



Secretary of Finance
&
Administration

**GOVERNMENT OF THE
FEDERATED STATES OF MICRONESIA
Department of Finance and Administration**

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Tax Ruling 18-01

**Subject: Public Ruling on Corporate Tax Treatment of Dissolution of FSM
Corporation After Transfer of Assets to Affiliated Foreign Entity**

Issue

Under the following situation, when a Major Corporation dissolves after transferring its assets to an affiliated foreign entity, what is the tax treatment of the transaction?

Situation

Major Corporation X is incorporated under the laws of FSM. Major Corporation X is owned by a single shareholder that is incorporated under the laws of Country B. Major Corporation X seeks to voluntarily dissolve under the procedures laid out in the FSM corporate law (Title 36). Rather than sell its assets as part of the winding up of the corporation and declare any gains as taxable income, Major Corporation X seeks to transfer the assets of the corporation to an affiliated company incorporated in Country C. The transfer does not involve an exchange of cash, only an outright transfer of the assets of Major Corporation X to the affiliated company. Country B utilizes the GAAP standard which provides that the transfer of assets and liabilities of a corporation to an affiliated company shall be valued at fair market value for purposes of determining the tax treatment of the transfer.

Applicable Law and Analysis

54 F.S.M.C. § 321 provides that, "A tax at the rate of 21 percent (21%) is . . . imposed for each taxable year on the taxable income of every major corporation." "Taxable income" is defined as a corporation's income "before income taxes, earned in the taxable year as determined under International Financial Reporting Standard (hereinafter, "IFRS") or Generally Accepted Accounting Principles (hereinafter, "GAAP"), as IFRS or GAAP, as the case may be, is regularly utilized to calculate taxable income in the major

corporation's principal shareholder's, if a corporation, place of incorporation or, if an individual, country of primary residence." 54 F.S.M.C. § 322.

Subpart 2.2 of the Regulations for Public Law 13-71, the Corporate Income Tax Act of 2004 (the "Regulation") defines the amount to be included in gross income and gross expense:

2.2 Computation of Taxable Income

(2) In computing taxable income, the amount to be included in gross income shall be, unless otherwise provided in these regulations, the amount of income in the stated Taxable Year from:

- (a) sale of assets;
- (b) gratuitous transfers of assets;
- (c) rendering of services;
- (d) gratuitous acquisitions of assets; and
- (e) any transactions other than capital transactions.


(3) In computing taxable income, the amount to be included in gross expense shall be, unless otherwise provided in these regulations . . . the cost of sales, cost of completed construction work, and other similar costs related to income during the Taxable Year;

(4) The amount of income in the Taxable Year prescribed in Subpart 2.2(2) and (3) hereinabove shall be computed in accordance with GAAP as prescribed in Section 322 of the Act.

Subpart 2.2(2) of the Regulations identifies the "gratuitous transfer[] of assets" as a situation to be included in the calculation of taxable income. Section 322 of Title 54 of the FSM Code states that income must be declared in accordance with International Financial Reporting Standard (IFRS) or Generally Accepted Accounting Principles (GAAP) as such standards are utilized in the major corporation's principal shareholder's place of incorporation. Country B utilizes the GAAP standard which defines "gratuitous transfers of assets" as a transfer of property for less than the fair market value of the property. Under the GAAP standard utilized by Country B, the transfer of assets and liabilities of a corporation to an affiliated company shall be valued at fair market value for purposes of determining the tax treatment of the transfer.

Ruling

1. When transferring its assets and liabilities to an affiliated foreign company in connection with dissolving its corporate status under Title 36 of the FSM code, a Major Corporation must revalue the assets and liabilities to a fair market value as of the date of the transfer.
2. Fair market value is the estimate of the price a willing buyer and a willing seller would agree to.
3. A taxpayer Major Corporation is required to submit the final corporate tax return dated as of the date of the dissolution of the major corporation.
4. A taxpayer Major Corporation must utilize a qualified third-party appraiser to determine fair market value. However, if the assets of the taxpayer Major Corporation consist solely of (1) cash (foreign currencies and currency equivalent) and (2) marketable securities traded on a reputable public market, then the Major Corporation may value these assets with reference to (1) the foreign exchange rate quoted by internationally reputable banks, and (2) the last traded price of the securities on the public market, on the date of the transfer.
5. Third-party appraisals (or the other information mentioned in 4 above) must be attached to the final tax return.
6. The Secretary retains the right to request further information regarding the appraisal, including, but not limited to: the method used for determining fair market value and the qualifications of the third-party appraiser.
7. The Secretary retains the right to utilize appraisers hired by the Department of Finance and Administration to determine the fair market value of the assets and liabilities of a dissolving corporation.
8. The Secretary retains the right to inspect and audit any dissolving company if the company's tax liability from a gratuitous transfer to an affiliated foreign company is not paid prior to filing for dissolution.
9. The taxpayer Major Corporation may request the Secretary of Finance to allow in-house valuation in certain circumstances including minor assets under \$10,000.


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