

# **(Taxation of Bayu-Undan Contractors) Regulations, 2013**

## Interpretation

### **Chapter I**

#### Section 1

#### **Preamble & Purposive interpretation & Short Title**

Where Sections in the present Regulation are capable of alternative interpretations, the interpretation that best achieves the intended purpose of the Taxation of Bayu-Undan Contractors Act, Law No. 3/2003 shall be adopted and any interpretation that frustrates the intended purpose of the legislation or impedes the right of Timor-Leste to collect the tax revenue accruing from Petroleum Operations in accordance with the applicable tax laws, including Treaties shall be rejected.

The present Regulations shall be referred to as TBUCA Regulations/19-2013

#### Section 2

#### **Definitions extend to other forms of words**

2.1 Definitions in the present Regulations in the singular form shall be read as applying to the plural form and definitions in the plural form shall be read as applying to the singular form as appropriate.

2.2 Definitions in the present Regulations in the masculine form shall be read as applying to the feminine form and definitions in this section in the feminine form shall be read as applying to the masculine form.

#### Section 3

#### **Scope of Regulations**

The present Regulations shall apply to the territory of Timor-Leste, including its territorial sea, and to its exclusive economic zone and continental shelf where, by international law, Timor-Leste has sovereign rights for the purposes of exploration for and exploitation of its natural resources and applies only in the area covered by the Production Sharing Contracts described in Annex F of the Timor Sea Treaty, namely: Production Sharing Contracts JPDA 03-12 and JPDA 03-13, inclusive of amendments and annexes to the contracts stipulating the natural gas valuation.

The present Regulations shall apply to a Contractor and Subcontractor (where appropriate) in connection with Petroleum activities or Petroleum Operations in the limited area described and designated as Annex F in the Timor Sea Treaty.

Section 4  
**Definitions**

In the present Regulation:

“**Accounting**” means a systematic process under the IFRS or a Generally Accepted Accounting Practice, of recording of data and information in respect of assets, liabilities or debt, equity, income and expenditures, and all outlays associated with the acquisition and delivery of goods and services, resulting in a financial report in the form of a balance sheet and profit and loss statement at end of each reporting period

“**Affiliate**” means in respect of a Contractor (or, if more than one person, in respect of each such person), a person that controls, is controlled by, or is under common control with the Contractor;

“**Associate**” in relation to a person means any other person who acts or is likely to act in accordance with the wishes of the person as a result of a connection between the persons or common ownership or control; it includes:

- a) A natural person and a relative of the natural person;
- b) A legal person and any person who owns directly or indirectly 50% or more, by value or number, of the capital or voting rights in the legal person; or
- c) Two or more legal person if a third owns directly or indirectly 50% or more, by value or number, of the capital or voting rights in each person;

“**Amount**” includes any value in kind or cash;

“**Air or Sea Transportation Services**” means any transportation of passengers, mail, or goods by air or sea:

- a) between two places in Timor-Leste;
- b) From a place in Timor-Leste to a place outside Timor-Leste;
- c) From a place outside Timor-Leste to a place in Timor-Leste

“**Annual Tax Return**” means a form used by a taxpayer to report the calculation and/or payment of tax due within a tax year as prescribed by the Commissioner and or the Tax Administration;

“**Approval**” means a written authorization by the authorizing organization, body or person;

“**Approved Contract**” means a contract made by the Contractor and approved by the responsible Ministry or Designated Authority, as the case may be, as part of a Development Plan;

“**Arm’s Length Transaction**” means transactions in which the conditions and or terms imposed between two related parties or associates in their commercial or financial relations are similar to those which would be made between independent and unrelated enterprises;

“**Audit**” means a series of activities to seek, gather and process data, documents and or information for tax compliance purposes;

“**Bank**” means any legal person licensed to accept deposits, and using such funds, either in whole or in part, to make extensions of credit or investments for the account, and at the risk, of the person carrying on the business;

“**Bayu-Undan**” is the discovered part of the Bayu-Undan field, as defined and designated in the Production Sharing Contracts JPDA 03-12 and JPDA 03-13;

“**Board**” means the Board of Tax and Customs Appeals established under the UNTAET Regulation 2000/18, including any amendments;

