GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES

Peer Review Report
Phase 1
Legal and Regulatory Framework

THE FEDERATED STATES OF MICRONESIA

OECD

Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: The Federated States of Micronesia 2014

PHASE 1:
LEGAL AND REGULATORY FRAMEWORK

April 2014
(reflecting the legal and regulatory framework as at December 2013)

Please cite this publication as:
OECD (2014), *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: The Federated States of Micronesia 2014: Phase 1: Legal and Regulatory Framework*, OECD Publishing.
http://dx.doi.org/10.1787/9789264210226-en

ISBN 978-92-64-21018-9 (print)
ISBN 978-92-64-21022-6 (PDF)

Series: Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews
ISSN 2219-4681 (print)
ISSN 2219-469X (online)

Corrigenda to OECD publications may be found on line at: *www.oecd.org/publishing/corrigenda*.

Table of Contents

About the Global Forum

The Global Forum on Transparency and Exchange of Information for Tax Purposes is the multilateral framework within which work in the area of tax transparency and exchange of information is carried out by over 120 jurisdictions, which participate in the Global Forum on an equal footing.

The Global Forum is charged with in-depth monitoring and peer review of the implementation of the international standards of transparency and exchange of information for tax purposes. These standards are primarily reflected in the 2002 OECD Model Agreement on Exchange of Information on Tax Matters and its commentary, and in Article 26 of the OECD Model Tax Convention on Income and on Capital and its commentary as updated in 2004. The standards have also been incorporated into the UN Model Tax Convention.

The standards provide for international exchange on request of foreseeably relevant information for the administration or enforcement of the domestic tax laws of a requesting party. Fishing expeditions are not authorised but all foreseeably relevant information must be provided, including bank information and information held by fiduciaries, regardless of the existence of a domestic tax interest or the application of a dual criminality standard.

All members of the Global Forum, as well as jurisdictions identified by the Global Forum as relevant to its work, are being reviewed. This process is undertaken in two phases. Phase 1 reviews assess the quality of a jurisdiction's legal and regulatory framework for the exchange of information, while Phase 2 reviews look at the practical implementation of that framework. Some Global Forum members are undergoing combined – Phase 1 and Phase 2 – reviews. The Global Forum has also put in place a process for supplementary reports to follow-up on recommendations, as well as for the ongoing monitoring of jurisdictions following the conclusion of a review. The ultimate goal is to help jurisdictions to effectively implement the international standards of transparency and exchange of information for tax purposes.

All review reports are published once approved by the Global Forum and they thus represent agreed Global Forum reports.

For more information on the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes, and for copies of the published review reports, please refer to www.oecd.org/tax/transparency and www.eoi-tax.org.

Executive Summary

1. This report summarises the legal and regulatory framework for transparency and exchange of information in the Federated States of Micronesia. The international standard which is set out in the Global Forum's Terms of Reference to Monitor and Review Progress Towards Transparency and Exchange of Information is concerned with the availability of relevant information within a jurisdiction, the competent authority's ability to gain timely access to that information, and in turn, whether that information can be effectively exchanged with its exchange of information partners.

2. The FSM is not a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes, but was identified in 2012 as a jurisdiction that is relevant to the Global Forum's work as a result of the development of its captive insurance industry.

3. The Federated States of Micronesia (FSM) is an independent country comprising a group of 607 small islands situated in the Western Pacific Ocean. It comprises four states – Chuuk, Kosrae, Pohnpei and Yap. It has a population of approximately 106 000 people and a total land area of 702 square kilometres.

4. The FSM economy consists primarily of subsistence farming and fishing, although industrial fishing, construction and tourism have developed recently. The FSM is heavily dependent on foreign aid, particularly from the United States. The financial sector has only recently developed and mainly targets the captive insurance business. The commercial legislation allows for the formation of commercial entities at the national or state level, or both, though in the cases of Chuuk and Kosrae this legislation has not been fully implemented with the consequence that it is not possible to register corporations in these states.

5. Ownership information is available with respect to captive insurance companies and "major corporations" (as defined in FSM law), companies formed under FSM's national law, as well as for foreign companies doing business in FSM. However, there are no requirements to maintain ownership information with respect to companies formed pursuant to the commercial

laws of two states (Chuuk and Kosrae). Information concerning the partners of limited partnerships formed in the FSM and for partnerships carrying on business in the FSM is generally (though not always) available. Trusts cannot be formed under the laws of the FSM, however trusts formed under the laws of foreign jurisdictions can be managed from the FSM and ownership and identity information is not ensured in this respect.

6. Reliable accounting information is fully available in respect of captive insurance companies. The laws that apply to corporations formed under the laws of the FSM and of Yap and Pohnpei require that adequate accounting records must be maintained, although they do not require that full underlying documentation be kept. Corporations formed in Chuuk and Kosrae, as well as all partnerships, foreign companies and foreign trusts carrying on business are required under tax law to keep some accounting records, but these requirements do not require the maintenance of accounting records that would allow financial statements to be prepared or the maintenance of underlying documentation.

7. In respect of banking information, the provisions of anti-money laundering legislation impose appropriate obligations to ensure that all records pertaining to customers' accounts as well as related financial transaction information are available.

8. The FSM has powers to obtain information for certain domestic tax purposes but these do not apply for exchange of information purposes. Moreover, secrecy provisions prohibit disclosure of information by the tax authorities to any foreign partner. The scope of legal professional privilege is broader than the international standard. In any case, the FSM has not entered into any instruments providing for exchange of information to the standard.

9. As elements which are crucial to achieving effective exchange of information are not yet in place in the FSM, it is recommended that the FSM does not move to a Phase 2 Review until it has acted on the recommendations contained in the Summary of Factors and Recommendations to improve its legal and regulatory framework. The FSM's position will be reviewed when it provides a detailed written report to the Peer Review Group within 12 months of the adoption of this report. In the meantime, a follow up report on the steps undertaken by the FSM to answer the recommendations made in this report should be provided to the PRG within six months after the adoption of this report.

Introduction

Information and methodology used for the peer review of the Federated States of Micronesia

10. The assessment of the legal and regulatory framework of the Federated States of Micronesia was based on the international standards for transparency and exchange of information as described in the Global Forum's *Terms of Reference*, and was prepared using the Global Forum's *Methodology for Peer Reviews and Non-Member Reviews*. The assessment was based on the laws, regulations, and exchange of information mechanisms in force or effect as at 13 December 2013, other materials supplied by the Federated States of Micronesia, and information supplied by other jurisdictions.

11. The Terms of Reference break down the standards of transparency and exchange of information into ten essential elements and 31 enumerated aspects under three broad categories: (A) availability of information; (B) access to information; and (C) exchanging information. This review assesses the Federated States of Micronesia's legal and regulatory framework against these elements and each of the enumerated aspects. In respect of each essential element, a determination is made that either *(i)* the element is in place, *(ii)* the element is in place but certain aspects of the legal implementation of the element need improvement, or *(iii)* the element is not in place. These determinations are accompanied by recommendations on how certain aspects of the system could be strengthened. A summary of the findings against those elements is set out at the end of this report.

12. The assessment was conducted by a team which consisted of three assessors: Mr Carlo Carag, from the Department of Finance of the Philippines, Ms Patricia Haynes, from the Ministry of Finance of Saint Kitts and Nevis, and Mr Francesco Positano from the Secretariat of the Global Forum. The assessment team examined the legal and regulatory framework for transparency and exchange of information and relevant exchange of information mechanisms in the Federated States of Micronesia.

Overview of the Federated States of Micronesia

13. The Federated States of Micronesia (FSM) is an independent country comprising a group of 607 small islands situated in the Western Pacific Ocean lying Northeast of Papua New Guinea, South of Guam, West of Nauru and the Marshall Islands, East of Palau and the Philippines and about 2 500 miles Southwest of Hawaii. It has a population of approximately 106 000 people and a total land area of 702 square kilometres. English is the official language, together with six other languages.

14. Previously a League of Nations mandated territory under Japan, and then a United Nations Trust Territory under United States' administration, the FSM attained independence in 1986. The political, social and economic ties with the United States are set out in the Compact of Free Association (the Compact), signed in 1984 and renewed in 2004. Incorporated in the Compact are provisions for sharing of information in various sectors, including the financial sectors, and for insuring banks by the United States Federal Deposit Insurance Corporation, but do not concern exchange of information in tax matters.

15. The FSM economy consists primarily of subsistence farming and fishing, although industrial fishing, construction and tourism have developed recently.[1] The financial sector has only recently developed and mainly targets the captive insurance business. As at 27 September 2013, there were 12 captive insurance companies; there were no securities dealers or brokers, and there were only 2 commercial banks with total assets of about USD 230 million. In 2010, the gross domestic product (GDP) amounted to approximately USD 300 million, with a gross national income per capita around USD 2 700.[2] The GDP has grown between 0.9% and 2.5% each year for the last four years.[3] The FSM is heavily dependent on foreign aid, particularly from the United States, which provides annual grants under the Compact. The United States is also FSM's main trading partner, followed by Australia, China, Japan, and New Zealand. The FSM official currency is the US dollar (USD).

16. The FSM joined the United Nations in 1991 and is a member of several other international organisations, including the International Monetary Fund and the World Bank.

1. www.pitic.org.au/pdfs/bigs/fsm.pdf.
2. http://data.worldbank.org/country/micronesia-federated-states.
3. Asian Development Bank, www.adb.org/sites/default/files/pub/2013/FSM.pdf.

Governance and legal system

17. The FSM is a federation of four states – Chuuk, Kosrae, Pohnpei and Yap. The national government is made of three branches which separate and balance the powers of the state: the legislative, executive and judicial. The legislative power is held by a unicameral Congress composed of 14 members directly elected by the people. The President, elected by the Congress from among its members, holds executive power and is assisted by an appointed Cabinet. The independent judicial branch is administered by national courts led by a Supreme Court. The head of state is the President of the FSM.

18. Each of the four states has its own constitution and state and municipal laws and judiciaries. Their governance reflects that of the national government as the power is divided into three branches – legislative, executive and judicial – which are held by a state congress, a state president, and a state judicial branch.

19. The FSM has a constitutional system adopted from the United States' model of democracy. The FSM Constitution of 1979 is the supreme law of the FSM and any act of the national government in conflict with it is invalid. It is the duty of FSM Supreme Court to review the compliance of any national law with the Constitution, including international treaties entered into by the FSM. The FSM Supreme Court also adjudicates on any appeal made to a decision rendered by a national court. Similarly, at state level the state supreme courts review the compatibility of any state law with the state constitution and are the appeal courts for decisions rendered by state courts. When rendering a decision, courts first have to look for Micronesian sources of law to supply a rule of decision. The hierarchy of laws in the FSM is as follows: FSM Constitution, FSM statutes (laws and regulations), state constitutions, and state statutes (laws and regulations). In addition, customs and traditions must be considered by courts. Where statutory law does not exist and there are no relevant Micronesian customs or traditions to decide a case, courts will look to the common law as introduced to the FSM from the United States during the period when it was a Trust Territory (i.e. from 1947 to 1979) (Semens vs. Continental Airlines, Inc. (I), 2 FSM Intrm. 131, 142 (Pon. 1985)). The common law of the United States is nonetheless not binding.

20. It is not clear whether a treaty's provisions are self-executing. Courts in the FSM have not dealt specifically with the issues of the legal status of international treaties.

Overview of commercial laws

21. Legal entities available for use in business in the FSM include corporations and partnerships.

22. Corporations can be incorporated or registered under either national or state laws,[4] except for "major corporations" which must be incorporated and registered under national laws (see below under *General information on the tax system*). A company that is not a "major corporation" may change registration place by de-registering from the previous register and re-register with the new register. The national law providing for the incorporation of corporations is Title 36 of the FSM Code "Corporations and Business Associations", which is complemented by Regulation 2-74 "Corporations, Partnerships and Associations". Each of the four states of the FSM has also enacted legislation governing companies: the Chuuk Business Organisations and Regulation Law, Title 15 of the Kosrae Code "Commerce", Title 37 of the Pohnpei Code "Business Associations", and Title 12 of the Yap Code "Corporations, Partnerships and Associations". The national or the state registrar oversees the registration of companies and the submission of any registered company. Partnerships can be formed at the state level and are generally subject to the principles of common law. The commercial statutes of Pohnpei and Yap also provide for the formation of general partnerships. Limited partnerships can be formed only in Yap. There are no statutes providing for the formation of commercial trusts in the FSM. Even though the common law (as introduced to the FSM from the United States during the period when it was a Trust Territory) may be applicable in certain circumstances, no specific court decision has formally recognised the establishment of trusts in the FSM.

