
A BILL FOR AN ACT

To further amend title 54 of the Code of the Federated States of Micronesia (Annotated), as amended, by creating a new chapter 5 to establish the Net Profit Tax Act of 2019, 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 (Annotated), as amended, is hereby further
3 amended by creating a new chapter 5 entitled "Taxation of Net
4 Profits."

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

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

13 "Section 511. Short title. This chapter may be
14 cited as the 'Net Profit Tax Act of 2019'."

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

19 "Section 512. Definitions.

1 Wherever used in this chapter, except where otherwise
2 specified, unless the subject matter, context, or
3 sense otherwise requires:

4 (1) 'Associate' has the meaning in section 515 of
5 this title.

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

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

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

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

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

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

25 (8) 'Depreciable asset' means any tangible personal

1 property or that portion of a structural improvement
2 to real property that:

3 (a) has a useful life exceeding one year;

4 (b) is likely to lose value as a result of
5 normal wear and tear, or obsolescence; and

6 (c) is used solely to derive gross revenue.

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

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

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

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

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

24 (14) 'Entity' means a company, corporation,
25 partnership, unincorporated association or other

1 business entity, trust, or estate.

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

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

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

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

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

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

22 (a) manufacturing operations;

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

25 (c) mining operations (other than an

1 accommodation building); or

2 (d) a hotel business.

3 (21) 'Intangible' means:

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

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

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

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

23 (22) 'Interest' means:

24 (a) an amount, whether described as interest,
25 discount, premium, or otherwise, whether periodical

1 or a lump sum, as consideration for the use of money
2 or being given time to pay;

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

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

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

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

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

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

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

1 entity.

2 (27) 'Natural resource amount' means:

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

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

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

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

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

22 (31) 'Non-resident person' means a person that is
23 not a resident person.

24 (32) 'Permanent establishment' means a fixed place
25 of business through which the business of a person is

1 wholly or partly carried on, and includes:

2 (a) a place of management, branch, office
3 (other than a liaison office), factory, warehouse, or
4 workshop;

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

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

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

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

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

25 (ii) habitually maintains a stock of

1 inventory from which the agent regularly delivers
2 inventory on behalf of the principal, but does not
3 include an agent of independent status; or

4 (f) any substantial equipment used by a
5 person.

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

9 (34) 'Prescribed' means set forth by the Secretary
10 in regulations.

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

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

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

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

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

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

25 (c) a spouse of the individual or any person

1 specified in paragraph (a) or (b) of this subsection.

2 (39) 'Resident person' means:

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

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

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

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

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

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

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

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

25 (b) the use of, or right to use any copyright

1 of a literary, artistic, or scientific work
2 (including films or video tapes for use in connection
3 with television or tapes in connection with radio
4 broadcasting);

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

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

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

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

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

23 (42) 'Small business' means a business that is
24 carried on by a person that is not registered for the
25 value added tax, but not including a business making

1 exempt supplies that would be above the value added
2 tax (VAT) registration threshold if the exempt
3 supplies were taxable supplies.

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

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

11 (45) 'Tax year' means:

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

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

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

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

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

23 Section 5. Title 54 of the Code of the Federated States
24 of Micronesia (Annotated), as amended, is hereby further
25 amended by inserting a new section 513 to subchapter I of

1 chapter 5 to read as follows:

2 "Section 513. Source of income.

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

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

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

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

17 (b) rental from the lease of real property in
18 the FSM;

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

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

24 (ii) paid by a non-resident person as an
25 expense of a business carried on through a permanent

1 establishment of the person in the FSM;

2 (d) a natural resource amount in respect of a
3 natural resource taken in the FSM;

4 (e) an insurance premium in respect of the
5 insurance of a risk in the FSM;

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

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

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

17 "Section 514. Fair market value.