“**Body**” means a type of business organization which may be a limited company, limited partnership, an enterprise owned by the government in whatever name and form, association, cooperative, joint venture or similar arrangement, permanent establishment and other such business enterprise;

“**Carry Forward Loss**” means a loss carried forward under Article 6(2) of the Law on Income Tax;

“**Code**” means the Petroleum Mining Code agreed and adopted by Timor-Leste and Australia under Article 7 of the Timor Sea Treaty, as amended, varied, modified, or replaced from time to time, and the regulations or orders made thereunder;

“**Commissioner**” means the Commissioner or the Director General of the Directorate of Revenue of the Ministry of Finance, Timor-Leste;

“**Contract Area**” means the area that is subject of a Petroleum Agreement and, if any part of a Contract Area is relinquished pursuant to a Petroleum Agreement, the Contract Area is the Contract Area originally granted;

“**Contractor**” means a person deemed to be a taxpayer who:

- (a) has entered into the Production Sharing Contract JPDA 03-12 or JPDA 03-13, or a Production Sharing Contract superseding the previous ones, in accordance with Annex F of the Timor Sea Treaty; or
- (b) succeeds to a taxpayer mentioned in paragraph (a) above, or who is an assignee thereof, under the terms provided for by the Production Sharing Contract JPDA 03-12 and or JPDA 03-13, as the case may be., and who is registered as a contractor under the terms of the Petroleum Mining Code; and
- (c) any other person who has entered into a Production Sharing Contract with the Designated Authority or the responsible Ministry, within the Annex F part of the JPDA;

“**Control**” means in relation to a person, the power of another person to secure:

- a) by means of the holding of shares or the possession of voting power, in or in relation to the first person or any other person; or
- b) by virtue of any power conferred by the articles of association of, or any other document regulating, the first person or any other person, that the affairs of the first person are conducted in accordance with the wishes or directions of that other person;

“**Controlled Taxpayer**” means any one of two or more taxpayers owned or controlled directly or indirectly by the same interests, and includes the taxpayer that owns or controls the other taxpayers;

“**Controlled transaction or controlled transfer**” means any transaction or transfer between two or more members of the same group of controlled taxpayers. The term uncontrolled transaction means any transaction between two or more taxpayers that are not members of the same group of controlled taxpayers;

“**Crude Oil**” means crude mineral oil and all liquid hydrocarbons in their natural state or obtained from Natural Gas by condensation or extraction;

“**Customs Controller**” means the Controller of the *Customs Service*;

“**Customs Service**” means the Timor-Leste Customs Service;

“**Customs Value**” means the fair market value of the *goods* including cost, insurance and freight as determined in accordance with article VII of GATT, or any amendments thereunder;

“**Deactivation Costs**” means the expenses approved under a Decommissioning Plan by the responsible Ministry or Designated Authority, as the case may be, under a Petroleum Agreement;

“**Deactivation Plan**” in respect of a petroleum project means, the Deactivation Plan approved in writing by the Designated Authority pursuant to the Production Sharing Contract that regulates a petroleum project, entered into between the Designated Authority and the Contractor;

“**Depreciable Asset**” means any tangible movable property that:

- (a) has a useful life exceeding one year (12 months);
- (b) is likely to lose value as a result of wear and tear, exploitation, or obsolescence; and
- (c) is wholly or substantially used in the conduct of taxable activities;

“**Designated Authority**” means the Designated Authority established under Article 6 of the Timor Sea Treaty;

“**Designation Notice**” is a notice described in Section 68 of UNTAET Regulation 2000/18;

“**Development Expenditure**” means expenditure incurred, after the responsible Ministry or Designated Authority has approved a Development Plan, in preparing a site for Petroleum

Operations, including drilling and completing production wells, and the construction of production facilities, but does not include any expenditure incurred in the acquisition or construction of a pipeline or in the acquisition of a depreciable asset;

“**Development Plan**” in respect of a petroleum project means, a Development Plan approved by the Designated Authority pursuant to the Production Sharing that regulates a petroleum project, entered into between the Designated Authority and the Contractor

“**Dividend**” means any distribution of profit from current year or from accumulated earnings by a legal person to a member as a result of participation in the capital of the legal person, including:

- a) Any amount returned to a member in respect of a membership interest in a legal person on a partial reduction in capital to the extent that the amount returned exceeds the amount or value by which the nominal value of the membership interest was reduced; or
- b) Any amount distributed to a member on redemption or cancellation of a membership interest, including liquidation, to the extent the amount distributed exceeds the nominal value of the membership interest;

“**Elang Kakatua Kakatua North**” means the discovered area Elang Kakatua Kakatua North, as defined in Production Sharing Contract JPDA 03-12;

“**Exploration Expenditure**” means expenditure relating to and connected with geological, geophysical and geochemical surveys, exploration or appraisal drilling, or feasibility and environmental impact studies incurred in conducting Petroleum Operations prior to the grant of an approval of the Development plan by the responsible Ministry or Designated Authority, as the case may be;

“**Export Pipeline**” means an export pipeline as defined in the Production Sharing Contracts JPDA 03-12 and JPDA 03-13;

“**Field Export Point**” means the point at which petroleum from a Contract Area leaves the Contract Area, or such earlier point at which it is loaded onto or enters a vessel, pipeline, or other means of transportation to be transported from the Contract Area;

“**Financial institution**” means any licensed bank or other licensed legal person that is primarily engaged in the business of making credit extensions or investments for the account, and the risk, of the person carrying on the business;

“**Goods**” means any substance, organism, article or thing, whether manufactured or natural, which is not a human body, cadaver or human remains;

“**Head Office Expenditures**” means any executive, management, or general administration expenditures incurred by a non-resident person in the ordinary course of business, and which expenses are incurred solely and primarily for business purpose and for the benefit of the permanent establishment of the person in Timor-Leste;

**“Intangible Asset”** means any property, other than tangible movable or immovable property, that:

- a) has a useful life exceeding one year;
- b) is used wholly or substantially in the conduct of taxable business activities;

**“Intangible expenditure”** means any expenditure incurred other than in the acquisition of any tangible movable or immovable property, or tangible asset;

**“Interest”** means:

- a) any amount (including a premium or original issue discount) paid or accrued under a debt obligation that is not a repayment of capital and pursuant to petroleum operations; or
- b) any amount that is functionally equivalent to an amount referred to in paragraph (a), such as amount paid or accrued under an interest rate swap agreement or as defaulted under a guarantee agreement, pursuant to petroleum operations;
- c) any commitment, guarantee, service, or similar fee payable in respect of a debt obligation or other instrument or agreement giving rise to interest under paragraphs (a) or (b);

**“International Financial Reporting Standards”** means the most recent International Financial Reporting Standards issued by the International Accounting Standards Board or any successor entity taking over the role of issuing International Financial Reporting Standards;

**“Joint Commission”** means the Joint Commission established pursuant to Article 6 of the Timor Sea Treaty;

**“Law on Income Tax”** means the Law on Income Tax, applicable in Timor-Leste as defined under UNTAET Regulation No. 1999/1

**“Law on Income Tax Regime and Procedures”** means the Law on the General Tax Regime and Procedures applicable in Timor-Leste, under the terms of the UNTAET Regulation No. 1999/1;

**“Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods”** means the Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods, applicable in Timor-Leste, under the terms of UNTAET Regulation No. 1999/1;

**“Legal Person”** means:

- a) any limited liability company, joint stock company, general partnership, limited partnership, or other unincorporated association or body of persons, whether incorporated, formed, organized, or established in Timor-Leste or elsewhere;
- b) any trust, undivided estate of a deceased natural person;

- c) a government, a political or administrative subdivision of a government in whatever name or form, or public international organisation, or an entity, organisation, association, or business form owned by a government, political subdivision of a government, or public international organisation;

“**Long-Term Contract**” is a contract for manufacture, installation, maintenance, or construction, or services related thereto, that is not completed in the tax year in which work under the contract commenced, other than a contract estimated to be completed within six months of the date on which work under the contract commenced;

“**Management Services**” means the provision of managerial services, consulting, supervisory or other similar services for a fee between related parties;

“**Member**” in relation to a legal person means a shareholder, partner in a partnership, or any other person with a membership interest in a legal person;

“**Method of Accounting**” includes not only the overall method of accounting of the taxpayer but also the accounting treatment of any item;

