return."

Section 45. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 573 to subchapter VII of chapter 5 to read as follows:

"Section 573. Payment of Tax.

The net profit tax or presumptive tax payable by a person for a tax year in respect of a business carried on by the person is payable by the date that the tax return of the business for the year is due."

Section 46. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 574 to subchapter VII of chapter 5 to read as follows:

"Section 574. Installments of Tax.

(1) A business must pay installments of net profit tax for a tax year on last working day of the third, sixth, ninth, and twelfth months of the tax year.

(2) The amount of each installment is one-quarter of the amount of net profits tax estimated by the business to be payable for the tax year. An estimate of net profit tax payable by the business for a tax year must be filed with the CEO by the due date for payment of the first installment for the year.

(3) An estimate filed under subsection (2) remains in force for the whole of the tax year unless a revised

estimate is filed with the CEO. A revised estimate applies to the calculation of installments of net profit tax for a tax year due both before and after the date the revised estimate was filed. The amount of any underpayment of installments made prior to filing the revised estimate must be paid by the business together with the first installment due after the revised estimate is filed. The amount of any overpaid installments is applied against future net profit tax installments due.

(4) If a business fails to file an estimate of net profit tax as required under subsection (2), the estimated net profit tax of the business for the tax year is such amount as estimated by the CEO. The CEO's estimate remains in force for the whole of the tax year unless revised by the business in accordance with subsection (3).

(5) Each installment of net profit tax paid during a tax year is credited against the assessed net profit tax of the business for the year. If the amount of the credit allowed exceeds the net profit tax due for the year, the amount of the excess may be credited against assessed taxes under any revenue law. If no other taxes are due, the overpayment is refunded to the business, or at the taxpayers election, may be credited against the

next year's tax assessment.

(6) If the estimate (including any revised estimate) of net profit tax payable by a business for a tax year is less than ninety percent (90%) of the assessed net profit tax liability of the business for the year (the difference is referred to as the "installment shortfall"), the business is liable for a penalty equal to:

(a) if the under-estimate is due to fraud or willful neglect, fifty percent of the installment shortfall; or

(b) in any other case, ten percent of the installment shortfall.

(7) No penalty is imposed under subsection (6)(b) if the CEO is satisfied that the reason for the installment shortfall was due to circumstances beyond the control of the business (such as a significant price fluctuation) and all reasonable care was taken in making the estimate."

Section 47. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 575 to subchapter VII of chapter 5 to read as follows:

"Section 575. Collection of Tax from Non-resident Ship Owners or Charterers.

(1) Subject to subsection (3), and applicable

regulations, before the departure of a ship owned or chartered by a non-resident person from a port in FSM-

(a) the master or agent of the ship must file with the CEO a return showing the gross revenue derived from the carriage of passengers, livestock, mail, merchandise, or goods embarked in the FSM in respect of the ship; and

(b) the CEO must determine the amount of tax due under section 524(1)(a) in respect of the ship and pursuant to regulatory guidelines, notify the master or agent, in writing, of the amount due.

(2) The return required under subsection (1)(a) must in the prescribed form and filed in the prescribed manner.

(3) The master of a ship is liable for the tax notified under subsection (1)(b).

(4) If the CEO is satisfied that the master or agent of a ship or the owner or charterer of the ship is unable to file the return required under subsection (1)(a) before the departure of the ship from the FSM, the CEO may allow the return to be filed within 30 days after departure of the ship provided the non-resident owner or charterer has made satisfactory arrangements for the payment of the tax due under section 524(1)(a) in respect of the ship.

(5) The CEO must not grant a port clearance for a ship owned or chartered by a non-resident person until satisfied that any tax due under section 524(1)(a) in respect of the ship has been paid or that arrangements for its payment have been made to the satisfaction of the CEO.

(6) This section does not relieve the owner or charterer of the ship from liability to pay any amount due under section 524(1)(a) that is not paid by the master or agent of the ship."

Section 48. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 576 to subchapter VII of chapter 5 to read as follows:

"Section 576. Collection of Tax from Non-resident Aircraft Owners or Charterers.

(1) The owner or charterer of an aircraft liable for tax under section 524(1)(a) must file a return with the CEO for each quarter within fifteen days after end of the quarter.

(2) The return required under subsection (1) must in the prescribed form and filed in the prescribed manner.

(3) A person that files a tax return under subsection (1) is treated as having made a self-assessment of the gross revenue derived for the carriage of passengers, livestock, mail, merchandise, or goods embarked in the

FSM during the quarter and the tax payable thereon under section 524(1)(a) as specified in the return.

(4) The tax payable by the non-resident person under section 524(1)(a) is collected quarterly and is due on the due date for filing the return for each quarter.

(5) If the tax payable for a quarter is not paid within three months of the due date, the CEO may issue to the [airport authority] a certificate specifying the name of the non-resident person and the amount of tax due, and the [airport authority] must refuse clearance from any airport in the FSM to any aircraft owned or chartered by the person until the tax due has been paid."

Section 49. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 577 to subchapter VII of chapter 5 to read as follows:

"Section 577. Records.

(1) A business must:

(a) keep such accounts, documents, and records as enable the computation of the net profit of the business for a tax year; and

(b) retain the records required under paragraph (a) for six (6) years after the end of the tax year to which they relate.

