

### Timor-Leste Highlights 2013

#### Investment basics:

**Currency** – United States Dollar (USD).

**Foreign exchange controls** – None.

**Accounting principles/financial statements** – IFRS. Financial statements for certain legal entities must be filed annually.

**Principal Business Entities** – These are: Private Limited Liability Company (Lda); Public Limited Company (S.A.); partnership; and branch of a foreign entity.

#### Taxation of non-petroleum operations:

The taxation of non-petroleum operations is governed primarily by the *Taxes and Duties Act*, Decree Law No. 8 of 2008 (TDA).

#### Corporate tax:

**Residence** – A legal person is considered to be a resident of Timor-Leste where such legal person is incorporated, formed, organised, or established in Timor-Leste.

**Basis** – Timor-Leste resident companies are taxed on worldwide income. A non-resident company generally pays tax only on Timor-Leste sourced income.

**Taxable income** – Taxable income generally corresponds to accounting income. The major exceptions relate to the income tax treatment of:

- Depreciable assets
- Intangibles
- Inventory
- Interest expenditure
- Provisions and reserves
- Payments in respect of which withholding tax was not properly applied
- Dividends
- Donations and gifts
- Fines and penalties
- Expenses charged or incurred for the personal benefit of shareholders, partners or members
- Excessive payments/compensation payments between associates, as consideration for work performed
- Expenditure/losses to the extent recoverable under a policy of insurance or contract of indemnity
- Assets (including cash) received by a legal person in exchange for shares or capital contributions
- Income derived by an approved pension fund.

In addition, certain income items that are subject to final withholding tax are excluded from taxable income.

**Capital gains** – Gains arising from the alienation of assets are subject to income tax. No distinction is made between revenue gains or capital gains.

**Grouping provisions** – Companies are assessed for income tax on an individual basis and there are no provisions to group income or offset losses of associated companies.

**Transfer pricing** – The current tax regime governing non-petroleum operations does not contain any specific rules for transfer pricing.

**Losses** – Tax losses may be utilised and carried forward indefinitely to offset against future assessable income provided a "continuity of ownership" (more than 50%) or a "same business test" is satisfied. The carry-back of tax losses is not permitted.

**Foreign losses** – Losses incurred in deriving income from a source in a foreign country are deductible only against such foreign-earned income. Foreign losses may be carried forward indefinitely for offset against foreign income.

**Income tax rate** – 10% on taxable income (excluding amounts that have been subject to final withholding tax).

**Foreign tax credits** – Timor-Leste resident companies are entitled to a credit for any foreign income tax paid.

**Withholding taxes (WHTs)** – The following table summarises the withholding taxes applicable to various types of payments made to a resident person or a permanent establishment of a non-resident person:

Type of Income	WHT Rate
• Income from construction or building activities	2%
• Income from construction consulting services	4%
• Income from the provision of air or sea transportation services	2.64%
• Income from mining or mining support services	4.5%
• Royalties	10%
• Rent	10%
• Prizes or winnings	10%

A flat withholding tax rate of 10% is applicable to income paid to non-residents without a permanent establishment in Timor-Leste. Dependent on the circumstances, the payer or the recipient may have the responsibility to withhold and remit the tax. The recipient may elect to be taxed on an actual profits basis rather than on a withholding basis. A person

who receives an amount that has been correctly subject to withholding tax has no further liability to income tax on those amounts. By the same token, the payer is denied a deduction for expenses incurred which give rise to income that is subject to final withholding tax.

**Tax year** – The tax year is the calendar year; however, a taxpayer may apply to use a substituted tax year.

**Filing and payment** – Taxpayers are required to file an annual income tax return by the last day of the third month after the end of the tax year and any income tax payable is also due by that date. Taxpayers are required to pay monthly instalments of income tax for a tax year. Taxpayers whose total turnover for the previous tax year is \$1M or less are permitted to pay quarterly instalments of income tax for the year. Instalments of income tax are due for payment by the 15<sup>th</sup> day after the end of the period to which they relate.

**Penalties and interest** – Penalties and interest may be applied for late filing, failure to file, underpayment of tax, failure to exercise due care and for tax evasion.

