
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:

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

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

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

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

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

15 "Section 512. Definitions.
16 Wherever used in this chapter, except where otherwise
17 specified, unless the subject matter, context, or sense
18 otherwise requires:

19 (1) 'Associate' has the meaning in section 515 of

1 this title.

2 (2) 'Authority' means the Federated States of
3 Micronesia Unified Revenue Authority established by
4 section 711 of this title.

5 (3) 'Board' means the Board of Directors of the
6 Unified Revenue Authority as appointed under Section
7 712 of this title.

8 (4) 'Business' includes any profession, trade,
9 manufacture, or other undertaking carried on for
10 pecuniary profit, but not including employment.

11 (5) 'Business asset' means an asset, whether of
12 revenue or capital nature, used, available for use, or
13 held in carrying on a business, including inventory, a
14 depreciable asset, an intangible, or goodwill.

15 (6) 'CEO' means the Chief Executive Officer
16 appointed under section 731 of this title.

17 (7) 'Consideration received', in relation to a
18 business asset, has the meaning attributed to it in
19 section 553 of this title.

20 (8) 'Cost', in relation to a business asset, has
21 the meaning attributed to it in section 552 of this
22 title.

23 (9) 'Depreciable asset' means any tangible
24 personal property or that portion of a structural
25 improvement to real property that:

1 (a) has a useful life exceeding one year;
2 (b) is likely to lose value as a result of
3 normal wear and tear, or obsolescence; and
4 (c) is used, available for use, or held
5 solely to derive gross revenue.

6 (10) 'Disposal', in relation to a business asset,
7 has the meaning in section 551 of this title.

8 (11) 'Distribution', in relation to an entity,
9 includes a distribution of profits or entitlement to
10 income by an entity to a member of the entity.

11 (12) 'Employee' means any individual who, under
12 the usual common law rules applicable in the FSM in
13 determining an employer-employee relationship, has the
14 status of an employee, and includes the holder of an
15 office.

16 (13) 'Employment' means an employer-employee
17 relationship as determined under the usual common law
18 rules applicable in the FSM and includes activities
19 performed as the holder of an office.

20 (14) 'Entertainment' means the provision of food,
21 beverages, tobacco, amusement, recreation, or
22 hospitality of any kind.

23 (15) 'Entity' means a company, corporation,
24 partnership, unincorporated association or other
25 business entity, trust, or estate.

1 (16) 'Finance lease' means a lease that is treated
2 under generally accepted accounting principles as a
3 finance lease and is so accounted for by the lessor in
4 its financial accounts.

5 (17) 'FSM' means the Federated States of
6 Micronesia.

7 (18) 'Generally Accepted Accounting Principles' or
8 'GAAP' means those accounting principles currently
9 accepted by certified public accountants, which are
10 utilized by auditors operating within the FSM;
11 PROVIDED, HOWEVER, that in the event International
12 Financial Reporting Standards (IFRS) become generally
13 accepted by the financial/auditing entities within the
14 FSM and as prescribed by law or regulations, then GAAP
15 shall be modified by IFRS.

16 (19) 'Gross revenue' has the meaning attributed to
17 it in section 532 of this title.

18 (20) 'Industrial building' means a building that
19 is a depreciable asset used, available for use, or held
20 solely in carrying on:

21 (a) manufacturing operations;

22 (b) research and development into improved
23 or new methods of manufacture;

24 (c) mining operations (other than an
25 accommodation building); or

1 (d) a hotel business.

2 (21) 'Intangible' means:

3 (a) a patent, invention, design or model,
4 secret formula or process, trademark, copyright, or
5 other like property or right;

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

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

15 (22) 'Interest' means:

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

20 (b) an amount that is functionally
21 equivalent to an amount referred to in paragraph (a) of
22 this subsection;

23 (c) any amount treated as interest under
24 section 546 of this title; or

25 (d) a commitment, guarantee, service, or

1 similar fee payable in respect of a debt or other
2 instrument or agreement giving rise to interest under
3 paragraphs (a), (b), or (c) of this subsection.

4 (23) 'Inventory' means anything produced,
5 manufactured, purchased, or otherwise acquired for sale
6 or exchange, and includes livestock, or any raw
7 materials, or consumables used in a production or
8 manufacturing process.

9 (24) 'Liaison office' means an office the sole
10 activity of which is representation.

11 (25) 'Management fee' means an amount as
12 consideration for the rendering of a managerial
13 service, but does not include salary or wages.

