

STANDING COMMITTEE REPORT NO. 13-179

RE: C.B. NO. 13-141/W&M

SUBJECT: CORPORATE INCOME TAX

OCTOBER 26, 2004

The Honorable Peter M. Christian
Speaker, Thirteenth Congress
Federated States of Micronesia
Fourth Regular Session, 2004

Dear Mr. Speaker:

Your Committee on Ways and Means, to which was referred C.B. No. 13-141, entitled:

C.B. No. 13-141, "A BILL FOR AN ACT TO FURTHER AMEND TITLE 54 OF THE CODE OF THE FEDERATED STATES OF MICRONESIA, AS AMENDED, BY ADDING NEW CHAPTER 3 TO ESTABLISH AN INCOME TAX FOR CORPORATIONS, AND FOR OTHER PURPOSES.",

begs leave to report as follows:

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

The subject bill would create a new income tax to be charged to large corporations and expand the duties of the Registrar of Corporations.

During the Fifth Special Session of the Thirteenth Congress, the subject bill was introduced and referred to your committee for further discussion. On September 14-17, 2004, your committee held hearings in Yap and Chuuk on seven bills involving changes to the FSM's tax laws, including the subject bill, at which members had an opportunity to hear from representatives of the state governments of Yap and Chuuk. In a letter dated October 1, 2004, the State of Yap provided further comments on the subject bill. On October 7, 2004, in Kosrae your committee held hearings on those same seven bills, including the subject bill, at which members had an opportunity to hear from representatives of Kosrae. On October 20, 2004, hearings were held in Pohnpei on those same seven bills. In addition, your committee performed some due diligence, including asking questions of the consultant, Registration Advisors Ltd., who initially prepared the bill and will be responsible for marketing FSM to foreign corporations, to confirm the legitimacy of the opportunity and the reputations of the consultant's principals.

In a letter dated October 22, 2004, the Attorney General raised

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several concerns regarding the enactment of the subject bill. Firstly, it mentioned that the enactment of this bill will make the FSM a destination of choice for money launderers. Your committee finds this comment highly speculative, since the bill merely imposes a new tax and does not alter the current money laundering laws of the FSM. Secondly, the Attorney General raised concerns about the FSM becoming perceived as a tax haven and the consequences that may result. Your committee notes that this bill does not decrease the amount of taxes to be paid by any existing or new FSM tax-payer. It also notes that it is to the advantage of the corporations that will be subject to the tax to fully report their taxable income. It finds this comment to be highly speculative. Thirdly, the Attorney General raised several issues in respect of the contract demands of the consultant. The committee agrees with these concerns raised by the Attorney General and as a result feels assured that these issues will be properly addressed by the executive branch when it negotiates the contract with the consultant. Finally, the Attorney raised concerns about a potential negative impact the enactment of this bill will have on the FSM's foreign relations. Your committee again finds this comment highly speculative and notes that it has carefully weighed the costs and benefits of legislation. Your committee now submits this report.

Your committee recognizes that, in light of reduced economic assistance from the United States of America, the FSM is in search of potential new sources of income. The subject bill may be a source of such potential income by encouraging and facilitating foreign corporations, in particular Japanese corporations, to incorporate in and pay tax to the Federated States of Micronesia, while not affecting the taxes paid by current FSM businesses. The consultant has forecasted that such a bill, if enacted, would likely produce tax revenues for FSM of "\$3 million in year 3, \$10 million per annum starting in year 4, and \$30 million per annum starting in year 10." This forecast is based on the incorporation of "6 companies (either from corporations or individuals in Japan) in the first year, and cumulatively 16 by the end of the second year, with 53 registered by the end of the fifth year."

Although agreeing with the general purpose and intent of C.B. 13-141, your committee submits that it should be amended in a number of respects:

(1) Based on a comment from the State of Yap with which your committee agrees, corporations that pay the corporate income tax in the subject bills should not also have to pay the gross revenues tax enacted as title 54, chapter 1, subchapter IV: Taxation of Gross Revenues. These corporations would in effect be

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paying double taxation, which would seriously reduce the likelihood of foreign corporations incorporating in and paying taxes to FSM. Therefore, the committee recommends that a gross revenues tax exemption for corporations paying the corporate income tax be added to C.B. 13-141.