23. Foreign persons can only carry on business in the FSM (including by simply holding an ownership interest in a domestic entity) if they have obtained a foreign investment permit, pursuant to the FSM Foreign Investment Act of 1997 or the relevant legislation enacted by the states. The foreign investment permit is issued by the Secretary of the Department of Resources and Development, or the competent state authority, depending on the type of permit and the place of business. Foreign persons must apply for a national or a state business permit, the choice depending on the category of economic sector and on the place of business of the foreign corporation. Certain categories of economic activity are reserved to national regulation, such as banking, insurance and international shipping. For foreign investment permit purposes, the definition of "carrying on business" generally refers to buying, selling,

4. Corporate regulation is governed by national law unless or until states undertake to establish corporate codes of their own (FSM Code Title 36 §206 and Mid-Pacific Constr. C. v. Semes, 7 FSM Intrm. 102, 105 (Pon 1995)). The FSM Supreme Court has applied national law where state law does not supply a rule for decision and the issue involves issues closely related to national powers to regulate banking and foreign and interstate commerce (Bank of Hawaii v. Jack, 4 FSM Intrm. 216, 218 (Pon 1990)).

leasing, or exchanging goods, products, or property of any kind for commercial purposes, providing services as a management firm or professional consultant in the management, supervision, or control of any business entity, and holding at least twenty per cent ownership interest in a business entity. It does not include the maintaining of bank accounts or the lawful sale of corporate shares or other interests or holdings in a business entity acquired not for speculation or profit (FSM Foreign Investment Act, s. 203).

24. Not all commercial legislation in the FSM has been implemented to a full extent. Title 33 of the FSM Code provides that securities must be registered with the Registrar of Corporations upon his/her approval, however, the securities registration requirement has not been effected, and no regulations have been issued. Even though Chuuk and Kosrae have passed corporate legislation, the state registry systems have not been implemented and, as at September 2013, it was not possible to register corporations.

Overview of the financial sector and relevant professions

25. The financial sector in the FSM primarily consists of banking and insurance business. Notably, the FSM enacted legislation in 2006 that allows for the creation and operation of captive insurance companies. The FSM captive insurance regime offers favourable tax rates and flexibility in selecting reporting currency, accounting standards and service providers.[5]

26. Captive insurance companies can only be incorporated or licensed under the national law, and notably under the Captive Insurance Law of 2006. Any captive insurance company (whether domestic or foreign) must be licensed by the Insurance Board, which supervises and regulates the insurance sector. There are four classes of captives allowed in the FSM. Class 1: pure captive insures the risks of its parent and affiliated companies or associations; class 2: allows the captive to insure the risks of its parent and affiliated companies and/or related third party businesses; class 3: multiple corporate captive, with one or more corporations organised as a group of corporate captive insurance companies under the laws of the FSM; class 4: captive insures the risks of its parent and affiliated companies and/or associations and/or related third party business and/or unaffiliated business and/or multiple corporate captive business. Generally, any foreign captive may become a domestic captive in the FSM by complying with the law and licensing provisions of the FSM. The Insurance Board issued the FSM Captive Insurance Regulations in 2008. A resident director is not required. As at 27 September 2013, there were 12 captive insurance companies licensed by the Insurance Board. In addition to the captive insurance business, there are 3 insurance brokers carrying on insurance (non-captive) business in the FSM.

5. www.fsmcaptives.fm/.

27. The shipping industry is regulated by the Ship Registry Law 1997 and the Commercial Shipping Regulations 2010. The shipping industry is supervised by the Micronesian Shipping Commission. In order for a vessel to be registered in the FSM it must be owned by an FSM corporation or be owned by a foreign corporation which has a valid foreign investment permit. As at 27 September 2013, the shipping registry consisted of 28 fishing vessels and 3 government vessels.

28. FSM depository banks are regulated and supervised under Title 29 of the FSM Code. All Banks in the FSM are required to maintain deposit insurance at least equivalent to insurance offered by the United States Federal Deposit Insurance Corporation (FDIC) (FSM Code 29 §404). In addition, foreign banks that are not FDIC insured are required to maintain paid in capital of more than USD 20 million (FSM Code 29 §401). FSM domestic banks that are insured by the FDIC are required by law to comply with current and future United States' banking laws and regulations, except where such laws, rules and regulations conflict with the FSM constitutional prohibition on land ownership by foreigners (FSM Code 29 §601(4)). The supervisory and regulatory body is the Banking Board. As at 27 September 2013, there were 2 commercial banks – FDIC insured – operating in the FSM, for total assets of about USD 231 million.

29. Relevant professions in the FSM include the provisions of law, accountancy and notarial services. The only persons authorised to practice law in the FSM are attorneys, who are regulated by the courts in which they are admitted to practice law. Accountants are not formally regulated and normally offer auditing services. Notaries public are persons who are appointed by the FSM Secretary of Justice or a State Attorney General to practice in the territory of the FSM and are authorised or accredited by the registrar of corporations to administer oaths and affirmations, receive proof and acknowledgment of writings, and present and protest commercial paper. The documents that major corporations (which include any captive insurance company, see also below under *General information on the tax system*) file with the national authorities under the relevant laws must be notarised, including the stock affidavit and the articles of incorporation.

30. The FSM has enacted the Money Laundering and Proceeds of Crime Act providing for anti-money laundering legislation. The activities covered by this legislation include those persons who carry on a business of an insurer, an insurance intermediary, commercial banking, safekeeping and administration of securities, and trading for their own account or for account of customers in money market instruments (such as checks, bills, certificates of deposit), foreign exchange, financial futures and options, exchange and interest rate instruments, and transferable securities.

General information on the taxation system

31. The FSM Constitution provides that the national government has exclusive power to tax imports and income (FSM Constitution, Article IX, s. 2). Other taxing powers are reserved to the states, although states are prohibited from imposing taxes that restrict interstate commerce.

32. The applicable national laws regulating the taxation of income are the FSM Income Tax Law, which includes Chapters on the Gross Revenue Tax, and the Wages and Salaries Tax, as well as the Corporate Income Tax Act 2004. States apply a transactions tax in the form of sales tax and/or services tax.

33. For tax purposes, there is a difference between the treatment of "major corporations" and all other business. Major corporations formed in the FSM are subject to the Corporate Income Tax Act, whereas all other businesses are subject to the Gross Revenues Tax Act.

34. Pursuant to the Corporate Income Tax Act, major corporation means any corporation (except banks) whose shareholders' equity or paid-in capital as of the beginning of its fiscal year is equal to or greater than USD 1 million, or whose aggregate amount of the shareholders' equity or paid-in capital of the control group (and not in the major corporation itself) is USD 10 million, or that is a captive insurance company licensed pursuant to the Captive Insurance Law regardless of the amount of capitalisation (Corporate Income Tax Act s. 312(2)). In 2012, the corporate tax imposed on major corporations formed in the FSM was at the rate of 21% on the taxable worldwide income (s. 321), regardless of whether or not they are doing business in the FSM. The taxable income of a major corporation equals its income, before income taxes, earned in the taxable year as determined under International Financial Reporting Standard or Generally Accepted Accounting Principles as regularly utilised in the major corporation's principal shareholder's, if a corporation, place of incorporation, or, if an individual, country of primary residence (Corporate Income Tax Act, s. 322). Major corporations are exempt from taxation of their gross revenues (see below) when they are not engaged in business in the FSM (Corporate Income Tax Act, s. 323) and pay the corporate income tax. Section 360 of the Corporate Income Tax Act provides that a corporation incorporated in the FSM that only holds, buys, sells, transfers or otherwise transacts with assets or property located outside of the FSM, including but not limited to, businesses, shares, stocks, bonds, annuities, treasury bills, partnership units or trust units, is not engaging in business in the FSM. The amount of any dividend received from another major corporation is excluded from the major corporation's gross income in computing the amount of income for the taxable year (Corporate Income Tax Act, s. 3.3).

35. As major corporations, captive insurance companies are taxed on their taxable worldwide income at the rate of 21%. In addition, pursuant to section 1 015 of the Captive Insurance Law, each captive insurance company must also pay into the General Fund of the FSM a tax on gross premiums of 0.05%. The annual maximum aggregate tax on premiums to be paid is USD 20 000.

36. The gross revenue of any business carried on in the FSM (and which is not a "major corporation") and which earns more that USD 10 000 per taxable year is subject to a tax rate of 3% under the Gross Revenues Act. The Gross Revenues Act establishes a territorial system of taxation as the gross revenue tax is applicable only to the revenues raised in the FSM. Section 112 of the Gross Revenues Act defines "business" as any profession, trade, manufacture, or other undertaking carried on for pecuniary profit and includes all activities whether personal, professional, or incorporated, carried on within the FSM for economic benefit either direct or indirect.

Recent developments

37. The FSM passed the FSM Revenue Administration Act proposing a tax reform which would create a unified revenue authority (FSM Unified Revenue Authority Act) and substituted the Gross Revenues Tax Act with the Net Profit Tax Act. At the state level, the transaction tax would be replaced by a value added tax (VAT). The FSM Revenue Administration Act contains a clause – so-called "sunset clause" – whereby if all of the four states of the FSM have not passed the VAT legislation, the reform will be null and void. Public Law No.18-16 extended the "sunset clause" to 31 March 2014. As of December 2013, the states of Chuuk and Kosrae had passed both a Value Added Tax and a State Revenue Administration Act providing rules for the FSM Unified Revenue Authority to administer each state's taxes. Pohnpei and Yap are currently considering the proposed VAT and State Revenue Administration Acts.

Compliance with the Standards

A. Availability of Information

Overview

38. Effective exchange of information (EOI) requires the availability of reliable information. In particular, it requires information on the identity of owners and other stakeholders as well as information on the transactions carried out by entities and other organisational structures. Such information may be kept for tax, regulatory, commercial or other reasons. If the information is not kept or it is not maintained for a reasonable period of time, a jurisdiction's competent authority may not be able to obtain and provide it when requested. This section of the report assesses the adequacy of the Federated States of Micronesia's (FSM) legal and regulatory framework on the availability of information.

39. Ownership information of domestic and foreign corporations, as well as of unlimited and limited partnerships carrying on business in the FSM, is generally (although not always) available with the registrars of corporations or the authorities issuing foreign permits. Full ownership information of companies formed in the states of Pohnpei and Yap is available at the level of the entity as these companies have an obligation to keep a register of shareholders. Bearer shares cannot be issued in the FSM as the shares issued by companies must be nominal and all securities are registered with the national or state register. Penalties for violations to keep ownership information are in place for all entities and arrangements.

40. Even though the laws of the FSM do not allow for the statutory formation of trusts, foreign trusts can be managed from the FSM and ownership and identity information is not ensured in this respect.

41. No foundations can be formed in the FSM.

42. Full accounting records and documentation are available for captive insurance companies for at least five years. Corporations formed under the laws of the FSM and of Yap and Pohnpei require that sufficient accounting records are maintained, although they do not require that full underlying documentation is kept. Chuuk and Kosrae corporations, as well as all partnerships carrying on business in the FSM, foreign companies and foreign trusts carrying on business are required under tax law to keep some accounting records, but these requirements do not require the maintenance of accounting records that would allow financial statements to be prepared. For these companies, accounting information must be kept for three years under tax law. There are no obligations on foreign trusts with a trustee resident in the FSM and not carrying out business in the FSM to keep accounting records. In respect of banking information, the provisions of anti-money laundering legislation impose appropriate obligations to ensure that all records pertaining to customers' accounts as well as related financial transaction information are available.

A.1. Ownership and identity information

Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to their competent authorities.

Companies *(ToR A.1.1)*

43. Companies are formed either under the laws of the federation or under the laws of one of the four states. The only types of companies provided for under the national and state law are corporations, which may be for profit or non-profit. For-profit corporations are entities which can be formed for any lawful purpose and are authorised to issue stock capital. Non-profit corporations can be established to conduct any lawful purpose, except the carrying on of a business, trade, avocation, or profession for profit.

44. For tax purposes, the laws identify "major corporations" as a company not principally engaged in business in the FSM as a bank and whose shareholders equity or paid-in capital as of the beginning of its fiscal year is USD 1 million or more, or the aggregate amount of the shareholders' equity or paid-in capital of the control group (and not in the major corporation itself) is USD 10 million or more, or that is a captive insurance company regardless of the amount of capitalisation (FSM Code 54 §312(2)). Major corporations

(and thus any captive insurance company) must be incorporated under the national law (FSM Code 36 §207). Any corporation formed under the laws of a state that subsequently meets the major corporation criteria must re-register under the national law.

National law

45. Title 36 of the FSM Code and Regulation 2-74 govern the formation of FSM corporations. All FSM corporations must be registered in the Register of Corporations. As at 27 September 2013, there were about 100 active FSM corporations registered with the Register of Corporations. In addition, there were another 41 major corporations registered, including 12 captive insurance companies.

Information provided to the authorities

46. Information on the owners of FSM corporations is maintained by the Registrar of Corporations. FSM corporations must be formed by submitting an application to the Registrar. The application must be accompanied by a copy of the articles of incorporation detailing, among other things, the place of its principal office or place of business in the FSM and mailing address, and the name and address of the directors and the incorporators (FSM Corporate Regulations FSM Corporate Regulations, s. 2.1). Any amendment to the articles of incorporation must be communicated to the Registrar (FSM Corporate Regulations §2(4)). Along with the articles of incorporation, an affidavit spelling out the number of authorised shares of the stock of the proposed corporation and the names of the initial subscribers for shares must be filed (FSM Corporate Regulations §2(5)). For major corporations, the affidavit can be filed within 60 days after the receipt of the charter of incorporation (FSM Code 36, §103(2)).

