

GUIDELINE FOR TAX CLAUSE TO INSERT IN CONTRACTORS CONTRACT

Every contract entered into by the FSM Government must have one of the below tax clauses inserted, unless the contractor is specifically exempted from tax (refer to Notes below):

1. **If the contractor is in business** (and therefore should pay the Gross Revenue Tax):

“The contractor shall register with the Customs and Tax Administration (CTA) to pay the Gross Revenue Tax (GRT) within 10 working days of the start date of this contract, and undertakes to file GRT returns, as well as pay their GRT due, by each due date.”

2. **If the contractor is an employee** (and therefore should pay the Wage & Salaries Tax):

“The contractor permits the Department or Agency (employer) to deduct the Wage & Salaries Tax (W&ST) from their payments for services from the commencement of this contract, and pay the amounts deducted to the Customs and Tax Administration (CTA) to be credited against the W&ST payable by the contractor. If the employer fails to deduct any or all of the W&ST payable by the contractor, then the contractor will register with the CTA to pay the W&ST within 10 working days of the non-deduction or shortfall-deduction, and undertakes to file W&ST returns to include the non-deducted W&ST, as well as pay their W&ST due, by the due date.”

The **contractor is considered to be in business** if most of the following criteria apply:

- They provide the major assets or working equipment needed for the job
- They pay for their own training
- They decide or control how they work

For example:

- when they take holidays
- when, where and what hours they work
- the standard or quality of work
- how much they get paid and how
- They invest or risk their own money in the activity
For example, can they say yes to the following:
 - Could they sell the business?
 - Do they support the business with their own money?
 - Are they responsible for losses or their own bad management?
 - Are they responsible for management and investment decisions?
- They are responsible for getting the work done
For example, can they say yes to the following:
 - Can they get other people to work with them or for them, without needing to get permission from anyone else?
 - Do they pay these people from their own money?
 - Can they do work for other people?

- Do they advertise to get themselves more work?
- Do they get someone else to do the job if they cannot?
- Does their contract say they'll be penalized if they stop work, or leave without finishing a project?
- Do they have to fix work that isn't as good as it should be, in their own time and at their own expense?

The **contractor is considered to be an employee** if most of the following criteria apply:

- They have to do the work themselves, instead of hiring someone to do it for them
- Someone can tell them what to do on the job, or when or how to do their work
- They are paid at a set rate
- They can get overtime pay or penal rates
- They work set hours, or a given number of hours each week or month
- Someone else decides the amount and quality of the sales or output they need to achieve
- They work at the FSM Government Department or Agency premises, or somewhere that the FSM Government decides
- Other people who do the same sort of job are treated as employees
- The contract is essentially for personal services and the person either holds a position within the FSM public service (whether permanently or otherwise)
- They are restricted from doing work for anyone else
- The FSM Government Department or Agency sets the rules or procedures they must follow

Notes

1. Title 54, section 112(5)(g) allows for an exemption from the Gross Revenue Tax for "***funds received by an international organization, foreign contractor, or other foreign entity paid from foreign aid proceeds donated*** to the Federated States of Micronesia pursuant to a foreign aid agreement entered into by the Federated States of Micronesia, the terms of which require that such gross revenue shall not be subject to taxation by the Government of the Federated States of Micronesia;" [emphasis added]
2. Title 54, section 112(13)(k) allows for an exemption from the Wage & Salaries tax for "... an employee, who is not a citizen of the Federated States of Micronesia, ***while employed by an international organization, foreign contractor, or other foreign entity performing services or otherwise conducting business in furtherance of a foreign aid agreement entered into by the Federated States of Micronesia, the terms of which require that such wages and salaries shall not be subject to taxation by the Government of the Federated States of Micronesia.***" [emphasis added]
3. GRT will be payable by contractors who are considered in business and based outside of the FSM on the portion earned whilst carried out in the FSM [definition of "*business*" in section 112 and section 142(2) of Title 54].

4. Wages or salaries does not include reasonable per diems, travel or rental allowances paid to an employee [*section 112(13)(b) and (c) of Title 54*].
5. United States contractors and personnel, and third country contractor personnel are exempt from FSM taxes if they are contracted under specific US Government programs to the FSM Government [*Article II, Federal Programs and Services Agreement Between the Government of the United States and the Government of the Federated States of Micronesia*].

If you are unsure whether the contractor is in business or an employee, or you believe they could be exempted from tax, you should contact the CTA for their advice prior to entering into the contract. Further information and legislation can be found on the CTA website at www.dofa.gov.fm/customs-tax-administration