



Secretary of Finance
&
Administration

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

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July 4, 2018

Tax Ruling 18-03

**Subject: Public Ruling on Corporate Tax Treatment of FSM Corporation Converting
into Foreign Corporation**

Issue

Under the following situation, when a Major Corporation converts into a foreign corporation or other business entity, what is the tax treatment of the conversion?

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 convert into a foreign corporation in Country C under the procedures laid out in the FSM corporate law (Title 36). As part of the conversion into a foreign corporation, the assets of the corporation will convert to property of the newly formed foreign corporation. 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 conversion, while no specific mention is made in the GAAP to conversion of a corporation to a foreign corporation.

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, while no specific mention is made in the GAAP to conversion of a corporation to a foreign corporation.

As a result of conversion of a major corporation to a foreign corporation, the assets of the major corporation shall become property of the newly formed foreign corporation without exchange of cash or other valuable consideration. This should be regarded as equivalent to an outright transfer of the assets of the major corporation to the foreign affiliated company. Therefore, assets and liabilities of a corporation that is converted to a foreign corporation shall be valued at fair market value for purposes of determining the tax treatment of the conversion. .

Ruling

1. When converting into a foreign corporation, a Major Corporation must revalue the assets and liabilities to a fair market value as of the date of conversion for corporate tax purposes.
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 conversion 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 converting corporation.
8. The Secretary retains the right to inspect and audit any converting company if the company's tax liability from a gratuitous transfer as a result of the conversion is not paid prior to the conversion.
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.

A handwritten signature in black ink, appearing to read 'Sihna', with a long horizontal flourish extending to the right.

Sihna N. Lawrence

Secretary, Department of Finance & Administration