

STANDING COMMITTEE REPORT NO. 18-165

RE: C.B. NO. 18-165/R&D

SUBJECT: APPLICATION OF CORPORATE INCOME TAX  
ON REGISTERED BRANCHES OF FOREIGN  
AND DOMESTIC CORPORATIONS

MAY 30, 2014

The Honorable Dohsis Halbert  
Speaker, Eighteenth Congress  
Federated States of Micronesia  
Fourth Regular Session, 2014

Dear Mr. Speaker:

Your Committee on Resources and Development, to which was referred C.B. No. 18-165, entitled:

"A BILL TO AMEND SECTIONS 312, 313, 314, 322, 331 AND 352 OF TITLE 54 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA, AS ENACTED BY PUBLIC LAW NO. 13-71, AND AS AMENDED BY PUBLIC LAWS NOS. 14-110, 16-19, 16-52 AND 17-73, TO EXPAND THE DEFINITION OF MAJOR CORPORATIONS TO INCLUDE QUALIFIED FOREIGN CORPORATIONS WITH REGISTERED BRANCHES IN THE FSM, AS WELL AS DOMESTIC CORPORATIONS, AND FOR OTHER PURPOSES."

begs leave to report as follows:

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

On May 13, 2014, the President transmitted the proposed bill through Presidential Communication No. 18-279. The impetus of the bill, according to P.C. 18-279, is to expand the definition of Major Corporation to include qualified Foreign Corporations with registered branches in the FSM as well as Domestic Corporations. The attempt is to cause the FSM's Corporate Income Tax to be applied to "branches" of Foreign Corporations.

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Your committee conducted a public hearing on C.B. No. 18-165 on Friday, May 23, 2014. In attendance were: Steve Baker, Kasio Mida, Ieski Ieshi, Assistant Attorney General Aaron Warren, Reed Oliver, Insurance Commissioner Jesse Giltamag, the President's Office representative Pelsasar Petrus and Amada Nakamura representing one of the captive insurance from Japan.

Chairman Panuelo opened the hearing and yielded the floor to the witnesses. Steve Baker thanked the Committee for the opportunity to appear before it and stated that the attempt here is to have corporate income tax assess on a registered branch of Foreign Corporation as well as a Domestic Corporation. He commented that this proposed bill if becomes law would give MRA market opportunity. For instance, when the asset of a Major Corporation is moved from the Japanese Corporation to a registered branch of the Japanese Corporation in the FSM, the asset is tax.

Your committee inquired on what kind of benefits the FSM will realize. Mr. Baker explained that currently there are 49 Major Corporations, and twelve (12) of those are captive insurance companies. He commented that he does not expect an explosion of corporate income tax to the FSM, but the FSM will get more corporate income tax from branches.

One of the questions asked at the hearing was whether applying an income tax to branches was common in the rest of the world. According to Mr. Baker, based upon the sources they checked, it seems that almost all countries impose a tax on the profits of branches. Some major examples include: the United States, Canada, the United Kingdom, Australia, Germany, France, Japan, Hong Kong, Singapore and Saudi Arabia. Mr. Steve Baker also stated that some countries even impose a tax on branch profits in addition to corporate level income taxes on branch earnings like the United States and Canada. There is a distinction between a branch and a Major Corporation, and not many corporations are doing this.

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Branch taxes are not limited to financial institutions, banks, insurance companies, but seem to apply to corporations generally.

Your committee asked if a branch tax is established in the FSM, what would be the image of the FSM if it passes this kind of branch tax legislation. Mr. Baker commented that the FSM is not an outlier in taxing branch profits, almost all countries do. The method embodied in the FSM Corporate Income Tax law is in line with the most recent model tax convention of 2010, which five countries have adopted and many more are considering.

According to Mr. Baker, in six a months period, he is confident that there will be two branch tax in FSM. Mr. Baker stated that if there is established a Japanese Corporation, this section will accommodate or comfort them not to be worried about registering more branches in the FSM. According to the Insurance Commissioner Jesse Giltamag, he stated that this is potential revenue generation to the FSM.

Your committee notes the frequency of proposed amendments to the FSM Code by our advisor (MRA) and wanted to know if MRA proposes something, what is the process involved. Mr. Baker explained that officially, the bill is transmitted from the President's Office. Mr. Baker stated that the review of the bill involved Japanese, American, and local lawyers. The tax will be on Major Corporation who has a Branch registered in the FSM.

Your committee inquired how will this proposal attract major corporation to the FSM. Mr. Baker explained that when the asset is moved to a branch in Micronesia, there is no tax applied. When a Major Corporation ultimately move the asset to Micronesia to its FSM branch, then the branch has to pay tax of 21% in Micronesia. Accordingly, this could be advantageous to the FSM.

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Your committee inquired also on the urgency of the bill. Mr. Baker stated that in the next six months, he is looking at bringing two. This is only deals with Investment and not class captive insurance.

Your committee asked the respective witnesses if they have any comment on the bill. Assistant Attorney General Aaron Warran stated that the President is in full support of the bill, and the revenue of this is attractive. On the regulatory aspect of it, there is need to strengthen the capacity of the Registrar of Corporation as well as the Insurance Commissioner so they can provide independent oversight on this kind of issue.

Committee would like to offer the following technical amendments to C.B. No. 18-165 as follows:

1. Title, after "16-52" insert "and 17-73".
2. Title, after "Foreign" delete "Corperation" and insert "Corporation" in lieu thereof.
3. Title, after "Domestic" delete "Corporation" and insert Corporation in lieu thereof.

**Recommendations of your committee**

Your Committee on Resources and Development is in accord with the intent and purpose of C.B. No. 18-165 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. 18-165, C.D.1.

Respectfully submitted,

/s/ David W. Panuelo  
David W. Panuelo, chairman

Victor Gouland, vice chairman

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/s/ Tiwiter Aritos  
Tiwiter Aritos, member

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/s/ Florencio S. Harper  
Florencio S. Harper, member

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/s/ Berney Martin  
Berney Martin, member

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Joseph J. Urusemal, member

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Paliknoa K. Welly, member