

FOREIGN INVESTMENT CLIMATE



KOSRAE FEDERATED STATES OF MICRONESIA

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Acknowledgement

The historical information provided in this paper has been taken from a paper published by Flex Inc. of 1997. The information provided herein updates the data from the Flex paper; other information has been modified to reflect only Kosrae statistics.

We acknowledge and thank Flex Inc for allowing us the use of their paper.

WHAT IS THE CURRENT INVESTMENT CLIMATE OF KOSRAE

To put it very succinctly, Kosrae welcomes foreign investment, and is acutely aware that foreign capital, professional management and modern technology are critical to its economic development.

Preference is given to foreign investments that are constructive, and encouragement is offered to activities and enterprises that:

- Earn or save foreign exchange;
- Create a significant number of jobs;
- Make efficient use of local raw materials
- Offer prospects for future expansion
- Stimulate technological development
- Develop new and modern industries
- Manage judicious use of natural resources
- Allow for local equity participation
- Offer training to locals at all levels of the business enterprise; and
- Have the support of Kosrae State Government

The Government

The Kosrae State Government has two agencies involved in the development of foreign investment activities. Potential foreign investors are advised to contact the offices listed below.

- The Department of Resources and Economic Affairs (DREA) has a role in promoting economic development as well as reviewing foreign investment permit applications. This includes business projects involving agriculture, fisheries or aquaculture. The Department of Resources and Economic Affairs (DREA) can be contacted at: Phone: (691) 370-3017/2044; Email: lyndonc.drea@gmail.com.
- Kosrae Island Resource Management Authority (KIRMA) is charged with balancing the economic development of the State with environmental protection issues. This includes the review and approval of environment impact statements (EIS) and permitting of development projects affecting the air, soil or water quality of the State. KIRMA may be contacted at: Phone: (691) 370-3646; c/o Email: rhjackson14@gmail.com.

Investment Opportunities

The state has identified the following areas for potential investment:

- Agro-industries (coconut based products, tropical fruit processing, animal feed, organic coffee, etc.)
- Livestock including goats, cow, swine, and poultry

- Commercial forestry development
- Fisheries and aquatic development, harvesting and processing
- Drying of fish
- Value addition
- Development of import substitution and export manufacturing/assembly operations.

Investment Incentives

Some of the incentives to foreign investment in Kosrae:

- Duty-Free Access to the US Market
 - All articles wholly grown, made or produced in the State can enter the US duty free. Certain categories, however, are not duty free. These include:
 - Watches, clocks and timing apparatus;
 - Buttons
 - Articles subject to textile agreements, for example, footwear and leather wearing apparel; and
 - Tuna canned in oil
 - Exports qualify for duty free treatment if the total cost of or value of the materials produced in Kosrae or FSM and the direct cost of processing operations performed in Kosrae constitutes not less than 35 percent (35%) of the appraised value of the merchandise at the time of its importation in the US.

Restrictions and Limitations on Foreign Investment

Access to Labor

Provided they are otherwise qualified, investors coming to Kosrae will be granted permits to reside in the State and the FSM for the duration of their investment. However, the use of expatriate labor is subject to a determination by the State and the FSM of the availability of local workers; preference is given to local hiring for all jobs, where such skills are available in the local market.

If an investor wishes to bring in outside labor, application must be made to the Division of Immigration and Labor, National Department of Justice, FSM. An attempt will be made to find suitably qualified local labor and, if none is available, import of labor will be subject to negotiation with Immigration over terms and conditions of the employment.

In actual practice, as Kosrae and FSM have a shortage of skilled labor, the requirements necessary to import foreign labor have not been difficult to meet. While the shortage is expected to continue for the foreseeable future, investors are advised to plan for the use of local employees and provide for their training.

Access to Land

Most property in Kosrae is held in family trust arrangements and land use rights are passed down from generation to generation within the extended family system. Sub-surface property rights are synonymous with surface rights. There is no publicly owned sub-surface mineral or water rights in Kosrae. However, the state government owns properties where water reaches during the highest tide.

Land ownership is limited by the Constitution to Kosraeans only. Even domestic corporations which have non-citizen shareholders may not own land. Non-citizen individuals and corporations may lease either public or private lands.

Because of its short supply and traditional importance, special significance is attached to land in Micronesia. Leasing of private lands may be complicated due to families' ownership and uncertain boundaries and titles. Many parcels of land are held by families who may have different factions, all of whom assert an interest.

The initial point of contact in respect of access to land should be the Director of the Department of Resources and Economic Affairs. State law does allow the lease of the public lands in Tofol area (seat of the Kosrae State Government) for private sector use. Lease of the public lands is coordinated and negotiated by Department of Resources and Economic Affairs.

All land leases are subject to statutory time limits.

REGULATORY FRAMEWORK

Review and Approval Mechanisms for Foreign Investment Proposals

If a business is to be a sole proprietorship or partnership and one of the partners is a foreign corporation, the only registration requirement is the Foreign Investment Permit. A foreign investor must apply for this permit before commencing business even if the investor acquires equity in a domestic corporation. All domestic corporations are registered with the Kosrae Office of the Attorney General; there is no fee for domestic corporation registration.

A foreign investment permit must be obtained by a foreign investor regardless of the type of business the investor wishes to engage in. However, if plan is to engage in business activity related to communications, air or sea transportation or financial services, the business must register with the FSM Department of Resources and Development, as these businesses are subject to national regulation.

