
A BILL FOR AN ACT

To further amend title 54 of the Code of the Federated States of Micronesia, as amended, by creating a new chapter 5 to establish the Net Profit Tax Act of 2013, 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
2 of Micronesia, as amended, is hereby further amended by
3 creating a new chapter 5 entitled "Taxation of Net Profits."

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

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

11 "Section 511. Short title. This chapter may be
12 cited as the 'Net Profit Tax Act of 2013'."

13 Section 4. Title 54 of the Code of the Federated States
14 of Micronesia, as amended, is hereby further amended by
15 inserting a new section 512 to subchapter I of chapter 5 to
16 read as follows:

17 "Section 512. Definitions.
18 Wherever used in this chapter, except where otherwise
19 specified, unless the subject matter, context, or

1 sense otherwise requires:

2 (1) 'Associate' has the meaning in section 515 of
3 this title.

4 (2) 'Business' includes any profession, trade,
5 manufacturing, or other undertaking carried on for
6 pecuniary profit, but not including employment.

7 (3) 'Business asset' means an asset, whether of
8 revenue or capital nature, used in carrying on a
9 business, including inventory, a depreciable asset,
10 an intangible, or goodwill.

11 (4) 'CEO' means the Chief Executive Officer
12 appointed under section 731 of this title.

13 (5) 'Consideration received', in relation to a
14 business asset, has the meaning attributed to it in
15 section 553 of this title.

16 (6) 'Corporation' includes corporations and
17 companies authorized to issue stock and any other
18 business associations that limit the liability of
19 individual owners.

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

23 (8) 'Depreciable asset' means any tangible personal
24 property or that portion of a structural improvement
25 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 solely to derive gross revenue.

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

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

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

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

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

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

25 (15) 'exempt income' has the meaning in section 533.

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
4 in its financial accounts.

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

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

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

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

20 (a) manufacturing operations;

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

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

25 (d) a hotel business.

1 (21) 'Intangible' means:

2 (a) a patent, invention, design or model,
3 secret formula or process, trademark, copyright, or
4 other like property or right that has a limited
5 useful life and is used solely to derive gross
6 revenue;

7 (b) a customer list, distribution channel, or
8 unique name, symbol or picture, or other marketing
9 intangible that has a limited useful life and is used
10 solely to derive gross revenue;

11 (c) contractual rights (including arising as a
12 result of a prepayment of expenses) with a benefit
13 for a limited period but of more than one year that
14 are used solely to derive gross revenue; or

15 (d) an expenditure that provides an advantage
16 or benefit for a period of more than one year, other
17 than expenditure incurred to acquire any tangible
18 personal or real property, provided that the
19 property, right, or expenditure is used solely to
20 derive gross revenue.

21 (22) 'Interest' means:

22 (a) an amount, whether described as interest,
23 discount, premium, or otherwise, whether periodical
24 or a lump sum, as consideration for the use of money
25 or being given time to pay;

1 (b) an amount that is functionally equivalent
2 to an amount referred to in paragraph (a) of this
3 subsection;

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

6 (d) a commitment, guarantee, service, or
7 similar fee payable in respect of a debt or other
8 instrument or agreement giving rise to interest under
9 paragraphs (a), (b), or (c) of this subsection.

10 (23) 'Inventory' means anything produced,
11 manufactured, purchased, or otherwise acquired for
12 sale or exchange, and includes livestock, or any raw
13 materials, or consumables used in a production or
14 manufacturing process.

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

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

20 (26) 'Member', in relation to an entity, means a
21 shareholder or other owner in a corporation, partner
22 in a partnership, beneficiary of a trust or estate,
23 or any other person with an ownership interest in the
24 entity.

25 (27) 'Natural resource amount' means:

1 (a) an amount (including a premium or like
2 amount) as consideration for the right to take
3 minerals or a living or non-living resource from land
4 or sea; or

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

8 (28) 'net book value', in relation to a business
9 asset, means the cost of the asset reduced by any
10 depreciation or amortization deductions allowed in
11 respect of the asset or, if section 552(5) applies,
12 the cost apportioned to the asset under that section
13 reduced by any depreciation or amortization
14 deductions allowed that relate to the cost
15 apportioned to the asset under section 552(5).

16 (29) 'Net profit' has the meaning in section 531 of
17 this title.

18 (30) 'Net profit tax' means a tax imposed under
19 subchapter II of this chapter.

20 (31) 'Non-resident person' means a person that is
21 not a resident person.

22 (32) 'Permanent establishment' means a fixed place
23 of business through which the business of a person is
24 wholly or partly carried on, and includes:

25 (a) a place of management, branch, office

1 (other than a liaison office), factory, warehouse, or
2 workshop;

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

5 (c) a building site, or a construction,
6 assembly or installation project, or supervisory
7 activities connected with such site or project, but
8 only if the site, project or activities continue for
9 more than ninety days;

10 (d) the furnishing of services by the person,
11 including consultancy services, through employees or
12 other personnel engaged by the person for such
13 purpose, but only if activities of that nature
14 continue for the same or a connected project for a
15 period or periods aggregating more than ninety days
16 within any twelve-month period;

17 (e) a person (referred to as an "agent")
18 acting on behalf of another person (referred to as
19 the "principal"), if the agent:

20 (i) has and habitually exercises an
21 authority to conclude contracts on behalf of the
22 principal; or

23 (ii) habitually maintains a stock of
24 inventory from which the agent regularly delivers
25 inventory on behalf of the principal, but does not

1 include an agent of independent status; or

2 (f) any substantial equipment used by a
3 person.

4 (33) 'Person' means an individual, entity, a
5 government, a political subdivision of a government,
6 or a public international organization.

7 (34) 'Prescribed' means set forth by the Secretary
8 in regulations.

9 (35) 'President' means the President of the FSM.

10 (36) 'Public international organization' has the
11 meaning in the International Organizations Immunities
12 Act of 1974, chapter 2 of title 10 of the Code of the
13 Federated States of Micronesia, or its successor.

14 (37) 'Real property' includes an exploration,
15 prospecting, development, or similar right relating
16 to real property.

