GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES

Peer Review Report on the Exchange of Information on Request

FEDERATED STATES OF MICRONESIA

2019 (Second Round)

OECD

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PEER REVIEW REPORT ON THE EXCHANGE OF INFORMATION ON REQUEST

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Reader's guide

The Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) is the multilateral framework within which work in the area of tax transparency and exchange of information is carried out by over 150 jurisdictions that participate in the Global Forum on an equal footing. The Global Forum is charged with the in-depth monitoring and peer review of the implementation of the international standards of transparency and exchange of information for tax purposes (both on request and automatic).

Sources of the Exchange of Information on Request standards and Methodology for the peer reviews

The international standard of exchange of information on request (EOIR) is primarily reflected in the 2002 OECD Model Agreement on Exchange of Information on Tax Matters and its commentary, Article 26 of the OECD Model Tax Convention on Income and on Capital and its commentary and Article 26 of the United Nations Model Double Taxation Convention between Developed and Developing Countries and its commentary. The EOIR standard provides for exchange on request of information foreseeably relevant for carrying out the provisions of the applicable instrument or to the administration or enforcement of the domestic tax laws of a requesting jurisdiction. Fishing expeditions are not authorised but all foreseeably relevant information must be provided, including ownership, accounting and banking information.

All Global Forum members, as well as non-members that are relevant to the Global Forum's work, are assessed through a peer review process for their implementation of the EOIR standard as set out in the 2016 Terms of Reference (ToR), which break down the standard into 10 essential elements under three categories: (A) availability of ownership, accounting and banking information; (B) access to information by the competent authority; and (C) exchanging information.

The assessment results in recommendations for improvements where appropriate and an overall rating of the jurisdiction's compliance with the EOIR standard based on:

1. The implementation of the EOIR standard in the legal and regulatory framework, with each of the element of the standard determined to be either (i) in place, (ii) in place but certain aspects need improvement, or (iii) not in place.
2. The implementation of that framework in practice with each element being rated (i) compliant, (ii) largely compliant, (iii) partially compliant, or (iv) non-compliant.

The response of the assessed jurisdiction to the report is available in an annex. Reviewed jurisdictions are expected to address any recommendations made, and progress is monitored by the Global Forum.

A first round of reviews was conducted over 2010-16. The Global Forum started a second round of reviews in 2016 based on enhanced Terms of Reference, which notably include new principles agreed in the 2012 update to Article 26 of the OECD Model Tax Convention and its commentary, the availability of and access to beneficial ownership information, and completeness and quality of outgoing EOI requests. Clarifications were also made on a few other aspects of the pre-existing Terms of Reference (on foreign companies, record keeping periods, etc.).

Whereas the first round of reviews was generally conducted in two phases for assessing the legal and regulatory framework (Phase 1) and EOIR in practice (Phase 2), the second round of reviews combine both assessment phases into a single review. For the sake of brevity, on those topics where there has not been any material change in the assessed jurisdictions or in the requirements of the Terms of Reference since the first round, the second round review does not repeat the analysis already conducted. Instead, it summarises the conclusions and includes cross-references to the analysis in the previous report(s). Information on the Methodology used for this review is set out in Annex 3 to this report.

Consideration of the Financial Action Task Force Evaluations and Ratings

The Financial Action Task Force (FATF) evaluates jurisdictions for compliance with anti-money laundering and combating terrorist financing (AML/CFT) standards. Its reviews are based on a jurisdiction's compliance with 40 different technical recommendations and the effectiveness regarding 11 immediate outcomes, which cover a broad array of money-laundering issues.

The definition of beneficial owner included in the 2012 FATF standards has been incorporated into elements A.1, A.3 and B.1 of the 2016 ToR. The 2016 ToR also recognises that FATF materials can be relevant for carrying out EOIR assessments to the extent they deal with the definition of beneficial ownership, as the FATF definition is used in the 2016 ToR (see 2016 ToR, annex 1, part I.D). It is also noted that the purpose for which the FATF materials have been produced (combating money-laundering and terrorist financing) is different from the purpose of the EOIR standard (ensuring effective exchange of information for tax purposes), and care should be taken to ensure that assessments under the ToR do not evaluate issues that are outside the scope of the Global Forum's mandate.

While on a case-by-case basis an EOIR assessment may take into account some of the findings made by the FATF, the Global Forum recognises that the evaluations of the FATF cover issues that are not relevant for the purposes of ensuring effective exchange of information on beneficial ownership for tax purposes. In addition, EOIR assessments may find that deficiencies identified by the FATF do not have an impact on the availability of beneficial ownership information for tax purposes; for example, because mechanisms other than those that are relevant for AML/CFT purposes exist within that jurisdiction to ensure that beneficial ownership information is available for tax purposes.

These differences in the scope of reviews and in the approach used may result in differing conclusions and ratings.

More information

All reports are published once adopted by the Global Forum. 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 reports, please refer to www.oecd.org/tax/transparency and http://dx.doi.org/10.1787/2219469x.

Abbreviations and acronyms

AML	Anti-Money Laundering
AML/CFT	Anti-Money Laundering/Countering the Financing of Terrorism
CTA	Customs and Tax Administration
DTC	Double Tax Convention
EOI	Exchange of information
EOI Act	Exchange of Tax Information Act of 2016
EOI Regulations	Implementing regulations issued under the EOI Act
BO Regulation	Regulation issued under the EOI Act concerning beneficial ownership requirements
BOA Regulation	Regulation issued under the Business Organisation Act concerning beneficial ownership requirements
EOIR	Exchange of information on request
FATF	Financial Action Task Force
FDIC	U.S. Federal Deposit Insurance Corporation
FSM	Federated States of Micronesia
Global Forum	Global Forum on Transparency and Exchange of Information for Tax Purposes
Multilateral Convention	The Multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended by the 2010 Protocol
PRG	Peer Review Group of the Global Forum
TIEA	Tax Information Exchange Agreement

2016 Methodology	2016 Methodology for peer reviews and non-member reviews, as approved by the Global Forum on 29-30 October 2015.
2016 Terms of Reference (ToR)	Terms of Reference related to Exchange of Information on Request (EOIR), as approved by the Global Forum on 29-30 October 2015.

Executive summary

1. This review is a second round review of the Federated States of Micronesia (FSM)'s compliance with the international standard of exchange of information on request. The report analyses FSM's legal and regulatory framework as well as its implementation in practice over the three year review period against the 2016 Terms of Reference. The report concludes that the FSM overall rating is **Largely Compliant**.

2. During the first round of EOIR peer reviews FSM's legal and regulatory framework was evaluated in 2014 where it was concluded that essential elements of the 2010 ToR were not in place and the FSM could not move to the second phase of the first round review. In addition, the FSM underwent a fast-track review in 2017 evaluating its legal and regulatory framework as well as its implementation in practice against the 2010 ToR. The fast-track report concluded that provisional ratings for each of the individual elements would likely result in the FSM achieving an overall rating of Largely Compliant.

3. The following table shows the comparison of results from the first and the second round review of FSM's implementation of the EOIR standard.

Element		2014 Report determination	2019 Report determination	2019 Report rating
A.1	Availability of ownership and identity information	Needs improvement	In place	LC
A.2	Availability of accounting information	Not in place	In place	LC
A.3	Availability of banking information	In place	Needs improvement	PC
B.1	Access to information	Not in place	In place	C
B.2	Rights and Safeguards	Not assessed	In place	C
C.1	EOIR Mechanisms	Not in place	In place	C
C.2	Network of EOIR Mechanisms	Not in place	In place	C
C.3	Confidentiality	Not in place	In place	C
C.4	Rights and Safeguards	Not in place	In place	C
C.5	Quality and timeliness of responses	Not applicable	Not applicable	LC
	OVERALL RATING	Not applicable	Not applicable	**LC**

C = Compliant; **LC** = Largely Compliant; **PC** = Partially Compliant; **NC** = Non-Compliant

Progress made since previous review

4. The main issues identified in the 2014 report were the lack of access powers for exchange of information purposes and the lack of EOI instruments. Further, the 2014 report concluded that appropriate accounting requirements were not in place and improvement was recommended also in respect of the availability of legal ownership information.

5. Since then the FSM has made significant progress mainly by bringing into force the EOI Act. The EOI Act addresses the above recommendations, in particular it provides clear access powers for exchange of information purposes and requires the availability of ownership and accounting information in line with the standard. The FSM has also taken active steps to develop its EOI network, including through approaching several of its potential EOI partners to conclude an EOI agreement. Nevertheless, the FSM continues not to have any EOI instrument allowing it to exchange tax relevant information.

Key recommendation(s)

6. The FSM has taken important measures to address deficiencies identified in the 2014 report. Nevertheless, a gap exists concerning the availability of beneficial ownership information for bank account holders.

7. The obligations concerning ownership and accounting information are recent and therefore their impact on the availability of information in the FSM remains to be seen.

Overall rating

8. The FSM's legal and regulatory framework is generally in place to provide for effective exchange of information. The relevant rules also appear to be adequately implemented overall. However, this remains to be confirmed in practice. This can be attributed to the fact that the FSM does not have any EOI instrument providing for exchange of tax information with other jurisdictions despite its efforts to conclude one, and that the EOI Act containing crucial rules concerning the availability of ownership and accounting information as well as access powers for exchange of information purposes is recent and remains to be fully tested.

9. In view of the above, the overall rating for the FSM is assigned as Largely Compliant.

10. The report was approved by the Peer Review Group at its meeting from 25-28 June 2019 and was adopted by the Global Forum on 29 July 2019. A follow-up report on the steps undertaken by the FSM to address the recommendations made in this report should be provided to the PRG no later than 30 June 2020 and thereafter in accordance with the procedure set out under the 2016 Methodology.

Summary of determinations, ratings and recommendations

Determination	Factors underlying recommendations	Recommendations
Jurisdictions should ensure that ownership and identity information, including information on legal and beneficial owners, for all relevant entities and arrangements is available to their competent authorities *(ToR A.1)*		
The legal and regulatory framework is in place.		
EOIR rating: Largely Compliant	The EOI Act brought in new ownership filing requirements with the tax administration. It requires the availability of beneficial ownership information for companies, partnerships and trusts, covers companies created under the state law of Chuuk and Kosrae which were previously not required to file or keep legal ownership information and brings in consistent rules ensuring the availability of legal ownership and identity information for partnerships and foreign companies with sufficient nexus with the FSM. Further, the FSM recently brought into force beneficial ownership requirements under the Business Organisation Act covering companies registered at the national level.	The FSM should monitor implementation of the EOI Act and the Business Organisation Act and, if necessary, take further measures to ensure that legal as well as beneficial ownership information is available as required under the standard.
Jurisdictions should ensure that reliable accounting records are kept for all relevant entities and arrangements *(ToR A.2)*		
The legal and regulatory framework is in place.		

Determination	Factors underlying recommendations	Recommendations
EOIR rating: Largely Compliant	The EOI Act which contains crucial accounting obligations came into force in February 2017. However, further measures are required to ensure its adequate implementation in practice as the regulation brings new substantive requirements.	The FSM should ensure that accounting obligations under the EOI Act are properly implemented in practice
Banking information and beneficial ownership information should be available for all account-holders *(ToR A.3)*		
The legal and regulatory framework is in place, but certain aspects of the legal implementation need improvement.	Although banks are required under the AML Act to identify their customers and the person on whose behalf, or for whose ultimate benefit the customer acts, these requirements do not ensure that beneficial ownership information as defined under the standard is available.	The FSM should ensure that beneficial ownership information in respect of bank account holders is available in line with the standard.
EOIR rating: Partially Compliant	The frequency of banking supervision appears adequate. Nevertheless, concerns arise in respect of its depth, in particular concerning review of due diligence measures required to be carried out under the AML Act.	The FSM should strengthen supervision of banks' compliance with their due diligence obligations.
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 legal and regulatory framework is in place.		

Determination	Factors underlying recommendations	Recommendations
EOIR rating: Compliant	Although the FSM access powers for exchange of information purposes appear adequate, their practical application for exchange of information purposes remains to be tested.	The FSM should monitor the use of access powers for exchange of information purposes so that information is exchanged effectively.
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 legal and regulatory framework is in place.		
EOIR rating: Compliant		
Exchange of information mechanisms should provide for effective exchange of information *(ToR C.1)*		
The legal and regulatory framework is in place.		
EOIR rating: Compliant		
The jurisdictions' network of information exchange mechanisms should cover all relevant partners *(ToR C.2)*		
The legal and regulatory framework is in place.		The FSM should develop its exchange of information network with all relevant partners.
EOIR rating: Compliant		
The jurisdictions' mechanisms for exchange of information should have adequate provisions to ensure the confidentiality of information received *(ToR C.3)*		
The legal and regulatory framework is in place.		
EOIR rating: Compliant		

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 legal and regulatory framework is in place.		
EOIR rating: Compliant		
The jurisdiction should request and provide information under its network of agreements in an effective manner *(ToR C.5)*		
Legal and regulatory framework:	**This element involves issues of practice. Accordingly, no determination on the legal and regulatory framework has been made.**	
EOIR rating: Largely Compliant	The FSM has put in place the necessary processes and resources to ensure effective exchange of information. However, there is no practice to demonstrate their effectiveness.	The FSM should monitor its exchange of information practice so that it provides and requests information under its EOI agreements in an effective manner.