14 (26) 'Member', in relation to an entity, means a
15 shareholder in a company, partner in a partnership,
16 beneficiary of a trust or estate, or any other person
17 with an ownership interest in the entity.

18 (27) 'Natural resource amount' means:

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

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

25 (28) 'Net profit' has the meaning in section 531

1 of this title.

2 (29) 'Net profit tax' means a tax imposed under
3 subchapter II of this chapter.

4 (30) 'Non-resident person' means a person that is
5 not a resident person.

6 (31) 'Permanent establishment' means a fixed place
7 of business through which the business of a person is
8 wholly or partly carried on, and includes:

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

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

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

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

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

4 (i) has and habitually exercises an
5 authority to conclude contracts on behalf of the
6 principal; or

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

11 (f) any substantial equipment used by a
12 person.

13 (32) 'Person' means an individual, entity, a
14 government, a political subdivision of a government, or
15 a public international organization.

16 (33) 'Prescribed' means set forth by the Secretary
17 in regulations.

18 (34) 'President' means the President of the FSM.

19 (35) 'Relative' in relation to an individual,
20 means:

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

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

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

3 (36) 'Resident person' means:

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

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

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

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

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

17 (37) 'Royalty' means an amount, however described,
18 whether periodical or a lump sum, as consideration for:

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

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

1 broadcasting);

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

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

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

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

17 (38) 'Secretary' means the Secretary of the
18 Department of Finance and Administration of the FSM
19 National Government.

20 (39) 'Small business' means a business that is
21 carried on by a person that is not registered for the
22 VAT, but not including a business making exempt
23 supplies that would be above the VAT registration
24 threshold if the exempt supplies were taxable supplies.

25 (40) 'State' means a State of the FSM.

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

6 (42) 'Tax year' means:

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

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

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

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

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

19 "Section 513. Source of income.

20 (1) An amount derived by a resident person in
21 carrying on a business is derived from sources in the
22 FSM except to the extent that it is attributable to a
23 business carried on through a permanent establishment
24 of the person outside the FSM.

25 (2) An amount derived by a non-resident person in

1 carrying on a business is derived from sources in the
2 FSM to the extent that it is attributable to a business
3 carried on through a permanent establishment of the
4 person in the FSM.

5 (3) Notwithstanding subsections (1) and (2) of
6 this section, the following amounts are considered
7 derived from sources in the FSM:

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

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

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

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

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

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

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

24 Section 6. Title 54 of the Code of the Federated States of
25 Micronesia is hereby further amended by adding a new section 514

1 to subchapter I of chapter 5 to read as follows:

2 "Section 514. Fair market value.

3 (1) The fair market value of an asset, property,
4 service, or benefit at a particular time is the
5 ordinary open market value of the asset, property,
6 service, or benefit at that time.

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

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

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

23 "Section 515. Associate.

24 (1) Subject to subsection (2) of this section,
25 two persons are associates if the relationship between

1 them is such that one may reasonably be expected to act
2 in accordance with the intentions of the other, or both
3 persons may reasonably be expected to act in accordance
4 with the intentions of a third person.

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

9 (3) Without limiting the generality of subsection
10 (1) of this section, the following are treated as
11 associates:

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

16 (b) a partner in a partnership and the
17 partnership, if the partner, either alone or together
18 with an associate or associates under another
19 application of this section, controls fifty percent
20 (50%) or more of the rights to income or capital of the
21 partnership;

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

24 (d) a shareholder in a company and the
25 company, if the shareholder, either alone or together

1 with an associate or associates under another
2 application of this section, controls either directly
3 or through one or more interposed persons:

4 (i) fifty percent (50%) or more of
5 the voting power in the company;

6 (ii) fifty percent (50%) or more of
7 the rights to dividends; or

8 (iii) fifty percent (50%) or more of
9 the rights to capital; and

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

14 (i) fifty percent (50%) or more of the
15 voting power in both companies;

16 (ii) fifty percent (50%) or more of the
17 rights to dividends in both companies; or

18 (iii) fifty percent (50%) or more of the
19 rights to capital in both companies.

20 (4) In applying subsection (3)(b), (d), or (e) of
21 this section holdings that are attributable to a person
22 from an associate are not reattributed to another
23 associate."

24 Section 8. Title 54 of the Code of the Federated States of
25 Micronesia is hereby further amended by adding a new subchapter

1 II to chapter 5 to be entitled "Imposition of Tax".

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

5 "Section 521. Imposition of net profit tax.

6 Net profit tax is imposed for each tax year at the rate
7 of twenty five percent (25%) on the net profit for the
8 tax year of every business."

