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A BILL FOR AN ACT

To further amend title 54 of the Code of the Federated States of Micronesia (Annotated), as amended, by enacting 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 amended by  
3 enacting a new chapter 5 entitled "Taxation of Net Profits."

4           Section 2. Chapter 5 of title 54 of the Code of the  
5 Federated States of Micronesia (Annotated), as amended, is  
6 hereby amended by designating sections 511 to 515 as subchapter  
7 I entitled "General Provisions."

8           Section 3. Title 54 of the Code of the Federated States  
9 of Micronesia (Annotated), as amended, is hereby amended by  
10 enacting a new section 511 to read as follows:

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

13           Section 4. Title 54 of the Code of the Federated States  
14 of Micronesia (Annotated), as amended, is hereby amended by  
15 enacting a new section 512 to read as follows:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25                   (16) 'Finance lease' means a lease that is treated

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1           under generally accepted accounting principles as a  
2           finance lease and is so accounted for by the lessor  
3           in its financial accounts.

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

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

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

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

19                   (a) manufacturing operations;

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

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

24                   (d) a hotel business.

25          (21) 'Intangible' means:

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

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

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

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

20                   (22) 'Interest' means:

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

25                   (b) an amount that is functionally equivalent

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1           to an amount referred to in paragraph (a) of this  
2           subsection;

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

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

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

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

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

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

24          (27) 'Natural resource amount' means:

25                   (a) an amount (including a premium or like

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1           amount) as consideration for the right to take  
2           minerals or a living or non-living resource from land  
3           or sea; or

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

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

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

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

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

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

24                  (a) a place of management, branch, office  
25                  (other than a liaison office), factory, warehouse, or

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1           workshop;

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

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

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

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

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

22                           (ii) habitually maintains a stock of  
23           inventory from which the agent regularly delivers  
24           inventory on behalf of the principal, but does not  
25           include an agent of independent status; or



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

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

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

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

9                    (36) 'Public international organization' has the  
10                   meaning in the International Organizations Immunities  
11                   Act of 1974, chapter 2 of title 10 of this code, or  
12                   its successor.

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

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

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

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

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

24                   (39) 'Resident person' means:

25                   (a) in the case of an individual, an

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1           individual who:

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

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

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

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

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

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

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

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

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1           broadcasting);

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

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

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

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

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

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

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

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

8           (45) 'Tax year' means:

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

12                   (b) in any other case, the 12-month period  
13 ending on December 31.

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

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

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

20           Section 5. Title 54 of the Code of the Federated States  
21 of Micronesia (Annotated), as amended, is hereby amended by  
22 enacting a new section 513 to read as follows:

23           "Section 513. Source of income.

24                   (1) An amount derived by a resident person in  
25 carrying on a business is derived from sources in the

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1           FSM except to the extent that it is attributable to a  
2           business carried on through a permanent establishment  
3           of the person outside the FSM.

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

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

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

13                   (b) rental from the lease of real property in  
14           the FSM;

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

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

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

23                   (d) a natural resource amount in respect of a  
24           natural resource taken in the FSM;

25                   (e) an insurance premium in respect of the

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1           insurance of a risk in the FSM;

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

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

9           Section 6. Title 54 of the Code of the Federated States  
10 of Micronesia (Annotated), as amended, is hereby amended by  
11 enacting a new section 514 to read as follows:

12           "Section 514. Fair market value.

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

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

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1           service, or benefit.

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

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

7           Section 7. Title 54 of the Code of the Federated States  
8 of Micronesia (Annotated), as amended, is hereby amended by  
9 enacting a new section 515 to read as follows:

10           "Section 515. Associate.

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

17           (2) Two persons are not associates solely by reason  
18           of the fact that one person is an employee or client  
19           of the other or both persons are employees or clients  
20           of a third person.

21           (3) Without limiting the generality of subsection  
22           (1) of this section, the following are treated as  
23           associates:

24                   (a) an individual and a relative of the  
25           individual, except if the CEO is satisfied that

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1           neither person may reasonably be expected to act in  
2           accordance with the intentions of the other;

3                   (b) a partner in a partnership and the  
4           partnership, if the partner, either alone or together  
5           with an associate or associates under another  
6           application of this section, controls 50% or more of  
7           the rights to income or capital of the partnership;

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

10                   (d) a member in a corporation and the  
11           corporation, if the member, either alone or together  
12           with an associate or associates under another  
13           application of this section, controls either directly  
14           or through one or more interposed entities:

15                           (i) 50% or more of the voting power in  
16           the corporation;

17                           (ii) 50% or more of the rights to  
18           dividends; or

19                           (iii) 50% or more of the rights to  
20           capital; and

21                   (e) two corporations, if a person, either  
22           alone or together with an associate or associates  
23           under another application of this section, controls  
24           either directly or through one or more interposed  
25           entities:



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1                    (i) 50% or more of the voting power in both  
2                    corporations;

3                    (ii) 50% or more of the rights to dividends in  
4                    both corporations; or

5                    (iii) 50% or more of the rights to capital in  
6                    both corporations.