17 (38) 'Relative' in relation to an individual, means:

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

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

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

25 (39) 'Resident person' means:

1 (a) in the case of an individual, an
2 individual who:

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

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

8 (iii) is an employee of the National or of
9 a State Government of the FSM posted abroad at any
10 time during the year;

11 (b) in the case of any other person, the
12 person is incorporated, formed, organized, or
13 otherwise established in the FSM; or

14 (c) the Government of the FSM, a Government of
15 a State Government in the FSM, or a local government
16 in the FSM.

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

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

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

1 with television or tapes in connection with radio
2 broadcasting);

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

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

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

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

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

21 (42) 'Small business' means a business that is
22 carried on by a person that is not registered for the
23 value added tax, but not including a business making
24 exempt supplies that would be above the value added
25 tax (VAT) registration threshold if the exempt

1 supplies were taxable supplies.

2 (43) 'State' means a State of the FSM.

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

9 (45) 'Tax year' means:

10 (a) in the case of a corporation, the period
11 of twelve months ending on the date of the annual
12 balance of its accounts; or

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

15 (46) 'use' or 'used', in relation to a business
16 asset, includes available for use or held.

17 (47) 'VAT' means the value added tax imposed
18 pursuant to applicable revenue laws.

19 (48) 'VAT Law' means the Value Added Tax Act of a
20 State."

21 Section 5. Title 54 of the Code of the Federated States
22 of Micronesia, as amended, is hereby further amended by
23 inserting a new section 513 to subchapter I of chapter 5 to
24 read as follows:

25 "Section 513. Source of income.

1 (1) An amount derived by a resident person in
2 carrying on a business is derived from sources in the
3 FSM except to the extent that it is attributable to a
4 business carried on through a permanent establishment
5 of the person outside the FSM.

6 (2) An amount derived by a non-resident person in
7 carrying on a business is derived from sources in the
8 FSM to the extent that it is attributable to a
9 business carried on through a permanent establishment
10 of the person in the FSM.

11 (3) Notwithstanding subsections (1) and (2) of this
12 section, the following amounts are considered derived
13 from sources in the FSM:

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

15 (b) rental from the lease of real property in
16 the FSM;

17 (c) interest, a royalty, or a management fee:

18 (i) paid by a resident person, other than
19 as an expense of a business carried on through a
20 permanent establishment of the person outside the
21 FSM; or

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

25 (d) a natural resource amount in respect of a

1 natural resource taken in the FSM;

2 (e) an insurance premium in respect of the
3 insurance of a risk in the FSM;

4 (f) a gain arising on disposal of real
5 property in the FSM; or

6 (g) a gain arising on disposal of an ownership
7 interest in an entity whose assets consist, directly
8 or indirectly, through one or more interposed
9 entities, solely or principally of real property in
10 the FSM."

11 Section 6. Title 54 of the Code of the Federated States
12 of Micronesia, as amended, is hereby further amended by
13 inserting a new section 514 to subchapter I of chapter 5 to
14 read as follows:

15 "Section 514. Fair market value.

16 (1) The fair market value of an asset, property,
17 service, or benefit at a particular time is the
18 ordinary open market value of the asset, property,
19 service, or benefit at that time.

20 (2) If it is not possible to determine the fair
21 market value of an asset, property, service, or
22 benefit at a particular time under subsection (1) of
23 this section, the fair market value is the
24 consideration a similar asset, property, service, or
25 benefit would ordinarily fetch in the open market at

1 that time, adjusted to take account of the
2 differences between the similar asset, property,
3 service, or benefit and the actual asset, property,
4 service, or benefit.

5 (3) If the fair market value of an asset, property,
6 service, or benefit cannot be determined under
7 subsection (1) or (2) of this section, the fair
8 market value is the amount determined by the CEO.

9 (4) This section is subsection to section 561."

10 Section 7. Title 54 of the Code of the Federated States
11 of Micronesia, as amended, is hereby further amended by
12 inserting a new section 515 to subchapter I of chapter 5 to
13 read as follows:

14 "Section 515. Associate.

15 (1) Subject to subsection (2) of this section, two
16 persons are associates if the relationship between
17 them is such that one may reasonably be expected to
18 act in accordance with the intentions of the other,
19 or both persons may reasonably be expected to act in
20 accordance with the intentions of a third person.

21 (2) Two persons are not associates solely by reason
22 of the fact that one person is an employee or client
23 of the other or both persons are employees or clients
24 of a third person.

25 (3) Without limiting the generality of subsection

1 (1) of this section, the following are treated as
2 associates:

3 (a) an individual and a relative of the
4 individual, except if the CEO is satisfied that
5 neither person may reasonably be expected to act in
6 accordance with the intentions of the other;

7 (b) a partner in a partnership and the
8 partnership, if the partner, either alone or together
9 with an associate or associates under another
10 application of this section, controls fifty percent
11 (50%) or more of the rights to income or capital of
12 the partnership;

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

15 (d) a member in a corporation and the
16 corporation, if the member, either alone or together
17 with an associate or associates under another
18 application of this section, controls either directly
19 or through one or more interposed entities:

20 (i) fifty percent (50%) or more of the
21 voting power in the corporation;

22 (ii) fifty percent (50%) or more of the
23 rights to dividends; or

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

1 (e) two corporations, if a person, either
2 alone or together with an associate or associates
3 under another application of this section, controls
4 either directly or through one or more interposed
5 entities:

6 (i) fifty percent (50%) or more of the voting
7 power in both corporations;

8 (ii) fifty percent (50%) or more of the rights
9 to dividends in both corporations; or

10 (iii) fifty percent (50%) or more of the rights
11 to capital in both corporations.

12 (4) In applying subsection (3) (b), (d), or (e) of
13 this section holdings that are attributable to a
14 person from an associate are not reattributed to
15 another associate."

16 Section 8. Title 54 of the Code of the Federated States
17 of Micronesia, as amended, is hereby further amended by
18 creating a new subchapter II under chapter 5 entitled:
19 "Imposition of Tax".

20 Section 9. Title 54 of the Code of the Federated States
21 of Micronesia, as amended, is hereby further amended by
22 inserting a new section 521 to subchapter II of chapter 5 to
23 read as follows:

24 "Section 521. Imposition of net profit tax.

25 Net profit tax is imposed for each tax year at the

1 rate of twenty five percent (25%) on the net profit
2 for the tax year of every business."