Overview of the FSM

11. This overview provides some basic information about the FSM that serves as context for understanding the analysis in the main body of the report. This is not intended to be a comprehensive overview of FSM's legal, commercial or regulatory systems.

Legal system

12. The FSM is a federation of four states (Chuuk, Kosrae, Pohnpei, and Yap). Each state has its own executive, legislative, and judicial bodies, and independent Constitutions. States also have their own state and municipal laws. The federal 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 states and national courts led by a Supreme Court.

13. The FSM operates a common law legal system based on the United States model. The FSM legal system is hierarchical with the laws of the four states subordinated to the FSM Constitution. The FSM Constitution is the supreme law of the FSM with national (federal) laws taking precedence over state laws. Where statutory law does not exist and there are no relevant FSM customs or traditions, courts take into account the United States common law. The position of international treaties within FSM's legal system is not clear as courts in the FSM have not yet specifically dealt with this issue.

14. The FSM Congress has the exclusive power to regulate interstate commerce and banking and exclusive authority to impose taxes on income and imports. States may generally regulate economic activity within their borders and may impose taxes other than on income or imports. For the most part, entities can be established under either state or national law, and each of the four states has legislation regulating the creation and operation of various entities.

Tax system

15. The FSM's main national taxes comprise of import duties, wages and salaries tax, gross revenue tax and corporate income tax on major corporations. Transactions taxes are levied on the level of individual states in the form of sales tax and/or services tax.

16. The tax system in the FSM is generally territorial, except for the corporate income tax on major corporations which taxes worldwide income. Residency for corporate income tax purposes is based on place of incorporation of the entity. Pursuant to the Corporate Income Tax Act, a major corporation is defined as a corporation (except a bank) 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 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 2018, the corporate tax rate for major corporations was 21%, regardless of whether the corporation does business in the FSM. However, the FSM does not levy tax on dividends or interest. The gross revenue of any business in the FSM (except for a "major corporation") which earns more that USD 10 000 per taxable year is subject to gross revenue tax at a rate of 3%. The gross revenues tax is based on territorial taxation as the tax is applicable only to revenues raised in the FSM. The same rules apply to trusts, i.e. if a trust operates within the FSM, it is taxed on its gross revenue generated from within the FSM.

17. The formulation of national tax policy is the responsibility of the Department of Finance and Administration (DOFA). The DOFA has four divisions, one of which is Customs and Tax Administration (CTA). The CTA administers national taxes as well as some state taxes.

Financial services sector

18. FSM's financial sector is limited and primarily consists of banking and insurance business. The financial sector represents about 4.5% of FSM's nominal GDP.

19. The banking sector consists of two depository banks i.e. Bank of FSM, domiciled in the FSM, and branches of the Bank of Guam, domiciled in the United States. Total assets of these commercial banks are USD 351 million as of December 2018. Only FSM citizens and resident foreigners with valid work permits are allowed to open accounts with the Bank of FSM. The average bank account deposits are small, with only a few of well-known local families holding accounts of over USD 100 000. In addition to commercial

banks, there are two development banks, i.e. the FSM Development Bank and the Pacific Islands Development Bank based in Guam.

20. FSM depository banks are regulated under title 29 of the FSM Code. In addition, both banks currently operating in the FSM are also regulated and insured by the U.S. Federal Deposit Insurance Corporation (FDIC). This is because the Bank of Guam is domiciled in the United States and the Bank of FSM is subject to FDIC regulation and supervision under the Compact Agreement with the United States, Article XI. Both FDIC insured banks in the FSM are therefore subject to existing and future U.S. banking and banking related laws, rules and regulations, except where such laws, rules, and regulations conflict with the FSM constitutional prohibition on land ownership by aliens, which are applicable in addition to the FSM regulations. The Banking Board is responsible for supervision and monitoring of the banking system including for the purposes of AML/CFT. The Banking Board's authority is governed by Title 29 of the FSM Code. In addition, the FDIC office in San Francisco, California does regular review of the FSM's banking system. There is no FSM central bank or monitoring authority outside of the Banking Board and the FDIC.

21. 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. Captive insurance companies can only be incorporated or licensed 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. The Insurance Board issued the FSM Captive Insurance Regulations which provide further details for the captive insurance sector. As at December 2018, there were 25 captive insurance companies licensed by the Insurance Board.

22. There is no stock market or securities exchange in the FSM. All securities must be registered with the Registrar of Corporations prior to being sold or transferred.

23. Relevant professions in the FSM include the provisions of law, accountancy and notarial services. Attorneys are regulated by the courts in which they are admitted to practice law. Accountants are not formally regulated. Notaries public are appointed by the FSM Secretary of Justice or a State Attorney General and are authorised or accredited by the Registrar of Corporations to administer the required procedural steps and filings. The documents that major corporations (which include any captive insurance company) file with the national authorities under the relevant laws must be notarised, including the stock affidavit and the articles of incorporation.

24. The FSM has enacted the Money Laundering and Proceeds of Crime Act providing for AML/CFT regulation. The activities covered by this legislation include persons who carry on a business of an insurer, an insurance intermediary, commercial banking, safekeeping or administration of securities.

25. Although the FSM is an observer of the Asia/Pacific Group on Money Laundering (APG), it is not a member of any of the Financial Action Task Force (FATF) style regional bodies and has not yet undertaken a Mutual Evaluation Report relating to the implementation of AML/CFT standards. The FSM status on the FATF list of countries is "monitored," indicating low risk of money laundering.

Recent developments

26. Subsequent to the 2014 report, the FSM enacted new legislation to specifically provide rules for exchange of information on request. The Exchange of Information Act 2016 (EOI Act) entered into force on 6 February 2017. The EOI Act and implementing Regulations (EOI Regulations) require every business or entity (regardless of state of incorporation and registration) to provide ownership and identity information to the CTA or the Secretary of Finance, if such information has not been submitted to the Registrar of Corporations, and to maintain accounting records. In addition, in April 2019, the FSM issued additional regulation under the EOI Act (BO Regulation) which defines the concept of beneficial owner for the purposes of the EOI Act.

27. The Business Organisation Act of 2016, became law on 3 August 2017 and replaces previous business regulations contained in Title 36, Chapter 1 of the FSM Code. The new act regulates corporations registered with the national Registrar of Corporations, including Major Corporations. The act does not bring substantive changes in the rules relied upon for the availability of legal ownership information already described in the 2014 report. Nevertheless, the act and subsequent regulation bring additional obligations in respect of the identification and maintenance of information on beneficial owners of companies (see further section A.1.1).

28. As the FSM is considered a developing country without a financial centre it has not been asked to commit to the implementation of the standard on automatic exchange of financial account information in tax matters.

Part A: Availability of information

29. Sections A.1, A.2 and A.3 evaluate the availability of ownership and identity information for relevant entities and arrangements, the availability of accounting information and the availability of bank information.

A.1. Legal and beneficial ownership and identity information

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

30. The 2014 report concluded that FSM's legal and regulatory framework generally ensures the availability of legal ownership information but improvement was recommended in respect of certain domestic companies and foreign trusts.

31. Since then, the FSM brought into force the EOI Act which strengthens the availability of ownership information in respect of all relevant entities and arrangements in the FSM and addressed the recommendations made in the 2014 report. Under the EOI Act, every entity and arrangement (including domestic companies and foreign trusts with resident trustees) must provide annually complete ownership and identity information to the tax administration. Small businesses are exempted from the filing obligation but are still required to maintain complete ownership information at their principal place of business in the FSM. The maintained information must be up to date and kept for at least five years since the end of the period to which it relates. Administrative as well as criminal sanctions apply for failure to comply with the EOI Act requirements.

32. The EOI Act also requires the availability of beneficial ownership information as defined under the standard. As in the case of legal ownership information, all relevant entities and arrangements must file the required beneficial ownership information with the tax administration or, in the case of small businesses, to maintain it at the place of business in the FSM. Further, the FSM recently brought into force beneficial ownership requirements under the Business Organisation Act covering companies registered at the national level. The obliged persons are required to keep and maintain up to date the

identification of their beneficial owners and file this information annually with the Registrar of Corporations.

33. The main source of legal ownership information in practice over the reviewed period was the information filed with the Registrars or information kept by the entities themselves. The FSM authorities report that about 90% of obligated entities are in compliance with their filing obligations with the Registrar and that the number of inactive companies is low (if any). In February 2017, the FSM brought into force ownership information requirements under the tax law which address the 2014 report recommendations and together with subsequent regulations ensure the availability of beneficial ownership information in line with the standard. Although the CTA and the Registrar of Corporations have taken certain measures to implement the new rules, their impact on the availability of legal as well as beneficial ownership information in the FSM remains to be seen. The FSM is therefore recommended to monitor their implementation.

34. As the FSM does not have any EOI instrument in place, there has been no EOI practice concerning ownership information.

35. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework		
Determination: In place		
Practical implementation of the standard		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of EOIR in practice	The EOI Act brought in new ownership requirements. It requires the availability of beneficial ownership information for companies, partnerships and trusts, covers companies created under the state law of Chuuk and Kosrae which were previously not required to file or keep legal ownership information and brings in consistent rules ensuring the availability of legal ownership and identity information for partnerships and foreign companies with sufficient nexus with the FSM. Further, the FSM recently brought into force beneficial ownership requirements under the Business Organisation Act covering companies registered at the national level.	The FSM should monitor implementation of the EOI Act and the Business Organisation Act and, if necessary, take further measures to ensure that legal as well as beneficial ownership information is available as required under the standard.
Rating: Largely Compliant		

A.1.1 Availability of legal and beneficial ownership information for companies

36. As described in the 2014 report, the FSM law provides for the creation of companies. Companies are formed either under the laws of the federation (national law) or under the laws of one of the four states. There are about 1 500 companies registered in the FSM. As of December 2018, there were 85 major corporations registered in the FSM,[1] 694 companies registered in Pohnpei, 235 companies registered in Chuuk, 288 in Yap, 236 in Kosrae.

37. Legal ownership information is required to be available in respect of all companies either under the company law or under the EOI Act (tax law). Beneficial ownership information must be available under the EOI Act and under the Business Organisation Act. Certain beneficial ownership information is also available with AML obligated entities or professionals to the extent they are engaged by the company. The following table[2] shows a summary of the scope of coverage of these rules.

Type	Company law	Tax law	AML Law
All companies	Legal – some Beneficial – some	Legal – all Beneficial – all	Legal – some Beneficial – some

Legal ownership and identity information requirements

38. The 2014 report concluded that legal ownership information in respect of domestic companies is available in line with the standard, except for the companies created under the state laws of Chuuk and Kosrae. All companies incorporated under national (FSM) law (which includes all captive insurance companies) are required to register with the Registrar and submit to it updated ownership information on an annual basis (ss. 5.4 and 21 Corporate Regulations). Further, all companies, except for companies created under the state laws of Chuuk and Kosrae, are required to maintain a register of shareholders containing identification of all their shareholders. The required

1. Pursuant to the Corporate Income Tax Act, major corporation is defined as a corporation (except a bank) 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 is USD 10 million, or that is a captive insurance company licensed pursuant to the Captive Insurance Law.
2. The table shows each type of company and whether the various rules applicable require availability of information for "all" such entities, "some" or "none". "All" in this context means that every company of this type is required to maintain ownership information in line with the standard and that there are sanctions and appropriate retention periods. "Some" in this context means that a company will be required to maintain information if certain conditions are met.

ownership information must be kept generally at least for five years since the end of the period to which it relates and sanctions are applicable in cases of failure. In addition, certain legal ownership information is available based on AML obligations of financial institutions to the extent it overlaps with beneficial ownership information required for due diligence purposes (see further section "AML obligations to identify customers" and section A.3).

39. Since the 2014 report, the FSM brought into force the EOI Act which strengthens the availability of legal ownership information in respect of all entities and arrangements in the FSM regardless of the state in which they were incorporated. According to section 603 of the EOI Act, every entity and arrangement must provide annually complete ownership and identity information to the tax administration on a prescribed form. Companies which have filed ownership information with the Registrar of Corporations at the national level within the previous year may file application for an exemption from the above requirements with the CTA Secretary. The annual filing is required to be made by 31 January but upon request it can be extended for 90 days (s. 603 EOI Act). The annual filing obligation covers also companies created under the state law of Chuuk and Kosrae and therefore addresses the recommendation made in the 2014 report.

40. Further rules are contained in the EOI Regulations issued under the EOI Act. In accordance with section 609 of the EOI Act, the EOI Regulations are legally binding and their breach is subject to penalties under the EOI Act described above. The EOI Regulations provide for an exemption from filing complete ownership information for small businesses. Small business is defined as an entity or arrangement with annual turnover and assets less than USD 100 000 (s. 1.6(f) EOI Regulations). There are currently about 1 200 companies which qualify as small businesses. Although small businesses are not required to file ownership and identity information with the CTA, they are still required to maintain such information at their principal place of business. The maintained information must be up to date, kept for at least five years and available for inspection upon request by the CTA (s. 2.4 EOI Regulations). However, it is unclear whether the information is also required to be kept after these entities cease to exist. The FSM should therefore ensure that the legal ownership information in respect of companies exempted from the ownership information filing requirements remains available for at least five years as required under the standard. It is nevertheless noted the exemption applies only in respect of small businesses likely not relevant for exchange of information purposes.