7                    (4) In applying subsection (3)(b), (d), or (e) of  
8                    this section holdings that are attributable to a  
9                    person from an associate are not reattributed to  
10                   another associate."

11                  Section 8. Chapter 5 of title 54 of the Code of the  
12 Federated States of Micronesia (Annotated), as amended, is  
13 hereby amended by designating sections 521 to 525 as subchapter  
14 II entitled "Imposition of Tax".

15                  Section 9. Title 54 of the Code of the Federated States  
16 of Micronesia (Annotated), as amended, is hereby amended by  
17 enacting a new section 521 to read as follows:

18                  "Section 521. Imposition of net profit tax.  
19                  Net profit tax is imposed for each tax year at the  
20                  rate of 25% on the net profit for the tax year of  
21                  every business."

22                  Section 10. Title 54 of the Code of the Federated States  
23 of Micronesia (Annotated), as amended, is hereby amended by  
24 enacting a new section 522 to read as follows:

25                  "Section 522. Imposition of presumptive tax.

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1           A presumptive tax of \$80 per tax year is imposed on  
2           a business if the gross revenue of the business for  
3           the tax year does not exceed \$10,000."

4           Section 11. Title 54 of the Code of the Federated States  
5 of Micronesia (Annotated), as amended, is hereby amended by  
6 enacting a new section 523 to read as follows:

7           "Section 523. General provisions applicable to net  
8           profit tax and presumptive tax.

9           (1) Net profit tax or presumptive tax is payable by  
10          the person or persons carrying on the business. If a  
11          person carries on more than one business, the net  
12          profit tax or presumptive tax payable is computed and  
13          reported separately for each business. For this  
14          purpose, if a business has operations in more than  
15          one State, the operations in each State are treated  
16          as a separate business.

17          (2) No net profit tax or presumptive tax is payable  
18          if the gross revenue of a business for a tax year  
19          does not exceed \$2,000.

20          (3) Notwithstanding subsection (1) of this section,  
21          in determining whether the gross revenue of a  
22          business carried on by a person does not exceed  
23          \$10,000 for the purposes of section 522 of this  
24          title, or \$2,000 for the purposes of subsection (2)  
25          of this section, account is taken of the gross

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1           revenue of all businesses carried on by the person  
2           and by associates of the person in the FSM."

3           Section 12. Title 54 of the Code of the Federated States  
4 of Micronesia (Annotated), as amended, is hereby amended by  
5 enacting a new section 524 to read as follows:

6           "Section 524. Imposition of tax on transportation  
7           income of non-resident person.

8           (1) Tax is imposed at the rate of 3% on the gross  
9           revenue derived by a non-resident person without a  
10          permanent establishment in the FSM operating a ship  
11          or aircraft for the carriage of passengers,  
12          livestock, mail, merchandise, or goods embarked in  
13          the FSM.

14          (2) Tax payable under this section shall be payable  
15          by the non-resident person deriving the amount  
16          subject to tax. The tax payable is discharged if the  
17          tax has been paid in accordance with section 575 or  
18          576 of this chapter.

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

21          Section 13. Title 54 of the Code of the Federated States  
22 of Micronesia (Annotated), as amended, is hereby amended by  
23 enacting a new section 525 to read as follows:

24          "Section 525. Imposition of tax on certain payments  
25          to non-resident persons.

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

6           (2) The rate of tax imposed under subsection (1) of  
7           this section is:

8                   (a) 5% of the gross amount of the insurance  
9                   premium; or

10                   (b) 15% of the gross amount of the interest,  
11                   royalty, natural resource amount, or management fee.

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

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

15                   (b) interest, a royalty, natural resource  
16                   amount, insurance premium, or management fee that is  
17                   attributable to a business carried on by the non-  
18                   resident person through a permanent establishment of  
19                   the person in the FSM and, in that case, the  
20                   interest, royalty, natural resource amount, insurance  
21                   premium, or management fee is taxable under section  
22                   521 of this chapter.

23           (4) The tax payable under subsection (1) of this  
24           section is discharged if the tax has been paid in  
25           accordance with section 581 of this chapter."

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1       Section 14. Chapter 5 of title 54 of the Code of the  
2 Federated States of Micronesia (Annotated), as amended, is  
3 hereby amended by designating sections 531 to 540 as subchapter  
4 III entitled "Computation of Net Profit".

