

STANDING COMMITTEE REPORT NO. 17-125

RE: C.B. NO. 17-15/W&M

SUBJECT: REVENUE ADMINISTRATION ACT OF 2011

MARCH 31, 2012

The Honorable Isaac V. Figir
Speaker, Seventeenth Congress
Federated States of Micronesia
Third Special Session, 2012

Dear Mr. Speaker:

Your Committee on Ways and Means (W&M), to which was referred C.B. No. 17-15 entitled:

"A BILL FOR AN ACT TO FURTHER AMEND TITLE 54 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA, BY REPEALING SECTIONS 801, 802, 803, 804 AND 805, AND INSERTING NEW SECTIONS 801, 802, AND 803 DESIGNATING SECTIONS 801, 802 AND 803 AS SUBCHAPTER I, AND BY ENACTING NEW SUBCHAPTERS II, III, IV, V, VI, VII, VIII, IX, X, XI, XII AND XIII FOR THE PURPOSE OF ESTABLISHING A NEW REVENUE ADMINISTRATION ACT OF 2011, AND FOR OTHER PURPOSES.",

begs leave to report as follows:

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

Your Committee reiterates its support for the Tax Reform Project of the Nation. However, your committee recognizes that we are not where we would have liked to be for this particular bill. Last April, 2011, Congress passed legislation to create the URA. It was the expectation of Congress that by this year, all state governments would have signified their positive adherence to the Tax Reform Project by passing legislation to change their own substantive tax laws and to give the new URA the authority to collect their tax. So far only two states have passed legislation to delegate such authority, and none have amended their own substantive tax laws. Your committee held a meeting with the Executive tax reform team on Friday, March 23, 2012

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to get an update on this issue. The concerns of the Committee is best explained by including in this report the letter that was subsequently sent to Vice President Alik:

"March 27, 2012

The Honorable Alik L. Alik
Vice President
Federated States of Micronesia
Palikir, Pohnpei FM 96941

Dear Vice President Alik:

Thank you for the briefing from your tax reform team last Friday. Members of Congress were grateful for the progress report on the different states' effort to pass tax reform legislation. We understand that Chuuk and Kosrae have passed their versions of the RAA and are ready to hand over the collection of their state taxes to the National Government at some point in the future. Yap is also working on a different form of legislation. We take note of your request for the National Government to pass its own RAA to prepare for that eventuality.

Subsequent to the briefing members had an internal discussion. Some issues that came up are these:

1. Supposing that some or all of the States pass their RAA, what guarantee does the National Government have that they will subsequently pass the substantive changes to their tax law, i.e. adopt the VAT and repeal their sales tax;
2. Supposing that the States do not change their laws, what would the URA be doing when it comes time to take over the states' tax collecting responsibility;
3. Supposing that not all states pass the RAA and VAT laws, what happens to the tax reform process.

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We ask if you can provide answers quickly to these three questions so that we can debate fully and expeditiously the national RAA.

Sincerely,

/s/ Dohsis Halbert
Dohsis Halbert
Chairman, Ways and Means Committee"

In response, Vice President Alik sent Chairman Halbert the following letter:

"March 28, 2012

The Honorable Dohsis Halbert
Chairman
Ways and Means Committee
17th FSM Congress
Palikir, Pohnpei FM 96941

Dear Chairman Halbert:

Thank you for your letter of March 27, regarding the briefing you and your members received on the progress of the Tax Reform Project. In response to your questions, I respectfully provide the following views:

As you know, the tax reform package, including the projected revenue estimates, is based on the assumption that all Governments will enact the entire tax reform legislative package as envisaged within the necessary timeframes (RAA prior to 19 April 2012 & the signing of the MOU; NPT in 2013; Import Duty and State VAT, with repeal of sales taxes in 2014 accompanied by changes to Wages & Salaries threshold). All Governments have worked together in a partnership approach thus far, through the Tax Reform Executive Steering Committee & the Technical Working Group - this has included extensive discussions regarding the legislative changes and their impacts.