47. Ownership information of FSM corporations must be annually communicated to the Registrar. Once a year, every corporation must submit to the Registrar a full and accurate exhibit of its state of affairs, in the form and containing such information as prescribed by the Registrar (FSM Corporate Regulations s. 5.4). Among other things, the annual exhibit discloses the names and addresses of the shareholders together with the shareholdings they are entitled to, any dividend paid to them in the previous year, and the names of the directors (Corporation Annual Report Form).[6] If a corporation has failed or neglected, for a period of two years in succession, to file an annual exhibit as required by law, the Registrar may liquidate the corporation (FSM Corporate Regulations s. 6.2).

6. www.fsmroc.fm/pdf/forms_rrf_DOM_AnnualReport.pdf, accessed April 2013.

48. For the purpose of major corporations, the affidavit, the articles of incorporation, and any other document required to be filed with the Registrar (including the annual report) must be notarised by a notary public (Non-FSM Notary Public Regulation, Part III). Notaries public are appointed by the Attorney General when they are FSM citizens, or are accredited by the Registrar when they are foreigners. Every notary public must record in a book of records all acts and other documents noted by him or done in his official capacity (FSM Code 32, s. 423). Ownership information is required to be maintained by the notaries public. Each year, notaries public must deposit the book of records with the Clerk of Courts for the Truk District. Foreign notaries public must submit these records to the Registrar.

Information held by companies

49. In addition to the information provided to the Registrar, FSM corporations have an independent obligation to keep updated information on their shareholders. The managers or directors of every corporation are required to keep a register of all persons who are shareholders of the corporation showing the number of shares of stock held by them respectively, and the time when they respectively became the owners of the shares (FSM Corporate Regulations s. 3.1). The register is open for inspection to all stockholders.

State laws

50. Each of the four states (Chuuk, Kosrae, Pohnpei, and Yap) has passed laws regulating the formation of companies: Chuuk Business Organisations and Regulations Act, Kosrae Code Chapter 15, Pohnpei Code Division V Chapter 37 (PC 37), Yap State Code Title 23 (YC 23). Pursuant to these laws, corporations must be registered with the registrar of the respective state. As at 27 September 2013, there were 308 corporations registered in Pohnpei (of which 236 were transferred from the national Register of Corporations),[7] and 58 in Yap. Even though Chuuk and Kosrae have passed corporate legislation, the state registry systems have not been implemented and, as at September 2013, there were no companies in these states as it was not possible to form or register corporations.

Information provided to the authorities

51. In order to register for incorporation, companies formed in each of the four states must provide the registrar with the articles of incorporation and the address of the principal office or place of business. At the time of

7. In case a company is re-registered at a state level, that company will be de-registered from the national register.

registration of a Yap company, the name of the initial shareholders is also provided (YC 12 §305(h)), and the principal office must be in the state. In Pohnpei, each corporation must have and continuously maintain in this state a registered agent and the registered office, which is the address of the registered agent (PC 37 1-112); the name and address of the registered agent must be communicated to the registrar when registering for incorporation and must be updated in case of change.

52. Both in Yap and Pohnpei, companies must also specify the number and type of shares that can be issued, while in Chuuk and Kosrae only the obligations attaching to shareholding must be communicated to the registrar. In Kosrae, securities must be registered with the authorities, and a person registers a security by filing a statement signed by the issuer, its principal executive officers and a majority of its board of directors or group performing similar functions, and if the issuer is a non-citizen, by its authorised representative in the state (Kosrae Code Chapter 15, Ch.2). The statement contains the information required by regulation of the registrar of corporations for the protection of investors. Issuance, sale, exchange or transfer of the security does not occur until the Governor has approved it. However, it is not clear precisely what information should be provided upon registration of the security or in the case of a subsequent transfer.

53. After registration, companies incorporated in Yap and Pohnpei must provide the respective registrars with an annual report. The registrars of these states have not issued the prescribed forms for annual reports, nonetheless, the legislation provides that some information must be reported yearly: Yap companies must accurately exhibit their "state of affairs" (YC 23, 604); Pohnpei companies must indicate the aggregate number of shares that the corporation has authority to issue and the name and address of the directors as well of the registered agent in Pohnpei (PC 37, 1-224 and 1-225).

Information held by companies

54. Even though the registrars do not maintain updated ownership information of companies formed in Pohnpei and Yap, these companies are required to keep a register of shareholders. As for Pohnpei corporations, the register of shareholders (stock transfer book) must be kept at their registered office or principal place of business, or at the office of its transfer agent or registrar, and must disclose the names and addresses of all shareholders and the number and class of the shares held by each (PC 37, 151). The rights to receive dividends and to vote in general meeting is conditional upon the persons' share ownership being stated in the stock transfer book (PC 37, 129). In the case of Yap corporations, it is the responsibility of the directors to maintain a register of stockholders, which must show the number of shares held by them respectively, and the time when they became the owners of the shares

(YC 23, 319). The shareholders register of both Pohnpei and Yap companies are open for inspection to their shareholders. It can also be accessed by the registrars of corporations in Pohnpei and Yap on demand (see section A.1.6 below).

55. The legislation in Chuuk and Kosrae requires corporations to produce books, documents and papers of the corporation upon request of the authorities, but it does not specify that these documents should contain ownership information. Even though the registry systems in these two states have not yet been implemented – and so no companies can be formed or registered under the laws of these states – there is no legal requirement to keep ownership information. It is therefore recommended that the FSM introduces clear obligations that will ensure the availability of ownership information of companies formed in Chuuk and Kosrae.

Licensed entities

56. In the FSM there are two sectors which are specifically regulated by imposing a requirement that the business be carried on by a license holder: banking and insurance. These licensing regulations impose additional requirements to retain identity and ownership information as a condition of the license. The oversight bodies in respect of these types of license are the Banking Board and the Insurance Board. Any banks or insurance companies must be incorporated and registered at the national level.

57. Banks are regulated under Title 29 of the FSM Code. Before issuing a license, the Banking Commissioner examines, among others, the capitalisation of the corporation and the names and places of residence of the stockholders, and, generally, whether such corporation has complied with all the provisions of law required to entitle it to a license to engage in the business of banking (FSM Code 29, §307). When a person seeks to acquire ownership of 10% or more of a bank, that person must obtain the prior approval of the Banking Board (FSM Code 29§621).

58. The Insurance Act of 2006, with subsequent amendments, establishes the legal framework for licensing insurance companies and intermediaries, as well as the captive insurance business. Specific regulations have also been adopted by the Insurance Board. In addition to the disclosure of ownership information to the Registrar of Corporations at the time of incorporation, the application for an insurance license requires the disclosure to the Insurance Board of all beneficial owners of the company (license application forms). Biographical data of all persons owning more than 10% of the insurer must also be provided. Ownership information needs not be updated to the Insurance Board. Nevertheless, the FSM authorities have indicated that the Insurance Board has this information because the Registrar of Corporations

communicates any ownership change of insurance companies to the Insurance Board. As described above, ownership information of any company formed at the national level must be reported annually to the Registrar of Corporations. Ownership information is also available as any FSM corporation has to maintain a register of shareholders.

Anti-money laundering legislation

59. The FSM enacted anti-money laundering legislation: chapter 9, Title 11 of the FSM Code (Money Laundering and Proceeds of Crime). The activities covered by this legislation include those persons who carry on a business of an insurer, an insurance intermediary, a securities dealer or a futures broker, an administration of a unit trust, commercial banking, safekeeping and administration of securities, and trading for their own account or for account of customers in money market instruments (such as checks, bills, certificates of deposit), foreign exchange, financial futures and options, exchange and interest rate instruments, and transferable securities. Any person who carries on an activity covered by the anti-money laundering legislation must take reasonable measures to identify any client seeking to enter into a business relationship with it, by requiring the client to produce an official record reasonably capable of establishing the true identity of the client, such as a birth certificate, passport or other official means of identification, and in the case of a corporation, a charter of incorporation together with its latest tax return filed with the government of the FSM (s. 913.1).

60. If it appears to a financial institution that an applicant requesting to enter into any transaction, whether or not in the course of a continuing business relationship, is acting on behalf of another person, then the institution or cash dealer shall take reasonable measures to establish the true identity of any person on whose behalf, or for whose ultimate benefit, the applicant may be acting in the proposed transaction, whether as trustee, nominee, agent or otherwise (s. 913.3).

Foreign companies

61. Companies incorporated in a foreign jurisdiction that carry on business in the FSM are required to hold a foreign investment permit, which is valid for one year, issued by the Secretary of the Department of Resources and Development, or the competent state authority. The definition of "carrying on business" varies slightly across state and national legislation, however, it generally refers to buying, selling, leasing, or exchanging goods, products, or property of any kind for commercial purposes, providing services as a management firm or professional consultant in the management, supervision, or control of any business entity, and holding at least twenty per cent

ownership interest in a business entity. It does not include the maintaining of bank accounts or the lawful sale of corporate shares or other interests or holdings in a business entity acquired not for speculation or profit (FSM Foreign Investment Act, s. 203).

62. Foreign companies that carry on business in the FSM pursuant to the relevant foreign investment legislation must apply for a national foreign investment permit or for a state foreign investment permit. The application must be notarised. The choice between a national permit or one of the state permits depends on the category of economic sector and on the place of business of the foreign corporation (i.e. the state or the states in which the corporation operates). Certain categories of economic activity are reserved to national regulation, such as banking, insurance and international shipping (FSM Foreign Investment Act, s. 206). The foreign investment regulation of economic sectors that are not of special national significance is delegated to the jurisdiction of the state governments. Each individual state is responsible for the regulation of foreign investment, including the issuance of permits, in respect of foreign investment taking place or proposed to take place within the territory of that state. If any foreign company carries on business within the territories of more than one state, each of those states has authority to regulate such foreign investment within its own territory (FSM Foreign Investment Act, s. 206).

63. The documents that must be delivered to the relevant authorities when applying for a foreign permit generally include the articles of incorporation of the company, the details of the capital invested in the FSM and the percentage held by FSM citizens, the principal office, and the name and address of the registered agent (FSM Foreign Investment Act, Schedule 5). The full list of the company shareholders is disclosed in the case of Pohnpei permits, where the application must include the "proposed and existing stockholders" (Chapter 7 of Title 37 of the Pohnpei Code 7-106(2)). In Kosrae, the standard application form requires to list all non-citizens who hold a "substantial ownership interest" in the applicant company (Kosrae State Foreign Investment Regulations, Schedule 1), although "substantial ownership" is not defined in the law. In the case of Yap permits, the standard application form requires information on all non-citizens who are "principals" of the applicant. Section 1.2 of the Yap State Foreign Investment Regulations defines "principal" as the owners of at least a 20% interest in any other type of business entity. In the case of Chuuk permits, the application form does not require to provide the list the owners of the foreign company (Chuuk Foreign Investment Regulations, Schedule 5).

64. Annually, a foreign company in receipt of a foreign investment permit must report to the authority issuing the permit in order to have its permit renewed. In Chuuk and the FSM, the annual report requires the disclosure of the list of all shareholders. In Pohnpei, the annual report must

detail any change in ownership, if any. In Kosrae the list of the shareholders indicates only the shareholders who are non-citizens of the FSM; in Yap the list of shareholders who are non-citizens is limited to those who have 20% of interest in the company.

65. When a company has obtained a foreign investment permit, it must also register with the relevant registrar of corporations. A foreign company that is carrying on business in the FSM under an FSM foreign investment permit does not need to register with the FSM registrar of corporation if the only activity that it is conducting is the holding of meetings of its directors or shareholders or carrying on other activities concerning its internal affairs. Similar provisions exist in the other states. The foreign company must file with the registrar certain documents and information and must report any update thereto annually. It is not mandatory to provide the list of shareholders unless the registrar requires such list to be produced. The list of shareholders would be available in the annual report to the authority issuing the foreign investment permit.

66. To sum up, any company incorporated abroad and that undertakes to do business in the FSM must obtain an annual foreign investment permit issued by the national government or by a state's government. When the permit is issued at the national level or by the state of Chuuk, information on the owners is disclosed in the annual report which must be submitted to the authorities in order to obtain a renewal of the permit. In case of permits issued by the state of Pohnpei, information on all shareholders must be submitted at the time of the application for the permit and the annual report would indicate any change in ownership. As for permits issued by the state of Kosrae, the standard application form requires to list all non-citizens who hold a "substantial ownership interest" in the applicant company, while the annual report would require the disclosure of all shareholders who are non-citizens of the FSM. As for permit issued by the state of Yap, information on the shareholders is limited to those non-citizens of the FSM who hold at least 20% of interest in the company.