5       Section 15. Title 54 of the Code of the Federated States  
6 of Micronesia (Annotated), as amended, is hereby amended by  
7 enacting a new section 531 to read as follows:

8               "Section 531. Net profit.  
9               The net profit of a business for a tax year is the  
10              gross revenue of the business for the year reduced by  
11              the total amount of deductions allowed to the  
12              business for the year."

13       Section 16. Title 54 of the Code of the Federated States  
14 of Micronesia (Annotated), as amended, is hereby amended by  
15 enacting a new section 532 to read as follows:

16              "Section 532. Gross revenue.  
17              (1) The gross revenue of a business for a tax year  
18              is the sum of the following amounts (other than an  
19              amount that is exempt income) derived by the business  
20              during the year from sources in the FSM:  
21                      (a) the gross receipts from the carrying on of  
22                      the business, including the gross proceeds from the  
23                      disposal of inventory and the gross fees for the  
24                      provision of services;  
25                      (b) the gross receipts from the capital of the

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1           business, including interest, royalties, and rentals;

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

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

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

9           (2) For the purposes of subsection (1)(c) of this  
10          section, the net gain on disposal of a business asset  
11          is the consideration received on disposal of the  
12          asset less the net book value of the asset at the  
13          time of disposal.

14          (3) For the purposes of subsection (1)(d) of this  
15          section, the net gain on disposal of a debt of a  
16          business is the amount of the debt less the amount  
17          received on satisfaction or cancellation of the debt.

18          (4) The gross revenue of a business does not  
19          include any amount subject to tax under sections 522,  
20          524, or 525 of this chapter."

21          Section 17. Title 54 of the Code of the Federated States  
22 of Micronesia (Annotated), as amended, is hereby further  
23 amended by enacting a new section 533 to read as follows:

24          "Section 533. Exempt income.

25          (1) The following amounts are exempt income:

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1                   (a) a distribution by an entity;

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

5                   (i) the debentures were issued by the  
6 corporation outside the FSM for the purpose of  
7 raising a loan outside the FSM;

8                   (ii) the debentures were issued with a  
9 view to public subscription or other wide  
10 distribution;

11                   (iii) the debentures were issued for the  
12 purpose of raising funds for use by the corporation  
13 in a business carried on in the FSM; and

14                   (iv) the interest is paid outside the FSM;  
15 and

16                   (c) an amount exempt from tax under an  
17 international agreement between the Government of the  
18 FSM and a foreign government or a public  
19 international organization.

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

23                   (3) For purposes of subsection (2) of this section,  
24 exemptions contained in chapter 3 this title and  
25 chapter 10 of title 37 of this code have legal

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1           effect.”

2           Section 18. Title 54 of the Code of the Federated States  
3 of Micronesia (Annotated), as amended, is hereby amended by  
4 enacting a new section 534 to read as follows:

5           “Section 534. Deductions.

6           (1) Subject to this chapter, the total amount of  
7 deductions allowed to a business for a tax year is  
8 the sum of:

9                   (a) subject to section 535 of this chapter,  
10 the expenses or losses incurred during the year  
11 solely in deriving amounts included in the gross  
12 revenue of the business;

13                   (b) the cost of inventory for the year as  
14 determined under this chapter;

15                   (c) the total amount, as determined under  
16 section 536 of this chapter, by which the value of  
17 the depreciable assets of the business have declined  
18 during the year by reason of wear and tear from use  
19 in deriving amounts included in the gross revenue of  
20 the business;

21                   (d) the total amount, as determined under  
22 section 537 of this chapter, by which the value of  
23 the intangibles of the business have declined in  
24 value during the year from use in deriving amounts  
25 included in the gross revenue of the business; and



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

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

8                   Section 19. Title 54 of the Code of the Federated States  
9 of Micronesia (Annotated), as amended, is hereby amended by  
10 enacting a new section 535 to read as follows:

11                   "Section 535. Non-deductible expenses.

12                   (1) No deduction is allowed for:

13                   (a) a distribution by an entity or capital  
14                   withdrawn from a business;

15                   (b) an expense or loss of a capital nature  
16                   except as provided in section 534(1)(c), (d), or (e)  
17                   of this chapter;

18                   (c) an amount placed in a reserve fund, a  
19                   provision for expected expenses or losses, or an  
20                   amount capitalized in any way;

21                   (d) an expense or loss to the extent  
22                   recoverable under a policy of insurance or contract  
23                   of indemnity;

24                   (e) an expense incurred in providing  
25                   entertainment except:

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1                   (i) if the entertainment was provided in  
2                   the ordinary course of a business carried on to  
3                   provide the entertainment and the entertainment was  
4                   not provided to an employee or an associate of the  
5                   person carrying on the business;