41. The EOI Regulations specify that the tax administration must maintain tax returns and related reports and supporting information, including ownership information, for at least six years after the date of the tax liability due (s. 2.7 EOI Regulations). According to the FSM authorities, the tax administration does not dispose of historical tax records and records

filed prior to the EOIR Act came into effect remain available. Information filed with the Registrar also remains available for an indefinite period of time. As ownership information must be filed with the tax administration or the Registrar of Corporations it remains available regardless whether the company ceases to exist.

42. The new EOI Act contains administrative as well as criminal penalties for failure to provide and maintain ownership information. If any entity or arrangement fails to comply with ownership and identity information requirements, it is subject to a penalty of USD 100 per month of delay and wilful violation of the EOI Act, or regulations issued thereunder, and upon conviction subject to imprisonment for a period of not more than one year, or fine of not more than USD 50 000, or both (ss. 607(1) and 608 EOI Act).

43. The EOI Act entered into force on 6 February 2017. Obligations under the EOI Act cover all registered entities and arrangements irrespective of date of registration and apply in respect of tax periods starting after February 2017.

44. Concerning foreign companies, the 2014 report concluded that 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 further stated that it was expected that the number of foreign companies with a sufficient nexus was very low, and, even if in the cases of Kosrae and Yap information on the shareholders was limited to non-citizens or to the non-citizens owning more than 20% of the shares, the gap appeared to be very narrow and was to be further examined in the course of the next EOIR review of the FSM. Since then the FSM brought into force the EOI Act which covers all entities and arrangements registered in the FSM but also foreign companies with permanent establishment in the FSM or owning assets therein (s. 602(3) EOI Act). As described above, pursuant to section 603 of the EOI Act, every entity covered by the EOI Act must provide annually complete ownership and identity information to the tax administration or to the Registrar of Corporations or in case of small businesses to maintain the information itself. The EOI Act covers all companies with sufficient nexus with the FSM because companies with a place of effective management or headquarters in the FSM will be considered as having permanent establishment in the FSM under the FSM tax law (or tax residency in case of major corporations) and/or own assets in the FSM. Therefore the legal concern described in the 2014 report is addressed.

Implementation of obligations to keep legal ownership information in practice

45. The main source of legal ownership information in practice is the information filed with the Registrar or information kept by the entities

themselves. In February 2017, the FSM brought into force ownership information filing requirements with the tax administration which will become important source of ownership information where information is not required to be filed with the Registrar of Corporations.

Practical availability of ownership information with the Registrar

46. Section 118 of title 36 of FSM Code provides that corporate existence begins when the articles of incorporation are filed with the Registrar. All registrations and subsequent filings are currently paper based. Registrars of Corporations are organised at the national level and at the state level. There is no central corporate register. Nevertheless, major companies are registered at the national level.

47. All major corporations are required to disclose ownership information upon registration with the Registrar of Corporations, file an annual report with the Registrar, and make their books and accounts available upon request of the Registrar of Corporations, subject to court order for contempt in case of failure to do so and criminal sanctions (s. 291 FSM Code, Title 36).

48. Major corporations must notarise documents to be filed with the Registrar. Notaries public are either appointed by the Attorney General (if FSM citizens) or accredited by the Registrars (if foreigners). Every notary public must record in a book of records all acts and other documents he/she has notarised or handled in an official capacity (s. 423 FSM Code, Title 32). Ownership information is among the information required to be maintained. There is no statutory timeframe for notaries public to maintain records, but on an annual basis, they must deposit the book of records with either the Clerk of Courts for the Truk District (if appointed by the Attorney General) or the Registrars (if accredited by the Registrar). A notary's failure to provide the records as required by law is sanctionable (s. 424 FSM Code, Title 32).

49. Registration of a company begins with filing of Articles of Incorporation with the Registrar of Corporations. The Registrar reviews the Articles of Incorporation against a checklist to determine whether the requirements of the corporation law are fulfilled. Prior to issuance of Certificate of Incorporation, the Registrar typically forwards the reviewed package to the Department of Justice for review. The Department of Justice's review is usually completed within seven days. Where a company plans to carry out regulated business in the FSM, the Department of Justice will inform the company of the licensing requirements (e.g. to obtain a fishing license from the FSM fisheries agency or to secure a license from the FSM Banking Board). The Department of Justice also conducts background checks of founders and officers of the new company, especially those that are not yet known in the FSM. This background check involves the FSM Transnational

Crime Unit to conduct verification of individuals to see if there are criminal records of those individuals.

50. Noncompliance with annual filing and disclosure requirements is subject to administrative fines and criminal penalties. A failure to file an annual return is subject to a fine of USD 100 for every 30 days of violation (s. 291 FSM Code, Title 36). A continuance of a failure to file the required report can ultimately trigger involuntary dissolution by the Registrar (s. 263(1)(b) FSM Code, Title 36). The Registrars of Corporations also have the power to subpoena witnesses and documents in an investigation of a corporation. Refusal to comply with the Registrar's request for records is a criminal offense. The Registrars of Corporations request inspection of shareholder registers on a case by case basis where a risk of non-compliance is perceived. It should also be noted that the information contained in the register of shareholders constitutes proof of shareholder rights in the company. Ownership information kept by the companies can be also verified through tax supervision which is becoming more prominent with the implementation of ownership requirements under the EOI Act.

51. The FSM authorities report that the number of registered inactive companies is low (if any) and none of these are major corporations. Rather than becoming inactive, companies tend to withdraw their registration and proceed with a dissolution. Less than five companies have been deregistered since the corporate registry was established in the FSM in 2006.

Practical availability of ownership information with the tax administration (CTA)

52. All FSM corporate entities must be registered with CTA, file quarterly or annually tax returns and maintain ownership information.

53. Currently, all tax registrations are paper based. The first step for any business prior to operation is to obtain a business license. Business licenses are issued at one of three levels of government (i.e. national, state or municipality level), depending on where the entity will mostly transact business. Business licenses must be renewed annually. To obtain a business license and open a bank account an entity must first obtain a Social Security ID from the Social Security Administration. The Social Security Administration shares with the CTA, based on a Memorandum of Understanding, all new registrations including identity and ownership information. The CTA also requests at the beginning of the tax year a list of all businesses registered and operational with the Social Security Administration for the year.

54. Annually, the CTA undertakes a double check by reconciling entities registered with the tax administration with lists obtained from the licensing authorities. This reconciliation is undertaken at the State CTA office level.

These lists are forwarded to the CTA National office for entry into the national tax register.

55. Generally the same procedures are used also for registration of major corporations. When a major corporation is registered with the Registrar and receives its Certificate of Incorporation it has 60 days to provide to the Secretary of Finance its initial report. This report contains information on the corporation's bank account, certificate of incorporation, mailing address, and its FSM contacts. It also includes a description of the nature of the business and its fiscal year. Based on this information the major corporation is entered into the tax register. The CTA receives further information from the Micronesia Registration Advisors, Inc. (MRA) and reconciles its tax register with the Registrar's records once a year.

56. The CTA sends out an annual questionnaire to all registered entities requesting information on current activity status, ownership, employment, and current contact information. The CTA has one staff member in each State responsible for maintaining the tax register for the State. The staff regularly visit the State Business Licence Office to cross check for any new licenses issued to ensure the new companies are also registered for tax purposes. They also visit municipality offices and drive around the respective islands inspecting any new businesses that appear. About 84% of domestic businesses in the FSM are traders (e.g. small stores) with annual turnover of less than USD 100 000. The CTA staff are typically familiar with business activities on their respective islands. The CTA carries out also on-site tax audits which are carried out at state office level. National staff visit state offices to support this activity (see further section A.2).

57. The CTA adopts an annual compliance audit strategy. The CTA ensures that large companies are filing tax returns each quarter. In 2017, only 347 businesses had total revenue over USD 100 000 with most of these companies based in Pohnpei State. The staff member in each CTA state office monitors the tax filing compliance through a spreadsheet for each quarter of the tax year. When a taxpayer does not make his quarterly tax payment daily penalties and interest are automatically applied. This incentivises most entities to pay on time. When a large taxpayer is missing at the end of a quarter they are sent a letter of tax default to remind them and to inform them that the penalty and interest clause has begun to take effect.

58. There are approximately 100 traders (mainly individuals) across the four States who did not file tax returns; representing about 7% of registered businesses. The FSM authorities inform that these are in most cases small stores that regularly close for periods of time as their owners travel overseas and typically are not companies. Nevertheless, enforcement action is taken by the CTA to prompt them into filing. All 85 major corporations (including captive insurance companies) were compliant with their tax filing requirements over the reviewed period.

Implementation of the EOI Act

59. As described above, the EOI Act brings new ownership information filing requirements with the tax administration for all entities and arrangements in the FSM regardless of the state in which they were incorporated. Companies which file ownership information with the FSM National Registrar may apply for an exemption with the CTA Secretary. The exemption applies for one year upon approval and verification of the application by the CTA.

60. Availability of ownership information based on the requirements of the EOI Act is to be ensured generally in the same way as in respect of other tax requirements described above. The FSM is currently finalising the necessary administrative measures (including the amendment of tax return filing forms) to implement these obligations.

61. After coming into force of the EOI Act, the CTA undertook a thorough update of the companies' tax register in October 2017. The update included a comprehensive review of the availability of ownership information. The CTA reviewed major corporations and confirmed that all major corporations filed their annual tax returns in 2017, which included updated ownership information as required by law.

62. The EOI Act brought in new ownership obligations towards the tax administration. The EOI Act covers also companies created under the state law of Chuuk and Kosrae which were previously not required to file or keep legal ownership information and brings consistent rules ensuring availability of legal ownership information for all foreign companies with sufficient nexus with the FSM. The CTA has taken certain measures to ensure proper implementation of the new rules. However, the ownership requirements remain to be fully implemented and the impact of these rules on the availability of legal ownership information in the FSM remains to be seen. The FSM is therefore recommended to monitor their implementation.

Beneficial ownership information

63. Under the 2016 ToR, beneficial ownership information on companies should be available. The following sections of the report deal with the requirements to identify beneficial owners of companies and their implementation in practice.

64. The availability of beneficial ownership information in the FSM is mainly based on the obligations contained in regulations issued under the EOI Act and the Business Organisation Act. These obligations cover all relevant entities and arrangements and require them to make beneficial ownership, as defined under the standard, available. Certain beneficial ownership

information is also required to be available based on AML obligations of financial institutions, if engaged by the company in the FSM (which is not required). However, this information is not up to the standard.

Beneficial ownership requirements under the EOI Act

65. As already described in respect of legal ownership information, in February 2017 the FSM brought into force the EOI Act which requires all relevant entities and arrangements to provide annually ownership and identity information to the tax administration (s. 603(1) EOI Act). The EOI Regulations further specify that the information required to be provided includes legal and beneficial ownership information (s. 2.1 EOI Regulations). Finally, the BO Regulation defines beneficial ownership information and obliges entities (and arrangements) to also maintain this information themselves.

66. The EOI Regulations state that every business or entity, except for a small business, shall provide complete ownership and identity information, including legal and beneficial ownership information, to the CTA on or before January 31 each year (s. 2.2 EOI Regulations). Business is defined as including any profession, trade, manufacture, or other undertaking carried on for pecuniary profit in the FSM, but excluding employment. Entity is defined as a company, corporation, partnership, unincorporated association or other business entity, trust, or estate that

- is registered in the FSM as a separate legal entity, including entities registered with the national government or with a state or local government
- has a permanent establishment in the FSM
- owns assets in the FSM, or
- in the case of a trust, has a trustee resident in the FSM (ss. 602(1) and 602(3) EOI Act and s. 1.6 EOI Regulations).

67. Small businesses are exempted from the filing obligations. Nevertheless, they are required to maintain records containing identification of their beneficial owners at their principal place of business in the FSM (s. 2.4 EOI Regulations).

68. In April 2019, the FSM brought into force a binding BO Regulation issued under s. 609 of the EOI Act which defines the concept of beneficial owner for the purposes of the EOI Act. The definition of the beneficial owner mirrors the definition under the standard. The beneficial owner is defined as "the natural person(s) who ultimately owns or controls a legal person or arrangement. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. Reference to ultimate ownership

or control and ultimate effective control refer to situations in which ownership/control is exercised through a chain of ownership or by means of control other than direct control." (s. 2(b)(1) BO Regulation).