67. The standard requires that ownership information should be available in relation to foreign companies with sufficient nexus to another jurisdiction, including being there for tax purposes (for example by reason of having its place of effective management or administration there). In FSM, information on the owners of companies formed outside the FSM must be provided to the authorities where such a company carries on business in the FSM, and not just when there is a sufficient nexus. It is expected that the number of foreign companies with a sufficient nexus is very low, and, even if in the cases of Kosrae and Yap information on the shareholders is limited to the non-citizens or to 20% of the non-citizens of the FSM, the gap appears to be very narrow. This issue will be further examined in the course of the Phase 2 review.

Nominees

68. Nominee share ownership is not allowed under FSM law. Shareholders must register their own names in the register of shareholders in order to exercise voting rights or to receive any dividends. The shares held by shareholders are deemed their personal property (FSM Corporate Regulations, s. 3.10). While shareholders can transfer their economic benefits derived from the shares to another person on a contractual basis, companies are required to pay such dividends to legal owners.

Conclusions

69. Ownership information of corporations formed under the national laws is available with the registrar of corporations as well as in the register of shareholders kept by these companies. This includes all captive insurance companies. Full ownership information of corporations formed under the laws of Pohnpei and Yap is available in the register of shareholders that these companies are obliged to keep. The requirements to keep ownership information for corporations formed under the laws of Chuuk or Kosrae are not sufficient, although as at September 2013 no companies could be formed in these states. Foreign companies carrying on business in the FSM must obtain an annual permit, for which ownership information must be generally submitted to the authorities annually, although not always full ownership information is provided in the cases of foreign companies doing business in Kosrae and Yap. Apart from the gaps identified regarding companies formed under the laws of Chuuk and Kosrae, the requirements to keep ownership information of companies generally meet the standard.

Bearer shares *(ToR A.1.2)*

70. There is no specific provision for corporations formed in the FSM (either under national law, or under state law) to issue shares in a bearer form. Pursuant to section 3.2 of the FSM Corporate Regulations, every certificate of stock issued by a FSM corporation must state, among others, the name of the shareholder, the number, designation, if any, and class or series of shares, and the par value, if any, of the shares represented thereby. Similar provisions exist in the legislation of the states of Pohnpei (PC 37 1-123) and Yap (YSC 23 §401). In Kosrae and Chuuk the registry systems for companies have not yet been implemented, and so no companies can be formed under the laws of these states. In Kosrae, the law prescribes that securities (shares) must be registered (Kosrae Code 15, §201). In Chuuk, no specific provision for the issuance of different types of shares is included (Chuuk Business Organisation and Regulation). While in Chuuk there is no specific reference to the possibility of issuing bearer shares, more generally ownership

information in respect of shareholders of these companies is not available (see A.1.1 above) and FSM should ensure the availability of ownership information of companies formed in Chuuk.

71. In addition to the provisions establishing that no bearer shares can be issued by FSM corporations, Title 33 of the FSM Code provides that no security (stock) may be issued or transferred in the FSM unless or until such security has been registered with the Registrar of Corporations and approval of the registered security has been granted (FSM Code, Title 33, s. 802). Any security may be registered by filing a registration statement signed by each issuer, its principal executive officer or officers, and the majority of its board of directors or persons performing similar functions, and in case the issuer is a non-citizen, by its duly authorised representative in the FSM (FSM Code, Title 33, s. 803). The securities registration requirement contained in Title 33 of the FSM Code has not been implemented, and no regulations have been issued. When implemented, the FSM authorities have indicated that Title 33 of the FSM Code would apply to any selling securities, including national, state, and foreign corporations.

Partnerships *(ToR A.1.3)*

72. General partnerships can be formed under the legislation of Pohnpei and Yap. Common law partnerships can also be formed in accordance with common law principles as articulated in decisions of FSM courts (Island Dev. Co. v. Yap, 9 FSM Intrm. 220, 223 (Yap 1999); In re Estate of Setik, 12 FSM Intrm. 423, 429 (Chk. S. Ct. Tr. 2004)). The Yap legislation also allows for the formation of limited partnerships. As at September 2013, there were no partnerships registered in Yap.

Common law partnerships and general partnerships

73. A partnership is defined under common law as an association of two or more persons to carry on as co-owners a business for profit (*In re Estate of Setik*, 12 FSM Intrm. 423, 429 (Chk. S. Ct. Tr. 2004)). Common law partnerships carrying on business in the FSM territory are not required to register with the Registrar of Corporations, nor with states commercial registrars. Common law partnerships carrying on business in the FSM are required to file an annual income tax return in the name of the partnership, which nevertheless does not contain ownership information (see subsection Tax law below). It is not clear whether there is any legal obligation (either on the partners, or on the partnership, or otherwise) to have information available on the partners of common law partnerships. However, it does not appear that there is a very significant level of business activity in FSM generally.

74. The legislation regulating general partnerships in Pohnpei is the Partnerships Act 1994. In any case not provided for in the Act, the rules of law and equity, including the merchant law, will apply (Pohnpei Code, Partnerships Act, s. 105). A general partnership is defined as an association of two or more persons, to carry on as co-owners, a business for profit. The agreement of a partnership does not have to be in writing. No registration with a state authority is required to form a general partnership in Pohnpei.

75. General partnerships formed under the law of Pohnpei are required to keep partnership books at the principal place of business of the partnership, and every partner may inspect them at all times (Pohnpei Code, Partnerships Act, s. 119). All partners are liable jointly and severally for everything chargeable to the partnership under the law and jointly for all other debts and obligations of the partnership (Pohnpei Code, Partnerships Act, s. 115). Moreover, no person can become a member of a partnership without the consent of all the partners (Pohnpei Code, Partnerships Act, s. 118(7)). It may be expected that this information is kept by all partners, however, this is not explicitly provided for in the law.

76. General partnerships formed under the law of Yap to do business in Yap must register with the registrar of corporations within 30 days after the partnership is formed (Yap Code, Corporations and Partnerships Act, s. 1001). An annual statement must be filed on or before March 31 of each year, listing the names of any partner admitted, withdrawn, or who has died during the year, and indicating any changes from the information provided in the registration statement. If any general partnership neglects or fails for a period of two years to file any annual statement as required by this division, the registrar may cancel the registration or certificate of such partnership (Yap Code, Corporations and Partnerships Act, s. 1006).

Limited partnerships

77. In Yap, a limited partnership is a partnership formed by two or more persons, having as members one or more general partners and one or more limited partners. Limited partnerships can be formed by submitting a registration statement outlining the location of the principal place of business and the name and place of residence of each member, general and limited partners being respectively designated, and the amount of contribution by each limited partner (Yap Code, Corporations and Partnerships Act, s. 1102). Every limited partnership must file an annual statement on or before March 31 of each year updating this information (Yap Code, Corporations and Partnerships Act, s. 1104). If any limited partnership fails or neglects for a period of two years to file any annual statement as required by this division, the registrar may cancel the certificate of such limited partnership (Yap Code, Corporations and Partnerships Act, s. 1121).

Foreign partnerships and partners

78. Similar to foreign companies, partnerships formed under the laws of a foreign jurisdiction (and partners of a partnership who are non-FSM citizens and hold at least 20% of ownership interest in the partnership) carrying on business in the territory of the FSM must obtain a foreign investment permit (national or state). Ownership information is disclosed in most cases at the time of application and in the annual report to the authority issuing the permit. When the permit is issued at the national level or by the state of Chuuk, information on the owners of partnerships is disclosed in the application form and in the annual report which must be submitted to the authorities in order to obtain a renewal of the permit (FSM Foreign Investment Act, Schedule 5; Chuuk Foreign Investment Regulation, Schedule 5). In case of permits issued by the state of Pohnpei, information on all partners must be submitted at the time of the application for the permit and the annual report would indicate any change in ownership. As for permits issued by the state of Kosrae, the standard application form requires to list all non-citizens who hold a "substantial ownership interest" in the applicant partnership, while the annual report would require the disclosure of all shareholders who are non-citizens of the FSM. As for permit issued by the state of Yap, information on the partners is limited to those non-citizens of the FSM who hold at least 20% of interest in the partnership (see also *foreign companies above*).

79. In order to issue and renew a foreign investment permit in the state of Yap, the names of the partners with an ownership interest of at least 20% in the partnership would need to be disclosed. Nonetheless, the names of all the partners of a foreign partnership doing business in Yap needs to be disclosed to the registrar. Any general partnership formed under the laws of another jurisdiction doing business in Yap must register within 30 days after the commencement of business in Yap. The registration statement must indicate, among others, the name and residence of each partner, and the location of the principal place of business of the partnership in Yap (Yap Code, Corporations and Partnerships Act, s. 1001). Foreign limited partnerships carrying on business in Yap must register and file an annual statement containing ownership information (Yap Code, Corporations and Partnerships Act, s. 1205).

Tax Law

80. Pursuant to section 143 of the FSM Income Tax Law, every business must make a full, true, and correct return showing all such gross revenue received, accrued, or earned, and the amounts deducted and set aside on account thereof during the preceding quarter. This means any partnership carrying on business in the FSM territory is subject to tax at the entity level, and must submit an income tax return. The tax return form submitted by the partnership must include such other information as required by the Secretary

of Finance, but no information about the partners of the partnership is required to be provided to the authorities (FSM Form 1 119).

Conclusions

81. Limited partnerships formed under the laws of Yap, as well as general partnerships and foreign partnerships carrying on business in Yap are required to disclose the identity of all the partners, indicating the limited partners where appropriate, when registering with the state authority and when submitting the annual report. Ownership information of foreign partnerships carrying on business in the FSM is disclosed at the time of application or in the annual report to the authority issuing the permit. It is not clear whether there is an obligation on partnerships created in the FSM under the common law and carrying on business in the FSM territory to have ownership information available. The information on the partners of general partnerships formed in Pohnpei may be available in the books that the partnerships are required to keep, however, this is not explicitly provided for in the law. As noted above, there are no partnerships carrying on business in Yap, and there is very little economic activity carried on in Chuuk and Kosrae. There are certain obligations on such partnerships carrying on business in Pohnpei, and if any foreign person were a partner in a partnership formed or carrying on a business in the FSM territory, the identity of the foreign partner would be known. Consequently, the gap identified here appears to be very limited. Nevertheless, the FSM is recommended to ensure the full availability of ownership information of general partnerships formed in Pohnpei as well as of partnerships formed under the common law when these companies carry on business in the FSM.

Trusts *(ToR A.1.4)*

82. The statutes of the FSM and of any of its states do not allow the formation of commercial trusts. Even though common law can be considered by the FSM courts, the FSM authorities indicated that there has been no case law formally recognising common law trusts. The only trusts that may be operating in the FSM are trusts formed under the laws of another jurisdiction.

83. The FSM authorities indicated that a foreign trust carrying on business in the FSM would be treated as an entity carrying on business. As the manager of the trust, the trustee would be required to file the income tax return for the profit of the trust. No information on the beneficiaries or the settlors of the trust is required to be disclosed to the tax authorities. In addition, the tax law excludes from the definition of gross revenue money held in a fiduciary capacity (Title 54 FSM Code sec. 112). Where the trust does not carry out any economic activities in the FSM, then the tax rules would not apply to the business of the trust.

84. The FSM authorities indicated that, even though there is no case law, service providers may be involved in the creation of foreign trusts. Nevertheless, the money-laundering legislation only applies specifically to trustees of unit trusts. As there are no requirements for the maintenance of information on trusts which have trustees resident in the FSM, it is recommended that the FSM ensure that the ownership and identity information of trusts is available in accordance with the standard.

Foundations (ToR A.1.5)

85. There are no provisions for the formation, conduct, or practices of foundations under FSM law. Non-for profit organisations can be formed in the form of non-profit corporations under the applicable legislation.

Enforcement provisions to ensure availability of information (ToR A.1.6)

86. Information on the owners of corporations formed under the national laws must be disclosed to the Registrar of Corporations, at the time of incorporation and annually. The information on the members of non-profit corporations is also available with the Registrar. If any corporation has failed or neglected, for a period of two years in succession, to file an annual exhibit as required by law, the Registrar may liquidate the corporation. (FSM Corporate Regulations s. 6.2).

87. An FSM corporation must keep a register of shareholders. There are no specific penalties for failing to maintain this register, nonetheless, the Registrar has the authority to request a review of the books and papers of any corporation and to examine its officers, members and others touching the affairs of the corporation under oath. Failure to produce these documents within 30 days without showing a good cause is a misdemeanour which may be punishable by a maximum fine of USD 50 or, when the order is directed to an individual, imprisonment of such individual for a period that does not exceed 90 days, or both (FSM Code 36 Ch.2 s. 204.2). The Registrar may compel the production of corporate documents and the examination of officers or members of a corporation by applying to the High Court (FSM Corporate Regulations, s. 5.4).