6                   (ii) if the entertainment is a meal or  
7                   refreshment consumed by the owner or employee of a  
8                   business while the owner or employee was traveling  
9                   for the purposes of the business; or

10                   (iii) if the entertainment is a meal or  
11                   refreshment provided to an employee on the business'  
12                   premises and which is available to all full-time  
13                   employees on equal terms;

14                   (f) interest payable to an associate other  
15                   than that interest included in the gross revenue of a  
16                   business carried on by the associate or taxable under  
17                   section 525 of this chapter;

18                   (g) the net profit tax, including any penalty  
19                   or late payment interest payable in respect of net  
20                   profit tax payable;

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

23                   (i) a bribe, kickback, or other expense  
24                   incurred to accomplish an illegal transaction or  
25                   activity.

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

6           (3) The only deduction allowed in relation to the  
7           cost of an intangible of a business is as provided  
8           for in section 537 of this chapter.”

9           Section 20. Title 54 of the Code of the Federated States  
10 of Micronesia (Annotated), as amended, is hereby amended by  
11 enacting a new section 536 to read as follows:

12           “Section 536. Depreciable assets.

13           (1) A business is allowed a deduction for a tax  
14           year for the amount by which the value of the  
15           depreciable assets of a business has declined during  
16           the year.

17           (2) The decline in value of a depreciable asset of  
18           a business for a tax year is computed by applying the  
19           rate specified in subsection (3) of this section  
20           against the cost of the asset.

21           (3) The rate of depreciation is:

22           (a) in the case of motor vehicles, buses and  
23           minibuses, goods vehicles, trucks, tractors,  
24           trailers, and trailer-mounted containers, computers  
25           and data handling equipment, construction equipment

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1           and earthmoving equipment, and plant and machinery  
2           used in manufacturing, mining, or farming operations,  
3           50%;

4                   (b) in the case of industrial buildings, 10%;

5                   (c) in the case of any other structural  
6           improvement, 5%; or

7                   (d) in the case of any other depreciable  
8           asset, 33<sup>1</sup>/<sub>3</sub>%.

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

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

19          Section 21. Title 54 of the Code of the Federated States  
20 of Micronesia (Annotated), as amended, is hereby amended by  
21 enacting a new section 537 to read as follows:

22                  "Section 537. Intangibles.

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

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1           year.

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

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

7                   (a) it has a useful life of more than 10  
8           years; or

9                   (b) it does not have an ascertainable useful  
10           life.

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

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

21           Section 22. Title 54 of the Code of the Federated States  
22 of Micronesia (Annotated), as amended, is hereby amended by  
23 enacting a new section 538 to read as follows:

24           "Section 538. Net loss carry forward.

25                   (1) If the total amount of deductions of a business

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1           allowed for a tax year (other than under this section  
2           or section 540(3) of this chapter) exceeds the gross  
3           revenue of the business for the year, the amount of  
4           the excess is the net loss of the business for the  
5           year.

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

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

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

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

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

3           Section 23. Title 54 of the Code of the Federated States  
4 of Micronesia (Annotated), as amended, is hereby amended by  
5 enacting a new section 539 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 amended by  
24 enacting a new section 540 to read as follows:

25          "Section 540. Interest expense.

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

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

$$13 \qquad \qquad \qquad \mathbf{A + (50\% \times (B - C))}$$

14          Where:

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

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

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

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



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

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

7           Section 25. Chapter 5 of title 54 of the Code of the  
8 Federated States of Micronesia (Annotated), as amended, is  
9 hereby amended by designating sections 541 to 547 as subchapter  
10 IV entitled "Tax Accounting".

11          Section 26. Title 54 of the Code of the Federated States  
12 of Micronesia (Annotated), as amended, is hereby amended by  
13 enacting a new section 541 to 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 chapter;

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

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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 chapter;

5                   (d) the amount allowed as a deduction under  
6           section 534(1)(b) of this chapter for a tax year is  
7           the total amount paid by the business for the cost of  
8           inventory acquired during the year and section 544 of  
9           this chapter 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 (Annotated), as amended, is hereby amended by  
16 enacting a new section 542 to read as follows:

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

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

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

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1           expense is incurred when it is payable;

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

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

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

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

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

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

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

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

25                   (b) an amount is payable when all the events

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1           that determine liability have occurred and the amount  
2           of the liability can be determined with reasonable  
3           accuracy, but not before economic performance occurs.

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

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

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

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

13           Section 28. Title 54 of the Code of the Federated States  
14 of Micronesia (Annotated), as amended, is hereby amended by  
15 enacting a new section 543 to read as follows:

16           “Section 543. Change in tax accounting method.