(2) The records that must be maintained by a business

accounting for net profit tax on a cash basis may be prescribed.

(3) The CEO may disallow a claim for a deduction for an expense if a business is unable, without reasonable excuse, to produce a receipt or other record of the expense, or to produce evidence relating to the circumstances giving rise to the claim for the deduction."

Section 50. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter VIII to chapter 5 to be entitled "Withholding Tax".

Section 51. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 581 to subchapter VIII of chapter 5 to read as follows:

"Section 581. Withholding of Tax from Payments to Non-resident Persons.

(1) A person paying an insurance premium that is liable to tax under section 524(1)(b) must withhold tax at the rate of 3% of the gross amount of the premium paid.

(2) A person paying interest, a royalty, natural resource amount, insurance premium, or management fee that is liable to tax under section 525 must withhold tax at the rate of:

(a) in the case of an insurance premium, 5% of the gross amount of the premium; or

(b) in any other case, 15% of the gross amount of the payment.

(3) If:

(a) a person is liable to pay a fee to a non-resident person for the rendering of independent services;

(b) the fee is derived by the non-resident person from sources in the FSM; and

(c) the fee is not attributable to a business carried on by the non-resident person through a permanent establishment of the person in the FSM, the person paying the fee must withhold tax from the gross amount paid at the rate of [10%].

(4) Tax required to be withheld by a person under this section must be paid to the URA within 15 days after the end of the month in which the person was required to withhold the tax.

(5) If a person:

(a) fails to withhold tax as required under this section; or

(b) having withheld tax fails to pay the tax to the URA as required under this section, the person is personally liable to pay the amount of tax to the URA.

(6) A person personally liable for an amount of tax

under subsection (5) as a result of failing to withhold the tax is entitled to recover the tax from the recipient of the payment.

(7) A person who has withheld tax from a payment under this section and paid the tax to the URA is indemnified against any claim by the recipient for payment of the withheld amount."

Section 52. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 582 to subchapter VIII of chapter 5 to read as follows:

"Section 582. Withholding Tax Documentation.

(1) A person withholding tax under section 581 must give to the recipient of the payment a tax withholding certificate as prescribed.

(2) A non-resident person required to file a net profit tax return for a tax year must attach to the return any tax withholding certificate received for the applicable tax period.

(3) A person withholding tax under section 581 shall, within two months after the end of the calendar year, file with the CEO an annual withholding tax statement as prescribed."

Section 53. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 583 to subchapter VIII of chapter 5 to read as follows:

"Section 583. Priority of Tax Withheld.

(1) Tax withheld from a payment by a person under section 581:

(a) is held by the person in trust for the National Government; and

(b) is not subject to attachment in respect of any debt or liability of the person.

(2) In the event of the liquidation or bankruptcy of a person who has withheld tax under section 581, any amount withheld does not form part of the estate of the person in liquidation or bankruptcy and the CEO has first claim for that amount before any distribution of property is made.

(3) An amount that a person is required to withhold from a payment under section 581 is:

(a) a first charge on the payment; and

(b) deducted prior to any other amount that the person may be required to deduct from the payment by virtue of an order of any Court or under any other law."

Section 54. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 584 to subchapter VIII of chapter 5 to read as follows:

"Section 584. Credit for Tax Withheld.

(1) If tax has been withheld under section 581(3):

(a) the gross revenue of the non-resident person deriving the fee is the amount of the fee before the withholding of the tax; and

(b) the non-resident person deriving the fee is allowed a credit for that tax against the net profit tax payable by the person for the tax year in which the tax was withheld.

(2) If the amount of the credit allowed under subsection (1)(b) for tax year exceeds the net profit tax due for the year, the amount of the excess must be refunded to the non-resident person."

Section 55. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new subchapter IX to chapter 5 to be entitled "Final Provisions".

Section 56. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 591 to subchapter IX of chapter 5 to read as follows:

"Section 591. Regulations.

(1) The Secretary shall, subject to approval of the President, prescribe and have printed reasonable regulations for the enforcement of this Chapter and such regulations have force and effect of law if they are not in conflict with the express provisions of this Chapter or other laws of the FSM.

(2) The regulations shall also provide for matters prescribed under the Chapter to be made by regulation.

(3) Such regulations shall be promulgated in accordance with law."

Section 57. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 592 to subchapter IX of chapter 5 to read as follows:

"Section 592. Transitional.

Any tax liability that arose before this Chapter came into force may be recovered under Chapter 9 of this Title, but without prejudice to any action already taken for the recovery of the tax."

Section 58. Title 54 of the Code of the Federated States of Micronesia, is hereby further amended by adding a new section 593 to subchapter IX of chapter 5 to read as follows:

"Section 593. Effective Date.

This Act shall become law upon approval by the President of the Federated States of Micronesia or upon its becoming law without such approval, and this Act shall take effect eighteen (18) months after the effective date of the Unified Revenue Authority Act."

Section 59. This act shall become law upon approval by the President of the Federated States of Micronesia or upon its becoming law without such approval.

Date: 3/26/10 Introduced by: /s/ Joe N. Suka

Joe N. Suka
(by request)