88. Under the legislation of the states, ownership information is required to be kept by corporations incorporated in Pohnpei and Yap. The registrars in Pohnpei and Yap may demand the production of the corporate documents (PC 37 1-233, YC 23, §205). In Pohnpei, the registrar can also interrogate corporate officers to ascertain whether a corporation has complied with the provisions of the corporate law. Failure to produce accurate corporate documents or to answer to interrogatories truthfully within 30 days may

be sanctioned with a fine up to USD 500 imposed on the corporation and each officer and director (PC 37, 1-231 and 1-232). In case a Yap corporation refuses to produce its books and papers upon the request of the registrar within 30 days, the sanction for the corporation is USD 50 or, when the order is directed to an individual, imprisonment of such individual for a period that does not exceed 90 days, or both. The registrar in Yap may also appoint officials to inspect, examine, audit, and report on the records of a corporation (YC 23, §205) and apply to the State Court for an order compelling production (YC 23, §604). The enforcement provisions on the failure to keep ownership information would only apply when the authorities demand the production of this information.

89. Foreign companies and foreign partnerships carrying on business in the FSM must disclose ownership information to the authorities issuing the foreign investment permit in their annual report. Any person who carries on business without a foreign investment permit, or who obtains a foreign investment permit by fraud or misrepresentation, commits a national crime and shall, upon conviction by a court, be subject to a fine up to USD 10 000 in the case of an individual and up to USD 50 000 in the case of a legal entity (Foreign Investment Act, s. 220(3), Chuuk Foreign Investment Act, Schedule 10). The authority may refuse to renew the permit if all requirements are not met (Foreign Investment Act, s. 209).

90. Limited partnerships formed under the laws of Yap, as well as general partnerships and foreign partnerships carrying on business in Yap are required to disclose the identity of all the partners when registering with the state authority and when submitting the annual report. If any partnership fails or neglects for a period of two years to file any annual statement as required, the registrar may cancel the certificate of such partnership (Yap Code, Corporations and Partnerships Act, s. 1006 and s. 1121). In a limited partnership, every general partner who neglects or fails to comply with any provision of this division is liable severally and individually for all debts and liabilities of the limited partnership (Yap Code, Corporations and Partnerships Act, s. 1120). Any person who signs and acknowledges or certifies as correct any statement or certificate filed pursuant to this division, knowing the same to be false in any material particular, shall be individually liable for all debts of the partnership, in addition to all other civil or criminal penalties which may be imposed.

91. Enforcement provisions are generally in place for all entities and arrangements that are required to keep ownership information. The effectiveness of the enforcement provisions is an issue of practice and it will be considered as part of the Phase 2 review of the FSM.

Determination and factors underlying recommendations

Determination	
The element is in place, but certain aspects of the legal implementation of the element need improvement.	
Factors underlying recommendations	**Recommendations**
Even though at the moment there are no companies registered under the laws of Chuuk and Kosrae, corporations formed under the laws of these states are not expressly obliged to have information available on their owners.	The FSM should ensure that information on the owners of all corporations formed in the FSM territory be available.
There are no requirements for the maintenance of information on trusts which have trustees resident in the FSM.	The FSM should ensure that the ownership and identity information of trusts is available in accordance with the standard.

A.2. Accounting records

Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements.

92. A condition for exchange of information for tax purposes to be effective, is that reliable information, foreseeably relevant to the tax requirements of a requesting jurisdiction is available, or can be made available, in a timely manner. This requires clear rules regarding the maintenance of accounting records. The *Terms of Reference* set out the standards for the maintenance of reliable accounting records and the necessary accounting record retention period. It provides that reliable accounting records should be kept for all relevant entities and arrangements.

93. To be reliable, accounting records should *(i)* correctly explain all transactions, *(ii)* enable the financial position of the entity or arrangement to be determined with reasonable accuracy at any time, and *(iii)* allow financial statements to be prepared (*ToR A.2.1*). In addition, accounting records should include underlying documentation, such as invoices, contracts, etc. (*ToR A.2.2*) and they must be kept for a minimum period of five years (*ToR A.2.3*).

***General requirements** (ToR A.2.1), **Underlying documentation** (ToR A.2.2), **Document retention** (ToR A.2.3)*

Companies

94. Pursuant to the FSM Corporate Regulations, all corporations incorporated under the FSM law must keep correct and complete books and records of account (s. 2.20). These books and records will generally cover disbursements, gains, losses, capital and surplus as well as any receipt. The Registrar has the authority to request a review of the books and papers of any corporation and to examine its officers, members and others touching the affairs of the corporation under oath. Failure to produce these documents within 30 days without showing a good cause is a misdemeanour which may be punishable by a maximum fine of USD 50 or, when the order is directed to an individual, imprisonment of such individual for a period that does not exceed 90 days, or both (FSM Code 36 Ch.2 s. 204.2). The Registrar may compel the production of corporate documents and the examination of officers or members of a corporation by applying to the High Court (FSM Corporate Regulations, s. 5.4).

95. It is not clear for how long companies formed under the FSM law should keep accounting records as there is no retention period specified in the FSM Corporate Regulations. The FSM authorities have indicated that, since there is no specified retention period, the current practice of FSM registries is to keep records indefinitely. Under the judicial procedure legislation, the general civil statute of limitations requires that legal actions must be commenced within six years after the cause of action accrues, which suggests that companies and any other business would be required to keep its records and books for at least six years. Under tax law, companies should keep accounting records for three years (see below).

96. In addition to the obligation under the FSM Corporate Regulations, captive insurance companies must keep accounting records and underlying documentation pursuant to the Insurance Act and the FSM Captive Insurance Regulations (CIR). Section XIII of the CIR requires captive insurance companies to maintain and have available for inspection and examination by the Insurance Commissioner any and all documents pertaining to the formation, operation, management, finances, insurance and reinsurance of each captive. The documentation which must be made available for inspection by the Insurance Commissioner includes, but it is not limited to, loss and expenses records, audited financial statements since start-up, ledgers (general, payable, receivable), journals (general, cash receipts, disbursements), premium invoices, bank statements, insurance policy records, and regulatory records. Pursuant to the Insurance Act, captive insurance companies must file audited financial statements prepared according to generally accepted accounting

principles or international financial standards, with such modifications as may be approved by the insurance regulators (Insurance Act, s. 1 010). At least once every three years, and whenever the Commissioner and Insurance Board determines it to be prudent, the Commissioner shall visit each captive insurance company and thoroughly inspect and examine its affairs to ascertain its financial condition, its ability to fulfil its obligations and whether it has complied with the law provisions (Insurance Act, s. 1 011(a)). The Commissioner and Insurance Board may enlarge the aforesaid three-year period to five years, upon petition by the captive insurance company. In any case, pursuant to section 318(2) of the Insurance Act, a license holder must keep for at least five years the original or an accurate copy of policies, premium payments, claims made and paid, and other items comprising records of transactions processed by it. For any violation of the Insurance Act or the CIR the license holder shall be subject to a fine of not more than USD 5 000 and if the violation is a continuing one, to a further fine not exceeding USD 1 000 for every day during which the violation continues (Insurance Act, s. 602).

97. The laws governing the formation and organisation of corporations in Yap and Pohnpei generally require the maintenance of correct and complete books and records of account (YSC 23, s. 318; 37 PC 1-151). In Yap, the law specifies that the books and records of account should include the assets, liabilities, receipts, disbursements, gains, losses, capital, and surplus of a corporation. In Pohnpei, upon the written request of any shareholder, the corporation must produce its most recent financial statements showing in reasonable detail its assets and liabilities and the results of its operations. The registrars in Pohnpei and Yap may demand the production of the corporate documents (PC 37 1-233, YC 23, §205). In Pohnpei, the registrar can also propound interrogatories to ascertain whether a corporation has complied with the provisions of the corporate law. Failure to produce accurate corporate documents or to answer to interrogatories truthfully within 30 days may be sanctioned with a fine up to USD 500 imposed on the corporation and each officer and director (PC 37, 1-231 and 1-232). In case a Yap corporation refuses to produce its books and papers upon the request of the registrar within 30 days, the sanction for the corporation is USD 50 or, when the order is directed to an individual, imprisonment of such individual for a period that does not exceed 90 days, or both. The registrar in Yap may also appoint officials to inspect, examine, audit, and report on the records of a corporation (YC 23, §205) and apply to the State Court for an order compelling production (YC 23, §604). The retention period is not indicated.

98. The corporations laws in Chuuk and Kosrae only require corporations to show their books of accounts and related documents upon request of the authorities (Chuuk Business Organisations and Regulation, s. 1 054; Kosrae Code 15, s. 106).

99. In relation to foreign companies doing business in the FSM, the national and state legislations do not specifically require the maintenance of accounting records. In general, the registrar may call at any time for the production of the books and papers of any foreign corporations doing business in the FSM. Foreign companies are obliged to maintain accounting records under tax law (see below).

100. To sum up, the provisions governing corporations formed under the federal laws and the laws of Yap and Pohnpei generally ensure that accounting records are kept, although they do not require that full underlying documentation is kept and it is not clear for how long the records must be kept. The corporate laws in Chuuk and Kosrae require that companies show their accounting records upon request of the authorities, but do not require by themselves that accounting records are kept, and in any case the laws do not indicate what accounting records – nor what underlying documentation – should be kept. Under the specific captive insurance legislation, captive insurance companies are obliged to keep full and reliable accounting records and documentation for at least five years.

Partnerships

101. For general partnerships formed in Pohnpei, there is an obligation to keep, subject to any agreement between the partners, at the principal place of business of the partnership the partnerships books, although it is not specified which accounting information should be recorded (Partnerships Act, s. 119). For both general and limited partnerships formed in Yap, the law does not prescribe records to be kept; however, for limited partnerships the limited partner may receive on demand true and full information of all things affecting the partnership, and a formal account of partnership affairs whenever circumstances render it just and reasonable (Corporations and Partnerships Act, s. 1 109). For all partnerships carrying on business in the FSM (including foreign partnerships), the requirements to keep some accounting information arise from the tax legislation (see below), however, it is recommended that the FSM requires these entities to keep accounting records and underlying documentation to the standard.

Tax Law

102. Title 54 of the FSM Code "Taxation and Customs" governs the taxation of the income generated by persons, corporations, and any other business. The power of national government to impose taxes on income is an exclusive national power that may not be exercised by the states (Youngstrom v. Kosrae, 5 FSM Intrm. 73, 74 (Kos. 1991)). Every business that operates in more than one state of the FSM must file a separate tax return for revenue collected in each state (FSM Code, 54 s. 141(4)).

103. Chapter 3 of Title 54 of the FSM Code, "Corporate Income Tax", and the "Corporate Income Tax Regulation" (CIT Regulation) govern the income tax obligations of major corporations (as defined by section 312(2) and 313 of Title 54 of the FSM Code). Every major corporation, as defined by law, is required to file with the Secretary of Finance an annual income tax return containing the income or loss and the amount of tax due (FSM Code, Title 54, s. 251 and CIT Regulation, s. 1.6(1)). Together with the income tax return, major corporations must attach their financial statements, which must include the balance sheet, income statement, and any other documents prescribed by the Secretary (CIT Regulation, s. 1.6(2)). The Secretary of Finance may inspect and audit records at any reasonable time, which is three years after the original return is filed, or within seven years if the inspection or audit reveals fraud, a wilful attempt to evade tax or no return is filed (CIT Regulation 8.1). Any major corporation failing to file a return on time or whose return is false and fraudulent (FSM Code, Title 54, s. 375) is liable upon conviction to a fine not more than USD 1 000, or, if a natural person, to imprisonment of not more than one year, or both (s. 376).

104. Chapter 1 of Title 54 of the FSM Code imposes an obligation on all persons, employees, and businesses required to make and file income tax returns to maintain accurate records (s. 151). The records will have to be evidence of what is contained in the tax return which must fully, truly, and correctly show all such gross revenue received, accrued, or earned, and the amounts deducted and set aside on account thereof during the preceding quarter (s. 143(2)). This obligation would cover any corporation, partnership and foreign trust carrying on business in the FSM, but would not include a foreign trust not carrying on business in the FSM. Every person, firm, corporation, or association engaging in any transaction subject to tax, fee or charge imposed under Title 54 must keep a full and accurate record of each such transaction for at least three years (s. 804). The records may be inspected and audited at any reasonable time by the Secretary of Finance or an authorised representative (ss.151 and 804). Any person wilfully failing to keep or make available for examination records shall upon conviction be imprisoned for a period of not more than one year, or fined not more than USD 500, or both (s. 901), and may be subject to immediate revocation of any business license (s. 804(2)). Penalties apply also if, among others, the persons fail to file a return on time or the return is false and fraudulent (s. 155) and any person or business convicted for these violations shall be fined not more than USD 1 000, or, if a natural person, imprisoned not more than one year, or both (s. 154).

105. The tax law obligations (other than those applying to major corporations) require persons carrying on business to keep accounting records that would correctly describe all transactions, but, given the limited scope of the tax base as defined by the Gross Revenue law, this would not necessarily

allow the financial position of the person to be determined. Moreover there is no specific obligation to keep underlying documentation.

106. The income tax returns are kept by the tax administration for three years (s. 116), which suggests that taxpayers are likewise required to keep their records for only that period. Title 54 of the FSM Code does not specify what kind of underlying documentation is to be maintained by taxpayers, although it requires that the records have to be evidence of what is contained in the tax return.