69. The definition of beneficial owner is further detailed in respect of legal persons as follows:

- The identity of the natural persons (if any – as ownership interests can be so diversified that there are no natural persons, whether acting alone or together, exercising control of the legal person or arrangement through ownership) who ultimately have a controlling ownership interest in a legal person. A person has a controlling ownership interest in a legal person if it has direct or indirect ownership or control over more than 25% of the shares or voting rights in that legal person; and
- To the extent that there is doubt as to whether the person(s) with the controlling ownership interest are the beneficial owner(s) or where no natural person exerts control through ownership interests, the identity of the natural persons (if any) exercising control of the legal person or arrangement through other means.
- Where no natural person is identified in the two steps above, the identity of the relevant natural person who holds the position of senior managing official (s. 2(b)(1)(i) BO Regulation).

70. In addition to filing obligations with the tax administration, all entities and businesses must keep and maintain up to date the identification of beneficial owners themselves and provide additional information upon request of the CTA (ss. 3(b) and 3(g) BO Regulation). The required information must contain the full name, current address and the date of birth of all identified persons and must be kept for at least six years after the end of the period to which it relates. The six-year retention period runs regardless of whether the business or entity continues to exist (s. 3(d) BO Regulation).

71. The beneficial ownership information filed with the CTA must be kept by the tax administration for at least six years after the date of the filing deadline (s. 2.7 EOI Regulations).

72. The same administrative and criminal sanctions apply as in the case of failure to maintain and provide legal ownership information (ss. 607(1) and 608 EOI Act).

73. As in the case of legal ownership information, beneficial ownership obligations under the EOI Act cover all registered entities and arrangements irrespective of date of registration and apply in respect of tax periods starting after February 2017 (see further section "Implementation of beneficial ownership requirements under the EOI Act and the Business Organisation Act").

74. In conclusion, beneficial ownership requirements under the EOI Act and subsequent regulations require availability of beneficial ownership information in line with the standard. The definition of the beneficial owner of companies covers all three aspects of beneficial ownership as foreseen under the standard (i.e. controlling ownership interest, control through other means and control based on formal position within the company). The requirement also covers all relevant companies including foreign companies with sufficient nexus with the FSM. The required information must be maintained for more than five years since the end of the period to which the information relates regardless whether the company ceases to exist and sanctions are applicable in cases of non-compliance.

Beneficial ownership requirements under the Business Organisation Act

75. Another source of beneficial ownership information is a regulation issued under the Business Organisation Act (BOA Regulation). The BOA Regulation came into force in April 2019 and requires all persons registered at the national level to maintain and file with the Registrar of Corporations beneficial ownership information. Persons registered at the national level are mainly major corporations but do not include companies registered at the state level or general partnerships and trusts.

76. Similarly to the BO Regulation, the obliged persons under the BOA Regulation are required to keep and maintain up to date the identification of their beneficial owners and file this information in their annual returns with the Registrar of Corporations (s. 2 BOA Regulation). The beneficial owner is defined in the same manner as in the BO Regulation and mirrors the standard definition.

77. The obliged persons must keep beneficial ownership information for at least five years after the end of the period to which it relates. The five-year retention period runs regardless of whether the entity continues to exist (s. 2(e) BOA Regulation). The beneficial ownership information filed with the Registrar of Corporations is kept for an indefinite period of time.

78. As already noted above in respect of legal ownership information, noncompliance with annual filing and disclosure requirements is subject to administrative fines and can ultimately trigger involuntary dissolution by the Registrar (ss. 291 and 263(1)(b) FSM Code, Title 36).

79. Beneficial ownership obligations under the BOA Regulation cover all obliged persons irrespective of the date of registration and apply in respect of tax periods starting after April 2019.

Implementation of beneficial ownership requirements under the EOI Act and the Business Organisation Act

80. Implementation of beneficial ownership requirements under the EOI Act is the responsibility of the tax administration. The tax administration carries out several supervisory measures to ensure that taxpayers are compliant with their filing and record keeping obligations as described above in the section dealing with the availability of legal ownership information and in section A.2. These measures include monitoring of tax filing requirements, carrying out audits and taking enforcement actions in cases of non-compliance.

81. The FSM is currently finalising the necessary administrative measures to implement beneficial ownership filing and record keeping obligations. These measures include an amendment of tax return filing forms and providing a guidance to the obliged persons on how to comply with their beneficial ownership requirements. The CTA has been primarily focused on completing the regulatory framework for the availability of beneficial ownership which was finalised in April 2019 with the issuance of BO Regulation. The CTA has also devoted resources to update the tax register and works further on transferring it into electronic form.

82. Implementation of the beneficial ownership requirements under the Business Organisation Act is the responsibility of the Registrar of Corporations. Similar to the obligation under the EOI Act, administrative measures are being taken to implement beneficial ownership filing and record keeping obligations. However, as the BOA Regulation is very recent these measures are mostly in planning stage and their effectiveness remains to be seen.

83. Beneficial ownership requirements under the EOI Act and the Business Organisation Act came into force only recently and their full implementation remains to be ensured. The tax administration and the Registrar of Corporations has already taken certain steps to ensure their implementation. Nevertheless, care should be taken, in particular, that companies identify their beneficial owners accurately and that the available beneficial ownership information is up to date. The FSM is therefore recommended to monitor the implementation of new beneficial ownership requirements and, if necessary, take further measures to ensure availability of beneficial ownership information as defined under the standard.

AML obligations to identify customers

84. In addition to obligations under the EOI Act, certain beneficial ownership information is required to be available with covered financial institutions pursuant to FSM's AML law.

85. The AML Act covers financial institutions defined as any person or entity which carries on a specified business activity. Financial institutions do not include lawyers, notaries, accountants or company service providers unless they carry on specified financial activities. These activities include the following:

- acceptance of deposits and other repayable funds from the public
- lending, including consumer credit, mortgage credit, factoring (with or without recourse) and financing of commercial transactions
- financial leasing
- money transmission services
- 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
- underwriting share issues and participation in such issues
- advice to undertakings on capital structure, industrial strategy and related questions, and advice and services relating to mergers and the purchase of undertakings; or
- money-brokering (s. 903(9) AML Act).

86. A financial institution must take reasonable measures to satisfy itself as to the true identity of the customer when entering into a business relationship with it, or when carrying out a transaction with it (s. 913(1) AML Act). True identity in the case of a corporation is established by a certificate of incorporation together with its latest tax return (s. 913(1) AML Act). Further, a financial institution must take reasonable measures to establish whether the customer is acting on behalf of another person. If it appears that a customer is acting on behalf of another person, then the financial institution must take reasonable measures to establish the true identity of any person on whose behalf, or for whose ultimate benefit, the customer is acting, whether as a trustee, a nominee, an agent or otherwise (s. 913(3) AML Act).

87. As further described in section A.3, the FSM's AML requirements ensure that certain beneficial ownership information is required to be available with the covered financial institution. However, the information required to be obtained in order to identify the customer and the person on whose behalf the customer acts does not conform with the definition of beneficial owner under the standard as the concept of acting on behalf of or to be for ultimate benefit of does not establish a clear obligation to identify an individual with ultimate effective ownership or control over the customer as required under the standard. This is particularly the case where the ultimate effective ownership or control is exercised through a chain of legal entities

or arrangements. Further, information required to be obtained pursuant to AML rules may not be available in respect of all companies as they are not legally required to engage a financial institution in the FSM. Consequently, the FSM's AML rules do not ensure that beneficial ownership information in respect of companies is available in the FSM in line with the standard.

88. The implementation of AML requirements is supervised by FSM's Banking Board. In addition, the FDIC does regular review of the FSM's banking system (see further section A.3).

ToR A.1.2. Bearer shares

89. The 2014 report did not raise a concern in respect of bearer shares as there is no provision for corporations formed in the FSM (either under national law, or under state law) to issue shares in a bearer form. There has been no change in this respect since the first round review.

ToR A.1.3. Partnerships

90. The FSM law provides for formation of general and limited partnerships. General partnerships can be formed in accordance with common law principles applicable in all FSM states and under the legislation of Pohnpei and Yap specifically regulating general partnerships. Limited partnerships can be formed only under Yap legislation. As of December 2018, there were no limited or general partnerships registered in Yap. The number of general partnerships created under FSM law is not directly available as general partnerships are not required to be registered with the Registrars. Nevertheless, based on the registrations with the tax authority (42 registered partnerships) the number is very low representing about 1% of entities and businesses.

Information on the identity of partners

91. The 2014 report concluded that information on the identity of partners is generally available in the FSM. However, it was not clear whether the identity information was required to be available in respect of all general partnerships created under the common law or under Pohnpei legislation. General and limited partnerships formed under the law of Yap must register with the Registrar of Corporations in Yap and file annual returns including the names of all partners in the partnership (ss. 1001 and 1104 Yap Code, Corporations and Partnerships Act). If any partnership fails for two years to file annual return, the registrar may strike off such partnership (ss. 1006 and 1121 Yap Code, Corporations and Partnerships Act). 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). Identity of partners information is disclosed at the time of the application or in the annual report to the authority issuing the permit.

92. In addition to the above rules, the FSM recently brought into force the EOI Act which strengthens the availability of information on the identity of partners in respect of all partnerships in the FSM regardless of the state in which they were incorporated. As described in section A.1.1, pursuant to the EOI Act every general and limited partnership must provide annually identity of all its partners to the tax administration. The annual filing obligation covers also general partnerships formed under common law or Pohnpei legislation and therefore addresses the concern contained in the 2014 report. The new EOI Act contains administrative as well as criminal penalties for failure to file the required identity information and the filed information remains available with the tax administration for at least six years after the date of the tax liability is due (s. 2.7 EOI Regulations).

93. As already described in section A.1.1, the EOI Regulations provide for an exemption from the filing obligation for small businesses (s. 2.4 EOI Regulations). There are currently 22 partnerships which qualify for this exemption. Although they are not required to file ownership and identity information with the CTA, small businesses are still required to maintain such information at their principal place of business. The maintained information must be up to date, kept for at least five years and available for inspection upon request by the CTA (s. 2.4 EOI Regulations). However, it is unclear whether information is required to be kept also after the exempted partnerships cease to exist. The FSM should therefore ensure that the identity of partners of these partnerships remains available as required under the standard.

94. There is limited experience with the practical implementation of the above rules primarily due to the low number of partnerships operating in the FSM. Annually, the CTA undertakes a double check by reconciling entities and arrangements registered with the tax administration with lists obtained from the licencing authorities. The CTA staff also visit municipality offices and inspect any new businesses that appear (see further section A.1.1 and A.2). The Secretary of Department of Resources and Development supervises the issuance of foreign investment permits. Based on the information provided by the FSM authorities, there have been no issues identified where the required information would not be provided or would be found inaccurate. Nevertheless, the FSM authorities informed that the number of foreign investment permits issued to partnerships is very low (if any).

95. The EOI Act brought new identification requirements covering all relevant partnerships and addresses concerns regarding general partnerships created under the common law or under the Pohnpei legislation identified in

the 2014 report. Although it appears that CTA has taken adequate measures to ensure proper implementation of the new rules, their full impact on the availability of information on the identity of partners of partnerships remains to be seen. The FSM is therefore recommended to monitor their implementation.

Beneficial ownership information

96. The availability of beneficial ownership information of partnerships is mainly based on the EOI Act and subsequent regulations. These obligations cover all relevant partnerships and require them to make beneficial ownership available. Certain beneficial ownership information is further required to be available based on AML obligations of financial institutions in the FSM, if engaged by the partnership.

97. The beneficial ownership requirements under the EOI Act are generally the same for partnerships as for companies. Accordingly, the EOI Act requires domestic partnerships and foreign partnerships carrying out business activities in the FSM to maintain and provide annually beneficial ownership information to the tax administration (s. 603(1) EOI Act, s. 2.1 EOI Regulations and s. 3 BO Regulation). The beneficial owner is defined in line with the standard as the natural person(s) who ultimately owns or controls a legal person or arrangement (s. 2(b)(1) BO Regulation). As in the case of legal ownership information, small businesses (e.g. a general partnership wholly owned by FSM citizens) are exempted from the filing obligations. Nevertheless, they are required to maintain records containing identification of their beneficial owners at their principal place of business in the FSM (s. 2.4 EOI Regulations and s. 3 BO Regulation) (see also section A.1.1).

98. As described above, the filed beneficial ownership information must be kept by the tax administration for at least six years after the date of the filing deadline (s. 2.7 EOI Regulations). Beneficial ownership information kept by entities or arrangements (including partnerships) themselves must remain available for at least six years after the end of the period to which it relates. The six-year retention period runs regardless of whether the business or entity continues to exist (s. 3(d) BO Regulation). Administrative as well as criminal sanctions apply for failure to comply with the EOI Act requirements (see further section A.1.1).

99. In addition to obligations under the EOI Act, certain beneficial ownership information is required to be available with covered financial institutions pursuant to the FSM's AML law. However, partnerships are not required to engage an AML obligated person in the FSM and the information required to be obtained in order to identify the customer and the person on whose behalf the customer acts does not conform with the definition of beneficial owner under the standard (see further section A.1.1 and A.3).

100. As described in section A.1.1, implementation of beneficial ownership requirements under the EOI Act is the responsibility of the tax administration. However, the EOI Act came into force only recently and its full implementation remains to be ensured. The FSM is therefore recommended to monitor the implementation of beneficial ownership requirements under the EOI Act and, if necessary, take further measures to ensure the availability of beneficial ownership information as required under the standard.