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

25                   (2) If the method of accounting used by a business

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

7           Section 29. Title 54 of the Code of the Federated States  
8 of Micronesia (Annotated), as amended, is hereby amended by  
9 enacting a new section 544 to read as follows:

10           "Section 544. Inventory.

11           (1) The amount allowed as a deduction under section  
12           534(1)(b) of this chapter for a tax year to a  
13           business accounting for net profits tax on an accrual  
14           basis for the cost of inventory is the cost of  
15           inventory disposed of during the year as computed  
16           under this section.

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

20           **(A + B) - C**

21           Where:

22           **A** is the opening value of the inventory for the  
23           tax year;

24           **B** is the cost of inventory acquired during the  
25           tax year; and

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1           C        is the closing value of inventory for the tax  
2           year.

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

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

6                   (b) if the business commenced during the year,  
7           the cost of inventory, if any, acquired by the owner  
8           of the business prior to commencement of the  
9           business.

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

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

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1           of manufacturing or producing inventory, other than  
2           direct labor and direct material costs.

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

11          Section 30. Title 54 of the Code of the Federated States  
12 of Micronesia (Annotated), as amended, is hereby amended by  
13 enacting a new section 545 to read as follows:

14          "Section 545. Long-term contracts.

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

24          (2) In this section, 'long-term contract' means a  
25          contract for manufacture, installation, or

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

7           Section 31. Title 54 of the Code of the Federated States  
8 of Micronesia (Annotated), as amended, is hereby amended by  
9 enacting a new section 546 to read as follows:

10           “Section 546. Finance leases.

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

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

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

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

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

24                   (a) if the lessor and lessee are not  
25           associates and an amount is stated as the cost or



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1           value of the asset in the lease agreement, that  
2           amount; or

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

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

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

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

17          Section 32. Title 54 of the Code of the Federated States  
18 of Micronesia (Annotated), as amended, is hereby amended by  
19 enacting a new section 547 to read as follows:

20                  "Section 547. Bad debts.

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

24                           (a) the amount of the debt:

25                                   (i) was previously included in the gross

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

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

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

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

14           Section 33. Chapter 5 of title 54 of the Code of the  
15 Federated States of Micronesia (Annotated), as amended, is  
16 hereby amended by designating sections 551 to 555 as subchapter  
17 V entitled "Business Assets".

18           Section 34. Title 54 of the Code of the Federated States  
19 of Micronesia (Annotated), as amended, is hereby amended by  
20 enacting a new section 551 to read as follows:

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

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

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1           chapter.

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

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

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

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

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

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

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

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

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

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1       Section 35. Title 54 of the Code of the Federated States  
2 of Micronesia (Annotated), as amended, is hereby amended by  
3 enacting a new section 552 to read as follows:

4           "Section 552. Cost.

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

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

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

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

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

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

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

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

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

7                   (4) The cost of a business asset does not include  
8           an expense allowed as a deduction under section  
9           534(1)(a) of this chapter.

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

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

25                   (7) The cost of a business asset treated as

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1           acquired under section 551(7) of this chapter is the  
2           fair market value of the asset determined at the date  
3           it is applied to business use.

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

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

13          (10) The cost of an asset of a business must not be  
14          reduced by an impairment write down in relation to  
15          the asset made in the financial accounts of the  
16          business.

17          (11) In this section, "impairment write down", in  
18          relation to an asset of a business, means the write  
19          down of the value of the asset in the financial  
20          accounts of the business because the fair market  
21          value of the asset is less than the cost of the  
22          asset."

23          Section 36. Title 54 of the Code of the Federated States  
24 of Micronesia (Annotated), as amended, is hereby amended by  
25 enacting a new section 553 to read as follows:

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1           "Section 553. Consideration received.

2           (1) Except as otherwise provided in this chapter,  
3           this section establishes the amount of consideration  
4           received on disposal of a business asset for the  
5           purposes of this chapter.

6           (2) The consideration received by a business on  
7           disposal of a business asset is the total amount  
8           received by the business for the asset, including the  
9           fair market value of any consideration received in  
10          kind determined at the time of disposal.

11          (3) If a business asset has been lost or destroyed,  
12          the consideration received by a business for the  
13          asset includes any compensation, indemnity, or  
14          damages received by the business as a result of the  
15          loss or destruction, including amounts received as a  
16          consequence of:

17                 (a) an insurance policy, indemnity, or other  
18                 agreement;

19                 (b) a settlement; or

20                 (c) a judicial decision.

21          (4) The consideration received for a business asset  
22          treated as disposed of under section 551(5) of this  
23          chapter is the fair market value of the asset  
24          determined at the time it is applied to personal or  
25          domestic use.