Conclusion

107. The requirements to keep accounting information arise from both commercial and tax legislation. The laws governing the formation and organisation of corporations in the FSM and in the states of Yap and Pohnpei require that sufficient accounting records are maintained, although they do not require that full underlying documentation is kept. In Chuuk and Kosrae, the corporate laws do not specifically require companies to keep accounting records. Similarly, the state laws governing the formation and organisation of general partnerships and limited partnerships do not sufficiently ensure that records are kept. Under the specific captive insurance legislation, captive insurance companies are obliged to keep full and reliable accounting records and documentation for at least five years.

108. Under tax law, all major corporations (regardless of whether they are carrying on business) are required to submit to the tax authorities their financial statements, which must also be submitted (audited) to the insurance regulators annually if they are captive insurance companies. Captive insurance companies are required to keep full accounting records and underlying documentation under the relevant legislation. For all entities and arrangements carrying on business in the FSM (other than major corporations and captive insurance companies), tax law provisions generally require that accounting records describing all transactions are kept, although these may not be sufficient to enable the financial position of the entity or arrangement to be determined. Moreover, even though underlying documents would be required to be kept to evidence what is contained in the tax return, the law does not specify what kind of underlying documentation should be maintained. In addition, the records and any underlying documents are to be kept for only three years.

109. To conclude, it is recommended that the FSM ensures, for corporations formed under the laws of the FSM (including major corporations except captive insurance companies), and under the laws of Yap and Pohnpei that underlying documentation to the standard is kept, i.e. underlying documentation that would reflect details of all sums of money received and expended and the matters

in respect of which the receipt and expenditure take place, all sales and purchases and other transactions, and the assets and liabilities of the corporation. Moreover, for corporations formed under the laws of Chuuk and Kosrae, and for all partnerships, foreign companies and foreign trusts carrying on business – whose requirements to keep accounting records arise only from tax laws other than the Corporate Income Tax – as well as for foreign trusts not carrying on business in the FSM, it is recommended that the FSM prescribes that accounting records and underlying documentation to the standard is kept. For all entities and arrangements (other than captive insurance companies), it is recommended that reliable accounting records be kept for a period of at least five years.

Determination and factors underlying recommendations

Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
Corporations formed under the laws of Chuuk and Kosrae, any partnerships formed under the laws of Yap and Pohnpei, foreign companies and any partnerships carrying on business in the FSM do not have specific obligations to keep accounting records. Apart from major corporations that are subject to the Corporate Income Tax, the requirements to keep accounting records under tax law are not specific enough. Foreign trusts not carrying on business in the FSM have no obligation to keep accounting records.	The FSM should ensure that these entities and arrangements be required explicitly to keep reliable accounting records and underlying documentation.
It is not clear what underlying documents are required to be kept by corporations formed under the laws of the FSM (except captive insurance companies) and the laws of Yap and Pohnpei.	The FSM should ensure that underlying documentation to the standard is kept by all entities and arrangements.
Except for captive insurance companies, the commercial legislation does not specify for how long companies formed under the FSM and state laws should keep accounting records. The retention period of accounting information under tax law is three years.	The FSM should establish that reliable accounting information for all entities and arrangement is kept for at least five years.

A.3. Banking information

Banking information should be available for all account-holders.

110. Access to banking information is of interest to the tax administration only if the bank has useful and reliable information about its customers' identity and the nature and amount of financial transactions.

Record-keeping requirements (ToR A.3.1)

111. Commercial banking in the FSM is regulated under Title 29 of the FSM Code. Pursuant to section 601 of Title 29, banks are regulated and supervised by the Banking Board. Banks must obtain a licence. FSM domestic banks that are insured by the FDIC are required by law to comply with current and future United States' banking laws and regulations, except where such laws, rules and regulations conflict with the FSM constitutional prohibition on land ownership by foreigners (FSM Code 29 §601(4)). As of September 2013, there were two commercial banks operating in the FSM, both of which FDIC insured.

112. Banking activity is generally subject to the anti-money laundering legislation provided in chapter 9, Title 11 of the FSM Code (Money Laundering and Proceeds of Crime). As such, when a person seeks to open a bank account and deposit money, banks must take reasonable measures to identify that person by requiring the production of an official records, such as a birth certificate, passport or other official means of identification, and in the case of a corporation, a charter of incorporation together with its latest tax return filed with the government of the Federated States of Micronesia (Money Laundering and Proceeds of Crime, s. 913(1)). Customers' accounts must be kept in the true name of the account holder (Money Laundering and Proceeds of Crime, s. 914(3)). Reasonable identifying measures must also be taken when a person seeks to carry out a transaction or series of transactions with the bank. A bank does not have to identify the customer where the client is itself a financial institution subject to the Money Laundering and Proceeds of Crime law, or where the transaction is taking place in the course of a business relationship in respect of which the applicant has already produced satisfactory evidence of identity (Money Laundering and Proceeds of Crime, s. 913(5)).

113. Where a client requests a financial institution to enter into a continuing business relationship, or in the absence of such a relationship, any transaction, the financial institution must take reasonable measures to establish whether the person is acting on behalf of another person (Money Laundering and Proceeds of Crime, s. 913(2)). If the financial institution suspects that a person requesting to enter into any transaction, whether or not in the course of a continuing

business relationship, is acting on behalf of another person, the financial institution should take reasonable measures to establish the true identity of any person on whose behalf, or for whose ultimate benefit, the applicant may be acting in the proposed transaction, whether as trustee, nominee, agent or otherwise (Money Laundering and Proceeds of Crime, s. 913(3)).

114. Banks must retain, also in electronic form, for at least five years, checks and other negotiable instruments drawn on it and paid by it, and other items comprising records of transactions processed by it (FSM Code, Title 29, s. 705). In addition, under AML law, financial institutions must maintain for at least five years customers' records of all transactions exceeding USD 10 000, or its equivalent in foreign currency (Money Laundering and Proceeds of Crime, s. 914). The records must identify, among others, the name, address and occupation of each person conducting the transaction, and if known, on whose behalf the transaction is being conducted; the nature and date of the transaction; the type and amount of currency involved; and, if the transaction involves a negotiable instrument other than currency, the name of the drawer of the of the instrument, the name of the payee (if any), the amount and date of the instrument, and details of any endorsements appearing on the instrument.

115. Under the anti-money laundering legislation, a financial institution who fails to comply with the identification or transaction-records requirement commits a felony offense, punishable by imprisonment for a maximum of five years or a maximum fine of USD 50 000, or both, provided, however, in the case of a corporation, company, commercial enterprise, commercial entity or other legal person that is not also a natural person, the maximum fine shall be increased to USD 250 000 (Money Laundering and Proceeds of Crime, s. 919). In addition, any director, manager or officer of a bank in the FSM who makes or authorises any transaction without taking or causing to be taken all reasonable steps to establish the true identity of the persons concerned in the transaction, that person is guilty of an offense and upon conviction, shall be fined not more than USD 10 000 or imprisonment for not more than one year or both (FSM Code, Title 29, s. 703).

116. The general penalty for violations of provisions of the Title 29 of the FSM Code is a fine of not more than USD 5 000 and if the violation is a continuing one, to a further fine not exceeding USD 1 000 for every day during which the violation continues. The penalty is applied by the Banking Board. In the case of a serious violation, the Banking Board can revoke the license.

Determination and factors underlying recommendations

Determination
The element is in place.

B. Access to Information

Overview

117. A variety of information may be needed in a tax enquiry and jurisdictions should have the authority to obtain all such information. This includes information held by banks and other financial institutions as well as information concerning the ownership of companies or the identity of interest holders in other persons or entities, such as partnerships and trusts, as well as accounting information in respect of all such entities. This section of the report examines whether the Federated States of Micronesia's (FSM) legal and regulatory framework gives the authorities access powers that cover all relevant persons and information and whether rights and safeguards that are in place are compatible with effective exchange of information (EOI).

118. The Micronesian domestic laws do not allow for access to any information with regard to any entity or arrangement pursuant to an EOI mechanism. The FSM tax authorities have access to accounting and banking information for domestic tax purposes. A confidentiality provision would nonetheless prevent the tax authorities from disclosing information to foreign counterparts pursuant to an EOI mechanism. The national and state registrars generally have the powers to compel the production of information from corporations and partnerships carrying on business in the FSM for the purpose of administering the corporate laws. The scope of professional secrecy is not consistent with the international standard as attorneys are bound by a duty of confidentiality which relates to all information relating to the representation of a client and applies at all time.

119. Because there are no access powers, and therefore no corresponding rights and safeguards, it was not possible to evaluate whether element B.2 is in place, as there is no basis on which to make this determination.

B.1. Competent Authority's ability to obtain and provide information

Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information (irrespective of any legal obligation on such person to maintain the secrecy of the information).

Ownership and identity information (ToR B.1.1); Accounting records (ToR B.1.2)

120. The powers of the FSM authorities to obtain information are found in tax law provisions as well as in the tax laws.

121. Under tax law (Income Tax Act (ITA) and Corporate Income Tax Act (CITA)), the tax administration can, for the purposes of ensuring that tax returns are filed correctly and accounting records are maintained, summon a person liable for tax or his designee to produce any documents and to give testimony as required in the summons (ITA, s. 157 and CITA s. 378). This provision also applies to any officer or employee of the person, and any third party (including banks) having possession, custody, or care of books of accounts relating to the business of the person liable for tax. With regard to major corporations, the Secretary of Finance may inspect the accounting records of major corporations for the purpose of administering the provision of the CITA (CITA Regulations, s. 8.1). It is not clear whether the tax administration would be able to collect ownership and other information, considering that the authority of the tax administration is limited to ensuring tax returns are filed correctly and accounting records are maintained.

122. Ownership information is available in some cases with the registers maintained by the registrars of corporations. The registrars generally have the powers to compel the production of information from corporations and partnerships carrying on business in the FSM for the purpose of administering the corporate laws. For the purposes of ensuring tax returns are filed and accounting records are maintained, the tax administration can use the powers provided for in section 157 of the ITA to access information held by the registrars of corporations.

Use of information gathering measures absent domestic tax interest (ToR B.1.3)

123. The tax administration can only access information for the purpose of ensuring that tax returns are filed correctly and accounting records are maintained. As a consequence, it does not have the powers to obtain information for EOI purposes. Moreover, the FSM applies a territorial system of taxation except for "major corporations" that are taxed on their worldwide income, and

consequently the circumstances where its authorities will not have a domestic interest in the information are broad. It is recommended that the FSM enact legislation that would give the government the power to access information pursuant to a request under an exchange of information mechanism.

Compulsory powers (ToR B.1.4)

124. If a person refuses to produce the information or to give a testimony as required by the tax administration, that person is liable, upon conviction, to a fine not exceeding USD 500, one year imprisonment, or both (FSM Code Title 54, s. 901). If that person is summoned under the CITA, the penalty for non-compliance is a fine not more than USD 1 000, or, if natural person, imprisonment for not more than one year, or both (CITA, s. 375). There are no search or seizure powers at the disposal of the tax administration.

125. As there are no access powers for EOI purposes, the FSM authorities do not have compulsory powers to obtain the information requested under an EOI mechanism. The FSM should ensure that, when it provides powers to its government authorities to access information pursuant to a request under an EOI mechanism, it establishes enforcement provisions to compel the production of information.

Secrecy provisions (ToR B.1.5)

126. Revenue officers are bound by a confidentiality rule and cannot exchange information with foreign competent authorities (FSM Code Title 54, s. 116). As no exception is foreseen for EOI purposes, this provision would prevent the tax authorities from disclosing information to foreign counterparts pursuant to an EOI mechanism. In 2012, the FSM has enacted the Unified Revenue Authority Act, which specifically permits disclosure of information to competent authorities of foreign governments with which the FSM has entered into an exchange of information agreement. Even though the Unified Revenue Authority Board has been organised, the Unified Revenue Authority Act has not yet been fully implemented (see Introduction above).

127. Confidential banking or insurance-related information can be disclosed when required to do so by a court in the FSM or in order to comply with the provisions of any other written law (FSM Code, Title 29, s. 704(1) and FSM Code Title 37, s. 1 004(1)(e)). Members or officers of the Banking Board or of the Insurance Board cannot disclose to any person any information, returns or data whatsoever relating to any licensed Bank or to its customers that he has acquired in the performance of his duties except, among others, when lawfully required to do so by any court (FSM Code, Title 29, s. 704(2) and FSM Code Title 37, s. 1 004(2)(b)).

128. Attorneys are regulated by the courts in which they are admitted to practice law, and the attorney-client privilege is recognised. Pursuant to the FSM Rule of Evidence 501, the privileges attaching to attorneys are determined by common law and custom, and FSM courts will look to United States authorities for guidance on the scope of the privilege. In general, the attorney attorney-client privilege relates only to the communications between an attorney and a client, and applies only in the context of a legal proceeding.