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

12 "Section 522. Imposition of presumptive tax.

13 A presumptive tax of eighty dollars (\$80) per tax year
14 is imposed on a business if the gross revenue of the
15 business for the tax year does not exceed ten thousand
16 dollars (\$10,000.)"

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

20 "Section 523. General provisions applicable to net
21 profit tax and presumptive tax.

22 (1) Net profit tax or presumptive tax is payable
23 by the person or persons carrying on the business. If a
24 person carries on more than one business, the net
25 profit tax or presumptive tax payable is computed and

1 reported separately for each business. For this
2 purpose, if a business has operations in more than one
3 State, the operations in each State are treated as a
4 separate business.

5 (2) No net profit tax or presumptive tax is
6 payable if the gross revenue of a business for a tax
7 year does not exceed two thousand dollars (\$2,000).

8 (3) Notwithstanding subsection (1) of this
9 section, in determining whether the gross revenue of a
10 business carried on by a person does not exceed ten
11 thousand dollars (\$10,000) for the purposes of section
12 522 of this title, or two thousand dollars (\$2,000) for
13 the purposes of subsection (2) of this section, account
14 is taken of the gross revenue of all businesses carried
15 on by the person or by associates of the person in the
16 FSM."

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

20 "Section 524. Imposition of tax on transportation or
21 insurance income of non-resident person.

22 (1) Tax is imposed at the rate of three percent
23 (3%) on the gross revenue derived by a non-resident
24 person without a permanent establishment operating a
25 ship or aircraft for the carriage of passengers,

1 livestock, mail, merchandise, or goods embarked in the
2 FSM.

3 (2) Tax payable under this section shall be
4 payable by the non-resident person deriving the amount
5 subject to tax. The tax payable is discharged if the
6 tax has been paid in accordance with section 575 or 576
7 of this title."

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

11 "Section 525. Imposition of tax on certain payments to
12 non-resident persons.

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

18 (2) The rate of tax imposed under subsection (1)
19 of this section is:

20 (a) five percent (5%) of the gross amount of
21 the insurance premium; or

22 (b) fifteen percent (15%) of the gross
23 amount of the interest, royalty, natural resource
24 amount, or management fee.

25 (3) Subsection (1) of this section does not apply

1 to:

2 (a) an amount that is exempt income; or

3 (b) interest, a royalty, natural resource

4 amount, insurance premium, or management fee that is

5 attributable to a business carried on by the non-

6 resident person through a permanent establishment of

7 the person in the FSM and, in that case, the interest,

8 royalty, natural resource amount, insurance premium, or

9 management fee is taxable under section 521 of this

10 title.

11 (4) The tax payable under subsection (1) of this

12 section is discharged if the tax has been paid in

13 accordance with section 581 of this title."

14 Section 14. Title 54 of the Code of the Federated

15 States of Micronesia is hereby further amended by

16 adding a new subchapter III to chapter 5 to be entitled

17 "Computation of Net Profit".

18 Section 15. Title 54 of the Code of the Federated States of

19 Micronesia is hereby further amended by adding a new section 531

20 to subchapter III of chapter 5 to read as follows:

21 "Section 531. Net profit.

22 The net profit of a business for a tax year is the

23 gross revenue of the business for the year reduced by

24 the total amount of deductions allowed to the business

25 for the year."

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

4 "Section 532. Gross revenue.

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

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

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

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

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

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

23 (2) For the purposes of subsection (1)(c) of this
24 section, the net gain on disposal of a business asset
25 is the consideration received on disposal of the asset

1 less the cost of the asset at the time of disposal.

2 (3) For the purposes of subsection (1)(d) of
3 this section, the net gain on disposal of a debt
4 of a business is the amount of the debt less the amount
5 received on satisfaction or cancellation of the
6 debt.

7 (4) The gross revenue of a business does not
8 include any amount subject to tax under sections 522,
9 524, or 525 of this title."

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

13 "Section 533. Exempt income.

14 (1) The following amounts are exempt income:

15 (a) a distribution by an entity;

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

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

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

24 (iii) the debentures were issued for the
25 purpose of raising funds for use by the company in a

1 business carried on in the FSM; and
2 (iv) the interest is paid outside the
3 FSM; and
4 (c) an amount exempt from tax under an
5 international agreement between the Government of the
6 FSM and a foreign government or a public international
7 organization.

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

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

14 "Section 534. Deductions.