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1           (5) If two or more business assets are disposed of  
2           by a business in a single transaction and the  
3           consideration received for each asset is not  
4           specified, the total consideration received by the  
5           business is apportioned among the assets disposed of  
6           in proportion to their respective fair market values  
7           determined at the time of the transaction.”

8           Section 37. Title 54 of the Code of the Federated States  
9 of Micronesia (Annotated), as amended, is hereby amended by  
10 enacting a new section 554 to read as follows:

11           “Section 554. Non-arm’s length transaction.

12           (1) For the purposes of this chapter, if a  
13           business asset is disposed of in a non-arm’s length  
14           transaction:

15           (a) the business disposing of the asset is  
16           treated as having received consideration equal to the  
17           fair market value of the asset determined at the time  
18           the asset is disposed of; and

19           (b) the business acquiring the asset is  
20           treated as having a cost equal to the amount  
21           determined under paragraph (a) of this section.

22           (2) Reserved]”

23           Section 38. Title 54 of the Code of the Federated States  
24 of Micronesia (Annotated), as amended, is hereby amended by  
25 enacting a new section 555 to read as follows:



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1           "Section 555. Gain or loss not recognized.

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

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

9                   (b) by reason of the transmission of the asset  
10          on the death of a person to an executor or  
11          beneficiary, but only if the asset is used by the  
12          executor or beneficiary in carrying on a business; or

13                   (c) by reason of the compulsory acquisition of  
14          the asset under any law if the consideration received  
15          for the disposal is reinvested by the recipient in an  
16          asset of a like kind (referred to as a 'replacement  
17          asset') within one year of the disposal.

18          (2) Subsection (1) of this section does not apply  
19          if the person acquiring the asset (including a  
20          replacement asset) is a non-resident person at the  
21          time of the acquisition.

22                   (3) If subsection (1)(a) or (b) of this section  
23          applies, the person acquiring the asset is treated as  
24          acquiring an asset of the same character as the  
25          person disposing of the asset for an amount equal to

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1           the cost of the asset for the person disposing of the  
2           asset at the time of the disposal.

3           (4) A person's cost of a replacement asset referred  
4           to in subsection (1)(c) of this section is the cost  
5           of the asset at the time it is compulsorily acquired  
6           plus the amount by which any consideration given by  
7           the person for the replacement asset exceeds the  
8           consideration received by the person for the asset  
9           compulsorily acquired."

10          Section 39. Chapter 5 of title 54 of the Code of the  
11 Federated States of Micronesia (Annotated), as amended, is  
12 hereby amended by designating sections 561 to 562 as subchapter  
13 VI under entitled "Anti-avoidance".

14          Section 40. Title 54 of the Code of the Federated States  
15 of Micronesia (Annotated), as amended, is hereby amended by  
16 enacting a new section 561 to read as follows:

17           "Section 561. Transfer pricing.

18           (1) The CEO may distribute, apportion, or allocate  
19           revenue and expenses between businesses as is  
20           necessary to reflect the outcome that would have  
21           arisen in a transaction between independent persons  
22           dealing with each other at arm's length in respect  
23           of:

24                   (a) a transaction between businesses carried  
25           on by persons who are associates; or

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1                   (b) a transaction between businesses carried  
2                   on by the same person.

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

7           Section 41. Title 54 of the Code of the Federated States  
8 of Micronesia (Annotated), as amended, is hereby amended by  
9 enacting a new section 562 to read as follows:

10           “Section 562. General anti-avoidance provision.

11                   (1) In this section, ‘tax avoidance scheme’ means  
12                   any transaction or arrangement where one of the main  
13                   purposes of a person in entering into the transaction  
14                   or arrangement is the avoidance or reduction of the  
15                   tax liability of a business under this chapter.

16                   (2) For the purposes of determining the tax  
17                   liability of a business under this chapter, the CEO  
18                   may:

19                           (a) determine the character of a transaction  
20                           or an element of a transaction that was entered into  
21                           as part of a tax avoidance scheme;

22                           (b) disregard a transaction that does not have  
23                           substantial economic effect;

24                           (c) determine the character of a transaction  
25                           if the form of the transaction does not reflect the

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1           substance; or

2                   (d) treat separate businesses carried on by  
3           the same person as a single business if business  
4           activity has been fragmented under a tax avoidance  
5           scheme."

6           Section 42. Chapter 5 of title 54 of the Code of the  
7 Federated States of Micronesia (Annotated), as amended, is  
8 hereby amended by designating sections 571 to 577 as subchapter  
9 VII entitled "Procedures".

10          Section 43. Title 54 of the Code of the Federated States  
11 of Micronesia (Annotated), as amended, is hereby amended by  
12 enacting a new section 571 to read as follows:

13           "Section 571. Filing of tax return.