ToR A.1.4. Trusts

101. The statutes of the FSM do not provide for the formation of 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. Therefore the only trusts that may be operating in the FSM are trusts formed under the laws of another jurisdiction. Currently, there is no trust registered with the CTA.

102. The 2014 report concluded that there are no requirements ensuring the availability of information on settlors, trustees and beneficiaries of trusts which have trustees resident in the FSM and the FSM was recommended to address this gap.

103. Since then the FSM brought into force the EOI Act which addresses the gap. Pursuant to the EOI Act every trust that has a trustee resident in the FSM must provide annually complete ownership and identity information to the tax administration which includes identity of the settlor, trustee(s), protector (if any), all of the beneficiaries or class of beneficiaries, and any other natural person exercising ultimate effective control over a trust or similar legal arrangement (ss. 602(3)(d) and 603(1) EOI Act, s. 2.1 EOI Regulations and s. 2(b)(1)(ii) BO Regulation). The FSM authorities confirm these requirements must be interpreted in line with the applicable international standards. As described above, small businesses (including a trust) are exempted from the filing obligations. Nevertheless, they are required to maintain records containing identification of their beneficial owners at their principal place of business in the FSM (s. 2.4 EOI Regulations).

104. The ownership information filed with the tax authority remains available for at least six years after the date of the tax liability is due (s. 2.7 EOI Regulations). Similarly, beneficial ownership information kept by trusts must remain available for at least six years after the end of the period to which it relates regardless of whether the trust ceases to exist (s. 3(d) BO Regulation).

105. As described in section A.1.1, the EOI Act contains administrative as well as criminal penalties for failure to maintain the required ownership information.

106. As already described in respect of the availability of ownership information on companies and partnerships, the implementation of ownership requirements under the EOI Act is the responsibility of the tax administration. However, the EOI Act came into force only recently and its full implementation remains to be ensured. It is also noted that the FSM authorities have very limited experience with trusts operating in the FSM or having a resident trustee therein. The FSM is therefore recommended to monitor the implementation of ownership requirements under the EOI Act and, if necessary, take further measures to ensure the availability of ownership information as required under the standard.

ToR A.1.5. Foundations

107. The 2014 report concluded that there are no legislative or common law principles which permit the establishment of foundations under the FSM law. While there are entities that are called foundations, they take the form of other recognised entities. There has been no change in this respect since the first round review.

A.2. Accounting records

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

108. The 2014 report concluded that the legal and regulatory framework to ensure the availability of accounting information was not in place.

109. Since then, the FSM brought into force the EOI Act and accompanying regulations which address the recommendations made. The EOI Act requires relevant entities and arrangements to maintain accounting records in line with the standard for a period of at least five years and sanctions are applicable in case of non-compliance.

110. The supervision of accounting requirements is mainly ensured through monitoring of tax obligations. The EOI Act which contains crucial accounting obligations came into force in February 2017. However, measures are required to be taken to ensure its adequate implementation in practice as the regulation brings new substantive requirements. The FSM is therefore recommended to ensure its appropriate implementation.

111. As the FSM does not have any EOI instrument in place, there has been no EOI practice concerning accounting information.

112. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework		
Determination: In place		
Practical implementation of the standard		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of EOIR in practice	The EOI Act which contains crucial accounting obligations came into force in February 2017. However, further measures are required to ensure its adequate implementation in practice as the regulation brings new substantive requirements.	The FSM should ensure that accounting obligations under the EOI Act are properly implemented in practice
Rating: Largely Compliant		

ToR A.2.1. General requirements and A.2.2 Underlying documentation

113. The 2014 report concluded that FSM's legal and regulatory framework did not ensure the availability of accounting information in line with the standard. General accounting obligations for companies were contained in the FSM national law and state laws of Yap and Pohnpei but they did not provide further rules including concerning requirement to maintain underlying documentation or the retention period. The laws of Chuuk and Kosrae did not require to keep accounting records at all. None of the state laws governing the formation and organisation of partnerships contained requirements for accounting records to be kept. Accounting obligations of captive insurance companies were found to be in line with the standard as they were obliged to keep full and reliable accounting records, and underlying documentation, for at least five years under the Insurance Act and the Captive Insurance Regulations (CIR).

114. Since then, the FSM brought into force the EOI Act and accompanying regulations to address the recommendations made in the 2014 report. The EOI Act requires relevant entities and arrangements to maintain reliable accounting records, including underlying documentation, for a period of six years. Accounting records are required to (i) correctly explain all transactions, (ii) enable the financial position of the business or entity to be determined with reasonable accuracy, and (iii) allow financial statements to be prepared. The accounting obligations under the EOI Act cover all businesses and entities (including partnerships and trusts) that are (i) registered in the FSM (regardless whether at the national or state level); (ii) have a permanent establishment in the FSM; (iii) own assets in the FSM; or (iv) in the case of trusts, have a

trustee resident in the FSM (s. 604 EOI Act and s. 1.6 EOI Regulations). The EOI Act contains administrative as well as criminal penalties for failure to comply with accounting requirements of the EOI Act or the EOI Regulations. If any entity or arrangement fails to provide accounting information, it is subject to a penalty of USD 500 per month until such information is provided. Further, any wilful violation of the EOI Act or EOI Regulations is, upon conviction, subject to imprisonment for a period of not more than one year, or fine of not more than USD 50 000, or both (ss. 607(2) and 608 EOI Act).

115. The EOI Act allows for simplification of accounting obligations of small businesses. Nevertheless, it provides that such simplification must ensure that accounting records remain compliant with international standards for tax transparency (s. 604(3) EOI Act). Small business is defined as an entity or arrangement with annual turnover and assets less than USD 100 000 (s. 1.6(f) EOI Regulations). The EOI Regulations further specify that the tax authority should provide sample forms and public education to small businesses about the requirements to maintain accounting records. In accordance with the EOI Regulations, accounting records of small businesses can be kept for five years instead of six years (s. 2.6(a) EOI Regulations).

116. The EOI Act does not specify the place where accounting records must be kept. Nevertheless, the records must at all times be available to the tax authority upon request (s. 606 EOI Act).

117. Entities and arrangements must keep records for at least five years, regardless whether the entity or arrangement ceases to exist. EOI Regulations specify that the required accounting records must be maintained even in the event that the entity or arrangement ceases to exist and that the records must be maintained by the person responsible for the winding up of the entity or arrangement (s. 2.5 EOI Regulations). According to the FSM authorities, the person responsible for the winding up of the entity or arrangement is typically the former representative of the entity or arrangement such as the director, or, if an entity was liquidated, the liquidator. Certain unclarity may arise concerning the scope of the concept of winding up and whether an entity or arrangement can cease to exist without a person being responsible for its winding up. According to the FSM authorities the concept of winding up should be interpreted broadly and covers all situations where an entity or arrangement which owned any assets ceases to exist including cases where an entity was liquidated. Nevertheless, given that the obligation is rather recent there is not yet sufficient basis to confirm this and therefore the FSM should monitor whether there are any cases where an entity or arrangement ceases to exist without accounting records being available as required under the standard. In addition to accounting records kept by the entities and arrangements, annual financial statements of major corporations (including captive insurance companies) are required to be submitted to the tax authority and/or the Registrar and remain available there (see further section A.1.1).

118. To conclude, the above requirements address the recommendations made in the 2014 report. The FSM legal and regulatory framework requires that adequate accounting records must be maintained for all relevant entities and arrangements for at least five years in line with the standard and sanctions are applicable in the case of non-compliance.

Implementation of accounting requirements in practice

119. The supervision of accounting requirements is mainly ensured through monitoring of tax obligations. During the peer review period, the tax authority undertook approximately 100 audits per year, covering about 7% of registered entities and arrangements. Tax audits regularly involve analysis of financial statements and check of ownership records of the audited entity. In about half of the tax audits (i.e. in about 50 cases) deficiencies were identified. These deficiencies typically related to underreporting of income. In all cases sanctions were applied consisting of fines and interests on the evaded tax.

120. All captive insurance companies undergo tax audit every three years. In addition, captive insurance companies are subject to supervision by the Insurance Board which includes checking of accounting information and review of annual financial statements.

121. As mentioned in section A.1.1, there are approximately about 7% of registered businesses which did not file tax returns for the respective period. The FSM authorities inform that these are in most cases small stores that regularly close for periods of time as their owners travel overseas. Enforcement action is taken by the CTA to prompt these small businesses into filing, e.g. by phone calls, warning letters, and finally prosecution if need be. All 85 major corporations (including captive insurance companies) were compliant with their tax filing requirements over the reviewed period. All filed tax returns are checked for consistency and irregularities with previous filings. If resulting findings are not properly explained and documented the tax authority opens a tax audit.

122. The EOI Act which contains crucial accounting obligations came into force in February 2017. Its implementation is supervised by already existing measures described above. New obligations under the EOI Act now explicitly require all relevant entities and arrangements to keep underlying documents and cover businesses which previously did not have any accounting obligations such as certain domestic entities or arrangements without FSM sourced income or foreign trusts with a resident trustee. Therefore to ensure compliance with the new obligations, further guidance and supervision are needed. Therefore, the FSM is recommended to ensure that the new accounting obligations under the EOI Act are properly implemented in practice.

A.3. Banking information

Banking information and beneficial ownership information should be available for all account holders.

123. In terms of banking information, the 2014 report concluded that banks' record keeping requirements are in line with the standard. There has been no change in the relevant provisions since the first round review. Supervision of banks compliance with their record keeping obligations is carried out by the FSM Banking Board under the control of the FDIC.

124. Banks are required to obtain certain beneficial ownership information under the AML Act in order to identify the customer and the person on whose behalf the customer acts. However, the identification requirement does not conform with the definition of beneficial owner under the standard. This is particularly the case where the ultimate effective ownership or control is exercised through a chain of legal entities or arrangements. As FSM's rules do not ensure that beneficial ownership information on bank account holders is available in line with the standard the FSM is recommended to address this gap.

125. The implementation of AML requirements is supervised by FSM's Banking Board together with prudential supervision. The frequency of banking supervision appears adequate. Nevertheless, concerns arise in respect of its depth, in particular concerning review of due diligence measures required to be carried out under the AML Act. The FSM is therefore recommended to strengthen its banking supervision in this respect.

126. As the FSM does not have any EOI instrument in place, there has been no EOI practice concerning banking information.

127. The updated table of determinations and ratings is as follows:

Legal and Regulatory Framework		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of the legal and regulatory framework	Although banks are required under the AML Act to identify their customers and the person on whose behalf, or for whose ultimate benefit the customer acts, these requirements do not ensure that beneficial ownership information as defined under the standard is available.	The FSM should ensure that beneficial ownership information in respect of bank account holders is available in line with the standard.
Determination: In place, but certain aspects of the legal implementation need improvement		

Practical implementation of the standard		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of EOIR in practice	The frequency of banking supervision appears adequate. Nevertheless, concerns arise in respect of its depth, in particular concerning review of due diligence measures required to be carried out under the AML Act.	The FSM should strengthen supervision of banks' compliance with their due diligence obligations.
Rating: Partially Complaint		

ToR A.3.1. Record-keeping requirements

128. The main banking regulations are contained in the FSM Bank Act and AML Act. All banks must be licensed with the Banking Board. As of December 2018, there were two commercial banks operating in the FSM. Both of these banks are FDIC insured and required to comply with current and future United States' banking laws and regulations, which are applicable in addition to the FSM regulations.

129. The 2014 report concluded that banks' record keeping requirements are in line with the standard. There has been no change in the relevant provisions since the first round review.

130. The main rules relevant for the current evaluation are contained in the AML Act. As already mentioned in section A.1, banks are covered financial institutions and therefore subject to requirements to identify their customers and establish whether a customer is acting on behalf of another party. For that purpose, a bank must take reasonable measures to satisfy itself as to the true identity of the customer when establishing a business relationship or when carrying out a transaction. Banks are required to obtain an official record reasonably capable of establishing the true identity of the customer, such as a birth certificate, passport or other official means of identification, and in the case of a corporation, a certificate of incorporation together with its latest tax return (s. 913(1) AML Act). Accordingly, anonymous accounts or the use of fictitious names are prohibited as customers' accounts must be kept in the true name of the account holder (s. 914(3) AML Act).

131. Banks are required to maintain transactional records in respect of all transactions exceeding USD 10 000, or its equivalent (s. 914(1) AML Act).

These records must (among other) include particulars sufficient to identify the:

- name, address and occupation (or where appropriate, business or principal activity) of each person conducting the transaction, or if known, on whose behalf the transaction is being conducted, as well as the method used by the financial institution or cash dealer to verify the identity of each such person
- nature and date of the transaction
- type and amount of currency involved
- the type and identifying number of any account with the financial institution involved in the transaction (s. 914(3) AML Act).

132. The required transactional and customer identification records must be kept by the bank for a period of at least five years from the end of the business relationship or the date when the transaction was completed (s. 914(4) AML Act).

133. A bank that 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 250 000 (s. 919 AML Act). 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 (s. 703 AML Act).