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

18 (a) subject to section 535 of this title,
19 the expenses or losses incurred during the year solely
20 in deriving amounts included in the gross revenue of
21 the business;

22 (b) the cost of inventory for the year as
23 determined under this chapter;

24 (c) the total amount, as determined under
25 section 536 of this title, by which the value of the

1 depreciable assets of the business have declined during
2 the year by reason of wear and tear from use in
3 deriving amounts included in the gross revenue of the
4 business;

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

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

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

16 Section 19. Title 54 of the Code of the Federated States of
17 Micronesia is hereby further amended by adding a new section 535
18 to subchapter III of chapter 5 to read as follows:

19 "Section 535. Non-deductible expenses.

20 (1) No deduction is allowed for:

21 (a) a distribution by an entity or capital
22 withdrawn from a business;

23 (b) an expense or loss of a capital nature
24 except as provided in section 534(1)(c), (d), or (e) of
25 this title;

1 (c) an amount placed in a reserve fund, a
2 provision for expected expenses or losses, or an amount
3 capitalized in any way;

4 (d) an expense or loss to the extent
5 recoverable under a policy of insurance or contract of
6 indemnity;

7 (e) an expense incurred in providing
8 entertainment except:

9 (i) if the entertainment was provided
10 in the ordinary course of a business carried on to
11 provide the entertainment and the entertainment was not
12 provided to an employee or an associate of the person
13 carrying on the business;

14 (ii) if the entertainment was provided
15 to an employee, it was provided while the employee is
16 traveling on business in course of the employee's
17 employment; or

18 (iii) if the entertainment is a meal or
19 refreshment provided to an employee on the business'
20 premises and which is available to all full-time
21 employees on equal terms;

22 (f) interest payable to an associate other
23 than that interest included in the gross revenue of a
24 business carried on by the associate or taxable under
25 section 525 of this title;

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

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

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

9 (2) A person required to withhold tax under
10 subchapter VII of this chapter in respect of an amount
11 paid to a non-resident person is not allowed a
12 deduction for the amount paid until the withheld tax
13 has been paid to the CEO."

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

17 "Section 536. Depreciable assets.

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

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

1 (3) The rate of depreciation is:
2 (a) in the case of motor vehicles, buses and
3 minibuses, goods vehicles, trucks, tractors, trailers,
4 and trailer-mounted containers, computers and data
5 handling equipment, construction equipment and
6 earthmoving equipment, and plant and machinery used in
7 manufacturing, mining, or farming operations, fifty
8 percent (50%);
9 (b) in the case of industrial buildings, ten
10 percent (10%);
11 (c) in the case of any other structural
12 improvement, five percent (5%); or
13 (d) in the case of any other depreciable
14 asset, thirty three and one-third percent (33¹/₃%).
15 (4) If a depreciable asset of a business is not
16 used, available for use, or held in carrying on the
17 business for the whole of the year, the amount computed
18 under subsection (2) of this section is reduced by the
19 proportion of the year that the asset was not so used.
20 (5) The total decline in value allowed as a
21 deduction under section 534(1)(c) of this title for a
22 depreciable asset for the current tax year and all
23 previous tax years must not exceed the cost of the
24 asset."

25 Section 21. Title 54 of the Code of the Federated States of

1 Micronesia is hereby further amended by adding a new section 537
2 to subchapter III of chapter 5 to read as follows:

3 "Section 537. Intangibles.

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

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

10 (3) An intangible is treated as having a useful
11 life of ten years if:

12 (a) it has a useful life of more than ten
13 years; or

14 (b) it does not have an ascertainable useful
15 life.

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

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

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

4 "Section 538. Net loss carry forward.

5 (1) If the total amount of deductions of a
6 business allowed for a tax year (other than under this
7 section or section 540(3) of this title) exceeds the
8 gross revenue of the business for the year, the amount
9 of the excess is the net loss of the business for the
10 year.

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

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

24 (4) If a business has a net loss carried forward
25 under this section for more than one tax year, the loss

1 of the earliest year is deducted first.

2 (5) If a business has a net loss carried forward
3 under this section and an interest expense carried
4 forward under section 540 of this title for a tax year,
5 the net loss carried forward is deducted first.

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

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

12 "Section 539. Currency translation.

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

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

22 (3) With the prior written permission of the CEO,
23 amounts taken into account in computing the net profit
24 or net loss of a business for a tax year may be
25 translated to United States dollars at the average mid-

1 exchange rate for the tax year between the foreign
2 currency and United States dollars."

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

6 "Section 540. Interest expense.