3 Section 10. Title 54 of the Code of the Federated States
4 of Micronesia, as amended, is hereby further amended by
5 inserting a new section 522 to subchapter II of chapter 5 to
6 read as follows:

7 "Section 522. Imposition of presumptive tax.
8 A presumptive tax of eighty dollars (\$80) per tax
9 year is imposed on a business if the gross revenue
10 of the business for the tax year does not exceed ten
11 thousand dollars (\$10,000.)"

12 Section 11. Title 54 of the Code of the Federated States
13 of Micronesia, as amended, is hereby further amended by
14 inserting a new section 523 to subchapter II of chapter 5 to
15 read as follows:

16 "Section 523. General provisions applicable to net
17 profit tax and presumptive tax.

18 (1) Net profit tax or presumptive tax is payable by
19 the person or persons carrying on the business. If a
20 person carries on more than one business, the net
21 profit tax or presumptive tax payable is computed and
22 reported separately for each business. For this
23 purpose, if a business has operations in more than
24 one State, the operations in each State are treated
25 as a separate business.

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

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

13 Section 12. Title 54 of the Code of the Federated States
14 of Micronesia, as amended, is hereby further amended by
15 inserting a new section 524 to subchapter II of chapter 5 to
16 read as follows:

17 "Section 524. Imposition of tax on transportation
18 income of non-resident person.

19 (1) Tax is imposed at the rate of three percent
20 (3%) on the gross revenue derived by a non-resident
21 person without a permanent establishment in the FSM
22 operating a ship or aircraft for the carriage of
23 passengers, livestock, mail, merchandise, or goods
24 embarked in the FSM.

25 (2) Tax payable under this section shall be payable

1 by the non-resident person deriving the amount
2 subject to tax. The tax payable is discharged if the
3 tax has been paid in accordance with section 575 or
4 576 of this title.

5 (3) Subsection (1) of this section does not apply
6 to an amount that is exempt income."

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

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

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

18 (2) The rate of tax imposed under subsection (1) of
19 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 amount
23 of the interest, royalty, natural resource amount, or
24 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

8 interest, royalty, natural resource amount, insurance

9 premium, or management fee is taxable under section

10 521 of this 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 States

15 of Micronesia, as amended, is hereby further amended by

16 creating a new subchapter III under chapter 5 entitled:

17 "Computation of Net Profit".

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

19 of Micronesia, as amended, is hereby further amended by

20 inserting a new section 531 to subchapter III of chapter 5 to

21 read as follows:

22 "Section 531. Net profit.

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

24 gross revenue of the business for the year reduced by

25 the total amount of deductions allowed to the

1 business for the year."

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

6 "Section 532. Gross revenue.

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

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

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

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

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

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

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

1 is the consideration received on disposal of the
2 asset less the net book value of the asset at the
3 time of disposal.

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

8 (4) The gross revenue of a business does not
9 include any amount subject to tax under sections 522,
10 524, or 525 of this title."

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

15 "Section 533. Exempt income.

16 (1) The following amounts are exempt income:

17 (a) a distribution by an entity;

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

21 (i) the debentures were issued by the
22 corporation outside the FSM for the purpose of
23 raising a loan outside the FSM;

24 (ii) the debentures were issued with a
25 view to public subscription or other wide

1 distribution;

2 (iii) the debentures were issued for the
3 purpose of raising funds for use by the corporation
4 in a business carried on in the FSM; and

5 (iv) the interest is paid outside the FSM;
6 and

7 (c) an amount exempt from tax under an
8 international agreement between the Government of the
9 FSM and a foreign government or a public
10 international organization.

11 (2) A provision in another law providing that an
12 amount is exempt income does not have legal effect
13 unless also provided for in this chapter.

14 (3) For purposes of subsection (2) of this section,
15 exemptions contained in chapter 3 of title 54 and
16 chapter 10 of title 37 of the Code of the Federated
17 States of Micronesia have legal effect."

18 Section 18. Title 54 of the Code of the Federated States
19 of Micronesia, as amended, is hereby further amended by
20 inserting a new section 534 to subchapter III of chapter 5 to
21 read as follows:

22 "Section 534. Deductions.

23 (1) Subject to this chapter, the total amount of
24 deductions allowed to a business for a tax year is
25 the sum of:

1 (a) subject to section 535 of this title, the
2 expenses or losses incurred during the year solely in
3 deriving amounts included in the gross revenue of the
4 business;

5 (b) the cost of inventory for the year as
6 determined under this chapter;

7 (c) the total amount, as determined under
8 section 536 of this title, by which the value of the
9 depreciable assets of the business have declined
10 during the year by reason of wear and tear from use
11 in deriving amounts included in the gross revenue of
12 the business;

13 (d) the total amount, as determined under
14 section 537 of this title, by which the value of the
15 intangibles of the business have declined in value
16 during the year from use in deriving amounts included
17 in the gross revenue of the business; and

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

20 (2) For the purposes of subsection (1)(e) of this
21 section, the net loss on disposal of a business asset
22 is the net book value of the asset at the time of
23 disposal less the consideration received on disposal
24 of the asset."

25 Section 19. Title 54 of the Code of the Federated States

1 of Micronesia, as amended, is hereby further amended by
2 inserting a new section 535 to subchapter III of chapter 5 to
3 read as follows:

4 "Section 535. Non-deductible expenses.

5 (1) No deduction is allowed for:

6 (a) a distribution by an entity or capital
7 withdrawn from a business;

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

11 (c) an amount placed in a reserve fund, a
12 provision for expected expenses or losses, or an
13 amount capitalized in any way;

14 (d) an expense or loss to the extent
15 recoverable under a policy of insurance or contract
16 of indemnity;

17 (e) an expense incurred in providing
18 entertainment except:

19 (i) if the entertainment was provided in
20 the ordinary course of a business carried on to
21 provide the entertainment and the entertainment was
22 not provided to an employee or an associate of the
23 person carrying on the business;

24 (ii) if the entertainment is a meal or
25 refreshment consumed by the owner or employee of a

1 business while the owner or employee was traveling
2 for the purposes of the business; or

3 (iii) if the entertainment is a meal or
4 refreshment provided to an employee on the business'
5 premises and which is available to all full-time
6 employees on equal terms;

7 (f) interest payable to an associate other
8 than that interest included in the gross revenue of a
9 business carried on by the associate or taxable under
10 section 525 of this title;

11 (g) the net profit tax, including any penalty
12 or late payment interest payable in respect of net
13 profit tax payable;

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

16 (i) a bribe, kickback, or other expense
17 incurred to accomplish an illegal transaction or
18 activity.