14                   (1) A person liable for tax under section 521 of  
15           this chapter in respect of a business must file a net  
16           profit tax return for the business for each tax year  
17           within three months after the end of the tax year.

18                   (2) A person liable for tax under section 522 of  
19           this chapter in respect of a business must file a  
20           presumptive tax return for the business for each tax  
21           year within three months after the end of the tax  
22           year.

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

25          Section 44. Title 54 of the Code of the Federated States

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1 of Micronesia (Annotated), as amended, is hereby amended by  
2 enacting a new section 572 to read as follows:

3 "Section 572. Self-assessment of net profit tax or  
4 presumptive tax due.

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

8 (a) if the business has a net profit for the  
9 year, the amount of the net profit of the business  
10 and the net profit tax payable thereon as specified  
11 in the return; or

12 (b) if the business has made a net loss for  
13 the year, the amount of the net loss of the business  
14 as specified in the return.

15 (2) A person that files a presumptive tax return in  
16 respect of a business for a tax year is treated as  
17 having made a self-assessment of the presumptive tax  
18 payable for the year as specified in the return."

19 Section 45. Title 54 of the Code of the Federated States  
20 of Micronesia (Annotated), as amended, is hereby amended by  
21 enacting a new section 573 to read as follows:

22 "Section 573. Payment of tax.

23 The net profit tax or presumptive tax payable by a  
24 person for a tax year in respect of a business  
25 carried on by the person is payable by the date that

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1           the tax return of the business for the year is due.”

2           Section 46. Title 54 of the Code of the Federated States  
3 of Micronesia (Annotated), as amended, is hereby amended by  
4 enacting a new section 574 to read as follows:

5           “Section 574. Installments of tax.

6           (1) A person must pay installments of net profit  
7 tax for a tax year in respect of a business carried  
8 on by the person on the last working day of the  
9 third, sixth, ninth, and twelfth months of the tax  
10 year.

11           (2) The amount of each installment is one-quarter  
12 of the amount of net profits tax estimated by the  
13 person to be payable in respect of the business for  
14 the tax year. An estimate of net profit tax payable  
15 by the person for a tax year in respect of a business  
16 must be filed with the CEO by the due date for  
17 payment of the first installment for the year.

18           (3) An estimate filed by a person under subsection  
19 (2) of this section remains in force for the whole of  
20 the tax year unless a revised estimate is filed with  
21 the CEO. A revised estimate applies to the  
22 calculation of installments of net profit tax for a  
23 tax year due both before and after the date the  
24 revised estimate was filed. The amount of any  
25 underpayment of installments made prior to filing the

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1        revised estimate must be paid by the person together  
2        with the first installment due after the revised  
3        estimate is filed. The amount of any overpaid  
4        installments is applied against future net profit tax  
5        installments due.

6            (4) If a person fails to file an estimate of net  
7        profit tax in respect of a business as required under  
8        subsection (2) of this section, the estimated net  
9        profit tax payable in respect of the business for the  
10       tax year is such amount as estimated by the CEO. The  
11       CEO's estimate remains in force for the whole of the  
12       tax year unless revised by the business in accordance  
13       with subsection (3) of this section.

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

25           (6) If the estimate (including any revised

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1           estimate) of net profit tax payable by a person in  
2           respect of a business for a tax year is less than 90%  
3           of the assessed net profit tax liability of the  
4           person in respect of the business for the year (the  
5           difference is referred to as the 'installment  
6           shortfall'), the business is liable for a penalty  
7           equal to:

8                   (a) if the under-estimate is due to fraud or  
9                   willful neglect, 50% of the installment shortfall; or

10                   (b) in any other case, 10% of the installment  
11                   shortfall.

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

18           Section 47. Title 54 of the Code of the Federated States  
19 of Micronesia (Annotated), as amended, is hereby amended by  
20 enacting a new section 575 to read as follows:

21                   "Section 575. Collection of tax from non-resident  
22                   ship owners or charterers.

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



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1           (a) the master or FSM agent of the ship must  
2           file with the CEO a return showing the gross revenue  
3           derived from the carriage of passengers, livestock,  
4           mail, merchandise, or goods embarked in the FSM in  
5           respect of the ship; and

6           (b) the CEO must determine the amount of tax  
7           due under section 524 of this chapter in respect of  
8           the ship and pursuant to regulatory guidelines,  
9           notify the master or FSM agent, in writing, of the  
10          amount due.

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

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

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

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1           chapter in respect of the ship.

