FEDERATED STATES OF MICRONESIA
TAX INFORMATION

Division of Customs and Tax Administration
Department of Finance and Administration

Taxpayer Services

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INTRODUCTION

The information contained in this pamphlet provides basic information about taxes levied by the national government of the Federated States of Micronesia. These taxes are administered by the Division of Customs and Tax Administration of the FSM Department of Finance and Administration.

The Division of Customs and Tax Administration maintains its headquarters in the State of Pohnpei and has a local office in each of the four States of Chuuk, Kosrae, Pohnpei and Yap. This pamphlet is not intended to be a detailed substitute for the FSM Tax Code and regulations. Specific questions should be directed to the Assistant Secretary, Divisions of Customs and Tax Administration, FSM National Government, Palikir, Pohnpei, 96941, or to the Deputy Assistant Secretary in your state.

August 26, 2016

Sihna Lawrence
Secretary of Finance

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I. Overview of the Federated States of Micronesia (FSM) tax system.

A. National Government Taxes. The National Government imposes three taxes through its Customs & Tax Administration "CTA". The first is an import tax on products brought in to the FSM. Imported items will not be released by customs officials until all import taxes have been paid. The Division of Customs oversees all customs responsibilities of the nation and collects the tax on imported commodities.

The second tax is assessed on the "gross revenues" of all "businesses" operating within the FSM. This tax is based on gross receipts and very few deductions are allowed in computing this tax. Almost every person or company earning money from activities within the FSM will be subject to this tax, unless that person is an employee.

The third tax is the wages and salaries tax. It is the responsibility of every employer doing business within the FSM to withhold this tax from wages and salaries earned by their employees. Withholding is based on gross wages and salaries (no deductions) and is according to tables prescribed by the Division of Customs and Tax Administration.

B. State and Municipal Taxes. The various states assess sales, excise and other miscellaneous taxes.
Municipalities are responsible for issuing and collecting fees for most business licenses. Each taxpayer should check with the authorities in the state or municipality where he is doing business to see what taxes his business is subject to.

II. The Import Tax.

A. <u>Rates.</u> According to Public Law No. 13-60, following are import tax rates:

1. **Cigarettes are taxed at the rate of $0.05 per cigarette. Any person is entitled to bring up to one (1) carton or 200 pieces of cigarettes per trip, tax free, for personal consumption.**
2. **Other tobacco products are 50% ad valorem, except that any person can bring in up to one pound of tobacco or twenty cigars per trip for personal consumption.**
3. **Perfumery, cosmetics and toiletries imported for resale are 25% ad valorem.**
4. **Soft drink, drink mixes, drink preparations, coffee, tea, and nonalcoholic beverages, at the rate of 25% ad valorem, provided that any beverage having a fruit juice content of twenty five percent or more by volume shall be at the rate of 3% ad valorem.**
5. **Beer and malt beverages, at the rate of $0.25 per 12 fluid ounces.**
6. **Distilled alcoholic beverages, at the rate of twelve dollars per gallon.**
7. **Wine at the rate of 30% ad valorem.**
8. **Foodstuffs for human consumption, at the rate of 3% ad valorem; provided, however, that fresh and frozen fish and seafood, shall be at the rate of 25% ad valorem.**
9. **Gasoline and diesel fuel for resale are taxed at 5 cents per gallon.**
10. **Laundry bar soap, at the rate of 25% ad valorem.**
11. **All other products imported, except those specified above, at the rate of 4% ad valorem.**

B. <u>Valuation.</u> The value to which import tax rates apply is the value of the goods delivered to the FSM port of entry. This is known as "CIF" (Cost, Insurance, and Freight) and, as the term implies, it includes shipping costs.

C. **Reimbursement.** **Good not received or goods received damaged and so certified by the carrier or his agents will be reimbursed within 28 days.**

D. **Exemptions. Goods imported for transshipment or re-export are exempt from tax. Goods which arrive in satisfactory condition but spoil or are damaged in the custody of the importer are not exempt from tax.**

E. **Customs Procedures. All imports are subject to physical inspection by customs officials. No carrier, agent, or terminal operator will release imports until entry documents have been stamped "cleared" by customs. All goods must be cleared within 15 days of departure of the carrier or a penalty will be assessed. Customs may refuse to clear imports until other delinquent taxes (Business Gross Revenue, Wages and Salaries) are paid. Appropriate arrangements can be made for clearing perishable merchandise.**