19 (2) A person required to withhold tax under
20 subchapter VII of this chapter in respect of an
21 amount paid to a non-resident person is not allowed a
22 deduction for the amount paid until the tax has been
23 withheld and paid to the CEO.

24 (3) The only deduction allowed in relation to the
25 cost of an intangible of a business is as provided

1 for in section 537."

2 Section 20. Title 54 of the Code of the Federated States
3 of Micronesia, as amended, is hereby further amended by
4 inserting a new section 536 to subchapter III of chapter 5 to
5 read as follows:

6 "Section 536. Depreciable assets.

7 (1) A business is allowed a deduction for a tax
8 year for the amount by which the value of the
9 depreciable assets of a business has declined during
10 the year.

11 (2) The decline in value of a depreciable asset of
12 a business for a tax year is computed by applying the
13 rate specified in subsection (3) of this section
14 against the cost of the asset.

15 (3) The rate of depreciation is:

16 (a) in the case of motor vehicles, buses and
17 minibuses, goods vehicles, trucks, tractors,
18 trailers, and trailer-mounted containers, computers
19 and data handling equipment, construction equipment
20 and earthmoving equipment, and plant and machinery
21 used in manufacturing, mining, or farming operations,
22 fifty percent (50%);

23 (b) in the case of industrial buildings, ten
24 percent (10%);

25 (c) in the case of any other structural

1 improvement, five percent (5%); or

2 (d) in the case of any other depreciable
3 asset, thirty three and one-third percent ($33\frac{1}{3}\%$).

4 (4) If a depreciable asset of a business is not
5 used in carrying on the business for the whole of the
6 year, the amount computed under subsection (2) of
7 this section is reduced by the proportion of the year
8 that the asset was not so used.

9 (5) The total decline in value allowed as a
10 deduction under section 534(1)(c) of this title for a
11 depreciable asset for the current tax year and all
12 previous tax years must not exceed the cost of the
13 asset."

14 Section 21. Title 54 of the Code of the Federated States
15 of Micronesia, as amended, is hereby further amended by
16 inserting a new section 537 to subchapter III of chapter 5 to
17 read as follows:

18 "Section 537. Intangibles.

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

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

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

3 (a) it has a useful life of more than ten
4 years; or

5 (b) it does not have an ascertainable useful
6 life.

7 (4) If an intangible of a business is not used in
8 carrying on the business for the whole of the year,
9 the amount computed under subsection (2) of this
10 section is reduced by the proportion of the year that
11 the intangible was not so used.

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

17 Section 22. Title 54 of the Code of the Federated States
18 of Micronesia, as amended is hereby further amended by
19 inserting a new section 538 to subchapter III of chapter 5 to
20 read as follows:

21 "Section 538. Net loss carry forward.

22 (1) If the total amount of deductions of a business
23 allowed for a tax year (other than under this section
24 or section 540(3) of this title) exceeds the gross
25 revenue of the business for the year, the amount of

1 the excess is the net loss of the business for the
2 year.

3 (2) If a business has a net loss for a tax year,
4 the amount of the loss is carried forward to the
5 following tax year and allowed as a deduction in
6 computing the net profit of the business for that
7 following year.

8 (3) If a net loss is not wholly deducted under
9 subsection (2) of this section, the amount not
10 deducted is carried forward to the next following tax
11 year and applied as specified in subsection (2) of
12 this section in that year, and so on until the loss
13 is fully deducted, but no loss can be carried forward
14 for more than three tax years after the year in which
15 the loss was incurred.

16 (4) If a business has a net loss carried forward
17 under this section for more than one tax year, the
18 loss of the earliest year is deducted first.

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

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

25 Section 23. Title 54 of the Code of the Federated States

1 of Micronesia, as amended, is hereby further amended by
2 inserting a new section 539 to subchapter III of chapter 5 to
3 read as follows:

4 "Section 539. Currency translation.

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

7 (2) Subject to subsection (3) of this section, if
8 an amount is in a currency other than United States
9 dollars, the amount must be translated to United
10 States dollars at the United States Federal Reserve
11 exchange rate applying between the foreign currency
12 and United States dollars on the date the amount is
13 taken into account for the purposes of this chapter.

14 (3) With the prior written permission of the CEO,
15 amounts taken into account in computing the net
16 profit or net loss of a business for a tax year may
17 be translated to United States dollars at the average
18 mid-exchange rate for the tax year between the
19 foreign currency and United States dollars."

20 Section 24. Title 54 of the Code of the Federated States
21 of Micronesia, as amended, is hereby further amended by
22 inserting a new section 540 to subchapter III of chapter 5 to
23 read as follows:

24 "Section 540. Interest expense.

25 (1) Subject to section 535(1)(f) of this title and

1 subsection (2) of this section, a business is allowed
2 a deduction for any interest expense incurred by the
3 business during a tax year to the extent to which the
4 business has used the proceeds or benefit of the debt
5 or other instrument or agreement giving rise to the
6 interest solely to derive amounts included in the
7 gross revenue of the business.

8 (2) The total amount of interest allowed to a
9 business as a deduction under this section for a tax
10 year must not exceed the amount computed according to
11 the following formula:

$$12 \qquad \qquad \qquad \mathbf{A + (50\% \times (B - C))}$$

13 Where:

14 **A** is the total interest income derived by the
15 business from sources in the FSM during the year;

16 **B** is the total gross revenue of the business for
17 the year, other than interest income; and

18 **C** is the total amount of deductions allowed to
19 the business for the year incurred in deriving
20 amounts included in gross revenue, other than for
21 interest incurred.

22 (3) If an amount of interest is not deducted in a
23 tax year as a result of subsection (2) of this
24 section, the undeducted amount of the interest is
25 carried forward and treated as interest incurred by

1 the business in the next following tax year and
2 deducted in accordance with this section in that
3 year, and so on until the interest is fully deducted.

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

6 Section 25. Title 54 of the Code of the Federated States
7 of Micronesia, as amended, is hereby further amended by
8 creating a new subchapter IV under chapter 5 to be entitled
9 "Tax Accounting".