129. In addition to the attorney-client privilege, all attorneys in the FSM are bound by a duty of confidentiality, as prescribed by Model Rules of Professional Conduct 1.6 1983. The Model Rules were adopted by the FSM National Court Chief Justice by general court order rendering them applicable to all legal practitioners in the national courts. Similarly, state chief justices have implemented versions of the MRPC by general court order to apply to state court practitioners. The power to issue a "general court order" is a quasi-statutory rule-making power that may be exercised by the highest judicial official in the FSM state and national court systems. General court orders are enforceable against any person within the jurisdiction of the court and are valid until superseded or voided by later court order, or by statute. The Model Rules establish that a lawyer must not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorised in order to carry out the representation; an attorney may also reveal such information in other cases (such as to prevent an imminent crime). The FSM authorities have indicated that the ethical duty prescribed by the Model Rule relates to all information relating to the representation of a client (including work product and non-privileged information disclosed by the client) and applies at all times. Such a scope of professional secrecy is not consistent with the international standard as set in Article 7 of the OECD Model TIEA which establishes that only confidential communications between a client and an attorney, solicitor, or other admitted legal representative may not be provided to the competent authority where such communications are produced for the purposes of seeking or providing legal advice, or for the purposes of use in existing or contemplated legal proceedings. It is recommended that the FSM ensures that the scope of professional secrecy meets the international standard for the purpose of exchange of information.

Determination and factors underlying recommendations

Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
The FSM authorities do not have the power to obtain information for EOI purposes absent a domestic tax interest. Secrecy provisions prevent the FSM authorities from exchanging information with foreign counterparts.	The FSM should enact and implement legislation that would give the government powers to access and exchange information pursuant to a request under an exchange of information mechanism.
The scope of professional secrecy is not consistent with the international standard as attorneys are bound by a duty of confidentiality which relates to all information relating to the representation of a client and applies at all time.	The FSM should ensure that professional secrecy is consistent with the standard for the purpose of exchange of information.

B.2. Notification requirements and rights and safeguards

The rights and safeguards (e.g. notification, appeal rights) that apply to persons in the requested jurisdiction should be compatible with effective exchange of information.

Not unduly prevent or delay exchange of information *(ToR B.2.1)*

130. Rights and safeguards should not unduly prevent or delay effective exchange of information. For instance, notification rules should permit exceptions from prior notification (e.g. in cases in which the information request is of a very urgent nature or the notification is likely to undermine the chance of success of the investigation conducted by the requesting jurisdiction).

131. There are no powers to access information to reply to a request made pursuant to a tax treaty in the FSM domestic laws (see section B.1. above). Consequently, there are also no notification rules or rights and safeguards. Therefore, it is not possible to assess whether this element is in place, as there is no basis upon which to make this determination. When the FSM chooses to implement access powers in its domestic laws, any rights and safeguards included should be evaluated at that time.

Determination and factors underlying recommendations

Determination
The assessment team is not in a position to evaluate whether this element is in place, as there is no basis upon which to make this determination.

C. Exchanging Information

Overview

132. Jurisdictions generally cannot exchange information for tax purposes unless they have a legal basis or mechanism for doing so. A jurisdiction's practical capacity to effectively exchange information relies both on having adequate mechanisms in place as well as an adequate institutional framework. This section of the report examines whether the Federated States of Micronesia (FSM) has a network of information exchange that would allow it to achieve effective exchange of information (EOI) in practice.

133. The FSM domestic laws do not provide for access to information pursuant to an exchange of information request, nor has the FSM entered into EOI bilateral or multilateral instruments to date. International agreements can be signed by the President of the FSM, the Secretary of External Affairs, or their authorised representatives.

134. The FSM tax laws prescribe that any person employed by the Department of Finance must maintain secrecy of all matters which come to their knowledge.

135. The present report does not address element C.5, as this involves issues of practice that will be dealt with in the Phase 2 review.

C.1. Exchange of information mechanisms

Exchange of information mechanisms should allow for effective exchange of information.

Foreseeably relevant standard *(ToR C.1.1)*

136. The international standard for exchange of information envisages information exchange upon request to the widest possible extent. Nevertheless it does not allow "fishing expeditions", i.e. speculative requests for information that have no apparent nexus to an open inquiry or investigation. The balance between these two competing considerations is captured in the

standard of "foreseeable relevance" which is included in Article 1 of the OECD Model TIEA, set out below:[8]

> "The competent authorities of the Contracting Parties shall provide assistance through exchange of information that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by this Agreement. Such information shall include information that is foreseeably relevant to the determination, assessment and collection of such taxes, the recovery and enforcement of tax claims, or the investigation or prosecution of tax matters".

137. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

In respect of all persons (ToR C.1.2)

138. For exchange of information to be effective it is necessary that a jurisdiction's obligations to provide information is not restricted by the residence or nationality of the person to whom the information relates or by the residence or nationality of the person in possession or control of the information requested. For this reason the international standard for exchange of information envisages that exchange of information mechanisms will provide for exchange of information in respect of all persons.

139. The FSM has not entered into international treaties providing for exchange of information for tax purposes yet.

Obligation to exchange all types of information (ToR C.1.3)

140. Jurisdictions cannot engage in effective exchange of information if they cannot exchange information held by financial institutions, nominees or persons acting in an agency or a fiduciary capacity. Both the OECD Model Convention and the OECD Model TIEA, which are primary authoritative sources of the standards, stipulate that bank secrecy cannot form the basis for declining a request to provide information and that a request for information cannot be declined solely because the information is held by nominees or persons acting in an agency or fiduciary capacity or because the information relates to an ownership interest.

141. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

8. Article 26(1) of the Model Tax Convention contains a similar provision.

Absence of domestic tax interest (ToR C.1.4)

142. The concept of "domestic tax interest" describes a situation where a contracting party can only provide information to another contracting party if it has an interest in the requested information for its own tax purposes. A refusal to provide information based on a domestic tax interest requirement is not consistent with the international standard. EOI partners must be able to use their information gathering measures even though invoked solely to obtain and provide information to the requesting jurisdiction.

143. Currently, the FSM has no powers to access information in order to reply to a request made under EOI bilateral or multilateral instrument (see section B.1 of this report).

Absence of dual criminality principles (ToR C.1.5)

144. The principle of dual criminality provides that assistance can only be provided if the conduct being investigated (and giving rise to the information request) would constitute a crime under the laws of the requested country if it had occurred in the requested country. In order to be effective, exchange of information should not be constrained by the application of the dual criminality principle.

145. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

Exchange of information in both civil and criminal tax matters (ToR C.1.6)

146. Information exchange may be requested both for tax administration purposes and for tax prosecution purposes. The international standard is not limited to information exchange in criminal tax matters but extends to information requested for tax administration purposes (also referred to as "civil tax matters").

147. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

Provide information in specific form requested (ToR C.1.7)

148. In some cases, a Contracting State may need to receive information in a particular form to satisfy its evidentiary or other legal requirements. Such forms may include depositions of witnesses and authenticated copies of original records. Contracting States should endeavour as far as possible to accommodate such requests. The requested State may decline to provide the information in the specific form requested if, for instance, the requested form

is not known or permitted under its law or administrative practice. A refusal to provide the information in the form requested does not affect the obligation to provide the information.

149. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

In force (ToR C.1.8)

150. Exchange of information cannot take place unless a jurisdiction has EOI arrangements in force. Where EOI arrangements have been signed, the international standard requires that jurisdictions must take all steps necessary to bring them into force expeditiously.

151. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

152. Foreign relations are exercised at the federal level. International agreements can be signed by the President of the FSM, the Secretary of External Affairs, or their authorised representatives (FSM Constitution, art.X s. 2(b) and FSM Code Title 10, s. 504). Article IX, section 4 of the FSM Constitution provides that "[a] treaty is ratified by vote of 2/3 of the members of the Congress, except that a treaty delegating major powers of government of the Federated States of Micronesia to another government shall also require majority approval by the legislatures of 2/3 of the states." As exchange of information treaties do not involve delegation of major powers to a foreign government, they will most likely ratified only by vote of 2/3 of the Congress.

Be given effect through domestic law (ToR C.1.9)

153. For information exchange to be effective the parties to an exchange of information arrangement need to enact any legislation necessary to comply with the terms of the arrangement.

154. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date. In any case, the shortcomings identified in Part B of this report mean that the FSM would not be able to fully comply with the terms of an EOI arrangement to the international standard. It is recommended that the FSM implement legislation to provide it with full access powers which may be exercised in order to respond to an EOI request with relevant exchange of information partners.

Determination and factors underlying recommendations

Phase 1 Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.
The FSM authorities do not have the power to obtain information for EOI purposes absent a domestic tax interest.	The FSM should enact legislation that would give the government powers to access information pursuant to a request under an exchange of information mechanism.

C.2. Exchange of information mechanisms with all relevant partners

The jurisdictions' network of information exchange mechanisms should cover all relevant partners.

155. Ultimately, the international standard requires that jurisdictions exchange information with all relevant partners, meaning those partners who are interested in entering into an information exchange arrangement. EOI agreements cannot be concluded only with counterparties without economic significance. If it appears that a jurisdiction is refusing to enter into EOI agreements or negotiations with partners, in particular ones that have a reasonable expectation of requiring information from that jurisdiction in order to properly administer and enforce its tax laws it may indicate a lack of commitment to implement the standards.

156. The FSM has not yet developed a network of information exchange agreements that would allow it to achieve effective exchange of information in practice. In the course of this review, comments were sought from the jurisdictions participating in the Global Forum and no partner has indicated that it has approached the FSM to negotiate an EOI agreement. Nevertheless, domestic limitation in the current legal and regulatory framework for EOI would prevent any EOI agreement from meeting the international standard.

Determination and factors underlying recommendations

Phase 1 Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
To date, the FSM has not entered into any instruments providing for exchange of information to the standard. While no jurisdiction has approached the FSM for the negotiation of an EOI agreement, it is noted that the FSM has not enacted legislation that would enable it to give full effect to the terms of an EOI agreement.	The FSM should ensure that it can give full effect to the terms of any EOI arrangements it enters into.
	The FSM should develop its exchange of information network with all relevant partners.

C.3. Confidentiality

The jurisdictions' mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received.

Information received: disclosure, use, and safeguards (ToR C.3.1); All other information exchanged (ToR C.3.2)

157. Governments would not engage in information exchange without the assurance that the information provided would only be used for the purposes permitted under the exchange mechanism and that its confidentiality would be preserved. Information exchange instruments must therefore contain confidentiality provisions that spell out specifically to whom the information can be disclosed and the purposes for which the information can be used. In addition to the protections afforded by the confidentiality provisions of information exchange instruments, jurisdictions with tax systems generally impose strict confidentiality requirements on information collected for tax purposes.

158. The FSM has signed no bilateral or multilateral instruments that provide for exchange of information to date.

159. The FSM tax law prescribes that the Secretary of Finance and every employee of the Department of Finance must maintain secrecy of all matters which come to their knowledge (FSM Code Title 54, s. 116). As no exception

is foreseen for EOI purposes, this provision would prevent the tax authorities from disclosing information to foreign counterparts pursuant to an EOI mechanism. In 2012, the FSM has enacted the Unified Revenue Authority Act, which specifically permits disclosure of information to competent authorities of foreign governments with which the FSM has entered into an exchange of information agreement. Even though the Unified Revenue Authority Board has been organised, the Unified Revenue Authority Act has not yet been fully implemented. When the FSM enters an EOI agreement, it should ensure that the FSM competent authority has the ability to disclose information to foreign counterparts.

Determination and factors underlying recommendations

Phase 1 Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.

C.4. Rights and safeguards of taxpayers and third parties

The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties.

Exceptions to requirement to provide information (ToR C.4.1)

160. The international standard allows requested parties not to supply information in response to a request in certain identified situations where an issue of trade, business or other listed secret may arise. Among other reasons, an information request can be declined where the requested information would disclose confidential communications protected by the attorney-client privilege. Attorney-client privilege is a feature of the legal systems of many jurisdictions. However, communications between a client and an attorney or other admitted legal representative are, generally, only privileged to the extent that the attorney or other legal representative acts in his or her capacity as an attorney or other legal representative.

161. Where attorney-client privilege is more broadly defined it does not provide valid grounds on which to decline a request for exchange of information. To the extent, therefore, that an attorney acts as a nominee shareholder, a

trustee, a settlor, a company director or under a power of attorney to represent a company in its business affairs, exchange of information resulting from and relating to any such activity cannot be declined because of the attorney-client privilege rule.

162. The FSM has not concluded any EOI agreements to date.

163. As noted in section B.1.5, the scope of professional secrecy attaching to lawyers is broader than the standard. The status of international agreements in the hierarchy of laws in the FSM is unclear, and to the extent that the domestic law would not be overridden by any agreement entered into by the FSM, the scope of professional secrecy will impede effective EOI.

Determination and factors underlying recommendations

Phase 1 Determination	
The element is not in place.	
Factors underlying recommendations	**Recommendations**
To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.

C.5. Timeliness of responses to requests for information

The jurisdiction should provide information under its network of agreements in a timely manner.