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

22 (2) If it is not possible to determine the fair
23 market value of an asset, property, service, or
24 benefit at a particular time under subsection (1) of
25 this section, the fair market value is the

1 consideration a similar asset, property, service, or
2 benefit would ordinarily fetch in the open market at
3 that time, adjusted to take account of the
4 differences between the similar asset, property,
5 service, or benefit and the actual asset, property,
6 service, or benefit.

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

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

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

16 "Section 515. Associate.

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

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

1 of a third person.

2 (3) Without limiting the generality of subsection
3 (1) of this section, the following are treated as
4 associates:

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

9 (b) a partner in a partnership and the
10 partnership, if the partner, either alone or together
11 with an associate or associates under another
12 application of this section, controls fifty percent
13 (50%) or more of the rights to income or capital of
14 the partnership;

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

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

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

24 (ii) fifty percent (50%) or more of the
25 rights to dividends; or

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

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

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

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

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

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

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

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

1 "Section 521. Imposition of net profit tax.
2 Net profit tax is imposed for each tax year at the
3 rate of twenty five percent (25%) on the net profit
4 for the tax year of every business."

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

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

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

18 "Section 523. General provisions applicable to net
19 profit tax and presumptive tax.

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

1 one State, the operations in each State are treated
2 as a separate business.

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

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

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

19 "Section 524. Imposition of tax on transportation
20 income of non-resident person.

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

1 embarked in the FSM.

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

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

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

13 "Section 525. Imposition of tax on certain payments
14 to non-resident persons.

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

20 (2) The rate of tax imposed under subsection (1) of
21 this section is:

22 (a) five percent (5%) of the gross amount of
23 the insurance premium; or

24 (b) fifteen percent (15%) of the gross amount
25 of the interest, royalty, natural resource amount, or

1 management fee.

2 (3) Subsection (1) of this section does not apply
3 to:

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

5 (b) interest, a royalty, natural resource
6 amount, insurance premium, or management fee that is
7 attributable to a business carried on by the non-
8 resident person through a permanent establishment of
9 the person in the FSM and, in that case, the
10 interest, royalty, natural resource amount, insurance
11 premium, or management fee is taxable under section
12 521 of this title.

13 (4) The tax payable under subsection (1) of this
14 section is discharged if the tax has been paid in
15 accordance with section 581 of this title."

16 Section 14. Title 54 of the Code of the Federated States
17 of Micronesia (Annotated), as amended, is hereby further
18 amended by creating a new subchapter III under chapter 5
19 entitled: "Computation of Net Profit".

20 Section 15. Title 54 of the Code of the Federated States
21 of Micronesia (Annotated), as amended, is hereby further
22 amended by inserting a new section 531 to subchapter III of
23 chapter 5 to read as follows:

24 "Section 531. Net profit.

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

1 gross revenue of the business for the year reduced by
2 the total amount of deductions allowed to the
3 business for the year."

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

8 "Section 532. Gross revenue.

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

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

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

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

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

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

1 (2) For the purposes of subsection (1)(c) of this
2 section, the net gain on disposal of a business asset
3 is the consideration received on disposal of the
4 asset less the net book value of the asset at the
5 time of disposal.

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

10 (4) The gross revenue of a business does not
11 include any amount subject to tax under sections 522,
12 524, or 525 of this title."

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

17 "Section 533. Exempt income.

18 (1) The following amounts are exempt income:

19 (a) a distribution by an entity;

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

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

1 (ii) the debentures were issued with a
2 view to public subscription or other wide
3 distribution;

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

7 (iv) the interest is paid outside the FSM;
8 and

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

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

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

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

24 "Section 534. Deductions.

25 (1) Subject to this chapter, the total amount of

1 deductions allowed to a business for a tax year is
2 the sum of:

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

7 (b) the cost of inventory for the year as
8 determined under this chapter;

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

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

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

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

1 of the asset.”

2 Section 19. Title 54 of the Code of the Federated States
3 of Micronesia (Annotated), as amended, is hereby further
4 amended by inserting a new section 535 to subchapter III of
5 chapter 5 to read as follows:

6 “Section 535. Non-deductible expenses.