10 Section 26. Title 54 of the Code of the Federated States
11 of Micronesia, as amended, is hereby further amended by
12 inserting a new section 541 to subchapter IV of chapter 5 to
13 read as follows:

14 "Section 541. Simplified tax accounting for small
15 businesses.

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

19 (a) the revenues and expenses of the business
20 are accounted for on a cash basis under which an
21 amount of revenue is derived when it is received and
22 an expense is incurred when it is paid;

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

25 (c) subject to paragraph (e) of this section,

1 the amount allowed for the depreciation of
2 depreciable assets or the amortization of intangibles
3 is computed in accordance with sections 536 and 537
4 of this title;

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

10 (e) an intangible that is a prepayment of a
11 business expense is deductible in the tax year in
12 which it is paid."

13 (2) Reserved.

14 Section 27. Title 54 of the Code of the Federated States
15 of Micronesia, as amended, is hereby further amended by
16 inserting a new section 542 to subchapter IV of chapter 5 to
17 read as follows:

18 "Section 542. Tax accounting for businesses other
19 than small businesses.

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

24 (a) the revenues and expenses of the business
25 are accounted for on an accrual basis under which an

1 amount of revenue is derived when it is due and an
2 expense is incurred when it is payable;

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

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

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

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

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

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

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

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

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

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

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

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

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

14 Section 28. Title 54 of the Code of the Federated States
15 of Micronesia, as amended, is hereby further amended by
16 inserting a new section 543 to subchapter IV of chapter 5 to
17 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
23 the method of accounting used by the business in
24 computing the net profit of the person's business and
25 the CEO shall in writing, approve or disapprove the

1 application.

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

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

13 "Section 544. Inventory.

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

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

23 **(A + B) - C**

24 Where:

25 **A** is the opening value of the inventory for the

1 tax year;

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

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

6 (3) The opening value of inventory for a tax 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 year,
10 the cost of inventory (if any) acquired by the owner
11 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
15 inventory 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
18 method. The absorption-cost method is the generally
19 accepted accounting principle under which the cost of
20 an item of inventory is the sum of direct material
21 costs, direct labor costs, and factory overhead
22 costs. Direct material costs are the cost of
23 materials that become an integral part of the
24 inventory manufactured or produced, or which are
25 consumed in the manufacturing or production process.

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

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

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

18 "Section 545. Long-term contracts.

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

1 recognized by reference to the stage of completion of
2 the contract.

3 (2) In this section, 'long-term contract' means a
4 contract for manufacture, installation, or
5 construction, or, in relation to each, the
6 performance of related services, that is not
7 completed within the tax year in which work under the
8 contract commenced, other than a contract estimated
9 to be completed within six months of the date on
10 which work under the contract commenced."

11 Section 31. Title 54 of the Code of the Federated States
12 of Micronesia, as amended, is hereby further amended by
13 inserting a new section 546 to subchapter IV of chapter 5 to
14 read as follows:

15 "Section 546. Finance leases.

16 (1) If a business has entered into a finance lease,
17 the net profit of the business is computed on the
18 basis that:

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

20 (b) the lessee acquired the asset at the
21 commencement of the lease, except in cases when the
22 lessee already was the owner of the asset; and

23 (c) the lessor has made a blended loan to the
24 lessee at the commencement of the lease and each
25 lease payment is in part repayment of principal and

1 in part payment of interest under that loan.

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

4 (a) if the lessor and lessee are not
5 associates and an amount is stated as the cost or
6 value of the asset in the lease agreement, that
7 amount; or

8 (b) in any other case, the fair market value
9 of the asset at the commencement of the lease.

10 (3) The amount of the loan referred to in
11 subsection (1)(c) of this section is the amount
12 determined under subsection (2) of this section as
13 the cost of the asset.

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

17 (5) In this section, a blended loan is a loan under
18 which payments by the borrower represent in part a
19 payment of interest and in part a repayment of
20 principal when the interest part is calculated on the
21 principal outstanding at the time of each payment."

22 Section 32. Title 54 of the Code of the Federated States
23 of Micronesia, as amended, is hereby further amended by
24 inserting a new section 547 to subchapter IV of chapter 5 to
25 read as follows:

1 "Section 547. Bad debts.

2 (1) A deduction is allowed for a tax year for a bad
3 debt of a business if the following conditions are
4 satisfied:

5 (a) the amount of the debt:

6 (i) was previously included in the gross
7 revenue of the business; or

8 (ii) is money lent by the business in the
9 normal course of carrying on a business of money
10 lending;

11 (b) the debt or part of the debt is written
12 off in the accounts of the business in the tax year;
13 and

14 (c) there are reasonable grounds for believing
15 that the debt is irrecoverable.

16 (2) The amount of the deduction allowed under this
17 section for a tax year must not exceed the amount of
18 the debt written off in the accounts of the business
19 for that year."

20 Section 33. Title 54 of the Code of the Federated States
21 of Micronesia, as amended, is hereby further amended by
22 creating a new subchapter V under chapter 5 entitled: "Business
23 Assets".

24 Section 34. Title 54 of the Code of the Federated States
25 of Micronesia, as amended, is hereby further amended by

1 inserting a new section 551 to subchapter V of chapter 5 to
2 read as follows:

3 "Section 551. Disposal and acquisition of business
4 assets.

5 (1) Except as otherwise provided in this chapter,
6 this section establishes when a business asset is
7 disposed of or acquired for the purposes of this
8 chapter.

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

12 (a) sold, exchanged, transferred, or
13 distributed; or

14 (b) cancelled, redeemed, relinquished,
15 destroyed, lost, expired, or surrendered.

16 (3) A disposal includes the disposal of a part of
17 an asset.

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

21 (5) The application of a business asset to personal
22 or domestic use is treated as a disposal of the asset
23 by the owner at the time the asset is so applied.

24 (6) A business acquires an asset at the time the
25 owner of the business begins to own the asset,

1 including at the time the owner is granted any right.

2 (7) The application of a personal asset by the
3 owner of a business to business use is treated as an
4 acquisition of the asset by the business at the time
5 the asset is so used.

6 (8) In this section, 'personal asset' means an
7 asset held wholly for personal or domestic use."

8 Section 35. Title 54 of the Code of the Federated States
9 of Micronesia, as amended, is hereby further amended by
10 inserting a new section 552 to subchapter V of chapter 5 to
11 read as follows:

12 "Section 552. Cost.