134. Record keeping obligations under the AML Act are supplemented by obligations under the Bank Act. Pursuant to the Bank Act, 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 (s. 705 Bank Act).

Implementation of record keeping requirements in practice

135. Supervision of the two banks in the FSM is carried out by the Banking Board under the purview of the Federal Deposit Insurance Corporation (FDIC).

136. The Banking Board conducts supervision through process of on-site and off-site examinations. The Banking Board analyses data submitted by banks on a monthly, quarterly and yearly basis. Two types of onsite examinations are conducted by the Banking Board. One is focused on consumer protection requirements and another on safety and soundness of each financial institution and the overall stability of the FSM banking system. During

the second type of examinations, the supervision team also places emphasis on the adequacy of banks' policies, procedures and practices with respect to obligations under the Bank Act, AML Act and the Criminal Act.

137. Over the last three years, the banking commissioner undertook on-site supervision missions in both banks' head offices and their four branches and accompanied the FDIC representative on one on-site supervision mission. The FSM authorities report that to date there have been no issues with regards to banks' compliance with the law or the supply of information.

ToR A.3.1. Beneficial ownership information on account-holders

138. As described above, a bank must take reasonable measures to satisfy itself as to the true identity of the customer when entering into a business relationship with it, or when carrying out a transaction with it (s. 913(1) AML Act). Further, a financial institution must take reasonable measures to establish whether the customer is acting on behalf of another person. If it appears that a customer is acting on behalf of another person, then the financial institution must take reasonable measures to establish the true identity of any person on whose behalf, or for whose ultimate benefit, the customer is acting, whether as a trustee, a nominee, an agent or otherwise (s. 913(3) AML Act). In determining what constitutes reasonable measures, banks must consider all circumstances of the case, and in particular (i) whether the customer is based or incorporated in a country in which applicable provisions are in force to prevent the use of the financial system for the purpose of money laundering; and (ii) to custom and practice in the relevant field of business (s. 913(4) AML Act).

139. The FSM's AML law does not provide for any simplified or alternative due diligence procedures in respect of some type of customers. It also does not allow banks to rely on due diligence measures performed by third parties.

140. The FSM's AML requirements ensure that certain beneficial ownership information is required to be available with banks. However, the information required to be obtained in order to identify the customer and the person on whose behalf the customer acts does not conform with the definition of beneficial owner under the standard as the concept of acting on behalf of or to be for ultimate benefit of does not include the clear obligation to establish an individual with ultimate effective ownership or control over the customer as required under the standard. This is particularly the case where the ultimate effective ownership or control is exercised through a chain of legal entities or arrangements. It is uncertain that banks must adequately understand ownership and control structure of the customer to the extent that allows them to identify the individual at the end of the chain of ownership or

control. There is also no definition of what is meant by acting on behalf of another person or of the ultimate benefit. It is understood that the person on whose behalf, or for whose ultimate benefit, the customer is acting can also be a legal entity or arrangement. Consequently, FSM's rules do not ensure that beneficial ownership information on bank account holders is available in line with the standard. It is therefore recommended that the FSM addresses this gap.

141. The implementation of AML requirements is supervised by FSM's Banking Board. The applied measures include on-site and off-site examinations as described above. In its on-site examinations, the Banking Board seeks to confirm compliance with banks record keeping and AML obligations. Nevertheless, the main focus of the supervision is on banks' prudential standing.

142. As described above, the frequency of banking supervision appears adequate. Nevertheless, concerns arise in respect of its depth, in particular concerning review of due diligence measures required to be carried out under the AML Act in order (i) to establish whether the customer is acting on behalf of, or for ultimate benefit of another person, (ii) to identify (and verify) this other person and (iii) to keep the obtained information accurate and up to date. As no cases of significant breaches of due diligence obligations were discovered, it also remains to be seen whether the applied enforcement measures would be adequate and deterrent enough to ensure compliance with due diligence rules. In view of the above, the FSM is recommended to strengthen its banking supervision.

Part B: Access to information

143. Sections B.1 and B.2 evaluate whether competent authorities have the power to obtain and provide information that is the subject of a request under an EOI arrangement from any person within their territorial jurisdiction who is in possession or control of such information; and whether rights and safeguards are compatible with effective EOI.

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).

144. The FSM has appropriate access powers to obtain all types of relevant information including ownership, accounting and banking information from any person in order to comply with obligations under FSM's EOI agreements. In the case of failure to provide the requested information, the tax administration has adequate powers to compel the production of information and the scope of information protected from disclosure appears in line with the standard.

145. The 2014 report concluded that the FSM should put in place legislation that would give the government powers to access and exchange information pursuant to a request under an EOI agreement and that the FSM should ensure that professional secrecy is consistent with the standard.

146. Since then the FSM has made legislative changes to address the recommendations:

- In February 2017, the EOI Act came into force. The EOI Act grants the tax administration powers to obtain tax information for the purpose of complying with a request for exchange of tax information and contains administrative and criminal penalties for failure to provide the requested information. The EOI Act also stipulates that

the tax administration's access powers under FSM's EOI agreements can be subject only to privileges recognised by the FSM Supreme Court, and without regard to contractual duties of confidentiality and professional ethical requirements.

- The FSM issued binding EOI Regulations providing more detailed rules for exchange of information. The EOI Regulations explicitly state that when responding to a request for exchange of information pursuant to an EOI agreement, the tax administration can exercise its access powers notwithstanding that the information may not be needed for the FSM's own tax purposes and confirm that privileges must be strictly construed and consistent with the terms of the EOI agreement.

147. These changes appear to address the recommendations made in the 2014 report. However, as the FSM does not have any EOI agreement and no EOI practice, their practical application remains to be tested. The FSM should therefore monitor their use so that information is exchanged effectively.

148. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework		
Determination: In place		
Practical implementation of the standard		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of EOIR in practice	Although the FSM access powers for exchange of information purposes appear adequate, their practical application for exchange of information purposes remains to be tested.	The FSM should monitor the use of access powers for exchange of information purposes so that information is exchanged effectively.
Rating: Compliant		

ToR B.1.1. Ownership, identity and bank information and ToR B.1.2. Accounting records

149. The tax administration has appropriate access powers to obtain all types of relevant information including ownership, accounting and banking information from any relevant person in order to comply with obligations under FSM's EOI agreements.

150. The 2014 report concluded that although the tax authorities have access to accounting and banking information for domestic tax purposes, FSM's domestic laws do not allow for access to any information with regard to any entity or arrangement pursuant to an EOI mechanism. Consequently, the FSM was recommended to enact legislation that would give the government powers to access and exchange information pursuant to an EOI request.

151. Since then the FSM has amended its domestic law to ensure that the tax administration has powers to access and provide information requested for exchange of information purposes. In February 2017, the new EOI Act came into force. Article 606 of the EOI Act stipulates that the CTA's Secretary has the authority to use any statutory powers to obtain access to tax information for the purpose of complying with a request for exchange of tax information, including:

- powers to summon persons to provide testimony or provide documents under section 157(1) of ITA
- powers to summon third parties to provide testimony or provide documents under section 157(2) of ITA
- powers of access to records under section 151 of ITA
- powers of search and seizure (s. 606(1) EOI Act).

152. The referred provisions of the ITA give the CTA's Secretary broadly defined power to summon the person or persons liable for tax to appear before the Secretary or his designee and at such appearance to produce such documents and to give such testimony as specified in the summons. These provisions apply also to any officer or employee or agent of such person or persons or any third party having possession, custody, or care of books of accounts relating to the business of the person or persons liable for tax.

153. Procedural rules for the exercise of statutory access powers for exchange of information purposes are the same as for domestic tax purposes (s. 606(2) EOI Act) (see also section B.2). Therefore, the exercise of access powers for exchange of information is not subject to any additional procedural requirements such as court approval. However, where information is to be obtained through search and seizure, the competent authority would have to have authorisation from the FSM Department of Justice or a court.

154. Access powers for exchange of information purposes are further confirmed and detailed in the EOI Regulations issued under the EOI Act. The EOI Regulations state that existing statutory powers to collect information for tax purposes may also be used to comply with a request for exchange of tax information. These powers must only be exercised pursuant to the terms of an agreement or treaty that provides for the exchange of information. The CTA Secretary should exercise such powers by notice in writing, and may require

any person (i) to furnish such information as the Secretary may require; (ii) to attend and give evidence concerning that person's or any other person's affairs; or (iii) to produce all accounts, books, documents, and records (including in electronic form) in the person's custody or under the person's control that may be necessary to respond to an EOI request. The Secretary may require the information or evidence to be given on oath, verbally or in writing (s. 3.1 EOI Regulations).

155. According to the FSM authorities, the use of these access powers in the domestic context is efficient and allows the tax administration timely access to all types of relevant information. In terms of the sources of information used for tax purposes, legal and beneficial ownership information is normally obtained from the corporate register or entities themselves, accounting information from the entities and banking information from banks. There are no specific procedures for access to banking information differing from access to other types of information. Generally, taxpayers are given 30 days to provide the requested information after which period enforcement measures can be applied.

156. As further described in part C of this report, the FSM does not have any EOI agreement and no EOI practice. Although the FSM access powers for exchange of information purposes appear adequate, their practical application for exchange of information purposes remains to be tested. The FSM should therefore monitor their use so that information is exchanged effectively.

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

157. 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.

158. The 2014 report concluded that the FSM was not able to use its domestic information gathering measures regardless of domestic tax interest as CTA's access powers were granted only for domestic tax purposes.

159. As described in section B.1.1, since then the FSM brought into force new legislation to address this gap. Article 606 of the EOI Act stipulates that the CTA's Secretary has the authority to use any statutory powers to obtain access to tax information for the purpose of complying with a request for exchange of tax information (s. 606(1) EOI Act). The use of access powers regardless of domestic tax interest is further confirmed in the EOI Regulations. The EOI Regulations explicitly state that when responding to a request for exchange of information pursuant to an EOI agreement, the CTA's Secretary may exercise such powers notwithstanding that the

information may not be needed for the FSM's own tax purposes (s. 3.1(b) EOI Regulations).

160. To conclude, the FSM now has access powers allowing it to obtain information for exchange of information purposes. These powers can be used pursuant to a valid request under an EOI agreement regardless of domestic tax interest. However, as the FSM does not have any EOI experience, their practical application for exchange of information purposes remains to be tested. The FSM should therefore monitor their use.

ToR B.1.4. Effective enforcement provisions to compel the production of information

161. Jurisdictions should have in place effective enforcement provisions to compel the production of information.

162. At the time of the 2014 report, the FSM did not have access powers for EOI purposes and therefore there were also no compulsory powers to obtain the information requested under an EOI agreement.

163. The new EOI Act contains administrative and criminal penalties for failure to provide information requested for exchange of information purposes. If any business or entity fails to provide ownership and identity information, it is subject to a penalty of USD 100 per month of delay. Failure to provide other types of information, including banking and accounting information, is subject to a fine of USD 500 per month until the information is provided. A person who fails to provide information pursuant to a third party request for information or testimony is subject to the same fine as a failure to provide accounting or banking information (s. 607 EOI Act). Further, any person, business or entity who wilfully violates any of the provisions of the EOI Act, or regulations issued thereunder, shall upon conviction be imprisoned for a period of not more than one year, or fined not more than USD 50 000, or both (s. 608 EOI Act).

164. The combination of FSM's access powers and applicable administrative and criminal penalties appears adequate to compel the production of requested information. However, the efficiency of enforcement provisions in exchange of information practice remains to be tested. The FSM should therefore monitor their use. It is nevertheless noted that over the reviewed period the CTA applied enforcement measures in domestic cases.

ToR B.1.5. Secrecy provisions

165. FSM's law provides for certain secrecy rules. The most relevant in the exchange of information context are bank secrecy and legal professional privilege.

Bank secrecy

166. As described in the 2014 report, client information kept by banks in connection with provision of banking services is subject to confidentiality and cannot be disclosed to unauthorised persons. Nevertheless, the prohibition of disclosure is not absolute and the banking law provides for exceptions including the following:

- disclosure upon written authorisation by the customer or his legal personal representative
- when required to do so by a court in the FSM; or
- in order to comply with the provisions of the Bank Act or any other written law (s. 704 Bank Act).

167. The EOI Act provides clear obligation on third parties, including banks, to provide information for exchange of information purposes (s. 606(1)(b) EOI Act). Therefore, as EOI Act has the power of a written law, banks cannot claim that the requested information is protected by bank secrecy and are required to provide the information in order to comply with the provisions of the EOI Act.

Legal professional privilege

168. The 2014 report concluded that the domestic protection of information held by legal professionals was too broad and not consistent with the standard. The report noted that the privileges attaching to legal professionals are determined by common law, custom and court precedents.[3] The FSM courts recognise the United States precedents concerning the scope of the privilege. Nevertheless, it further noted that in addition, lawyers are bound by a duty of confidentiality, as prescribed by Model Rules of Professional Conduct, which goes beyond that and covers all information relating to the representation of a client (including work product and non-privileged information disclosed by the client) at all times.