#### Wage income tax:

**Application** – Wage income tax (WIT) is a final withholding tax and applies to taxable wages received by an employee in respect of employment exercised in Timor-Leste. In the case of an employee of the Government of Timor-Leste, wage income tax applies whether the employment is exercised in Timor-Leste or elsewhere. The concept of wages includes cash and the value of non-cash benefits.

**Rates** – In the case of a resident natural person, wage income tax at the following rates apply:

Monthly taxable wages	WIT Rate
US\$0 to US\$500	0%
Exceeding US\$500	10% of the amount exceeding US\$500

In the case of a non-resident natural person, the rate of wage income tax applicable is 10% of the taxable wages received by the employee. The obligation to withhold wage income tax rests with the employer. An employee in receipt of wages that have been correctly subject to wage income tax has no further liability to income tax on those wages.

#### Indirect taxes:

**Value added tax** – Not applicable.

**Sales tax** – Generally, where a taxpayer imports any taxable goods into Timor-Leste, sales tax is imposed on the value of the taxable goods. Sales tax is calculated at 2.5% of the customs value of the goods, including any import duty and excise tax payable on the importation of the goods.

**Services tax** – Applies to certain designated services, namely, hotel services, restaurant and bar services and telecommunications services. The rate of services tax applicable to persons with a monthly turnover of designated services of less than US\$500 is 0% with a rate of 5% applicable where monthly turnover exceeds US\$500.

**Import duty** – Applies to goods imported into Timor-Leste at the rate of 2.5% of the customs value.

**Excise tax** – Applies at varying rates to goods manufactured in Timor-Leste and to imported goods.

## Taxation of petroleum operations:

The tax regime(s) applicable to the taxation of petroleum operations is dependent on the geographic location of the petroleum activities.

## Salient features of tax regime in Timor-Leste's sovereign territory (excluding the Joint Petroleum Development Area (JPDA)):

The general taxation provisions in the TDA, subject to special rules contained in Chapter IX of the TDA primarily govern the taxation of petroleum operations in Timor-Leste's sovereign territory.

### Taxation of contractors:

**Income tax rate** – 30%.

**Taxable income** – Taxable income generally corresponds to accounting income. The major exceptions relate to:

**Ring-fencing** – Expenditure incurred by a contractor in relation to petroleum operations is only deductible against gross income arising from such petroleum operations.

**Interest expenditure** – Special rules apply to the deduction of interest expenditure in relation to petroleum operations.

**Allocation of head office expenditure** – Restrictions apply to the deduction of head office expenditure by a permanent establishment in Timor-Leste.

**Decommissioning expenditure** – A contractor may claim a deduction based on a prescribed formula for amounts carried to a decommissioning costs reserve for a tax year in respect of petroleum operations.

**Exploration and development expenditure** – Exploration and development expenditure

incurred under a Petroleum Agreement is treated as intangible expenditure and amortised on a straight line basis.

**Small field depreciation** – Subject to certain conditions being satisfied, a contractor may elect for depreciable assets or intangibles (including exploration and development expenditure) to be depreciated or amortised under the units of production method based on a prescribed formula.

**Transfer of interest in Petroleum Agreement** – Where a contractor transfers an interest in a Petroleum Agreement, the transferee continues to amortise any exploration or development expenditure in the manner and on the same basis as the original contractor amortised the expenditure.

**Supplemental petroleum tax (SPT)** – SPT applies on the basis of cash flow in the year in which accumulated net receipts for petroleum operations are positive. SPT applies in addition to income tax, although a contractor is entitled to claim an income tax deduction for the SPT paid.

**Transfer pricing** – Newly introduced transfer pricing rules apply to international transactions/dealings between separate legal entities, as well as permanent establishments. The acceptable transfer pricing methods in Timor-Leste are the Comparable Uncontrolled Price, Resale Price, Cost Plus, Comparable Profit and Residual Profit Split methods out of which the most appropriate method should be applied. The National Directorate of Petroleum Revenue has the discretion to adjust the pricing of transactions that are considered not to be at arm's length. Disclosure and documentation requirements exist and there are penalties for non-compliance.