Responses within 90 days *(ToR C.5.1)*

164. In order for exchange of information to be effective, it needs to be provided in a timeframe which allows tax authorities to apply the information to the relevant cases. If a response is provided but only after a significant lapse of time, the information may no longer be of use to the requesting authorities. This is particularly important in the context of international cooperation as cases in this area must be of sufficient importance to warrant making a request.

165. The FSM domestic laws do not provide for access to information pursuant to an exchange of information request, nor has the FSM entered into EOI bilateral or multilateral instruments to date.

166. As regards the timeliness of responses to requests for information the assessment team is not in a position to evaluate whether this element is in place, as it involves issues of practice that are dealt with in the Phase 2 review.

Organisational process and resources (ToR C.5.2)

167. A review of the FSM organisational process and resources will be conducted in the context of its Phase 2 review.

Absence of restrictive conditions on exchange of information (ToR C.5.3)

168. Exchange of information assistance should not be subject to unreasonable, disproportionate, or unduly restrictive conditions.

169. The FSM domestic laws do not provide for access to information pursuant to an exchange of information request, nor has the FSM entered into EOI bilateral or multilateral instruments to date.

Determination and factors underlying recommendations

Phase 1 Determination
The assessment team is not in a position to evaluate whether this element is in place, as it involves issues of practice that are dealt with in the Phase 2 review.

Summary of Determinations and Factors Underlying Recommendations

Determination	Factors underlying recommendations	Recommendations
Jurisdictions should ensure that ownership and identity information for all relevant entities and arrangements is available to their competent authorities *(ToR A.1)*		
The element is in place, but certain aspects of the legal implementation of the element need improvement.	Even though at the moment there are no companies registered under the laws of Chuuk and Kosrae, corporations formed under the laws of these states are not expressly obliged to have information available on their owners.	The FSM should ensure that information on the owners of all corporations formed in the FSM territory be available.
	There are no requirements for the maintenance of information on trusts which have trustees resident in the FSM.	The FSM should ensure that the ownership and identity information of trusts is available in accordance with the standard.
Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements *(ToR A.2)*		
The element is not in place.	It is not clear what underlying documents are required to be kept by corporations formed under the laws of the FSM (except captive insurance companies) and the laws of Yap and Pohnpei.	The FSM should ensure that underlying documentation to the standard is kept by all entities and arrangements.

Determination	Factors underlying recommendations	Recommendations
	Corporations formed under the laws of Chuuk and Kosrae, any partnerships formed under the laws of Yap and Pohnpei, foreign companies and any partnerships carrying on business in the FSM do not have specific obligations to keep accounting records. Apart from major corporations that are subject to the Corporate Income Tax, the requirements to keep accounting records under tax law are not specific enough. Foreign trusts not carrying on business in the FSM have no obligation to keep accounting records.	The FSM should ensure that these entities and arrangements be required explicitly to keep reliable accounting records and underlying documentation.
	Except for captive insurance companies, the commercial legislation does not specify for how long companies formed under the FSM and state laws should keep accounting records. The retention period of accounting information under tax law is three years.	The FSM should establish that reliable accounting information for all entities and arrangement is kept for at least five years.
Banking information should be available for all account-holders *(ToR A.3)*		
The element is in place.		

Determination	Factors underlying recommendations	Recommendations
Competent authorities should have the power to obtain and provide information that is the subject of a request under an exchange of information arrangement from any person within their territorial jurisdiction who is in possession or control of such information (irrespective of any legal obligation on such person to maintain the secrecy of the information) *(ToR B.1)*		
The element is not in place.	The FSM authorities do not have the power to obtain information for EOI purposes absent a domestic tax interest. Secrecy provisions prevent the FSM authorities from exchanging information with foreign counterparts.	The FSM should enact and implement legislation that would give the government powers to access and exchange information pursuant to a request under an exchange of information mechanism.
	The scope of the duty of confidentiality is not consistent with the international standard as attorneys are bound by a professional secrecy which relates to all information relating to the representation of a client and applies at all time.	The FSM should ensure that professional secrecy is consistent with the standard for the purpose of exchange of information.
The rights and safeguards (e.g. notification, appeal rights) that apply to persons in the requested jurisdiction should be compatible with effective exchange of information *(ToR B.2)*		
The assessment team is not in a position to evaluate whether this element is in place, as there is no basis upon which to make this determination.		

Determination	Factors underlying recommendations	Recommendations
Exchange of information mechanisms should allow for effective exchange of information *(ToR C.1)*		
The element is not in place.	To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.
	The FSM authorities do not have the power to obtain information for EOI purposes absent a domestic tax interest.	The FSM should enact legislation that would give the government powers to access information pursuant to a request under an exchange of information mechanism.
The jurisdictions' network of information exchange mechanisms should cover all relevant partners *(ToR C.2)*		
The element is not in place.	To date, the FSM has not entered into any instruments providing for exchange of information to the standard. While no jurisdiction has approached the FSM for the negotiation of an EOI agreement, it is noted that the FSM has not enacted legislation that would enable it to give full effect to the terms of an EOI agreement.	The FSM should ensure that it can give full effect to the terms of any EOI arrangements it enters into.
		The FSM should develop its exchange of information network with all relevant partners.
The jurisdictions' mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received *(ToR C.3)*		
The element is not in place.	To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.

Determination	Factors underlying recommendations	Recommendations
The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties *(ToR C.4)*		
The element is not in place.	To date, the FSM has not entered into any instruments providing for exchange of information to the standard.	The FSM should develop its exchange of information network with all relevant partners.
The jurisdiction should provide information under its network of agreements in a timely manner *(ToR C.5)*		
The assessment team is not in a position to evaluate whether this element is in place, as it involves issues of practice that are dealt with in the Phase 2 review.		

Annex 1: Jurisdiction's Response to the Review Report[9]

The Government of the Federated States of Micronesia ("FSM") is grateful for the opportunity to provide a brief statement as part of the peer review process of the Global Forum on Transparency and Exchange of Information for Tax Purposes. Although the FSM is not currently in a position to become a member of the Global Forum, the FSM is committed to the international standards of transparency and exchange of information for tax purposes. Based on this commitment, the FSM has fully participated in the peer review process in a spirit of openness and cooperation.

The FSM is a small island nation with a very limited corporate and financial sector. The FSM has minimal technical capacity and experience in areas relevant to the work of the Global Forum, and is wholly without experience in the area of exchange of information for tax purposes. Indeed, the report correctly notes that no country participating in the Global Forum has approached the FSM to negotiate an Exchange of Information Agreement. The FSM notes that due to its history as part of the Trust Territory administered by the U.S. government, much of the FSM's legal framework was inherited or adopted from U.S. models. Under the Compact of Free Association, the FSM continues to share a close relationship with the U.S. and as a result receives FDIC rating for its banking system and receives institutional support in a range of other areas of economic activity. On the other hand, some of the financial laws inherited from the Trust Territory period that remain on the books are not being implemented due in great part to the minimal amount of economic activity requiring financial management, particularly at the state level. Finally, the FSM has a recently established captive insurance industry that is regulated by the national government in compliance with international industry standards.

The lack of experience in the area of exchange of information for tax purposes makes it somewhat difficult for FSM to understand the work of the Global Forum and to adequately respond to the draft report. Nevertheless, the

9. This Annex presents the jurisdiction's response to the review report and shall not be deemed to represent the Global Forum's views.

FSM has done its best to assist with the peer review process. The FSM carefully reviewed the draft Phase 1 report, and believes that the facts reported in the draft report are accurate.

The FSM wishes to emphasize that legislation is currently pending that would significantly reform the FSM tax system and would appreciably improve the legal framework relevant to the availability and exchange of information for tax purposes. The FSM Tax Reform Program legislation was prepared with the assistance of the International Monetary Fund and it was the understanding of the FSM Government that those reforms would be consistent with international standards for all areas of tax policy and administration, including exchange of information for tax purposes. To the extent improvements to the existing FSM Tax Reform Program legislation would be necessary to conform to international standards, the FSM would welcome the opportunity to make such improvements. Although the FSM Tax Reform Program is facing political challenges, tax reform remains the official policy of the FSM Government and, indeed, is one of the Government's highest priorities. Therefore, the FSM believes that the report should be considered in light of FSM's demonstrated commitment to bring its legal framework for taxation into line with international best practices.

Also, the FSM is actively engaged with its international partners in taking steps to reform its legal system in a range of areas related to the regulation of its financial sector, including among others a pending bill to liberalize its telecommunications market and ongoing review for compliance with the UN Convention on Corruption. Some of these initiatives may have overlapping goals with areas identified for review by the Global Forum. Although the FSM may not be able to contribute monetarily to the success of these efforts, the FSM is committed to achieving recognized goals and offers the full support of its legal and technical staff to work with its partners.

_____

Kensley Ikosia

Secretary, FSM Department of Finance and Administration

Annex 2: List of all Exchange of Information Mechanisms

To date, the Federated States of Micronesia has not signed any mechanisms providing for tax information exchange.

Annex 3: List of all Laws, Regulations and Other Material Received

Commercial laws

FSM Code, Title 36, "Corporations and Business Associations"

FSM Corporate Regulations "Corporations, Partnerships and Associations".

FSM Captive Insurance Law of 2006

FSM Captive Insurance Regulations of 2008

FSM Insurance Act of 2006

FSM Foreign Investment Act of 1997

FSM Foreign Investment Regulations

Chuuk Business Organisations and Regulation Law

Chuuk Foreign Investment Act

Chuuk Foreign Investment Regulations

Kosrae Code, Title 15, "Commerce"

Kosrae State Foreign Investment Regulations

Pohnpei Code, Title 37, "Business Associations"

Pohnpei Partnerships Act of 1994

Yap Code, Title 12, "Corporations, Partnerships and Associations"

Yap State Foreign Investment Regulations

Banking laws

FSM Code, Title 29, "Commercial Banking"

Anti-money laundering laws

Money Laundering and Proceeds of Crime Act

Tax laws

FSM Code, Title 54, "Taxation and Customs", FSM Income Tax Law

Chapter 3 of Title 54 of the FSM Code, "Corporate Income Tax Act" of 2004

Corporate Income Tax Regulation

Chapter 1 of Title 54 of the FSM Code "Taxation of Wages and Salaries"

Chapter 1 of Title 54 of the FSM Code "Taxation of Wages, Salaries, and Gross Revenues"

Public Law 18-16 amending further section 934 of title 54 of the Code of the Federated States of Micronesian to extend the deadline set for the implementation of the tax reform

Miscellaneous

FSM Constitution of 1979

Case law

Youngstrom v. Kosrae, 5 FSM Intrm. 73, 74 (Kos. 1991)

Semens vs. Continental Airlines, Inc. (I), 2 FSM Intrm. 131, 142 (Pon. 1985)

Island Dev. Co. v. Yap, 9 FSM Intrm. 220, 223 (Yap 1999)

In re Estate of Setik, 12 FSM Intrm. 423, 429 (Chk. S. Ct. Tr. 2004)

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The European Union takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

OECD PUBLISHING, 2, rue André-Pascal, 75775 PARIS CEDEX 16
(23 2014 09 1 P) ISBN 978-92-64-21018-9– 2014

Global Forum on Transparency and Exchange of Information for Tax Purposes

PEER REVIEWS, PHASE 1: THE FEDERATED STATES OF MICRONESIA

The Global Forum on Transparency and Exchange of Information for Tax Purposes is the multilateral framework within which work in the area of tax transparency and exchange of information is carried out by over 100 jurisdictions which participate in the work of the Global Forum on an equal footing.

The Global Forum is charged with in-depth monitoring and peer review of the implementation of the standards of transparency and exchange of information for tax purposes. These standards are primarily reflected in the 2002 *OECD Model Agreement on Exchange of Information on Tax Matters* and its commentary, and in Article 26 of the *OECD Model Tax Convention on Income and on Capital* and its commentary as updated in 2004, which has been incorporated in the *UN Model Tax Convention*.

The standards provide for international exchange on request of foreseeably relevant information for the administration or enforcement of the domestic tax laws of a requesting party. "Fishing expeditions" are not authorised, but all foreseeably relevant information must be provided, including bank information and information held by fiduciaries, regardless of the existence of a domestic tax interest or the application of a dual criminality standard.

All members of the Global Forum, as well as jurisdictions identified by the Global Forum as relevant to its work, are being reviewed. This process is undertaken in two phases. Phase 1 reviews assess the quality of a jurisdiction's legal and regulatory framework for the exchange of information, while Phase 2 reviews look at the practical implementation of that framework. Some Global Forum members are undergoing combined – Phase 1 plus Phase 2 – reviews. The ultimate goal is to help jurisdictions to effectively implement the international standards of transparency and exchange of information for tax purposes.

All review reports are published once approved by the Global Forum and they thus represent agreed Global Forum reports.

For more information on the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes, and for copies of the published review reports, please visit ***www.oecd.org/tax/transparency*** and ***www.eoi-tax.org.***

OECD publishing
www.oecd.org/publishing

ISBN 978-92-64-21018-9
23 2014 09 1 P

9 789264 210189