(2) The Foreign-Investment Act, title 32, chapter 2 of the Code of FSM requires that any non-citizen wishing to engage in business or acquire a greater than 20% interest in a business operating in the FSM must acquire a foreign business permit. Considering that:

1. the aim of the subject bills is to encourage foreign corporations to incorporate in and pay taxes to the FSM;
2. these foreign corporations most likely will be holding or owning business assets outside of the FSM;
3. it may be interpreted that such foreign corporations be required to obtain a foreign business permit, if they wished to incorporate in the FSM; and
4. the expense, hassle and uncertainty of acquiring a foreign business permit is likely to deter such foreign corporations from incorporating in and paying taxes to the FSM;

the committee recommends that a section be inserted in C.B. 13-141 that clearly states that holding or owning assets outside of the FSM is neither a business operating in the FSM nor constitutes engaging in business in the FSM for the purposes of the Foreign-Investment Act.

(3) Considering the subject bill is closely tied with C.B. 13-135, the committee is of the opinion that C.B. 13-141 should use similar terminology to C.B. 13-135. Therefore, the committee recommends that the term 'major corporation' be defined in the subject bill to describe corporations that will pay the corporate income tax and used in such manner.

(4) Your committee also recommends a number of technical amendments to improve the clarity of the subject bill as identified below.

Specifically, your committee recommends the following amendments to C.B. No. 13-141:

1. Page 1, line 13 - preceding "control group" delete "a".
2. Page 1, line 13 - delete "control" and insert "Control" in lieu thereof.

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3. Page 1, line 14 - delete "the" and insert "a" in lieu thereof.

4. Page 2, line 1 - following "(2)", insert:

"`Major Corporation' means any corporation that is subject to taxation under this chapter, specifically, any corporation that is not exempt from taxation by section 313 of this chapter.

(3)"

5. Page 1, line 19 - following "Administration." insert:

"(4) 'Taxable Year' shall mean the fiscal year of the major corporation as reported to the Secretary under section 314 of this chapter."

6. Page 2, line 8 - preceding "unless", insert "incorporated in the Federated States of Micronesia".

7. Page 2, line 10 - delete "taxable" and insert "fiscal" in lieu thereof.

8. Page 2, line 23 - preceding "corporation", insert "major".

9. Page 2, lines 23 and 24 - delete "that is subject to taxation under this chapter".

10. Page 3, line 2 - preceding "corporation", insert "major".

11. Page 3, line 3 - preceding "corporation", insert "major".

12. Page 3, line 5 - preceding "corporation", insert "major".

13. Page 3, line 7 - preceding "corporation", insert "major".

14. Page 3, line 9 - preceding "corporation", insert "major".

15. Page 3, line 10 - preceding "corporation", insert "major".

16. Page 3, line 12 - preceding "corporation", insert "major".

17. Page 3, line 12 - delete "taxable" and insert "fiscal" in lieu thereof.

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18. Page 3, line 13 - delete "for which the report is being filed".
19. Page 3, line 14 - delete "(7)".
20. Page 3, line 14 - preceding "corporation", insert "major".
21. Page 3, line 15 - delete "after" and insert "of" in lieu thereof.
22. Page 3, line 15 - preceding "corporation", insert "major".
23. Page 3, line 15 - delete "becomes" and insert "becoming" in lieu thereof.
24. Page 3, line 21 - preceding "corporation", insert "major".
25. Page 3, line 24 - delete "311" insert "313" in lieu thereof.
26. Page 4, line 7 - preceding "corporation", insert "major".
27. Page 4, line 7 - delete "subject to taxation under this chapter".
28. Page 4, line 12 - preceding "corporation", insert "major".
29. Page 4, line 12 - delete "subject to taxation under this chapter".
30. Page 4, line 13 - delete ", for" and insert "earned in" in lieu thereof and after "year" delete the comma.
31. Page 4, line 15 - delete "Principals" and insert "Principles" in lieu thereof.
32. Page 4, line 15 - delete ", consistently applied".
33. Page 4, line 15 - preceding "'GAAP'" insert "hereinafter,".
34. Page 4, line 16 - delete "country of incorporation or country of citizenship of the".
35. Page 4, line 18 - preceding "corporation's", insert "major".
36. Page 4, line 18 - following "principal shareholder", insert "'s, if a corporation, place of incorporation or, if an individual, country of primary residence".

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37. Page 4, line 19 - following "Section 9." insert:

"Title 54 of the Code of the Federated States of Micronesia, as amended, is hereby further amended by adding a new section 323 of chapter 3 to read as follows:

Section 323. Exemption from Taxation of Gross Revenues. Any major corporation that is not engaging in business in the Federated States of Micronesia or a business operating in the Federated States of Micronesia pursuant to section 360 of this chapter and remits tax pursuant to section 321 of this chapter is exempt from the requirements of title 54, chapter 1, subchapter IV: Taxation of Gross Revenues for each taxable year that the major corporation has remitted tax pursuant to section 321 of this chapter.
Section 10."