13 (1) Except as otherwise provided in this chapter,
14 this section establishes the cost of a business asset
15 for the purposes of this chapter.

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

18 (a) the total consideration given by a
19 business for the asset, including the fair market
20 value of any consideration in kind determined at the
21 time the asset is acquired and, if the asset is
22 constructed or developed, the cost of construction or
23 development;

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

1 (c) any expenditure incurred by the business
2 to install, alter, renew, reconstruct, or improve the
3 asset.

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

6 (a) in relation to an intangible referred to
7 in paragraph (a), (b) or (c) of the definition of
8 'intangible' in section 512 of this title, the total
9 expenditure incurred in acquiring, creating,
10 improving, or renewing the intangible; or

11 (b) in relation to an intangible referred to
12 in paragraph (d) of the definition of 'intangible' in
13 section 512 of this title, the amount of the
14 expenditure.

15 (4) The cost of a business asset does not include
16 an expense allowed as a deduction under section
17 534(1)(a).

18 (5) If a business disposes of a part of a business
19 asset, the cost of the asset is apportioned between
20 the part of the asset retained and the part disposed
21 of in accordance with their respective fair market
22 values determined at the time the business acquired
23 the asset.

24 (6) The cost of a business asset does not include
25 the amount of any grant, subsidy, rebate, commission,

1 or other assistance received or receivable by a
2 business in respect of the acquisition or holding of
3 the asset, except to the extent to which the amount
4 is included in the gross revenue of the business.

5 The reference to 'other assistance' in this
6 subsection does not include a loan repayable with or
7 without interest.

8 (7) The cost of a business asset treated as
9 acquired under section 551(7) of this title is the
10 fair market value of the asset determined at the date
11 it is applied to business use.

12 (8) If the acquisition of a business asset is the
13 derivation of an amount included in the gross
14 revenue of a business, the cost of the asset is the
15 amount so included plus any amount paid by the
16 business for the asset.

17 (9) If the acquisition of a business asset is the
18 derivation of exempt income, the cost of the asset is
19 the exempt amount plus any amount paid by the
20 business for the asset.

21 (10) The cost of an asset of a business must not be
22 reduced by an impairment write down in relation to
23 the asset made in the financial accounts of the
24 business.

25 (11) In this section, "impairment write down", in

1 relation to an asset of a business, means the write
2 down of the value of the asset in the financial
3 accounts of the business because the fair market
4 value of the asset is less than the cost of the
5 asset."

6 Section 36. Title 54 of the Code of the Federated States
7 of Micronesia, as amended, is hereby further amended by
8 inserting a new section 553 to subchapter V of chapter 5 to
9 read as follows:

10 "Section 553. Consideration received.

11 (1) Except as otherwise provided in this chapter,
12 this section establishes the amount of consideration
13 received on disposal of a business asset for the
14 purposes of this chapter.

15 (2) The consideration received by a business on
16 disposal of a business asset is the total amount
17 received by the business for the asset, including the
18 fair market value of any consideration received in
19 kind determined at the time of disposal.

20 (3) If a business asset has been lost or destroyed,
21 the consideration received by a business for the
22 asset includes any compensation, indemnity, or
23 damages received by the business as a result of the
24 loss or destruction, including amounts received as a
25 consequence of:

1 (a) an insurance policy, indemnity, or other
2 agreement;

3 (b) a settlement; or

4 (c) a judicial decision.

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

10 (5) If two or more business assets are disposed of
11 by a business in a single transaction and the
12 consideration received for each asset is not
13 specified, the total consideration received by the
14 business is apportioned among the assets disposed of
15 in proportion to their respective fair market values
16 determined at the time of the transaction."

17 Section 37. Title 54 of the Code of the Federated States
18 of Micronesia, as amended, is hereby further amended by
19 inserting a new section 554 to subchapter V of chapter 5 to
20 read as follows:

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

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

25 (a) the business disposing of the asset is

1 treated as having received consideration equal to the
2 fair market value of the asset determined at the time
3 the asset is disposed of; and

4 (b) the business acquiring the asset is
5 treated as having a cost equal to the amount
6 determined under paragraph (a) of this section.

7 (2) Reserved. "

8 Section 38. Title 54 of the Code of the Federated States
9 of Micronesia, as amended, is hereby further amended by
10 inserting a new section 555 to subchapter V of chapter 5 to
11 read as follows:

12 "Section 555. Gain or loss not recognized.

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

16 (a) between spouses as part of a divorce
17 settlement or under an agreement to live apart, but
18 only if the asset is used by the recipient spouse in
19 carrying on a business;

20 (b) by reason of the transmission of the asset
21 on the death of a person to an executor or
22 beneficiary, but only if the asset is used by the
23 executor or beneficiary in carrying on a business; or

24 (c) by reason of the compulsory acquisition of
25 the asset under any law if the consideration received

1 for the disposal is reinvested by the recipient in an
2 asset of a like kind (referred to as a 'replacement
3 asset') within one year of the disposal.

4 (2) Subsection (1) of this section does not apply
5 if the person acquiring the asset (including a
6 replacement asset) is a non-resident person at the
7 time of the acquisition.

8 (3) If subsection (1) (a) or (b) of this section
9 applies, the person acquiring the asset is treated as
10 acquiring an asset of the same character as the
11 person disposing of the asset for an amount equal to
12 the cost of the asset for the person disposing of the
13 asset at the time of the disposal.

14 (4) A person's cost of a replacement asset referred
15 to in subsection (1) (c) of this section is the cost
16 of the asset at the time it is compulsorily acquired
17 plus the amount by which any consideration given by
18 the person for the replacement asset exceeds the
19 consideration received by the person for the asset
20 compulsorily acquired."

21 Section 39. Title 54 of the Code of the Federated States
22 of Micronesia, as amended, is hereby further amended by
23 creating a new subchapter VI under chapter 5 entitled: "Anti-
24 avoidance".

25 Section 40. Title 54 of the Code of the Federated States

1 of Micronesia, as amended, is hereby further amended by
2 inserting a new section 561 to subchapter VI of chapter 5 to
3 read as follows:

4 "Section 561. Transfer pricing.

