

STANDING COMMITTEE REPORT NO. 13-185

RE: C.B. NO. 13-86/W&M

SUBJECT: TAX PENALTIES

OCTOBER 26, 2004

The Honorable Peter M. Christian
Speaker, Thirteenth Congress
Federated States of Micronesia
Fourth Regular Session, 2004

Dear Mr. Speaker:

Your Committee on Ways & Means to which was referred C.B. No. 13-86 entitled:

"A BILL FOR AN ACT TO FURTHER AMEND TITLE 54 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA, AS AMENDED, BY AMENDING SECTIONS 134, 139, 144, 155 AND 902 THEREOF FOR THE PURPOSE OF MODIFYING AND CLARIFYING THE PENALTIES ASSESSABLE AGAINST TAXPAYERS FOR FAILURE TO FILE RETURNS OR PAY TAXES WHEN DUE, AND FOR OTHER PURPOSES.",

begs leave to report as follows:

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

Penalties are included in the tax laws as an incentive for taxpayers to pay taxes when due. They are intended as an aid in collecting taxes. However, the existing FSM tax laws have been criticized for imposing excessively severe penalties for late filing and payment. Penalties and interest can build up, relatively quickly, to a total that dwarfs the amount of the original unpaid taxes, resulting in a total tax bill beyond the ability of the taxpayer to pay. Your committee notes that, in the first year after a tax becomes due, the penalties and interest can amount to as much as 150% of the principal amount of the tax owed. As a result, taxpayers, overwhelmed by the rapidly escalating tax bill, can become discouraged from paying anything at all. Thus, it is believed, the current tax penalty provisions may be actually hindering the National Government's efforts to collect taxes. Further, the current penalties are so severe as to potentially create a sense of unfairness among the taxpaying public.

The principal purpose of C.B. No. 13-86 is to reduce certain penalties assessable against taxpayers who are late in filing tax returns or paying taxes. The bill would amend current law by (a) reducing the rate at which certain penalties accumulate and (b) lowering the caps on certain penalties, or instituting caps for the first time. The

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bill also proposes amending certain language for the purpose of clarifying the intent of the law. The amendments are designed both to be fairer than current law and also to remove an impediment to the collection of taxes.

Your Committee on Ways & Means, jointly with the Committee on Resources and Development, held hearings in each of the states at which leaders of the state governments and business community were given an opportunity to ask questions and make comments with respect to C.B. No. 13-86. A hearing was held in Chuuk on September 14, 2004, in Yap on September 17, 2004, in Kosrae on October 7, 2004 and in Pohnpei on October 20 and 26, 2004. In addition to the comments made at the hearings, your committee also received written comments from the state government of Yap and from the Governor of Kosrae. Although the state of Yap questioned whether a reduction in penalties would remove the incentive for timely payment of taxes, the comments received by your committee generally supported passage of the bill. No opposition to the bill was expressed.

Your committee submits that, due to scheduled reductions in the availability of Compact funds, it is critical that the nation increase its revenues from local sources. Tax reform is needed, but, also, the National Government needs to become much more effective at collecting the taxes that are owed. It is estimated that, at present, delinquent taxes may total as much as \$10 million. There are a number of reasons that account for this poor collection record. The reduction in tax penalties, standing alone, will not remedy all of the problems with the FSM's current tax collection effort, but your committee believes that it will eliminate one, unnecessary impediment to collection. Your committee has considered the concern expressed by the state of Yap that a reduction in penalties might actually remove a useful incentive to prompt payment. In this regard, we note that, at present, the FSM's penalties are substantially more harsh than those imposed in other countries. Further, even with the amendments proposed in C.B. No. 13-86, the FSM Code would continue to contain substantial incentives for prompt payment of taxes. The maximum penalties and interest that could be assessed in the first year of delinquency would be reduced, but a taxpayer could still face penalties and interest of as much as 44% if he were to be a year late in paying. Your committee

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is of the opinion that this is an adequate incentive to payment. Thus, your committee supports the amendments contained in C.B. No. 13-86.

Your committee also recommends an additional aid to collection of taxes that are currently delinquent. Believing that there are overdue taxes that have been rendered uncollectible by the assessment of large penalties and interest, we recommend that a brief period be established during which all penalties and interest will be waived for taxpayers who, during that period, pay the full amount of the principal tax amount owed. Your committee believes that the creation of this waiver program may result in payment of a significant amount of delinquent taxes that might otherwise never be collected.

With these thoughts in mind, your committee recommends the following amendments to C.B. No. 13-86:

1. Title, line 6, after "due," insert "by enacting a new section 903 thereof to provide for the waiver of penalties and interest on delinquent taxes paid during a specified period,".
2. Page 5, line 12, insert a new section 6 to read as follows and renumber the existing section 6:

"Section 6. Title 54 of the Code of the Federated States of Micronesia, as amended, is hereby further amended by enacting a new section 903 to read as follows:

'Section 903. Notwithstanding any other provision of this title, all civil penalties and interest under this title, which were levied or could have been levied prior to the effective date of this Act, shall be waived with respect to any taxpayer who, at any time between the effective date of this Act and June 30, 2005, pays the full amount of the tax owed by the taxpayer, except that no penalty assessed under section 155(4) of this title shall be waived".

With these amendments, your Committee on Ways & Means is in accord with the intent and purpose of C.B. No. 13-86 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. 13-

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86, C.D.1.

Respectfully submitted,

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/s/ Roosevelt D. Kansou
Roosevelt D. Kansou, vice
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/s/ Claude H. Phillip
Claude H. Phillip, member

/s/ Henry C. Asugar
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/s/ Peter M. Christian
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