“**Mining**” means any method or process by which any mineral is taken from the soil or from any substance or constituent of the soil;

“**Mining Support services**” means every service relating to mining other than technical, management, consulting, or architectural services;

“**Natural Gas**” means all gaseous hydrocarbons and inerts, including wet mineral gas, dry mineral gas, casing head gas, and residue gas remaining after the extraction of liquid hydrocarbons from wet gas, but not crude oil;

“**Natural Resources**” means any mineral, petroleum, or any other living or non-living resource that may be taken from the land or sea;

“**Non-Resident Person**” means any person who is not present in Timor-Leste for a period of, or periods in aggregate to, one hundred and eighty three days or more in the tax year in aggregate;

“**Non-Wage Benefits**” means any reward for services provided by an *employer* to an *employee*, including:

- (a) the market value of any non-cash benefit provided by an *employer* to an *employee*;
- (b) the value determined by the *Commissioner* of the provision by the *employer* to an *employee* of the use of a motor vehicle wholly or partly for private purposes of the *employee*;
- (c) the value determined by the *Commissioner* of the provision by the *employer* of accommodation or housing;

- (d) the value determined by the *Commissioner* of the provision by an *employer* to an *employee* of a housekeeper, driver, guard, gardener, or other domestic assistant; and
- (e) the cost to the *employer* of providing an *employee* with any meal, refreshment, or entertainment except in the course of providing a *good* or service for the *employer* where the *Commissioner* considers that the cost of provision for the *employer* is reasonable;

**“Overall Deactivated Costs Approved”** means the total deactivation costs approved by the Designated Authority in writing, in accordance with the Deactivation or Decommissioning Plan for a petroleum project, including revisions and or amendments to date;

**“Person”** means:

- (a) a natural person, including a sole trader;
- (b) a company, wherever incorporated, or other juridical person;
- (c) a partnership, wherever formed;
- (d) a trust, wherever established; or
- (e) any other unincorporated association or body of persons;

**“Percentage Transfer Factor”** under Sections 13 of the present Regulations and 16 of the Taxation of Bayu-Undan Contractors Act means the percentage of the right or stake held by the transferring or assigning Contractor, in a petroleum project, which is either transferred or assigned, divided by the total percentage of the right or stake held by the transferring or assigning Contractor in the petroleum project immediately before the occurrence of the transfer or assignment;

**“Petroleum”** means:

- (a) any naturally occurring hydrocarbon, whether in a gaseous, liquid or solid state;
- (b) any naturally occurring mixture of hydrocarbons, whether in a gaseous, liquid or solid state; or
- (c) any naturally occurring mixture of one or more hydrocarbons, whether in a gaseous, liquid or solid state, as well as other substances produced in association with such hydrocarbons, and includes any petroleum as defined by paragraphs (a), (b) and (c) as defined above, that has been returned to the reservoir;

**“Petroleum Agreement”** means

- (a) a contract, licence, permit, or other authorization in relation to petroleum operations made or given pursuant to the Timor-Leste Petroleum Act, except Seepage Use Authorisation; or
- (b) an authorisation or production sharing contract made under the Code;

**“Petroleum Project”** means authorized activities in Bayu-Undan, with the exception of Elang Kakatua Kakatua North, under a Petroleum Agreement;



“**Reserves**” means the estimated quantity of petroleum or gas that can be expected to be profitably extracted, processed, and sold under the current and foreseeable economic conditions;

“**Reservoir**” means an accumulation of petroleum in a geological unit limited by rock, water or other substances without pressure communication through liquid or gas to another accumulation of petroleum;

“**Resident**” in respect of a natural person means:

a natural person who is present in Timor-Leste for more than 183 days in a tax year unless the person’s permanent place of abode is not in Timor-Leste;

“**Royalty**” means any amount, however described or computed, whether periodical or not, as consideration for:

- (a) the use or right to use any copyright, patent, design, or model, secret formula or process, trademark, or other like property;
- (b) the use or right to use any motion picture films, films or video tapes for use in connection with television or internet broadcasting, or tapes for use in connection with radio or internet broadcasting;
- (c) the receipt of, or right to receive, any visual images or sounds, or both, transmitted by satellite, cable, optic fiber, or similar technology in connection with television, radio, or internet broadcasting;
- (d) the supply of any scientific, technical, industrial, or commercial knowledge or information;
- (e) the use of or right to use any tangible movable property;
- (f) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any such property, supply, or right as mentioned in paragraphs (a)-(e);
- (g) the partial or total forbearance in respect of any matter referred to in paragraphs (a)-(f); or
- (h) the disposal of any property or right referred to in paragraphs (a)-(g);

“**Sales Tax Value**” means:

- (a) for imported taxable *goods*, the *customs value* of *goods* increased by any import duty and excise tax payable on the importation of the *goods*;
- (b) for taxable goods sold in Timor-Leste, the price of the *goods* not including any sales tax; and
- (c) for taxable services provided in Timor-Leste, the price of the service not including any sales tax;

“**Seepage Use Authorisation**” has the meaning in the Timor-Leste Petroleum Act;

“**Services**” includes the hiring of equipment;

“**Subcontractor**” means any person supplying goods or services directly or indirectly to a Contractor in respect of a petroleum project;

“**Tax Administration**” means the National Directorate of Petroleum Revenue or any other public bodies or central services charged under the laws of Timor-Leste to carry out the enforcement of petroleum and mineral tax laws and collect petroleum and mineral taxes and duties, Commissioner or the Minister of Finance or any other competent member or organ of the Government, when exercising their administrative and or statutory power in relation to tax matters, including policies and regulations;

“**Taxpayer**” is anybody, individual or corporate, who or which, pursuant to the provisions in the tax laws, is required to fulfill tax obligations (including filing of periodic information returns and registration with the Tax Administration of Timor-Leste, and who are compliant), persons required to withhold certain withholding taxes, be it income or wages-related and remit same to the Timor-Leste Tax Administration and persons who are deemed to be Contractor or Subcontractor and carrying on oil and gas business within the Annex F part of the Joint Production Development Area;

“**Tax Assessment**” means understatement of tax and or underpayment of tax including interest and any additional tax imposed under Sections 72, 73 and 74 of UNTAET Regulation 2000/18; the Law on Income Tax, the Law on the General Tax Regime and Procedures (to the extent applicable in Timor-Leste) and the present Regulations;

“**Taxable Business Activities**” means business activities carried on to derive business income and which is includible in gross income;

“**Tax Collection Notice or Notice of Assessment**” means a form for the imposition and collection of tax and or additional or administrative penalties either in the form of interest, fines etc;

“**Tax Correction Notice**” means a notice correcting errors in writing or calculation and or errors in the application of relevant principles or provisions of tax laws in connection with a tax return or Tax Collection Notice or Notice of Assessment;

“**Tax Form**” means:

- (a) an annual income tax form, including all the required information and or data;
- (b) an annual Additional Petroleum Tax form, including all the required information and or data;
- (c) an annual wage income tax withholding information form, including all the required information and or data;
- (d) an excise tax form;
- (e) the income and Additional Petroleum tax instalment forms, ;
- (f) an income tax withholding form;
- (g) a sales tax form;

- (h) a services tax form;
- (i) a wage income tax withholding form;
- (j) any forms designated by the *Commissioner* for the purposes of *persons* applying for tax identification numbers and being registered for tax purposes;
- (k) any forms designated by the *Commissioner* under Section 45.1(c) of the UNTAET Regulation 2000/18; or
- (l) any consolidated form designated by the *Commissioner* which includes the information from 2 or more of the above forms;

provided that where, in relation to any *person*, any consolidated form has been designated by the *Commissioner*, then the forms which that consolidated form has replaced shall no longer be “tax forms”;

“**Tax Period**” means a calendar month or calendar year, unless otherwise stipulated by the Commissioner and or the Minister of Finance, as the case may be;

“**Tax Return**” means a form designated as such by the Commissioner under Section 42 of UNTAET Regulation 2000/18 or described in Section 3 of the UNTAET Regulation 2000/18, including all the required information and or data or a form used by a Taxpayer to report the calculation and payment of tax due pursuant to the provisions of the applicable tax laws;

“**Tax Treaty**” means:

- (a) an agreement between the Government of the Democratic Republic of Timor-Leste and the government of a sovereign country providing for the relief from double taxation and the prevention of fiscal evasion; or
- (b) an agreement between the Government of the Democratic Republic of Timor-Leste and the government of a foreign country providing for reciprocal assistance in the enforcement of income tax liabilities;

“**Tax Year**” means the 12 month period from 1 January to 31 December, or if a taxpayer has permission to use a substituted tax year, the substituted tax year;

“**Timor-Leste**”, when referring to a geographic area, means the territory of Timor-Leste and its territorial waters, the economic zone off the coast of Timor-Leste as defined in Section 4 of the Constitution of the Democratic Republic of Timor-Leste and recognized under the law of the Sea and by any Treaty Of Timor-Leste;

“**Timor-Leste Petroleum Act**” means the Timor-Leste Petroleum Act, 2004 as amended, varied, modified, or replaced from time to time, and includes any regulations and amendments made under the Act;

“**Timor Sea Treaty**” means the Timor Sea Treaty dated 20 May 2002 between the Government of the Democratic Republic of Timor-Leste and the Government of Australia;

“**Transaction**” means any sale, assignment, lease, license, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, however such transaction is effected, and whether or not the terms of such transaction are formally documented. A transaction also includes the performance of any services for the benefit of, or on behalf of, another taxpayer;

“**True taxable income**” means, in the case of a controlled taxpayer, the taxable income that would have resulted had it dealt with the other member or members of the group at arm's length. It does not mean the taxable income resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement the controlled taxpayer chose to make (even though such contract, transaction, or arrangement is legally binding upon the parties thereto);

“**Uncontrolled comparable**” means the uncontrolled transaction or uncontrolled taxpayer that is compared with a controlled transaction or taxpayer under any applicable pricing methodology.

“**Uncontrolled taxpayer**” means any one of two or more taxpayers not owned or controlled directly or indirectly by the same interests;

“**Underlying Ownership**” in relation to a legal person, means a membership interest in the person held, directly or indirectly through an interposed legal person or persons, by a natural person or by a person not ultimately owned by natural persons;

“**Wages**” means any reward for services provided by an *employer* to an *employee*, including:

- (a) any salary provided to the *employee*, including leave pay, overtime payments, commissions, and bonuses;
- (b) director's fees;
- (c) the value of gifts provided by an *employer* to an *employee*;
- (d) any allowance provided by the *employer* for the benefit of an *employee*;
- (e) any payment provided by the *employer* in respect of loss or termination of employment;
- (f) any payments however described made on termination of employment in respect of entitlements outstanding at the time of termination;
- (g) the reimbursement or discharge by an *employer* of any expense of the *employee* including utilities expenses;
- (h) the amount of any reimbursement or discharge by an *employer* of an *employee*'s medical expenses;
- (i) the amount of any waiver where any *employer* waives an obligation of the *employee* to pay an amount owing to the *employer*; and
- (j) *Non-wage benefits* greater than \$20 provided in a calendar month to *employees* of an *employer* that is exempt from income tax;

“**Verification**” is a series of steps undertaken to evaluate the completeness and accuracy of an information provided to the Commissioner and or the tax administration of Timor-Leste.

## Section 5 Applicable Laws

### 5.1

Every contractor executing a petroleum project, whether directly or indirectly through an Operator, is liable to tax in accordance with:

- a) the applicable Indonesian Law on Income Tax;
- b) the applicable Indonesian Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods;
- c) the applicable Indonesian Law on the General Tax Regime and Procedures, as modified by the UNTAET Regulation 2000/18 and or the present Regulations, including amendments thereto and the modifications contained in the Taxation of Bayu-Udan Contractors Act, Law No. 3/2003.

### 5.2

The application of subparagraphs 5.1(a)-(c) above shall be done in accordance with the provisions of the UNTAET Regulation No. 1999/1.

### 5.3

Every Subcontractor carrying on business within the Annex F part of the Joint Production Development Area shall be subject to the provisions of Section 5.1 insofar as it is relevant and applicable to their operations as Subcontractors.

### 5.4

The corporate tax rate on the assessable income of a Contractor and Subcontractor shall be 30 per cent (30%).