**Tax year** – The tax year is the calendar year; however, a taxpayer may apply to use a substituted tax year.

**Income tax return filing and payment** – Taxpayers are required to file an annual income tax return by the last day of the third month after the end of the tax year and any income tax payable is also due by that date. Taxpayers are required to pay monthly instalments of income tax for a tax year. Instalments of income tax are due for payment by the 15<sup>th</sup> day after the end of the month to which they relate.

**SPT return filing and payment** – Contractors are required to file an annual SPT return for the year which shall be delivered in the same manner and by the same due date as the annual income tax return of the contractor for the year. Monthly instalment payments of SPT are due for payment by the 15<sup>th</sup> day after the end of the month to which they relate.

**Penalties and interest** – Penalties and interest may be applied to late filing, failure to file, underpayment of tax, failure to exercise due care and for tax evasion.

## Employees of contractors and subcontractors:

**Income Tax Rate** – In the case of a resident natural person:

Monthly taxable wages	Rate
US\$0 to US\$550	10%
Exceeding US\$550	US\$55 + 30% of the amount exceeding US\$550

In the case of a non-resident natural person, a flat rate of 20% applies on taxable wages.

## Subcontractors and suppliers of services:

Timor-Leste sourced services income relating to petroleum operations is taxed on a withholding basis. Such income is subject to a final withholding tax at a flat rate of 6%. Withholding taxes also apply to passive income, such as dividends, interest, royalties and rental income. A person who receives an amount that has been correctly subject to withholding tax has no further liability to income tax on that amount and is not allowed a deduction for any expenditure or loss incurred in earning such income.

### Indirect taxes:

**Value added tax** – Not applicable.

**Services tax** – The rate of services tax on the provision of designated services to a contractor in relation to petroleum operations is 12%.

**Sales tax** – The rate of sales tax on an importation of goods by a contractor in relation to petroleum operations is 6%.

**Import duty** – The rate of import duty on the importation of goods by a contractor in relation to petroleum operations is 6%.

## Salient features of tax regime in JPDA (excluding Bayu-Undan and Elang Elang Kakatua Kakatua North (EKKN) and Greater Sunrise):

Broadly the tax regime in the JPDA is the same as that in Timor-Leste's sovereign territory (discussed above) with the following main exceptions:

- **Timor Sea Treaty (TST)** – The TST is an agreement between Australia and Timor-Leste which came into force on 20 May 2002 and effectively grants 90% of the tax revenue from the JPDA to Timor-Leste and 10% to Australia. The tax regime applicable to Timor-Leste's sovereign territory (above) applies equally to petroleum operations in the JPDA with the main difference being that the relevant tax rates are set at

90% of their normal levels.

- **Indirect taxes** – VAT at a rate of 9% (10% x 90%) is applied to “taxable services” provided in the JPDA. VAT is only collected and remitted by contractors who are parties to a Production Sharing Contract (PSC) from the services rendered by second tier service providers (i.e. subcontractors). The contractor has the obligation with respect to the calculation and remittance of VAT to the Timor-Leste Revenue Service. Where services are provided by a subcontractor to another subcontractor, there is no requirement for VAT to be withheld.
- **Sales tax, services tax and excise tax** – Not applicable in the JPDA.

## Salient features of the tax regime in Bayu-Undan:

The Bayu-Undan field (covering PSCs JPDA 03-12 and 03-13) is located in the Timor Sea and as such is governed by the TST. In accordance with the TST, Timor-Leste has the right to tax 90% of the revenue from the JPDA. The right to tax the remaining 10% of revenue from the JPDA lies with Australia. In addition to the TST, the Bayu-Undan field is subject to Indonesian taxation law in effect as at 25 October 1999 as its general taxation law. This general taxation law (referred to as the Law on Income Tax) has been amended by various regulations. This law is subject to further modification as a result of the *Taxation of Bayu-Undan Contractors Act (ToBUCA)* and the *Law on The Petroleum Development of Timor Sea (Tax Stability)* (the Tax Stability Act).