7 (1) No deduction is allowed for:

8 (a) a distribution by an entity or capital
9 withdrawn from a business;

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

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

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

19 (e) an expense incurred in providing
20 entertainment except:

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

1 (ii) if the entertainment is a meal or
2 refreshment consumed by the owner or employee of a
3 business while the owner or employee was traveling
4 for the purposes of the business; or

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

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

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

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

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

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

1 (3) The only deduction allowed in relation to the
2 cost of an intangible of a business is as provided
3 for in section 537."

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

8 "Section 536. Depreciable assets.

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

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

17 (3) The rate of depreciation is:

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

25 (b) in the case of industrial buildings, ten

1 percent (10%);

2 (c) in the case of any other structural
3 improvement, five percent (5%); or

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

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

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

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

20 "Section 537. Intangibles.

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

25 (2) The decline in value of an intangible of a

1 business for a tax year is computed by dividing the
2 cost of the intangible by its useful life.

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

5 (a) it has a useful life of more than ten
6 years; or

7 (b) it does not have an ascertainable useful
8 life.

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

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

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

23 "Section 538. Net loss carry forward.

24 (1) If the total amount of deductions of a business
25 allowed for a tax year (other than under this section

1 or section 540(3) of this title) exceeds the gross
2 revenue of the business for the year, the amount of
3 the excess is the net loss of the business for the
4 year.

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

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

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

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

25 (6) If a person carries on more than one business,

1 this section applies separately to each business.”

2 Section 23. Title 54 of the Code of the Federated States
3 of Micronesia (Annotated), as amended, is hereby further
4 amended by inserting a new section 539 to subchapter III of
5 chapter 5 to read as follows:

6 “Section 539. Currency translation.

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

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

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

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

1 "Section 540. Interest expense.

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

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

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

15 Where:

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

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

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

24 (3) If an amount of interest is not deducted in a
25 tax year as a result of subsection (2) of this

1 section, the undeducted amount of the interest is
2 carried forward and treated as interest incurred by
3 the business in the next following tax year and
4 deducted in accordance with this section in that
5 year, and so on until the interest is fully deducted.

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

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

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

16 "Section 541. Simplified tax accounting for small
17 businesses.

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

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

25 (b) no deduction is allowed for an amount

1 specified in section 535 of this title;

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

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

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

15 (2) Reserved.

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

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

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

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

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

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

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

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

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

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

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

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

1 of the entitlement is postponed or the amount is
2 payable by installments; and

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

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

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

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

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

16 Section 28. Title 54 of the Code of the Federated States
17 of Micronesia (Annotated), as amended, is hereby further
18 amended by inserting a new section 543 to subchapter IV of
19 chapter 5 to read as follows:

20 "Section 543. Change in tax accounting method.

21 (1) If a business that is a small business ceases
22 to be a small business or a business that is not a
23 small business becomes a small business, the business
24 shall apply, in writing, to the CEO for a change in
25 the method of accounting used by the business in

1 computing the net profit of the person's business and
2 the CEO shall in writing, approve or disapprove the
3 application.

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

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

15 "Section 544. Inventory.

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

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

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

1 Where:

2 **A** is the opening value of the inventory for the
3 tax year;

4 **B** is the cost of inventory acquired during the
5 tax year; and

6 **C** is the closing value of inventory for the tax
7 year.

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

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

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

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

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

1 inventory manufactured or produced, or which are
2 consumed in the manufacturing or production process.
3 Direct labor costs are the labor costs directly
4 related to the manufacture or production of
5 inventory. Factory overhead costs are the total costs
6 of manufacturing or producing inventory, other than
7 direct labor and direct material costs.

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

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

20 "Section 545. Long-term contracts.

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

1 accounting principle under which revenues and
2 expenditures arising under a long-term contract are
3 recognized by reference to the stage of completion of
4 the contract.

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

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

17 "Section 546. Finance leases.