38. Page 4, line 23 - preceding "corporation", insert "major".

39. Page 4, lines 23 and 24 - delete "subject to taxation under this chapter".

40. Page 4, line 25 - after "accrued on" delete "the".

41. Page 5, line 3 - preceding "corporation", insert "major".

42. Page 5, line 6 - preceding "corporation", insert "major".

43. Page 5, line 8 - preceding "corporation", insert "major".

44. Page 5, line 19 - delete "10" and insert "12" in lieu thereof.

45. Page 5, line 23 - preceding "corporation", insert "major".

46. Page 5, line 25 - preceding "corporation", insert "major".

47. Page 6, line 1 - preceding "corporation", insert "major".

48. Page 6, line 3 - delete "12" and insert "13" in lieu thereof.

49. Page 6, line 6 - delete the entirety of section 341, and insert, in lieu thereof:

"Section 341. Change of Fiscal Year. A major corporation may, at its option, change its fiscal year, provided that such a change may not be done

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more than once during any sixty (60) month period without the advance written consent of the Secretary."

50. Page 6, line 9 - delete "12" and insert "13" in lieu thereof.
51. Page 7, line 2 - preceding "corporation", insert "major".
52. Page 7, line 2 - delete "methods" and insert "method" in lieu thereof.
53. Page 7, line 3 - delete "on the basis of".
54. Page 7, line 3 - preceding "corporation", insert "major".
55. Page 7, lines 4 and 5 - delete "in keeping its books under GAAP".
56. Page 7, line 5 - preceding "corporation", insert "major".
57. Page 7, line 11 - preceding "corporation", insert "major".
58. Page 7, line 12 - preceding "corporation", insert "major".
59. Page 7, line 14 - delete ", however,".
60. Page 7, line 18 - delete "13" and insert "14" in lieu thereof.
61. Page 7, line 22 - preceding "corporation", insert "major".
62. Page 7, line 22 - delete "subject to taxation under this chapter".
63. Page 7, line 25 - preceding "corporation's", insert "major".
64. Page 8, line 2 - preceding "corporation", insert "major".
65. Page 8, line 16 - preceding "corporation", insert "major".
66. Page 8, line 3 - preceding "financial statements" insert "audited".
67. Page 8, line 3 - preceding "acceptable" insert "in a form".
68. Page 8, line 4 - following "sixth month" insert "period".
69. Page 8, line 4 - delete "close", and insert "last day" in lieu

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thereof.

70. Page 8, line 5 - preceding "corporation", insert "major".
71. Page 8, line 10 - delete "close", and insert "last day" in lieu thereof.
72. Page 8, line 10 - preceding "corporation's", insert "major".
73. Page 8, line 10 - preceding "corporation", insert "major".
74. Page 8, line 14 - preceding "corporation", insert "major".
75. Page 8, line 15 - following "sixth month" insert "period".
76. Page 8, line 15 - delete "close", and insert "last day" in lieu thereof.
77. Page 8, line 16 - preceding "corporation", insert "major".
78. Page 8, line 19 - preceding "corporation", insert "major".
79. Page 8, line 19 - following "interest" insert ", compounded monthly and not in advance,".
80. Page 8, line 21 - delete "due".
81. Page 8, line 21 - following "date" delete "of".
82. Page 8, line 22 - following "amount" insert "was due".
83. Page 8, line 22 - delete "due".
84. Page 8, line 24 - insert a new section 16:

"Section 16. Title 54 of the Code of the Federated States of Micronesia, as amended, is hereby further amended by adding a new section 360 of chapter 3 to read as follows:

Section 360. Engaging in business or operating a business in the Federated States of Micronesia. A corporation incorporated in the Federated States of Micronesia that only holds, buys, sells, transfers or otherwise transacts with assets or property located outside of the Federated States of Micronesia, including but not limited to,

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businesses, shares, stocks, bonds, annuities, treasury bills, partnership units or trust units, is not engaging in business in the Federated States of Micronesia or a business operating in the Federated States of Micronesia for the purposes of section 323 of this chapter or title 32, chapter 2: the Foreign-Investment Act of the Code of the Federated States of Micronesia.
Section 17."

With the foregoing amendments, your Committee on Ways and Means is in accord with the intent and purpose of C.B. 13-141 and recommends its passage on First Reading, and that it be placed on the Calendar for Second and Final Reading in the form attached hereto as C.B. No. 13-141, C.D.1.

Respectfully submitted,

Sabino S. Asor, chairman

/s/ Roosevelt D. Kansou
Roosevelt D. Kansou, vice
chairman

/s/ Henry C. Asugar

Henry C. Asugar, member

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

/s/ Isaac V. Figir

Isaac V. Figir, member

Dohsis Halbert, member

Claude H. Phillip, member