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The very fact that the National Government has passed the URA Act and that the Government of Chuuk & Kosrae have passed the RAA is a clear sign of commitment to, and engagement with the tax reform process. We are advised that the Government of Yap is considering passage of some form of enabling legislation, and this advice also applies to the Government of Pohnpei.

However, as mentioned in our briefing session, without the legislative changes for tax reform being passed as a 'package', and to these timeframes, there will be consequences in terms of the URA's ability to achieve the revenue projections and to progress on the path of tax modernization.

There is an important leadership role for the National Congress and your Committee to continue to play on behalf of all of FSM - by passing the RAA and committing to the other requisite legislative changes, you will be sending an important and vital message to your colleagues in the State Governments regarding the ongoing importance of tax reform as a fundamental plank of the wider economic reforms that all Governments in FSM need to embrace now, and in the future.

No project team with responsibility for changes of such magnitude in any jurisdiction would claim to have a 'guarantee' of success on all the fronts involved in such a complex project. However, given the progress to date, and the risk assessments we have undertaken, it appears that there is a much stronger degree of commitment to the tax reform agenda amongst your colleagues in FSM than was previously the case. As you know, the journey of tax reform anywhere in the world is an arduous one which requires significant courage and leadership at all levels - it also requires ongoing commitment and engagement if the journey is to be successful on any level.

If some State Governments chose not to either joint the URA or amend their tax laws there are a number of possible scenarios for the operations of the URA and

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for the tax reform agenda. For example, if we proceed with 3 Governments having passed the RAA, then the URA will, once past the transitional period, be able to administer those jurisdictions' tax laws on their behalf - whether extant tax laws or new tax laws. This in itself will provide a degree of improved efficiency and effectiveness in tax administration for FSM; however, I again note that it will not allow the URA the same scope for improving the cost of collections ratios or increasing revenue.

Equally, if only some States pass some of the new tax laws, clearly there will be an impact on the positive outcomes expected from tax reform - in terms of timing, scope for improvements in administration, revenue flows and the perception from tax officers, taxpayers and the wider community both here and elsewhere regarding FSM's degree of commitment to being seen to help itself by way of economic and public sector reforms.

Having said this, as mentioned at our briefing, there are a number of examples which include a phased approach to tax reform and which are feasible. Such a situation also provides an opportunity for the URA to focus on some of the key steps in streamlining the tax system by improving approaches to e.g. improving the audit process, delinquent tax payers, collection of outstanding debts and improving filing practices.

Sincerely,

/s/ Alik L. Alik
Alik L. Alik
Vice President

The two letters give a good summary of where we are in the tax reform process. The decision comes down to this: given that we are not where we would have like to be, and faced with a deadline of April 19, 2012 for the effectiveness of the URA, how should we proceed?

Vice President Alik is giving us the answer. The action we are

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taking with this RAA is a leap of faith. We have no guarantee at this point that the all the States will follow through. This Committee has always been wary of dictating any policy preference to the States. However, we believe in rationality, and the willingness and capacity of leaders to see the positive benefit of the Tax Reform Project of which this bill is but one step.

Recommendations

Your Committee believes tax reform should be a cooperative process involving each of the five governments. Without the input and cooperation of each of the states meaningful tax reform is impossible. Your Committee would like to offer the following amendments to the bill as follows:

1. Page 92, line 21, insert "Section 87. Title 54 of the Code of the Federated States of Micronesia is hereby amended by adding a new section 934 to subchapter XIII of chapter 8 to read as follows: 'Section 934. If any of the four states of the Federated States of Micronesia have not passed into law value added tax legislation as of midnight April 19, 2013, this act is null and void.'" "

Your Committee on Ways and Means is in accord with the intent and purpose of C.B. No. 17-15 as amended 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. 17-15, C.D.1.

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Respectfully submitted,

/s/ Dohsis Halbert
Dohsis Halbert, chairman

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

/s/ Roger S. Mori
Roger S. Mori, member

Tony H. Otto, member

David W. Panuelo, member

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

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