2           (5) The CEO must not grant a port clearance for a  
3           ship owned or chartered by a non-resident person  
4           until satisfied that any tax due under section 524 of  
5           this chapter in respect of the ship has been paid or  
6           that arrangements for its payment have been made to  
7           the satisfaction of the CEO.

8           (6) This section does not relieve the owner or  
9           charterer of the ship from liability to pay any  
10          amount due under section 524 of this chapter that is  
11          not paid by the master or FSM agent of the ship."

12          Section 48. Title 54 of the Code of the Federated States  
13 of Micronesia (Annotated), as amended, is hereby amended by  
14 enacting a new section 576 to read as follows:

15          "Section 576. Collection of tax from non-resident  
16          aircraft owners or charterers.

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

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

24          (3) A person that files a tax return under  
25          subsection (1) of this section is treated as having

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1           made a self-assessment of the gross revenue derived  
2           for the carriage of passengers, livestock, mail,  
3           merchandise, or goods embarked in the FSM during the  
4           quarter and the tax payable thereon under section 524  
5           of this chapter as specified in the return.

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

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

18          Section 49. Title 54 of the Code of the Federated States  
19 of Micronesia (Annotated), as amended, is hereby amended by  
20 enacting a new section 577 to read as follows:

21          "Section 577. Records.

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

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

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1                   (b) retain the records required under  
2                   paragraph (a) of this subsection for six years after  
3                   the end of the tax year to which they relate.

4                   (2) The records that must be maintained by a person  
5                   liable to pay presumptive tax or tax under section  
6                   524 of this chapter may be prescribed.

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

13           Section 50. Chapter 5 of title 54 of the Code of the  
14 Federated States of Micronesia (Annotated), as amended, is  
15 hereby further amended by designating sections 581 to 584 as  
16 subchapter VIII entitled "Withholding Tax".

17           Section 51. Title 54 of the Code of the Federated States  
18 of Micronesia (Annotated), as amended, is hereby amended by  
19 enacting a new section 581 to read as follows:

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

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

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1                   (a) in the case of an insurance premium, 5% of  
2                   the gross amount of the premium; or

3                   (b) in any other case, 15% of the gross amount  
4                   of the payment.

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

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

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

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

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

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

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

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

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

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

9           Section 52. Title 54 of the Code of the Federated States  
10 of Micronesia (Annotated), as amended, is hereby amended by  
11 enacting a new section 582 to read as follows:

12           "Section 582. Withholding tax documentation.

13           (1) A person withholding tax under section 581 of  
14           this chapter must give to the recipient of the  
15           payment 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 chapter shall, within two months after the end  
22           of 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 amended by

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1 enacting a new section 583 to read as follows:

2 "Section 583. Priority of tax withheld.

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

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

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

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

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

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

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

22 Section 54. Title 54 of the Code of the Federated States  
23 of Micronesia (Annotated), as amended, is hereby amended by  
24 enacting a new section 584 to read as follows:

25 "Section 584. Credit for tax withheld.

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

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. Chapter 5 of title 54 of the Code of the  
16 Federated States of Micronesia (Annotated), as amended, is  
17 hereby amended by designating sections 591 to 593 as subchapter  
18 IX entitled "Final Provisions".

19           Section 56. Title 54 of the Code of the Federated States  
20 of Micronesia (Annotated), as amended, is hereby amended by  
21 enacting a new section 591 to read as follows:

22                   "Section 591. Regulations.

23                   (1) The Secretary shall, subject to approval of the  
24                   President, prescribe such regulations necessary for  
25                   the enforcement of this chapter, and such regulations



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

4           (2) Such regulations shall be promulgated in  
5           accordance with law."

6           Section 57. Title 54 of the Code of the Federated States  
7 of Micronesia (Annotated), as amended, is hereby amended by  
8 enacting a new section 592 to read as follows:

9           "Section 592. Transition.  
10           Any tax liability that arose before this chapter came  
11           into force may be recovered under chapter 8 of this  
12           title, but without prejudice to any action already  
13           taken for the recovery of the tax."

14           Section 58. Title 54 of the Code of the Federated States  
15 of Micronesia (Annotated), as amended, is hereby amended by  
16 enacting a new section 593 to read as follows:

17           "Section 593. Commencement of administration.  
18           Administration of this act shall commence on the  
19           commencement of administration date as determined by  
20           Executive Order of the President."

21           Section 59. Sections 141, 142, 143, and 144 of title 54  
22 of the Code of the Federated States of Micronesia (Annotated)  
23 are hereby repealed in their entirety.

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2           Section 60. Effective date. This act shall become law  
3 upon approval by the President of the Federated States of  
4 Micronesia or upon its becoming law without such approval, this  
5 act shall take effect upon the commencement of administration  
6 date set by Executive Order of the President.

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8 Date: 11/14/19

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

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