III. The Business Gross Revenue Tax

A. **Who is subject to the tax? Almost every activity carried on for profit (other than being an employee) constitutes a "business" under the FSM Tax Code. This includes all stores, rental agencies, manufacturing, carriers and self assessed against each "business" rather than each corporation or individual doing business. Thus, companies or individuals engaged in more than one business should file a separate tax return for each business.**

B. **What is gross revenue? Gross revenue means all receipts of a business, from whatever source, with few deductions. Receipts are taxable when accrued (when earned or when a sale takes place) rather than when received. The only deductions allowed from gross revenue are the following:**

   1. **Refunds received from a supplier or similar person.**

2. **Money held for someone else (agency).**
3. **Refunds to customers**
4. **State sales tax collected by the seller and paid over to the State.**
5. **Social security taxes, employer's share.**
6. **Wages and salaries of employees.**
7. **Electric utility and water utilities cost paid by the business which are directly related to business operations.**
8. **Communication expenses paid by the business which are directly related to business operations**

C. **<u>How is the tax calculated</u>? The tax rate is eighty dollars ($80.00) on the first $10,000 of gross revenue and 3% on the excess for the calendar year. Businesses with less than $2,000 in gross revenue during a year are exempt from tax.**

D. **<u>Filing Requirements</u>. All businesses must file a gross revenue tax return for each calendar quarter. These returns are due January 1-31, April 1-30, July 1-31, and October 1-31. Businesses operating more than one state must file a separate tax return in each of the state where it operates. There is a penalty of one percent (1%) of the tax due for failure to file a return on time plus an additional one percent (1%) for each thirty days the return is late. The minimum penalty for late filing is five dollars ($5.00) and the maximum penalty is 25% of the tax due.**

The tax due must be paid when the tax return is filed. The penalty for late payment is five percent (5%) plus an additional one percent (1%) for each month the tax is not paid with a maximum penalty not to exceed 25% of the tax due. Interest at the rate of six percent (6%) per annum is also charged on unpaid taxes.

A business which is not sure if it will generate with gross revenue of more than $2,000 in the year should file tax returns. If the business ends up earning less than $2,000, all taxes paid will be refunded.

E. Businesses operating both inside and outside the FSM

The FSM Tax Code presumes that businesses operating both within and outside the FSM during a calendar year derive all gross revenue from sources within the FSM and that all gross revenue is subject to FSM tax. Such businesses can file for apportionment of the tax with the Secretary of Finance and tax will be levied only on gross revenue earned from transactions or parts of transactions within the FSM. Regulations are currently being developed on apportionment methods for various businesses.

IV. The Wages and Salaries Tax.

A. Who is subject to the tax? All persons performing services as "employees" are subject to the tax. An "employee" is a person who works for someone else, rather than having his own business.

B. What are "wages and salaries"? All "wages and salaries" of employees are subject to the tax. Wages and salaries include almost everything of value an employee receives in exchange for his services. "Wages and salaries" are taxable even though not paid in cash. For example, money due you at the end of the year but not yet paid is taxable in the year. Likewise, if someone gives you merchandise or other goods in exchange for your services, the value of those goods are taxed as "wages and salaries".

C. Exemptions. The following are not taxed as "wages and salaries' of an employee.

1. Reasonable per diem and travel allowances

2. Housing allowances, but only if the allowance is actually used for rent or provide a home.

3. Payments on account of sickness, disability, or medical or hospitalization expenses paid by the employer for the employee.

4. Payments other than in cash for services not in the ordinary course of the employer's trade or business.
5. Payments for casual labor not in the ordinary course of the employer's trade or business and for not more than one week in each calendar month.
6. Payments received by domestic help.
7. There are also exemptions for military personnel, trust or annuity payments, scholarships, and clergy.

D. How is the tax calculated? The tax is six percent (6%) of the first $11,000 and ten percent (10%) of any excess earned during each calendar year. Employees earning less than $5,000 during a calendar year are entitled to a $1,000 deduction before computing the tax.

E. Responsibilities of employees. All employees of businesses within the FSM should make sure their employers are withholding this tax from their paychecks and paying it over to the Division of Customs and Tax Administration. If the tax is not withheld and paid by the employer, the Division of Customs and Tax Administration may come after the employee to pay the tax, interest, and penalties. Employees of businesses not having a "place of business" within the FSM or an agent within the FSM are responsible for filing and paying their own wages and salaries tax on amounts earned while in the FSM. Most employers with employees operating within the FSM will also have a "place of business" within the FSM.

