

STANDING COMMITTEE REPORT NO. 16-106

RE: C.B. NO. 16-140/R&D

SUBJECT: AMENDMENTS TO CORPORATE TAX

SEPTEMBER 28, 2010

The Honorable Isaac V. Figir
Speaker, Sixteenth Congress
Federated States of Micronesia
Third Regular Session, 2010

Dear Mr. Speaker:

Your Committee on Resources and Development (R&D), to which was jointly assigned and referred as C.B. No. 16-140, entitled:

"A BILL FOR AN ACT TO FURTHER AMEND CHAPTER 3 OF TITLE 54 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA, AS AMENDED, BY FURTHER AMENDING SECTION 312, AS AMENDED BY PUBLIC LAW NO. 14-110, SECTION 313, AS AMENDED BY PUBLIC LAW NOS. 14-110 AND 16-19, SECTION 321, AS AMENDED BY PUBLIC LAW NO. 16-36, SECTION 322, SECTION 331, SECTION 342, SECTION 351, AS AMENDED BY PUBLIC LAW NO. 14-110, SECTION 352, AND SECTION 370, AND BY ENACTING NEW SECTIONS 371, 372, 373, 374, 375, 376, 377, 378, TO MAKE PROCEDURAL CHANGES TO THE CORPORATE TAX IN ORDER TO MAKE IT MORE ATTRACTIVE TO POTENTIAL TAXPAYERS, AND FOR OTHER PURPOSES",

begs leave to report as follows:

The intent and purpose of the bill are expressed in its title.

The purpose of the various provisions of C.B. No. 16-140 is to ensure the proper tax rate is applied to the appropriate tax year, to add International Financial Reporting Standards (IFRS) as an alternative accounting method, to place a time limit on the carry forward of foreign tax credits, to limit who must file audited financial statements, and to replace the incorporation by reference under section 370 with a statement of the applicable law.

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Your Committee held a meeting on C.B. No. 16-140 on September 15, 2010. At that meeting the Committee heard detailed explanation of each of the bill's provisions. In general the proposed amendments are to put the finishing touches on our corporate tax. The goal is to improve upon our corporate tax regime and make it more competitive and attractive to potential taxpayer corporations.

Each amendment was then explained to the Committee individually. The first was the clarification of the effective date of the rate decrease. The amendment clarifies the way the new tax rate will be applied to existing captives for this year. Congress, in Public Law No. 16-36, amended the rate of tax, but did not specify an effective date. This omission left the effect upon captives ambiguous. The amendment clears up the ambiguity making it clear when the new rate becomes effective. It was also explained that this provision would only have effect during the current year. After March 31, 2011 the new tax rate will be uniformly effective to all captives.

Next came an explanation of the change regarding applicability of the corporate tax to captives. The current wording states all captives are subject to the corporate income tax. The proposal is to change the wording to instead state all captives are major corporations. All major corporations are subject to corporate tax; therefore all captives are still subject to corporate tax. The effect of this amendment is the uniform treatment of captives; the change removes disparate treatment between large and small captives.

On the proposal to allow International Financial Reporting Standards (IFRS) as an alternative method of calculating taxable income, it was explained that the captive insurance law under title 37 allows the use of IFRS, whereas the corporate tax law currently does not. There is a need for consistency within our law and that is the reason for this particular amendment.

The next amendment discussed was the limitation of foreign tax credit carry forward to seven years. This proposal will limit the carry forward to seven years where before there was no limit on carry forward. This amendment makes our corporate tax regime more transparent and clear and because it limits credit carry forwards it has the potential to increase taxes collected.

Next was the proposal to remove the requirement that all major shareholders of corporate taxpayers provide audited financial statements. This requirement is a major hurdle to promotion of

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the FSM corporate tax regime. For private corporations with captives in the FSM this is the only requirement of yearly audited reports. This is a considerable and costly compliance burden that does and will continue to deter captive establishment in the FSM absent this amendment. Removing this compliance burden will greatly improve the competitiveness of our tax regime compared to those of other countries.

The next proposal is to require taxpayer corporations to pay 50% of their estimated tax on the eighth month of their fiscal year and the remaining 50% 60 days following the end of their fiscal year. This schedule of payments will accelerate payments received from captives and will increase the ability to monitor and verify the accuracy of the captive's tax information.

The next amendment proposes to remove the reference in section 370 and replace it with a restatement of the provisions previously incorporated by reference. Stating the provisions in the law rather than only referencing them will allow the provisions applicable to the corporate tax to be amended without amending the provisions applicable to other taxes. This will allow more flexibility and responsiveness should amendments need to be made to these provisions.

The final proposal is to limit the assessment period relating to captives to seven years. This change is to bring the assessment period for captives in line with the treatment of other FSM taxpayers. The change will make the tax procedures for captives more uniform with the tax procedures for other companies.

Your Committee on Resources and Development is in accord with the intent and purpose of C.B. No. 16-140 and recommends its passage on First Reading, and that it be placed on the calendar for Second and Final reading in the form attached hereto as C.B. No. 16-140.

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Respectfully submitted,

/s/ Roger S. Mori
Roger S. Mori, chairman

/s/ Tony H. Otto
Tony H. Otto, vice chairman

/s/ Peter M. Christian
Peter M. Christian, member

/s/ Dion G. Neth
Dion G. Neth, member

/s/ Peter Sitan
Peter Sitan, member

/s/ Joseph J. Urusemal
Joseph J. Urusemal, member

/s/ Paliknoa K. Welly
Paliknoa K. Welly, member