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

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

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

25 (c) the lessor has made a blended loan to the

1 lessee at the commencement of the lease and each
2 lease payment is in part repayment of principal and
3 in part payment of interest under that loan.

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

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

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

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

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

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

24 Section 32. Title 54 of the Code of the Federated States
25 of Micronesia (Annotated), as amended, is hereby further

1 amended by inserting a new section 547 to subchapter IV of
2 chapter 5 to read as follows:

3 "Section 547. Bad debts.

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

7 (a) the amount of the debt:

8 (i) was previously included in the gross
9 revenue of the business; or

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

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

16 (c) there are reasonable grounds for believing
17 that the debt is irrecoverable.

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

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

1 Section 34. Title 54 of the Code of the Federated States
2 of Micronesia (Annotated), as amended, is hereby further
3 amended by inserting a new section 551 to subchapter V of
4 chapter 5 to read as follows:

5 "Section 551. Disposal and acquisition of business
6 assets.

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

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

14 (a) sold, exchanged, transferred, or
15 distributed; or

16 (b) cancelled, redeemed, relinquished,
17 destroyed, lost, expired, or surrendered.

18 (3) A disposal includes the disposal of a part of
19 an asset.

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

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

1 (6) A business acquires an asset at the time the
2 owner of the business begins to own the asset,
3 including at the time the owner is granted any right.

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

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

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

14 "Section 552. Cost.

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

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

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

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

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

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

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

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

17 (4) The cost of a business asset does not include
18 an expense allowed as a deduction under section
19 534(1)(a).

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

1 (6) The cost of a business asset does not include
2 the amount of any grant, subsidy, rebate, commission,
3 or other assistance received or receivable by a
4 business in respect of the acquisition or holding of
5 the asset, except to the extent to which the amount
6 is included in the gross revenue of the business.
7 The reference to 'other assistance' in this
8 subsection does not include a loan repayable with or
9 without interest.

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

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

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

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

1 business.

2 (11) In this section, "impairment write down", in
3 relation to an asset of a business, means the write
4 down of the value of the asset in the financial
5 accounts of the business because the fair market
6 value of the asset is less than the cost of the
7 asset."

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

12 "Section 553. Consideration received.

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

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

22 (3) If a business asset has been lost or destroyed,
23 the consideration received by a business for the
24 asset includes any compensation, indemnity, or
25 damages received by the business as a result of the

1 loss or destruction, including amounts received as a
2 consequence of:

3 (a) an insurance policy, indemnity, or other
4 agreement;

5 (b) a settlement; or

6 (c) a judicial decision.

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

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

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

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

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

1 transaction:

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

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

9 (2) Reserved. "

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

14 "Section 555. Gain or loss not recognized.

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

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

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

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

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

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

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

23 Section 39. Title 54 of the Code of the Federated States
24 of Micronesia (Annotated), as amended, is hereby further
25 amended by creating a new subchapter VI under chapter 5

1 entitled: "Anti-avoidance".

2 Section 40. Title 54 of the Code of the Federated States
3 of Micronesia (Annotated), as amended, is hereby further
4 amended by inserting a new section 561 to subchapter VI of
5 chapter 5 to read as follows:

6 "Section 561. Transfer pricing.

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

13 (a) a transaction between businesses carried
14 on by persons who are associates; or

15 (b) a transaction between businesses carried
16 on by the same person.

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

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

25 "Section 562. General anti-avoidance provision.

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

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

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

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

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

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

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

25 Section 43. Title 54 of the Code of the Federated States

1 of Micronesia (Annotated), as amended, is hereby further
2 amended by inserting a new section 571 to subchapter VII of
3 chapter 5 to read as follows:

4 "Section 571. Filing of tax return.

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

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

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

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

20 "Section 572. Self-assessment of net profit tax or
21 presumptive tax due.

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

25 (a) if the business has a net profit for the

1 year, the amount of the net profit of the business
2 and the net profit tax payable thereon as specified
3 in the return; or

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

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

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

15 “Section 573. Payment of tax.