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

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

19 **A + (50% x (B - C))**

20 Where:

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

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

25 **C** is the total amount of deductions allowed to the

1 business for the year, other than for interest
2 incurred.

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

10 (4) Subsection (2) of this section does not apply
11 to a financial institution."

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

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

18 "Section 541. Simplified tax accounting for small
19 businesses.

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

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

1 is incurred when it is paid;

2 (b) no deduction is allowed for an amount
3 specified in section 535 of this title;

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

8 (d) the amount allowed as a deduction under
9 section 534(1)(b) of this title for a tax year is the
10 total amount paid by the business for the cost of
11 inventory acquired during the year and section 544 of
12 this title does not apply; and

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

16 (2) Reserved.

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

20 “Section 542. Tax accounting for businesses other than
21 small businesses.

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

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

5 (b) no deduction is allowed for any amount
6 specified in section 535 of this title;

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

11 (d) the deduction allowed for inventory is
12 computed in accordance with section 544 of this title;

13 (e) the gross revenues and expenses arising
14 under a long-term contract are determined under section
15 545 of this title;

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

19 (g) a deduction for a bad debt is allowed in
20 accordance with section 547 of this title.

21 (2) For the purposes of subsection (1)(a) of this
22 section:

23 (a) an amount is due when the business is
24 entitled to receive it even if the time for discharge
25 of the entitlement is postponed or the amount is

1 payable by installments; and

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

6 (3) For the purposes of subsection (2) of this
7 section, economic performance occurs:

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

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

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

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

18 “Section 543. Change in tax accounting method.

19 (1) If a business that is a small business ceases
20 to be a small business or a business that is not a
21 small business becomes a small business, the business
22 shall apply, in writing, to the CEO for a change in the
23 method of accounting used by the business in computing
24 the net profit of the person’s business and the CEO
25 shall in writing, approve or disapprove the

1 application.

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

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

12 "Section 544. Inventory.

13 (1) The amount allowed as a deduction under
14 section 534(1)(b) of this title for a tax year to a
15 business accounting for net profits tax on an accrual
16 basis for the cost of inventory is the cost of
17 inventory disposed of during the year as computed under
18 this section.

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

22 (A + B) - C

23 Where:

24 **A** is the opening value of the inventory for the
25 tax year;

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

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

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

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

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

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

16 (5) The cost of inventory on hand at the end of a
17 tax year is computed under the absorption-cost method.
18 The absorption-cost method is the generally accepted
19 accounting principle under which the cost of an item of
20 inventory is the sum of direct material costs, direct
21 labor costs, and factory overhead costs. Direct
22 material costs are the cost of materials that become an
23 integral part of the inventory manufactured or
24 produced, or which are consumed in the manufacturing or
25 production process. Direct labor costs are the labor

1 costs directly related to the manufacture or production
2 of inventory. Factory overhead costs are the total
3 costs of manufacturing or producing inventory, other
4 than direct labor and direct material costs.

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

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

16 "Section 545. Long-term contracts.

17 (1) A business accounting for net profit tax on
18 an accrual basis must compute the net profit arising
19 under a long-term contract during a tax year under the
20 percentage of completion method. The percentage of
21 completion method is the generally accepted accounting
22 principle under which revenues and expenditures arising
23 under a long-term contract are recognized by reference
24 to the stage of completion of the contract.

25 (2) In this section, 'long-term contract' means a

1 contract for manufacture, installation, or
2 construction, or, in relation to each, the performance
3 of related services, that is not completed within the
4 tax year in which work under the contract commenced,
5 other than a contract estimated to be completed within
6 six months of the date on which work under the contract
7 commenced."

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

11 "Section 546. Finance leases.

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

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

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

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

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

25 (a) if the lessor and lessee are not

1 associates and an amount is stated as the cost or value
2 of the asset in the lease agreement, that amount; or
3 (b) in any other case, the fair market value
4 of the asset at the commencement of the lease.

5 (3) The amount of the loan referred to in
6 subsection (1)(c) of this section is the amount
7 determined under subsection (2) of this section as the
8 cost of the asset.

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

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

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

20 "Section 547. Bad debts.

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

24 (a) the amount of the debt:

25 (i) was previously included in the

1 gross revenue of the business; or

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

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

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

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

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

17 Section 34. Title 54 of the Code of the Federated States of
18 Micronesia is hereby further amended by enacting a new section
19 551 to subchapter V of chapter 5 to read as follows:

20 "Section 551. Disposal and acquisition of business
21 assets.