### 5.5

Notwithstanding the provisions of subparagraphs 5.1 and 5.2 above, Contractors who are deemed to be taxpayers in Timor-Leste as defined in the present Regulations are exempt from the taxes of Timor-Leste, including taxes applicable under the Indonesian Law on Income Tax, the Law on Value Added Tax on Goods and services and Sales Tax on Luxury Goods, and of the Law on the General Tax Regime and Procedures, as modified by UNTAET Regulation No. 2000/18, including any amendments thereto, in relation to income and building activities, installation and operation of an export pipeline.

An amount is Timor-Leste-source income to the extent to which the amount is connected with the performance of petroleum operations or project:

- (a) income from petroleum operations or project carried on by a Contractor or Subcontractor resident in Timor-Leste; or
- (b) by a non-resident through a permanent establishment in Timor-Leste as determined under the present Regulation and any other applicable tax laws;
- (c) income from the alienation of any movable property of a Contractor used in deriving Timor-Leste-source income referred to in subparagraphs (a) and (b);

- (d) income from the lease of immovable property in Timor-Leste whether improved or not, or from any other interest in or over immovable property, including the right to explore for, or exploit, natural resources, in Timor-Leste;
- (e) income from the alienation of any property or right referred to in paragraph (d) or from the alienation of any ownership interest in a legal person the assets of which consist wholly or principally of property or rights referred to in paragraph (d);
- (f) dividend paid by a resident or permanent establishment;
- (g) interest, royalties, management fees, annuity, or any other income paid by a resident or borne by a permanent establishment in Timor-Leste of a non-resident;
- (h) income from services rendered in Timor-Leste relating to construction, building activities, construction consulting services, air or sea transportation, mining and mining consulting services, insofar as the remuneration is paid by a resident person or borne by a Timor-Leste permanent establishment of a non-resident person; and
- (i) notwithstanding paragraphs (a)-(h), an amount taxable in Timor-Leste under an international agreement or Treaty.

## 5.2.

Income is a foreign-source to the extent to which it is not Timor-Leste-source income.

## Section 6

### **Reserve for Deactivation Costs Expenditure**

#### 6.1

Notwithstanding the provision of Article 9.1(c) of the Law on Income Tax, for the purposes of computing the taxable income for a tax year, a Contractor may deduct the annual amount transferred to a reserve established to deactivate a petroleum project against the gross income arising from the petroleum project.

#### 6.2

The annual amount transferred to a reserve for a tax year and allowable as deduction for a tax year under Sections 4 of the Taxation of Bayu-Undan Contractors Act and 6.1 of the present Regulations, is the amount determined for that year under a Petroleum Agreement and arising from the Total Deactivation Costs agreed upon between the Designated Authority and the Contractor or Contractors.

#### 6.2.1

The value of the reserve referred to in paragraph 6.1 for a given tax year is the value authorized in writing for that year by the Designated Authority and within the scope of the Production Sharing Contract or Contracts regulating a petroleum project, entered into between the Designated Authority and the Contractor.

#### 6.3

As a condition precedent to the tax deductibility of Deactivation Cost allowable pursuant to Section 4 of the Taxation of Bayu-Undan Contractors Act in the current year, a Contractor is required to exhibit a copy of the approval granted by the Designated Authority to the annual tax return submitted to the Commissioner and in which a claim is made for such deduction against the taxable income and or Additional Petroleum Tax.

6.4

The amount of Deactivation Cost deductible in a current tax year shall be calculated on the basis of the formula prescribed pursuant to Section 4(2) of the Taxation of Bayu-Undan Contractors Act.

6.5

If, at any time, the value of the Deactivation Costs deductible under this Section exceeds the amount Overall Deactivation Costs Approved, the amount of the excess shall be includible in the gross income of the Contractor in the tax year in which the excess occurs.

Section 7  
**Depreciation**

7.1

The depreciation deductions for an asset with a useful life exceeding one (1) year allowable under Sections 5 of the Taxation of Bayu-Undan Contractors Act and 11 of the Law on Income Tax for tangible assets used in petroleum operations are permissible only when the Contractor is the legal and titled owner of the asset, and the asset is used in furtherance of the business activities of the taxpayer and exclusively in connection with a petroleum project.