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

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

24 “Section 574. Installments of tax.

25 (1) A person must pay installments of net profit

1 tax for a tax year in respect of a business carried
2 on by the person on the last working day of the
3 third, sixth, ninth, and twelfth months of the tax
4 year.

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

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

25 (4) If a person fails to file an estimate of net

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

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

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

1 a penalty equal to:

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

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

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

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

17 “Section 575. Collection of tax from non-resident
18 ship owners or charterers.

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

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

1 respect of the ship; and

2 (b) the CEO must determine the amount of tax
3 due under section 524 of this title in respect of the
4 ship and pursuant to regulatory guidelines, notify
5 the master or FSM agent, in writing, of the amount
6 due.

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

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

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

23 (5) The CEO must not grant a port clearance for a
24 ship owned or chartered by a non-resident person
25 until satisfied that any tax due under section 524 of

1 this title in respect of the ship has been paid or
2 that arrangements for its payment have been made to
3 the satisfaction of the CEO.

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

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

12 "Section 576. Collection of tax from non-resident
13 aircraft owners or charterers.

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

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

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

1 quarter and the tax payable thereon under section 524
2 of this title as specified in the return.

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

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

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

19 “Section 577. Records.

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

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

24 (b) retain the records required under
25 paragraph (a) of this subsection for six (6) years

1 after the end of the tax year to which they relate.

2 (2) The records that must be maintained by a person
3 liable to pay presumptive tax or tax under section
4 524 of this title may be prescribed.

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

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

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

19 "Section 581. Withholding of tax from payments to
20 non-resident persons.

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

25 (a) in the case of an insurance premium, five

1 percent (5%) of the gross amount of the premium; or
2 (b) in any other case, fifteen percent (15%)
3 of the gross amount of the payment.

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

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

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

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

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

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

21 (a) fails to withhold tax as required under
22 this section; or

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

25 (5) A person personally liable for an amount of tax

1 under subsection (4) of this section as a result of
2 failing to withhold the tax is entitled to recover
3 the tax from the recipient of the payment.

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

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

12 "Section 582. Withholding tax documentation.

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

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

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

24 Section 53. Title 54 of the Code of the Federated States
25 of Micronesia (Annotated), as amended, is hereby further

1 amended by inserting a new section 583 to subchapter VIII of
2 chapter 5 to read as follows:

3 "Section 583. Priority of tax withheld.

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

6 (a) is held by the person in trust for
7 the National Government; and

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

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

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

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

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

23 Section 54. Title 54 of the Code of the Federated States
24 of Micronesia (Annotated), as amended, is hereby further
25 amended by inserting a new section 584 to subchapter VIII of

1 chapter 5 to read as follows:

2 "Section 584. Credit for tax withheld.

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

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

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

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

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

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

25 "Section 591. Regulations.

1 (1) The Secretary shall, subject to approval of the
2 President, prescribe and have printed reasonable
3 regulations for the enforcement of this chapter and
4 such regulations shall have the force and effect of
5 law if they are not in conflict with the express
6 provisions of this chapter or other laws of the FSM.

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

10 (3) Such regulations shall be promulgated in
11 accordance with law."

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

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

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

25 "Section 593. Commencement of administration.

1 Administration of this act shall commence on the
2 commencement of administration date as determined by
3 Executive Order of the President."

4 Section 59. Subchapter IV of chapter 1 of title 54 of the
5 Code of the Federated States of Micronesia (Annotated), as
6 amended, comprising sections 141, 142, 143, and 144 of title 54
7 F.S.M.C., is hereby repealed in its entirety.

8 Section 60. Effective date. This act shall become law
9 upon approval by the President of the Federated States of
10 Micronesia or upon its becoming law without such approval, this
11 act shall take effect upon the commencement of administration
12 date set by Executive Order of the President.

13

14 Date: 7/14/19

Introduced by: /s/ Isaac V. Figir
Isaac V. Figir

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