5 (1) The CEO may distribute, apportion, or allocate
6 revenue and expenses between businesses as is
7 necessary to reflect the outcome that would have
8 arisen in a transaction between independent persons
9 dealing with each other at arm's length in respect
10 of:

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

13 (b) a transaction between businesses carried
14 on by the same person.

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

19 Section 41. Title 54 of the Code of the Federated States
20 of Micronesia, as amended, is hereby further amended by
21 inserting a new section 562 to subchapter VI of subchapter 5 to
22 read as follows:

23 "Section 562. General anti-avoidance provision.

24 (1) In this section, 'tax avoidance scheme' means
25 any transaction or arrangement where one of the main

1 purposes of a person in entering into the transaction
2 or arrangement is the avoidance or reduction of the
3 tax liability of a business under this chapter.

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

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

10 (b) disregard a transaction that does not have
11 substantial economic effect;

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

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

19 Section 42. Title 54 of the Code of the Federated States
20 of Micronesia, as amended, is hereby further amended by
21 creating a new subchapter VII under chapter 5 entitled:
22 "Procedures".

23 Section 43. Title 54 of the Code of the Federated States
24 of Micronesia, as amended, is hereby further amended by
25 inserting a new section 571 to subchapter VII of chapter 5 to

1 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
11 year.

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

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

18 "Section 572. Self-assessment of net profit tax or
19 presumptive tax due.

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

23 (a) if the business has a net profit for the
24 year, the amount of the net profit of the business
25 and the net profit tax payable thereon as specified

1 in the return; or

2 (b) if the business has made a net loss for
3 the year, the amount of the net loss of the business
4 as specified in the return.

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

9 Section 45. Title 54 of the Code of the Federated States
10 of Micronesia, as amended, is hereby further amended by
11 inserting a new section 573 to subchapter VII of chapter 5 to
12 read as follows:

13 "Section 573. Payment of tax.

14 The net profit tax or presumptive tax payable by a
15 person for a tax year in respect of a business
16 carried on by the person is payable by the date that
17 the tax return of the business for the year is due."

18 Section 46. Title 54 of the Code of the Federated States
19 of Micronesia, as amended, is hereby further amended by
20 inserting a new section 574 to subchapter VII of chapter 5 to
21 read as follows:

22 "Section 574. Installments of tax.

23 (1) A person must pay installments of net profit
24 tax for a tax year in respect of a business carried
25 on by the person on the last working day of the

1 third, sixth, ninth, and twelfth months of the tax
2 year.

3 (2) The amount of each installment is one-quarter
4 of the amount of net profits tax estimated by the
5 person to be payable in respect of the business for
6 the tax year. An estimate of net profit tax payable
7 by the person for a tax year in respect of a business
8 must be filed with the CEO by the due date for
9 payment of the first installment for the year.

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

23 (4) If a person fails to file an estimate of net
24 profit tax in respect of a business as required under
25 subsection (2) of this section, the estimated net

1 profit tax payable in respect of the business for the
2 tax year is such amount as estimated by the CEO. The
3 CEO's estimate remains in force for the whole of the
4 tax year unless revised by the business in accordance
5 with subsection (3) of this section.

6 (5) Each installment of net profit tax paid by a
7 person in respect of a business during a tax year is
8 credited against the assessed net profit tax of the
9 business for the year. If the amount of the credit
10 allowed exceeds the net profit tax due for the year,
11 the amount of the excess is credited against the
12 assessed net profit tax liability of the person in
13 relation to any other business carried on by the
14 person. Any remaining excess is refunded to the
15 person, or at the person's election, may be credited
16 against the next year's tax assessment.

17 (6) If the estimate (including any revised
18 estimate) of net profit tax payable by a person in
19 respect of a business for a tax year is less than
20 ninety percent (90%) of the assessed net profit tax
21 liability of the person in respect of the business
22 for the year (the difference is referred to as the
23 'installment shortfall'), the business is liable for
24 a penalty equal to:

25 (a) if the under-estimate is due to fraud or

1 willful neglect, fifty percent (50%) of the
2 installment shortfall; or

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

5 (7) No penalty is imposed under subsection (6) (b)
6 of this section if the CEO is satisfied that the
7 reason for the installment shortfall was due to
8 circumstances beyond the control of the business
9 (such as a significant price fluctuation) and all
10 reasonable care was taken in making the estimate."

11 Section 47. Title 54 of the Code of the Federated States
12 of Micronesia, as amended, is hereby further amended by
13 inserting a new section 575 to subchapter VII of chapter 5 to
14 read as follows:

15 "Section 575. Collection of tax from non-resident
16 ship owners or charterers.

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

20 (a) the master or FSM agent of the ship must
21 file with the CEO a return showing the gross revenue
22 derived from the carriage of passengers, livestock,
23 mail, merchandise, or goods embarked in the FSM in
24 respect of the ship; and

25 (b) the CEO must determine the amount of tax

1 due under section 524 of this title in respect of the
2 ship and pursuant to regulatory guidelines, notify
3 the master or FSM agent, in writing, of the amount
4 due.

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

8 (3) The master or FSM agent of a ship is liable for
9 the tax notified under subsection (1)(b) of this
10 section.

11 (4) If the CEO is satisfied that the master or FSM
12 agent of a ship or the owner or charterer of the ship
13 is unable to file the return required under
14 subsection (1)(a) of this section before the
15 departure of the ship from the FSM, the CEO may allow
16 the return to be filed within 30 days after departure
17 of the ship provided the non-resident owner or
18 charterer has made satisfactory arrangements for the
19 payment of the tax due under section 524 of this
20 title in respect of the ship.

21 (5) The CEO must not grant a port clearance for a
22 ship owned or chartered by a non-resident person
23 until satisfied that any tax due under section 524 of
24 this title in respect of the ship has been paid or
25 that arrangements for its payment have been made to

1 the satisfaction of the CEO.

2 (6) This section does not relieve the owner or
3 charterer of the ship from liability to pay any
4 amount due under section 524 of this title that is
5 not paid by the master or FSM agent of the ship."

6 Section 48. Title 54 of the Code of the Federated States
7 of Micronesia, as amended, is hereby further amended by
8 inserting a new section 576 to subchapter VII of chapter 5 to
9 read as follows:

10 "Section 576. Collection of tax from non-resident
11 aircraft owners or charterers.