22 (1) Except as otherwise provided in this chapter,
23 this section establishes when a business asset is
24 disposed of or acquired for the purposes of this
25 chapter.

1 (2) A business is treated as having made a
2 disposal of an asset at the time the business parts
3 with the ownership of the asset, including when the
4 asset is:

5 (a) sold, exchanged, transferred, or
6 distributed; or

7 (b) cancelled, redeemed, relinquished,
8 destroyed, lost, expired, or surrendered.

9 (3) A disposal includes the disposal of a part of
10 an asset.

11 (4) The transmission of an asset by succession or
12 under a will is treated as a disposal of the asset by
13 the deceased at the time the asset is transmitted.

14 (5) The application of a business asset to
15 personal or domestic use is treated as a disposal of
16 the asset by the owner at the time the asset is so
17 applied.

18 (6) A business acquires an asset at the time the
19 owner of the business begins to own the asset,
20 including at the time the owner is granted any right.

21 (7) The application of a personal asset by the
22 owner of a business to business use is treated as an
23 acquisition of the asset by the business at the time
24 the asset is so used.

25 (8) In this section, 'personal asset' means an

1 asset held wholly for personal or domestic use."

2 Section 35. Title 54 of the Code of the Federated States of
3 Micronesia is hereby further amended by adding a new section 552
4 to subchapter V of chapter 5 to read as follows:

5 "Section 552. Cost.

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

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

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

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

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

21 (3) Subject to this chapter, the cost of a
22 business asset that is an intangible is:

23 (a) in relation to an intangible referred to
24 in paragraph (a) or (b) of the definition of
25 'intangible' in section 512 of this title, the total

1 expenditure incurred in acquiring, creating, improving,
2 or renewing the intangible; or

3 (b) in relation to an intangible referred to
4 in paragraph (c) of the definition of 'intangible' in
5 section 512 of this title, the amount of the
6 expenditure.

7 (4) The cost of a business asset is reduced by
8 the amount of any deduction allowed to the business in
9 respect of amounts included in the cost of the asset,
10 including a deduction allowed under section 536 or 537
11 of this title.

12 (5) If a business disposes of a part of a
13 business asset, the cost of the asset is apportioned
14 between the part of the asset retained and the part
15 disposed of in accordance with their respective fair
16 market values determined at the time the business
17 acquired the asset.

18 (6) The cost of a business asset does not include
19 the amount of any grant, subsidy, rebate, commission,
20 or other assistance received or receivable by a
21 business in respect of the acquisition or holding of
22 the asset, except to the extent to which the amount is
23 included in the gross revenue of the business. The
24 reference to 'other assistance' in this subsection does
25 not include a loan repayable with or without interest.

1 (7) The cost of a business asset treated as
2 acquired under section 551(7) of this title is the fair
3 market value of the asset determined at the date it is
4 applied to business use.

5 (8) If the acquisition of a business asset is the
6 derivation of an amount included in gross revenue of a
7 business, the cost of the asset is the amount so
8 included plus any amount paid by the business for the
9 asset.

10 (9) If the acquisition of a business asset is the
11 derivation of exempt income, the cost of the asset is
12 the exempt amount plus any amount paid by the business
13 for the asset."

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

17 "Section 553. Consideration received.

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

22 (2) The consideration received by a business on
23 disposal of a business asset is the total amount
24 received by the business for the asset, including the
25 fair market value of any consideration received in kind

1 determined at the time of disposal.

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

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

10 (b) a settlement; or

11 (c) a judicial decision.

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

17 (5) If two or more business assets are disposed
18 of by a business in a single transaction and the
19 consideration received for each asset is not specified,
20 the total consideration received by the business is
21 apportioned among the assets disposed of in proportion
22 to their respective fair market values determined at
23 the time of the transaction."

24 Section 37. Title 54 of the Code of the Federated States of
25 Micronesia is hereby further amended by adding a new section 554

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

2 "Section 554. Non-arm's length transaction.

3 (1) For the purposes of this chapter, if a business
4 asset is disposed of in a non-arm's length transaction:

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

9 (b) the business acquiring the asset is treated
10 as having a cost equal to the amount determined under
11 paragraph (a) of this section.

12 (2) Reserved. "

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

16 "Section 555. Gain or loss not recognized.

17 (1) For the purposes of this chapter and subject
18 to subsection (2) of this section, no gain or loss is
19 taken to arise on the disposal of a business asset:

20 (a) between spouses as part of a divorce
21 settlement or under an agreement to live apart, but
22 only if the asset is used, available for use, or held
23 by the recipient spouse in carrying on a business;

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

1 beneficiary, but only if the asset is used, available
2 for use, or held by the executor or beneficiary in
3 carrying on a business; or

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

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

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

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

1 acquired.”