Application forms for a Kosrae Foreign Investment Permit (FIP) may be obtained from the Foreign Investment Program, Division of Trade and Investment, Kosrae State Department of Resources and Economic Affairs and are filed with a non-refundable fee

of USD150. The application process takes approximately fifteen days, provided all requested information is submitted. Decisions on the granting of a FIP are made by the Department of Resources and Economic Affairs after consultation with other appropriate offices within the State.

OPERATIONAL PROCEDURES

Company/Business Structures

Business in the FSM may be done through sole proprietorships, partnerships, joint ventures or corporations. While there is no legal restriction on a local business being totally foreign owned, the preferred approach is for foreign investors to enter into joint business structures with local partners. The complex land ownership situation also tends to make it beneficial for an outside investor to identify suitable local partners.

Business Registration

To establish a domestic corporation or to register a foreign corporation, a draft copy (preferably on a flash drive or other electronic means) of the proposed Articles of Incorporation and Corporate Bylaws must be submitted to the Attorney General's Office. Information on the legal requirements to create a domestic corporation may also be obtained from that Office. Once approved by the OAG, a Corporate Charter is issued by the Governor. The issuance of a corporate charter in the FSM is now largely done at the State level and can be accomplished quickly.

Business licenses are required by the municipal governments. Every business should apply for a business license from the municipal government where the business will be operating. The license fees vary based on the type of business and the specific municipal government, ranging from \$15.00 - \$100.00.

Labor and Labor Regulations

The current local workforce is estimated at 1,550¹ with the State Government being the largest single employer. The potential labor force in Kosrae is about 5,000 persons.

The population is young (over 50 percent are under the age of 16), providing Kosrae with excellent potential to support longer-term economic development. Education is compulsory for Grades 1 to 8 or to the age of fifteen. However, the majority of students do attend high school and the College of Micronesia provides associate degree programs. While there continues to be a deficit in the availability of skilled and technical training, most of the available labor pool is literate, though inexperienced.

Labor laws are applied consistently throughout the FSM, Kosrae State Government nor the FSM has not yet established a minimum wage rate applicable to the private sector. An

¹ Statistical Yearbook FSM 2008, Table 4.1. Page 24.

expatriate work permit fee of US\$100 is levied by the National Government for each overseas worker.

All persons employed in the FSM are required to contribute to the FSM Social Security System. Currently, employers and employees each pay seven and half percent (7.5%) of wages and salaries to the FSM Social Security.

Banking

Two commercial banks operate in the state:

- Bank of the FSM
- Bank of Guam

Two other financial institutions operate in the FSM:

- The FSM Development Bank has the ability to mobilize financial resources for development projects and providing medium and long-term loans and equity capital for high-priority projects.
- The Pacific Islands Development Bank also offers financial resources for development and medium and long-term loans and equity capital for projects.

Special Visas

For US citizens, visas are not required but proof of US citizenship is necessary. Non US citizens must have a valid passport and a round trip ticket. Entry for visitor/tourism purposes for both US and non-US citizens may be granted for a 30 day period. Persons coming for a longer period or for purposes other than tourism must obtain ***before their arrival*** an FSM work permit and/or FSM entry permit. A Kosrae Foreign Investment Permit may be used as supporting documentation for an FSM entry permit.

Taxation

Income Taxes

Company Taxes

Currently, all business operating in the FSM pay a gross receipt tax which is assessed on the basis of 'gross revenue', that is, all receipts of a business from whatever source (including 'passive income' such as interest, dividends, etc) without deductions, are taxable when they occur, rather than when they are received.

The tax rate is \$80 on the first \$10,000 of gross revenue and three percent on any gross revenue received in excess \$10,000 for the calendar year. Businesses with less than \$2,000 in gross revenue during a year are exempt from tax.

A business must file a gross revenue tax return for each quarter of the calendar year.

Personal Income Tax

Personal income tax is required to be paid on all personal income, including non-cash income. The tax is six percent of the first \$11,000 and ten percent of any amounts earned over \$11,000 during a calendar year. Employees earning less than \$5,000 during a calendar year are entitled to reduce their taxable income by \$1,000 before six percent tax is assessed.

US Tax Considerations

Through the Compact of Free Association, corporations doing business in Freely Associated States will enjoy the same tax treatment as if doing business in a US possession.

It is hoped that this information is helpful to you. If further information is needed, you may contact any of the following agencies or organizations:

Contacts for Further Information:

Dept of Resources and Economic Affairs
P.O. Box 600
Tofol, Kosrae, FM 96944
Tel: (691) 370-2004/3017
Fax: (691) 370-8199
c/o E-mail: sraffilman@investkosrae.fm
Website: www.investkosrae.fm

Kosrae Island Resource Mgt. Authority
P.O. Box 480
Tofol, Kosrae, FM 96944
Tel: (691) 370-3646/2076
Fax: (691) 370-2867
E-mail: rhjackson14@gmail.com

Kosrae Chamber of Commerce
P.O. Box 877
Tofol, Kosrae, FM 96944
c/o Tel: (691) 370-2038
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Office of Attorney General
P.O. Box 870
Tofol, Kosrae, FM 96944
Tel: (691) 370-3215/3043
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