169. Since then the FSM enacted the EOI Act which limits the scope of privileges applicable in respect of exchange of information under FSM's EOI agreements. The EOI Act stipulates that CTA's access powers under EOI agreements can be subject only to privileges recognised by the FSM Supreme Court, and without regard to contractual duties of confidentiality and professional ethical requirements (s. 606(3) EOI Act). EOI Regulations further detail that such privileges must be consistent with the terms of the EOI agreement and must be strictly construed and limited only to privileges

3. See *Adams*, *supra*; *AHPW. Inc. v. FSM* 10 FSM lntrm.420 (Pon.2001) and *Adams v. Island Homes Constr., Inc.* 11 FSM Intrm. 218.230-31 (Pon. 2002).

required by the EOI agreement pursuant to which the information is being collected (s. 3.2 EOI Regulations).

170. The measures taken by the FSM seem to address the 2014 report's concerns. The FSM confirmed that while deciding the scope of rights and safeguards under an EOI agreement, the Supreme Court would take into account not only the text of the agreement but also OECD Commentary providing further explanations, in particular concerning the scope of legal professional privilege. Nevertheless, the interaction between the privileges in the FSM domestic law and under an EOI agreement remains to be tested. It is therefore recommended that the FSM monitors the use of its access powers for exchange of information purposes.

B.2. Notification requirements, 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.

171. Rights and safeguards contained in FSM's law are compatible with effective exchange of information.

172. The FSM's law does not require notification of a taxpayer, subject of an EOI request, before (or after) the requested information is exchanged.

173. Appeal rights applicable while obtaining and providing the requested information are the same as in domestic cases. These are administrative appeal to the CTA's Commissioner or a judicial review. Their impact on exchange of information practice remains to be tested. Nevertheless, the FSM authorities reported that they do not prevent or cause undue delays in domestic tax procedures.

174. The table of determinations and ratings remains as follows:

Legal and Regulatory Framework
Determination: In place
Practical implementation of the standard
Rating: Compliant

ToR B.2.1. Rights and safeguards should not unduly prevent or delay effective exchange of information

175. The rights and safeguards that apply to persons in the requested jurisdiction should be compatible with effective EOI.

176. The 2014 report concluded that as there were no powers to access information to reply to a request made pursuant to an EOI agreement, it was not possible to assess whether rights and safeguards applicable when obtaining and providing the requested information are compatible with effective exchange of information. Accordingly, no determination of the element's compliance with the standard was made. Since then the FSM enacted legislation giving effect to its EOI agreements in FSM domestic law, including providing for access powers pursuant to an EOI request. Therefore, the compliance of applicable rights and safeguards with the standard can be assessed.

177. The FSM law does not require notification of a taxpayer, subject of an EOI request, before or after the requested information is exchanged.

178. Regarding applicable appeal rights, the EOI Act stipulates that the CTA has the power to use domestic access powers for the purpose of complying with an EOI request and that procedural requirements associated with the exercise of statutory access powers for a domestic tax purpose apply when exercising such powers for the purpose of exchange of information (s. 606 EOI Act). A person concerned (i.e. either the person subject of the request or the information holder) may challenge the agency's action before its highest administrative official (s. 108 FSM Code, Title 17). Further, the person concerned can appeal to the court for judicial review of the actions taken by the CTA affecting him/her (see further section C.3 for confidentiality of exchanged information). A court could issue a temporary restraining order or injunction after a hearing demonstrating likelihood that the competent authority was acting illegally, not in the public interest, and in a manner that would cause irreparable harm. However, a person concerned would normally not have acceptable grounds to object to efforts to obtain or exchange the requested information as the EOI Act provides the CTA with clear powers in this respect.[4]

179. The above appeal rights appear compatible with effective exchange of information. These appeal rights are the same as used in the domestic context. The FSM authorities reported they do not prevent or cause undue delays in tax procedures. Over the course of last four years there were less than five cases where appeal rights were exercised in the domestic context. In all cases the appeal process was completed within 90 days since the appeal was launched. Nevertheless, as the FSM does not have any EOI experience, impact of appeal rights on exchange of information practice remains to be tested. The FSM should therefore monitor the use of appeal rights in the EOI context.

4. See FSM v. Kansou, 14 FSM R. 136, 138 (Chk. 2006).

Part C: Exchanging information

180. Sections C.1 to C.5 evaluate the effectiveness of FSM's EOI in practice by reviewing its network of EOI mechanisms – whether these EOI mechanisms cover all its relevant partners, whether there were adequate provisions to ensure the confidentiality of information received, whether it respects the rights and safeguards of taxpayers and third parties and whether the FSM could provide the information requested in an effective manner.

C.1. Exchange of information mechanisms

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

181. The FSM does not have any EOI instruments. This continues to be the case since the 2014 review. The 2014 report concluded that the FSM should enact legislation that would give the government access powers for exchange of information purposes and that it should develop its exchange of information network with all relevant partners.

182. The FSM took several legal as well as practical measures in order to address these recommendations:

- In February 2017, the FSM brought into force the EOI Act. The EOI Act authorises the CTA to enter into EOI agreements and provides the CTA with powers to obtain and exchange information requested under FSM EOI agreements (see further section B.1).
- In May 2017, the FSM issued EOI Regulations providing further rules pursuant to the EOI Act. The EOI Regulations among other things state that collection and exchange of information should take place pursuant to an agreement or treaty and that the CTA must ensure that any collection or exchange of information is consistent with the requirements of the relevant agreement or treaty and with the FSM laws and policies related to exchange of information for tax purposes (s. 4.1 EOI Regulations).

- The FSM adopted a Model EOI agreement based on the OECD Model TIEA. The FSM's model mirrors the model wording and provides for exchange of information in line with the standard.
- The FSM approached several jurisdictions to conclude an EOI agreement. However, the approached jurisdictions did not provide a positive response (see further section C.2).

183. FSM's domestic legislation does not contain any additional conditions to provide information upon request other than contained in the EOI agreement. The FSM authorities confirm that EOI agreements should be interpreted in line with the OECD Commentaries, including taking into account the 2012 update of the Commentary to Article 26 of the OECD Model DTC (e.g. in respect of group requests). Although no jurisdiction agreed to conclude an EOI agreement with the FSM, the adoption of the model EOI agreement demonstrates FSM's willingness to exchange information up to the standard.

184. To conclude, the FSM has the legal framework in place to provide for effective exchange of information once an EOI agreement is in force. Further, the FSM authorities assure that EOI agreements will be applied in line with the standard. Nevertheless, despite FSM's efforts, it still has no EOI agreement (and accordingly no EOI practice) and therefore practical application of the EOI framework remains to be tested. The FSM should monitor application of its EOI instruments (once there are any) so that information is exchanged effectively.

185. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework
Determination: In place
Practical implementation of the standard
Rating: Compliant

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

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

186. The FSM does not have any EOI relationships. This was the case also at the time of the 2014 report which concluded that the FSM should ensure that it gives full effect to the terms of any EOI arrangements it enters into and that it should develop its exchange of information network with all relevant partners.

187. Since then, the FSM took several steps to address the recommendations made. These steps include the following:

- The FSM brought into force the EOI Act. The EOI Act authorises the CTA to enter into EOI agreements and gives them effect in the FSM's domestic law upon their ratification by the Congress. As described in sections B.1 and C.1, the EOI Act provides the CTA with powers to obtain and exchange information requested under FSM EOI agreements.
- The FSM approached three jurisdictions to conclude an EOI agreement. As the FSM was deemed to be a jurisdiction of interest due to its captive insurance industry, it approached the jurisdiction whose entities were most prominent among foreign captive insurance companies, based on the reasoning that this jurisdiction would be the most likely relevant partner for the FSM. The FSM also approached two other of its main trading partners. All three jurisdictions were approached in 2017 through diplomatic channels. However, the jurisdictions approached did not see a need for an exchange agreement with the FSM. The FSM has also published information about its Competent Authority on its government website to facilitate contact with its potential EOI partners.
- The FSM started the internal process of joining the Multilateral Convention. The FSM is currently analysing the necessary steps and preparing the documentation to be submitted to the responsible body of the Multilateral Convention.

188. In the context of the current review, peers were requested to provide inputs on their EOIR experience with the FSM including on FSM's willingness to enter into EOI agreements. As no input was received, it can be concluded that no jurisdiction has concerns about the FSM's willingness to conclude an EOI agreement without insisting on additional conditions. In fact, the FSM informed that it has never been approached by a jurisdiction to enter into any such agreement.

189. To conclude, measures taken by the FSM since the 2014 review address the recommendation made in respect of giving effect to its EOI agreements (see further section C.1). The FSM took also several steps to develop its EOI network, as recommended in the 2014 report. Nevertheless, despite its efforts the FSM continues not to have any EOI instrument allowing it to exchange tax relevant information with other jurisdictions either on bilateral or multilateral basis (e.g. through joining the Multilateral Convention). It is therefore recommended that the FSM should develop its exchange of information network with all relevant partners.

190. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework
Determination: In place.
Practical implementation of the standard
Rating: Compliant

C.3. Confidentiality

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

191. The FSM domestic legal framework contains adequate provisions to ensure the confidentiality of information exchanged under FSM's EOI agreements. However, the FSM does not have any EOI agreement providing for exchange of information in tax matters and therefore there is no practice to demonstrate effectiveness of the EOI confidentiality regime.

192. The 2014 report concluded that the FSM should develop its exchange of information network with all relevant partners and that when it enters into an EOI agreement, it should ensure that the FSM competent authority has the ability to disclose information to foreign counterparts.

193. Since then the FSM put in place domestic legislation which guarantees confidentiality of exchanged information and at the same time allows provision of the requested information under an EOI agreement. The EOI Act stipulates that any exchange of information agreements entered into by the FSM shall contain confidentiality safeguards and that exchange of information pursuant to an EOI agreement shall be exempt from any confidentiality or secrecy provisions provided for by law to the extent permitted under the EOI agreement and applicable law (s. 605 EOI Act).

194. Confidentiality of exchanged information is further elaborated in EOI Regulations (Part 5 EOI Regulations). The confidentiality provisions in the EOI Regulations apply to all exchanged information, including communications between the competent authorities. The EOI Regulations also deal with the content of notices to information holders which do not require disclosure of information going beyond the description of the requested information and the legal basis for requesting it (s. 3.1 EOI Regulations).

195. Finally, administrative rules regarding confidentiality of exchanged information are detailed in the EOI Manual. Among other measures, the EOI Manual requires that all documents related to an exchange of information case should be clearly stamped with confidentiality statement (s. 7.6 EOI Manual). The Manual further specifies that the request letter cannot be

disclosed (s. 7.7 EOI Manual). Certain exchanged information can be communicated to the taxpayer to support a tax charge (e.g. details of unreported bank account or income) or when a case against the taxpayer is considered by a court and the information is required by the judicial authorities. However, according to the FSM authorities the information disclosed to the information holder would not include the EOI request letter and the foreign competent authority would always be informed before exchanged information could be disclosed outside of the tax administration. Further, any disclosure of exchanged information must be authorised by the EOI Manager, having checked that such disclosure is allowed under the legal instrument and domestic legislation (s. 7.7 EOI Manual).

196. Wilful violation of any of the regulations contained in the EOI Act is punishable, upon conviction, with a fine of USD 50 000, or a term of imprisonment for no more than a year, or both (s. 608 EOI Act 2016).

197. The CTA's office is a secured area. Within the CTA tax records are kept in a locked filing cabinet whereby only the responsible officers and the Assistant Secretary of the CTA have access. The FSM tax administration is currently paper-based. Where tax information between the CTA employees is shared electronically this is within the Government's internal network system. The FSM is receiving World Bank funding to introduce a Revenue Management Information System (RMIS) and a key component of this system will be the security of tax information.

198. To conclude, the FSM has taken measures to address recommendations made in the 2014 report and has in place rules and procedures to ensure confidentiality of tax information. This was also demonstrated in the domestic context as no case of breach of tax confidentiality has been reported by the FSM authorities over the reviewed period. Nevertheless, despite its efforts the FSM continues not to have any EOI instrument allowing it to exchange tax relevant information and therefore it also does not have any EOI practice. Consequently, efficiency of measures to ensure confidentiality of exchanged information is untested and the FSM should monitor their implementation.

199. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework
Determination: In place
Practical implementation of the standard
Rating: Compliant

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

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

ToR C.4.1. Exceptions to requirement to provide information

200. At the time of the 2014 report the FSM did not have any EOI agreement and the report concluded that rights and safeguards of taxpayers and third parties are not in place as required under the standard.

201. Although the FSM still has not concluded any EOI agreement (see further section C.1 and C.2), it has taken measures to put in place rules to ensure that rights and safeguards in the context of exchange of information are appropriately respected. These measures are as follows:

- As described in section B.1.5, the FSM enacted the new EOI Act and regulations which stipulate that the information collection powers of the CTA shall give effect to such legal privileges as recognised by the FSM Supreme Court and consistent with the terms of the EOI agreement (s. 606(3) EOI Act and s. 3.2(a) EOI Regulations). Further, such legal privileges must be strictly construed and limited only to privileges required by the EOI agreement pursuant to which the information is being collected (s. 3.2(b) EOI Regulations).
- The FSM adopted a Model EOI agreement based on the OECD Model TIEA. The FSM's model EOI agreement provides that the requested jurisdiction should not be obliged to exchange information that would disclose any trade, business, industrial, commercial or professional secret, or information that is the subject of attorney-client privilege in line with the standard wording.