2 Section 39. Title 54 of the Code of the Federated States of
3 Micronesia is hereby further amended by adding a new subchapter
4 VI to chapter 5 to be entitled “Anti-avoidance”.

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

8 “Section 561. Transfer pricing.

9 (1) The CEO may, in respect of:

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

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

18 (2) In applying subsection (1) of this section,
19 the CEO may be guided by international standards, case
20 law, and guidelines on transfer pricing issued by
21 international organizations concerned with taxation.”

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

25 “Section 562. General anti-avoidance provision.

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

6 (2) For the purposes of determining the tax
7 liability of a business under this chapter, the CEO
8 may:

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

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

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

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

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

24 Section 43. Title 54 of the Code of the Federated States of
25 Micronesia is hereby further amended by adding a new section 571

1 to subchapter VII of chapter 5 to read as follows:

2 "Section 571. Filing of tax return.

3 (1) A person liable for tax under section 521 of
4 this title in respect of a business must file a net
5 profit tax return for the business for each tax year
6 within three months after the end of the tax year.

7 (2) A person liable for tax under section 522 of
8 this title in respect of a business must file a
9 presumptive tax return for the business for each tax
10 year within three months after the end of the tax year.

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

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

16 "Section 572. Self-assessment of net profit tax or
17 presumptive tax due.

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

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

25 (b) if the business has made a net loss for

1 the year, the amount of the net loss of the business as
2 specified in the return.

3 (2) A person that files a presumptive tax return
4 in respect of a business for a tax year is treated as
5 having made a self-assessment of the presumptive tax
6 payable for the year as specified in the return."

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

10 "Section 573. Payment of tax.
11 The net profit tax or presumptive tax payable by a
12 person for a tax year in respect of a business carried
13 on by the person is payable by the date that the tax
14 return of the business for the year is due."

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

18 "Section 574. Installments of tax.
19 (1) A person must pay installments of net profit
20 tax for a tax year in respect of a business carried on
21 by the person on the last working day of the third,
22 sixth, ninth, and twelfth months of the tax year.

23 (2) The amount of each installment is one-quarter
24 of the amount of net profits tax estimated by the
25 person to be payable in respect of the business for the

1 tax year. An estimate of net profit tax payable by the
2 person for a tax year in respect of a business must be
3 filed with the CEO by the due date for payment of the
4 first installment for the year.

5 (3) An estimate filed by a person under
6 subsection (2) of this section remains in force for the
7 whole of the tax year unless a revised estimate is
8 filed with the CEO. A revised estimate applies to the
9 calculation of installments of net profit tax for a tax
10 year due both before and after the date the revised
11 estimate was filed. The amount of any underpayment of
12 installments made prior to filing the revised estimate
13 must be paid by the person together with the first
14 installment due after the revised estimate is filed.
15 The amount of any overpaid installments is applied
16 against future net profit tax installments due.

17 (4) If a person fails to file an estimate of net
18 profit tax in respect of a business as required under
19 subsection (2) of this section, the estimated net
20 profit tax payable in respect of the business for the
21 tax year is such amount as estimated by the CEO. The
22 CEO's estimate remains in force for the whole of the
23 tax year unless revised by the business in accordance
24 with subsection (3) of this section.

25 (5) Each installment of net profit tax paid by a

1 person in respect of a business during a tax year is
2 credited against the assessed net profit tax of the
3 business for the year. If the amount of the credit
4 allowed exceeds the net profit tax due for the year,
5 the amount of the excess is credited against the
6 assessed net profit tax liability of the person in
7 relation to any other business carried on by the
8 person. Any remaining excess is refunded to the person,
9 or at the person's election, may be credited against
10 the next year's tax assessment.

11 (6) If the estimate (including any revised
12 estimate) of net profit tax payable by a person in
13 respect of a business for a tax year is less than
14 ninety percent (90%) of the assessed net profit tax
15 liability of the person in respect of the business for
16 the year (the difference is referred to as the
17 'installment shortfall'), the business is liable for a
18 penalty equal to:

19 (a) if the under-estimate is due to fraud or
20 willful neglect, fifty percent (50%) of the installment
21 shortfall; or

22 (b) in any other case, ten percent (10%) of
23 the installment shortfall.