F. Responsibility of FSM Employers. Employers within a "place of business" within the FSM are required to withhold the wages and salaries tax from amounts paid to employees and to pay the amounts withheld to the government each quarter. An Employer's Income Tax Quarterly Withholding Return must be filed for each quarter, showing each employee, the amount of wages paid, and the amount of tax withheld, along with certain other information. These tax

returns and the payment of the tax withheld are due on January 31, April 30, July 31 and October 31.
An employer not withholding the tax from employees or withholding the tax but not paying it over to the Division of Customs and Tax Administration can be held liable for the tax, interest and penalties.

Tax forms and withholding tables are available from any Division of Customs and Tax Administration office.

G. <u>Responsibility of Foreign Employers</u>. An employer is exempt from the withholding requirement only if he has no "place of business" within the FSM and he has no agent within the FSM. Very few foreign employers will be exempt from the withholding requirement.

H. <u>Employees working outside the FSM</u>. All wages and salaries earned by an employee attributable to services performed both within and outside the FSM in any calendar month will be subject to the FSM tax.

I. <u>Refunds and Year End Processing</u>. At the end of each calendar year, the Division of Customs and Tax Administration tabulates information on all Employer's Income Tax Quarterly Withholding Returns and determine whether a refund is due or additional tax is due for each employee. Withholding statements for each calendar year are prepared by each employer and given to the employees. Refund checks are prepared by the Division of Customs and Tax Administration and given to employers for distribution to employees. No claim need be filed to receive this refund. If a refund is due, however, eligible employees that for some reasons find that they do not receive refunds can contact the Division of Customs and Tax Administration to file a claim. Any additional tax due may be collected from the employer or the employee.

V. Licensing. Individual municipalities throughout the FSM issue business licenses. In some states the business licenses are issued by the state.

Any non-FSM citizen or any business in which a non-FSM citizen has an interest is not allowed to do business in the FSM without a foreign investment permit. Application for such a permit is made through the individual FSM State.

The FSM Department of Resources and Development administers licensing for importers, exporters, securities dealers, insurance companies, insurance brokers and insurance agents.

VI. State and Municipal Requirements. The various states and municipalities have certain licensing requirements and taxation laws. For example, the State of Pohnpei assesses a sales tax and a hotel tax. The State also has licensing authority over alcoholic beverages. Each municipality requires that each business within its boundaries obtain a municipal business license.

You should check with the state and municipal authorities where you do or plan to do business in order to determine their requirements.

VII. CTA's Compliance Branch Audit Program.

From time to time, the Division of Customs and Tax Administration through its Compliance Branch at the Central Office conducts audits to determine if taxpayers are paying the correct amount of tax. The Compliance Branch may ask to see taxpayer's books and records, including sales records, payroll, copies of contracts and other legal documents, bank statements, etc. Taxpayers are required by law to furnish these documents on request. The Division of Customs and Tax Administration will make every effort to schedule audits and meetings at a time convenient to the taxpayers.

VIII. If you disagree with a tax assessment. After an audit, the Compliance Branch of the Division of Customs and Tax

Administration will issue an audit report ("Notice of Tax Examination Changes") if it has determined there is additional tax due. The report will also show any interest or penalties due. The report will be accompanied by a written explanation of the adjustment and copies of applicable working papers.

If you disagree with the additional tax, you should immediately contact the nearest Division of Customs and Tax Administration office and explain why you disagree. Your explanation should be in writing.

If after considering your arguments, the Division of Customs and Tax Administration does not change the additional tax due, you have one (1) year to file a petition in the FSM Supreme Court to overturn the decision of the Division of Customs and Tax Administration.

IX. Record Keeping Requirements. The record keeping requirements of the regulations issued under the FSM Tax Code are detailed and complex. However, at a minimum, all businesses must keep records showing each day's cash and credit sales and showing all payroll information. Failure to keep these records or to show them to the Division of Customs and Tax Administration personnel on request is a crime.

Contact your local Division of Customs and Tax Administration office for more information on what records are required.

X. Summary. The information in this booklet is current as of FY 2015; however, the tax law and regulations are subject to change.

This booklet has been produced by the Division of Customs and Tax Administration at the direction of the FSM Secretary of Finance in order to increase understanding of the FSM tax laws by both FSM citizens and outsiders wishing to do business within the FSM. Only through voluntary compliance with our tax laws will enough local revenue be raised to insure a free and independent government.

Thank You!!

Taxpayer Services Manager