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

16 (2) The return required under subsection (1) of
17 this section must be in the approved form and filed
18 in the prescribed manner.

19 (3) A person that files a tax return under
20 subsection (1) of this section is treated as having
21 made a self-assessment of the gross revenue derived
22 for the carriage of passengers, livestock, mail,
23 merchandise, or goods embarked in the FSM during the
24 quarter and the tax payable thereon under section 524
25 of this title as specified in the return.

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

5 (5) If the tax payable for a quarter is not paid
6 within three months of the due date, the CEO may
7 issue to the relevant airport authority a certificate
8 specifying the name of the non-resident person and
9 the amount of tax due, and the relevant airport
10 authority must refuse clearance from any airport in
11 the FSM to any aircraft owned or chartered by the
12 person until the tax due has been paid."

13 Section 49. Title 54 of the Code of the Federated States
14 of Micronesia, as amended, is hereby further amended by
15 inserting a new section 577 to subchapter VII of chapter 5 to
16 read as follows:

17 "Section 577. Records.

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

19 (a) keep such accounts, documents, and records
20 as enable the computation of the net profit of the
21 business for a tax year; and

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

25 (2) The records that must be maintained by a person

1 liable to pay presumptive tax or tax under section
2 524 of this title may be prescribed.

3 (3) The CEO may disallow a claim for a deduction
4 for an expense if a business is unable, without
5 reasonable excuse, to produce a receipt or other
6 record of the expense, or to produce evidence
7 relating to the circumstances giving rise to the
8 claim for the deduction."

9 Section 50. Title 54 of the Code of the Federated States
10 of Micronesia, as amended, is hereby further amended by
11 creating a new subchapter VIII under chapter 5 entitled:
12 "Withholding Tax".

13 Section 51. Title 54 of the Code of the Federated States
14 of Micronesia, as amended, is hereby further amended by
15 inserting a new section 581 to subchapter VIII of chapter 5 to
16 read as follows:

17 "Section 581. Withholding of tax from payments to
18 non-resident persons.

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

23 (a) in the case of an insurance premium, five
24 percent (5%) of the gross amount of the premium; or

25 (b) in any other case, fifteen percent (15%)

1 of the gross amount of the payment.

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

4 (a) a person is liable to pay a fee to a
5 non-resident person for the rendering of independent
6 services;

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

9 (c) the fee is not attributable to a
10 business carried on by the non-resident person
11 through a permanent establishment of the person in
12 the FSM.

13 (3) Tax required to be withheld by a person under
14 this section must be paid to the CEO within 15 days
15 after the end of the month in which the person was
16 required to withhold the tax.

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

19 (a) fails to withhold tax as required under
20 this section; or

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

23 (5) A person personally liable for an amount of tax
24 under subsection (4) of this section as a result of
25 failing to withhold the tax is entitled to recover

1 the tax from the recipient of the payment.

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

6 Section 52. Title 54 of the Code of the Federated States
7 of Micronesia, as amended, is hereby further amended by
8 inserting a new section 582 to subchapter VIII of chapter 5 to
9 read as follows:

10 "Section 582. Withholding tax documentation.

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

14 (2) A non-resident person required to file a net
15 profit tax return for a tax year must attach to the
16 return any tax withholding certificate received for
17 the applicable tax period.

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

22 Section 53. Title 54 of the Code of the Federated States
23 of Micronesia, as amended, is hereby further amended by
24 inserting a new section 583 to subchapter VIII of chapter 5 to
25 read as follows:

1 "Section 583. Priority of tax withheld.

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

4 (a) is held by the person in trust for
5 the National Government; and

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

8 (2) In the event of the liquidation or bankruptcy
9 of a person who has withheld tax under section 581 of
10 this title, any amount withheld does not form part of
11 the estate of the person in liquidation or bankruptcy
12 and the CEO has first claim for that amount before
13 any distribution of property is made.

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

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

17 (b) deducted prior to any other amount that
18 the person may be required to deduct from the payment
19 by virtue of an order of any Court or under any other
20 law."

21 Section 54. Title 54 of the Code of the Federated States
22 of Micronesia, as amended, is hereby further amended by
23 inserting a new section 584 to subchapter VIII of chapter 5 to
24 read as follows:

25 "Section 584. Credit for tax withheld.

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

3 (a) the gross revenue of the non-resident
4 person deriving the fee is the amount of the fee
5 before the withholding of the tax; and

6 (b) the non-resident person deriving the fee
7 is allowed a credit for that tax against the net
8 profit tax payable by the person for the tax year in
9 which the tax was withheld.

10 (2) If the amount of the credit allowed under
11 subsection (1)(b) of this section for a tax year
12 exceeds the net profit tax due for the year, the
13 amount of the excess must be refunded to the non-
14 resident person."

15 Section 55. Title 54 of the Code of the Federated States
16 of Micronesia, as amended, is hereby further amended by
17 creating a new subchapter IX under chapter 5 entitled: "Final
18 Provisions".

19 Section 56. Title 54 of the Code of the Federated States
20 of Micronesia, as amended, is hereby further amended by
21 inserting a new section 591 to subchapter IX of chapter 5 to
22 read as follows:

23 "Section 591. Regulations.

24 (1) The Secretary shall, subject to approval of the
25 President, prescribe and have printed reasonable

1 regulations for the enforcement of this chapter and
2 such regulations shall have the force and effect of
3 law if they are not in conflict with the express
4 provisions of this chapter or other laws of the FSM.

5 (2) The regulations shall also provide for matters
6 prescribed under the chapter to be made by
7 regulation.

8 (3) Such regulations shall be promulgated in
9 accordance with law."

10 Section 57. Title 54 of the Code of the Federated States
11 of Micronesia, as amended, is hereby further amended by
12 inserting a new section 592 to subchapter IX of chapter 5 to
13 read as follows:

14 "Section 592. Transition.
15 Any tax liability that arose before this chapter came
16 into force may be recovered under chapter 8 of this
17 title, but without prejudice to any action already
18 taken for the recovery of the tax."

19 Section 58. Title 54 of the Code of the Federated States
20 of Micronesia, as amended, is hereby further amended by
21 inserting a new section 593 to subchapter IX of chapter 5 to
22 read as follows:

23 "Section 593. Commencement of administration.
24 Administration of this act shall commence on the
25 commencement of administration date as determined by