24 (7) No penalty is imposed under subsection (6)(b)
25 of this section if the CEO is satisfied that the reason

1 for the installment shortfall was due to circumstances
2 beyond the control of the business (such as a
3 significant price fluctuation) and all reasonable care
4 was taken in making the estimate."

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

8 "Section 575. Collection of tax from non-resident ship
9 owners or charterers.

10 (1) Subject to subsection (3) of this section,
11 before the departure of a ship owned or chartered by a
12 non-resident person from a port in FSM:

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

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

22 (2) The return required under subsection (1)(a)
23 of this section must be in the prescribed form and
24 filed in the prescribed manner.

25 (3) The master or agent of a ship is liable for

1 the tax notified under subsection (1)(b) of this
2 section.

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

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

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

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

25 "Section 576. Collection of tax from non-resident

1 aircraft owners or charterers.

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

6 (2) The return required under subsection (1) of
7 this section must be in the prescribed form and filed
8 in the prescribed manner.

9 (3) A person that files a tax return under
10 subsection (1) of this section is treated as having
11 made a self-assessment of the gross revenue derived for
12 the carriage of passengers, livestock, mail,
13 merchandise, or goods embarked in the FSM during the
14 quarter and the tax payable thereon under section
15 524(1)(a) of this title as specified in the return.

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

20 (5) If the tax payable for a quarter is not paid
21 within three months of the due date, the CEO may issue
22 to the relevant airport authority a certificate
23 specifying the name of the non-resident person and the
24 amount of tax due, and the relevant airport authority
25 must refuse clearance from any airport in the FSM to

1 any aircraft owned or chartered by the person until the
2 tax due has been paid."

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

6 "Section 577. Records.

7 (1) A person carrying on a business must:

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

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

14 (2) The records that must be maintained by a
15 person liable to pay presumptive tax or tax under
16 section 524 of this title may be prescribed.

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

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

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

4 "Section 581. Withholding of tax from payments to non-
5 resident persons.

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

10 (a) in the case of an insurance premium,
11 five percent (5%) of the gross amount of the premium;
12 or

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

15 (2) A person must withhold tax from the gross
16 amount paid at the rate of ten percent (10%) if:

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

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

22 (c) the fee is not attributable to a
23 business carried on by the non-resident person through
24 a permanent establishment of the person in the FSM.

25 (3) Tax required to be withheld by a person under

1 this section must be paid to the CEO within 15 days
2 after the end of the month in which the person was
3 required to withhold the tax.

4 (4) A person is personally liable to pay the
5 amount of the tax to the CEO if that person:

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

8 (b) having withheld tax fails to pay the tax
9 to the CEO as required under this section.

10 (5) A person personally liable for an amount of
11 tax under subsection (4) of this section as a result of
12 failing to withhold the tax is entitled to recover the
13 tax from the recipient of the payment.

14 (6) A person who has withheld tax from a payment
15 under this section and paid the tax to the CEO is
16 indemnified against any claim by the recipient for
17 payment of the withheld amount."

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

21 "Section 582. Withholding tax documentation.

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

25 (2) A non-resident person required to file a net

1 profit tax return for a tax year must attach to the
2 return any tax withholding certificate received for the
3 applicable tax period.

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

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

11 "Section 583. Priority of tax withheld.

12 (1) Tax withheld from a payment by a person under
13 section 581 of this title:

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

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

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

24 (3) An amount that a person is required to
25 withhold from a payment under section 581 of this title

1 is:

2 (a) a first charge on the payment; and

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

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

10 "Section 584. Credit for tax withheld.

11 (1) If tax has been withheld under section 581(2)
12 of this title:

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

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

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

25 Section 55. Title 54 of the Code of the Federated States of

1 Micronesia is hereby further amended by adding a new subchapter
2 IX to chapter 5 to be entitled "Final Provisions".

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

6 "Section 591. Regulations.

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

13 (2) The regulations shall also provide for
14 matters prescribed under the chapter to be made by
15 regulation.

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

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

21 "Section 592. Transition.

22 Any tax liability that arose before this chapter came
23 into force may be recovered under chapter 9 of this
24 title, but without prejudice to any action already
25 taken for the recovery of the tax."

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

4 "Section 593. Commencement of administration.
5 Administration of this act shall commence six (6)
6 months after the commencement of administration date of
7 the Unified Revenue Authority Act as determined by
8 section 769 of this title."

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

12

13 Date: _____ Introduced by: _____

Joe N. Suka
(by request)

14

15

16

17

18

19

20

21

22

23

24

25