## Corporate tax:

**Taxable income** – Taxable income is calculated according to Indonesian generally accepted accounting principles, subject to certain modifications as outlined in the various legislation, rulings, decrees and elucidations in operation in Timor-Leste. Special rules apply in the determination of taxable income for permanent establishments.

**Tax losses** – Tax losses may be carried forward for a maximum of five years. The carry-back of tax losses is not permitted.

## Taxation of contractors:

**Income tax rate** – 30% (prior to application of the TST).

**Exemption from taxes under ToBUCA** – Income derived from building activities, installation and operation of the Bayu-Undan export pipeline are exempt from:

- Income tax
- VAT
- Sales tax on luxury goods.

**Interest** – Deductions are allowed for interest expenditure to the extent the interest expense is approved by the Designated Authority as an operating cost under the Production Sharing Contract under the project.

**Reserve for deactivation costs** – A contractor may claim a deduction for the annual amount transferred to a reserve meant to deactivate a petroleum project. The amount of the deduction is calculated in accordance with a prescribed formula.

**Depreciation and amortization** – Depreciation of exploration assets in respect of a petroleum project is calculated using the straight line method on a single asset basis; a maximum useful life of five years applies. The depreciation of any property acquired before commercial production commences from the date of commercial production.

**Branch profits tax** – Not applicable to income derived by a contractor or a subcontractor from a petroleum project.

**Additional profits tax (APT)** – Applies on the basis of cash flow in the year in which accumulated net receipts for petroleum operations is positive. APT applies in addition to income tax although a contractor is entitled to claim an income tax deduction for the APT paid. APT is applied on the same basis as SPT.

## Taxation of subcontractors:

**Income tax rate** – The table below sets out the applicable income tax rates (prior to the application of the TST):

Annual taxable income	Rate
On the first US\$3,368 of annual taxable income	10%
On the next US\$3,368 of annual taxable income	15%
On the remaining amount of annual taxable income	30%

**Withholding taxes** – A comprehensive range of withholding taxes exist with application to different income types. In most instances, income tax is paid by way of a final withholding tax without the need to file an income tax return.

The applicable withholding tax rates vary depending on the type of services rendered and the residency of the recipient.

Withholding taxes also apply to passive income such as dividends, interest, royalties and rental income.

If an entity is resident in or has a permanent establishment in Timor-Leste, it will be required to withhold tax from payments made to suppliers.

## Taxation of employees:

**Income tax rate** – In the case of a resident natural person:

Monthly taxable wages	Rate
US\$0 to US\$3,368	10%
US\$3,369 to US\$6,737	15%
Exceeding US\$6,737	30%

The above rates are prior to the application of the TST.

In the case of a non-resident natural person, a flat rate of 20% applies to the gross value of the remuneration.

## Salient features of tax regime in Greater Sunrise:

The Greater Sunrise field (covering PSCs JPDA 03-19 and 03-20) is located partly within the JPDA (i.e. 20.1%) and partly within waters that are claimed exclusively by Australia and Timor-Leste, respectively. The tax regime is governed by the TST, the Sunrise International Unitisation Agreement (SIUA) and the Certain Maritime Agreements in the Timor Sea Treaty (CMATS). In accordance with the TST and the SIUA, 20.1% of production revenue from the Greater Sunrise field is attributable to the JPDA while 79.9% is attributable to Australia. This means that Timor-Leste is effectively entitled to tax 18.09% of the production revenue attributable to the Greater Sunrise field falling within the JPDA.

In relation to that part of the Greater Sunrise field falling outside the JPDA, the CMATS provides for a 50:50 revenue-sharing ratio.

## Source of tax law:

- *Taxes and Duties Act*, Decree Law No. 8 of 2008
- *Indonesian Law on Income Tax* as at 25 October 1999 (LOIT)
- Timor Sea Treaty (TST)
- *Taxation of Bayu-Undan Contractors Act (ToBUCA)*
- *Law on The Petroleum Development of Timor Sea (Tax Stability)*

## Tax treaties:

In addition to the Timor Sea Treaty with Australia, there is a double taxation agreement with Portugal.

## Tax authorities:

The National Directorate of Domestic Revenue and the National Directorate of Petroleum Revenue.

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