202. The measures taken by the FSM seem to address the 2014 report concerns. The EOI Act and regulations make clear that rights and safeguards should be applied in line with the EOI agreement. Further, the FSM declared its willingness to conclude EOI agreements with any relevant partners which will provide for exchange of information in line with the standard. The FSM confirmed that while deciding the scope of rights and safeguards under an EOI agreement, the Supreme Court would take into account not only the text of the agreement but also the OECD Commentary, in particular concerning the scope of legal professional privilege. Nevertheless, the interaction between the rights and safeguards in the FSM domestic law and under an EOI agreement remains to be tested as the FSM has no EOI agreement and consequently no practice. This is a particular concern with regard to the scope of legal professional privilege which is not defined in the FSM's Model

EOI Agreement and which appears to be broad in the FSM domestic regulatory framework (see also section B.1.5). In view of these considerations it is recommended that the FSM monitors the application of rights and safeguards in the exchange of information context.

203. The new table of determinations and ratings is as follows:

Legal and Regulatory Framework
Determination: In place
Practical implementation of the standard
Rating: Compliant

C.5. Requesting and providing information in an effective manner

The jurisdiction should request and provide information under its network of agreements in an effective manner.

204. In order for EOI to be effective, jurisdictions should request and provide information under its network of EOI mechanisms in an effective manner. In particular:

- *Responding to requests*: Jurisdictions should be able to respond to requests within 90 days of receipt by providing the information requested or provide an update on the status of the request.
- *Organisational processes and resources*: Jurisdictions should have appropriate organisational processes and resources in place to ensure quality of requests and quality and timeliness of responses.
- *Restrictive conditions*: EOI assistance should not be subject to unreasonable, disproportionate, or unduly restrictive conditions

205. The 2014 report dealt with FSM's legal and regulatory framework and did not cover matters of practice. Consequently, no conclusions on the effectiveness of FSM's exchange of information were made although the report noted that FSM domestic laws did not provide for access to information pursuant to an exchange of information request, nor did the FSM have any EOI instruments to exchange information.

206. As described mainly in sections B.1 and C.1, since then the FSM put in place the EOI Act and EOI Regulations which give effect to FSM's future EOI agreements including providing the tax administration with powers to obtain and exchange information requested pursuant to a valid EOI request. Nevertheless, despite FSM's efforts to conclude an EOI instrument with some of its important trading partners, the FSM still does not have any EOI

instrument allowing it to exchange tax relevant information with other jurisdictions. Accordingly, the FSM has not received or sent any EOI request.

207. Although the FSM has no EOI practice, it has put in place processes and resources to ensure effective exchange of information. The national government appointed the Department of Finance and Administration (DOFA) with the responsibility for exchange of information in tax matters. The designated authority for exchange of information is the DOFA Secretary. The DOFA has four divisions, one of which is Customs and Tax Administration (CTA) vested with the authority to practically handle any future exchange of information. The CTA is headed by an Assistant Secretary with 14 staff. Currently two consultants are specifically assigned to handle international affairs related to exchange of information (one in the CTA and one assisting the DOFA Secretary), as well as the Assistant Secretary at the Department of Justice who will be available to assist if a request is made.

208. In June 2017, the FSM adopted a comprehensive EOI Manual containing processes to be followed in exchange of information upon request. The EOI Manual is based on the 2013 Global Forum Manual on Information Exchange. The EOI Manual specifies steps to be taken when obtaining and providing the requested information, including deadlines; foresees recording of EOI requests and their progress in the EOI database; deals with protection of confidentiality of received information; and contains a checklist of what information to include in an EOI response letter and various templates for making and responding to requests. Generally, the taxpayer is to be given 30 days to provide the requested information; banks are requested to provide the information within 15 days. Where the requested information cannot be provided to the EOI partner within 90 days, the Competent Authority must send status updates every 90 days until the complete information is provided. The EOI Manual also details processes for making requests which substantially mirror processes for responding to requests.

209. The staff responsible for exchange of information matters participated on two training seminars provided by the Global Forum. Further, in 2017 and 2018, the Annual Tax Conference training was conducted with CTA and tax offices staff which focused (among others) on exchange of information upon request and how to handle any requests for tax or company information. The 2017 training was particularly focused on the availability of beneficial ownership information in the FSM and the importance of being able to obtain this information upon request.

210. To sum up, the FSM has put in place the necessary processes and resources to ensure effective exchange of information. However, as it has not received or sent any EOI request, there is no practice to demonstrate their effectiveness. It is also noted that experience with practical handling of EOI cases is an important factor contributing to effective exchange of information.

It is therefore recommended that FSM monitors its exchange of information practice once an EOI instrument is in place.

211. The table of determinations and ratings is as follows:

Legal and Regulatory Framework		
This element involves issues of practice. Accordingly no determination on the legal and regulatory framework has been made.		
Practical implementation of the standard		
	Underlying Factor	**Recommendation**
Deficiencies identified in the implementation of EOIR in practice	The FSM has put in place the necessary processes and resources to ensure effective exchange of information. However, there is no practice to demonstrate their effectiveness.	The FSM should monitor its exchange of information practice so that it provides and requests information under its EOI agreements in an effective manner.
Rating: Largely Compliant		

Annex 1: List of in-text recommendations

The assessment team or the PRG may identify issues that have not had and are unlikely in the current circumstances to have more than a negligible impact on EOIR in practice. Nevertheless, there may be a concern that the circumstances may change and the relevance of the issue may increase. In these cases, a recommendation may be made; however, such recommendations should not be placed in the same box as more substantive recommendations. Rather, these recommendations can be mentioned in the text of the report. A list of such recommendations is presented below.

- Section A.1.1 and A.1.3: The FSM should ensure that legal ownership and identity information in respect of companies and partnerships exempted from the filing obligations under the EOI Act remains available as required under the standard regardless whether they cease to exist.
- Section A.2: The FSM should monitor whether there are any cases where an entity or arrangement ceases to exist without accounting records being available as required under the standard.
- Section B.2: The FSM should monitor the use of appeal rights in the EOI context.
- Section C.1 The FSM should monitor application of any EOI instruments entered into so that information is exchanged effectively.
- Section C.3: The FSM should monitor implementation of measures to ensure confidentiality of exchanged information.
- Section C.4: The FSM should monitor the application of rights and safeguards in the exchange of information context.

Annex 2: List of FSM's EOI mechanisms

To date, the FSM has not signed any mechanisms providing for tax information exchange.

Annex 3: Methodology for the review

The reviews are conducted in accordance with the 2016 Methodology for peer reviews and non-member reviews, as approved by the Global Forum in October 2015 and the 2016-21 Schedule of Reviews.

The current evaluation was based on information available to the assessment team, including the laws and regulations in force or effective as at 3 May 2019, FSM's responses to the EOIR questionnaire and information supplied by peer jurisdictions.

Although the FSM is not a member of the Global Forum, it was identified as a jurisdiction of relevance in 2012 in accordance with paragraphs 65-66 of the Revised Methodology for peer reviews and non-member reviews (2010 Methodology).

List of laws, regulations and other material received

FSM Code (Public Law No. 18-96)

Title 11 Chapter 9	Money Laundering and Proceeds of Crime
Title 29 Chapter 2	Banking Commission
Title 29 Chapter 3	Domestic Banks
Title 29 Chapter 4	Foreign Banks
Title 29 Chapter 5	Licensing Banks
Title 29 Chapter 6	Regulation and Supervision
Title 29 Chapter 7	Control over Banks
Title 29 Chapter 9	FDIC and FBDs
Title 30 Chapter 1	Development Banking
Title 32 Chapter 1	Business Licensing
Title 32 Chapter 2	Foreign Investment

Title 36 Chapter 1	Business Organisation Act
Title 37 Chapter 3	Insurance Licensing
Title 54 Chapter 1	Wages, Salaries and Gross Revenue Taxes
Title 54 Chapter 2	Duties and Customs
Title 54 Chapter 3	Income Tax Regime Major Corporations
Title 54 Chapter 6	Exchange of Tax Information Act of 2016 ("EOI Act")

Regulations, guidelines and other materials

Beneficial Ownership Regulation issued under the EOI Act ("BO Regulation")

Regulation issued under the Business Organisation Act ("BOA Regulation")

Regulations issued under the EOI Act ("EOI Regulations")

CTA EOI Manual

FSM Captive Insurance Regulations

DoFA Code of Conduct

Current and previous review(s)

This report provides the outcomes of the second peer review of FSM's implementation of the EOIR standard conducted by the Global Forum. The FSM previously underwent EOIR peer review in 2014 conducted according to the ToR approved by the Global Forum in February 2010 (2010 ToR) and the 2010 Methodology. The 2014 review evaluated FSM's legal and regulatory framework as at December 2013. The 2014 report concluded that six of the essential elements (A.2, B.1, C.1, C.2, C.3 and C.4) were "not in place", preventing the FSM from moving forward to a Phase 2 review. In addition, the FSM underwent a fast-track review in 2017 evaluating its legal and regulatory framework as well as its implementation in practice against the 2010 ToR. The fast-track report concluded that provisional ratings for each of the individual elements would likely result in the FSM achieving an overall rating of Largely Compliant.

Information on each of the FSM's peer reviews is listed in the table below.

Review	Assessment team	Period under review	Legal Framework as of	Date of adoption by Global Forum
2014 report	Mr Carlo Carag, the Department of Finance, the Philippines; Ms Patricia Haynes, the Ministry of Finance, Saint Kitts and Nevis; and Mr Francesco Positano from the Secretariat of the Global Forum.	Evaluation of the legal and regulatory framework only	13 December 2013	April 2014
2019 report	Mr Harry Hallett-Hook, Inland Revenue, New Zealand; Mr Steven Paisi, Internal Revenue Commission, Papua New Guinea; and Mr Radovan Zídek from the Global Forum Secretariat.	1 April 2014 to 31 March 2017	3 May 2019	July 2019

Annex 4: FSM's response to the review report[5]

As reflected in our positive Peer Review Report, the Federated States of Micronesia is committed to transparency, and the exchange of information for tax purposes, to assist with the detection of global tax evasion and to strengthen tax compliance. We also confirm our support of the Global Forum's work, and are currently making steps towards membership.

The Federated States of Micronesia accepts the recommendations of the assessment team, which have now been approved by the Peer Review Group, and is pleased to see that our efforts to improve our transparency and capability to exchange information for tax purposes have been reflected in mostly compliant ratings in the assessed elements, and an overall Largely Compliant rating. We value both the opportunity to discuss our country specific content, and the diligence of the Peer Review Group to ensure our efforts to implement effective exchange of information for tax purposes and our unique circumstances were considered. We also commend the Global Forum Secretariat for maintaining consistency and transparency in the assessment process.

The Federated States of Micronesia will take the necessary actions to address the recommendations that have been made, and will provide the Secretariat with an update of its progress in its 2020 follow-up report.

The Federated States of Micronesia wishes to thank Mr Radovan Zidek and his assessment team for their dedication, professionalism and support throughout the review process. Our appreciation is also extended to the members of the Peer Review Group for their constructive input into both reviewing the report, and considering our progress extensively during the Peer Review Group Meeting.

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

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GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES

Peer Review Report on the Exchange of Information on Request FEDERATED STATES OF MICRONESIA 2019 (Second Round)

The Global Forum on Transparency and Exchange of Information for Tax Purposes is a multilateral framework for tax transparency and information sharing, within which over 150 jurisdictions participate on an equal footing.

The Global Forum monitors and peer reviews the implementation of international standard of exchange of information on request (EOIR) and automatic exchange of information. The EOIR provides for international exchange on request of foreseeably relevant information for the administration or enforcement of the domestic tax laws of a requesting party. All Global Forum members have agreed to have their implementation of the EOIR standard be assessed by peer review. In addition, non-members that are relevant to the Global Forum's work are also subject to review. The legal and regulatory framework of each jurisdiction is assessed as is the implementation of the EOIR framework in practice. The final result is a rating for each of the essential elements and an overall rating.

The first round of reviews was conducted from 2010 to 2016. The Global Forum has agreed that all members and relevant non-members should be subject to a second round of review starting in 2016, to ensure continued compliance with and implementation of the EOIR standard. Whereas the first round of reviews was generally conducted as separate reviews for Phase 1 (review of the legal framework) and Phase 2 (review of EOIR in practice), the EOIR reviews commencing in 2016 combine both Phase 1 and Phase 2 aspects into one review. Final review reports are published and reviewed jurisdictions are expected to follow up on any recommendations made. The ultimate goal is to help jurisdictions to effectively implement the international standards of transparency and exchange of information for tax purposes.

This report contains the 2019 Peer Review Report on the Exchange of Information on Request of Federated States of Micronesia.

Consult this publication on line at ***https://doi.org/10.1787/4bc8ab63-en***.

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