7.2

The costs of acquisition, construction costs, installations, improvements or repairs that enhance the value or convert the asset from one use to the other or prolong the life of a tangible asset are required to be depreciated exclusively on a straight-line basis and each asset is required to be depreciated individually.

7.3

For the purposes of calculating depreciation deductions in respect of tangible assets used in petroleum operations and which is connected to a petroleum agreement, the amount and rates of depreciation shall be as follows:

**USEFUL LIFE OF ASSETS**

**DEPRECIATION RATES**

One-Four (1-4) years  
Over Four (4) years

Twenty five percent (25%)  
Twenty percent (20%)

7.4

Other than the year in which first production commences, the amount of the depreciation deduction allowable in that tax year under paragraph 7.3 in respect of a depreciable asset, shall be calculated in accordance with the following formula:

## **A x B**

Where:

(**A** is the cost of the asset; and **B** is the applicable depreciation rate prescribed in paragraph 7.3).

### 7.5.1

In the year in which first production commences, the amount of the depreciation deduction in respect of a depreciable asset acquired, created and or constructed before the commencement of the first production is calculated in accordance with the following formula:

## **A x B/C**

Where

**A** is the value determined under paragraph 7.3;

**B** is the number of days from the date of the first production until the end of the tax year in which the first production has occurred; and

**C** is the number of days in the tax year.

### 7.6

The depreciation of tangible assets under the present Regulation and Sections 5 of the Taxation of Bayu-Undan Contractors Act and 11 of the Law on Income Tax, whether acquired or built before the commencement of the first production, shall be calculated and be deductible for tax purposes only from the date of the first production.

## Section 8

### **Amortisation**

#### 8.1

The amortisation of Exploration, Development and other expenses incurred in respect of petroleum activities (intangibles), including those incurred by a Contractor prior to the commencement of the first production, in creating, acquiring and or preserving an intangible asset with a useful life exceeding one (1) year, shall be calculated individually and exclusively on a straight line basis.

#### 8.2

For the purposes of calculating amortisation deductions in respect of intangible assets used in petroleum operations and which is connected to a petroleum agreement, the amount and rates of amortisation shall be as follows:

### **USEFUL LIFE OF ASSETS**

One-Four (1-4) years

Over Four (4) years

### **AMORTISATION RATES**

Twenty five percent (25%)

Twenty percent (20%)

#### 8.3



Other than the year in which first production commences, the amount of the amortisation deduction allowable in that tax year under paragraph 8.2 in respect of an amortisable asset, shall be calculated in accordance with the following formula:

**A x B**

Where:

(**A** is the cost of the asset; and **B** is the applicable depreciation rate prescribed in paragraph 8.2).

8.4.

In the year in which first production commences, the amount of the amortisation deduction in respect of an amortisable asset owned by the Contractor before the commencement of the first production is calculated in accordance with the following formula:

**A x B/C**

Where

**A** is the value determined under paragraph 8.2;

**B** is the number of days from the date of the first production until the end of the tax year in which the first production has occurred; and

**C** is the number of days in the tax year.

8.5

The amortisation of an intangible assets, whether acquired or developed before the first production date, shall be calculated and be deductible for tax purposes only from the date of the first production.

## **Section 9 First Production**

For the purposes of Sections 7 and 8 of the present Regulation, the first production occurs when there are at least thirty (30) days of commercial production, and the commencement of the first production shall be the first 30-day period.

## **Section 10 Inventory**

10.1

Inventories shall:

- (a) conform as nearly as may be to the best accounting practice in the trade or business, and
- (b) must clearly reflect the income.

## 10.2.

Inventories shall be valued at cost or market, whichever is lower. Where inventories are valued at cost by the Contractor, the cost shall be determined according to the absorption-cost method.

### 10.2.2

Where particular items of inventory are not readily identifiable, a Contractor may account for inventory under first-in-first-out (FIFO) or the weighted average cost method.

### 10.2.3

A change of inventory method is permissible subject to the written approval of the Commissioner and subject to any terms and conditions that the Commissioner may impose to reflect accurate income and expenditures.

## 10.3

- (a) Use of full absorption method of inventory costing. In order to conform as nearly as may be possible to the best accounting practices and to clearly reflect income as required by section 9.1(b) of the present Regulations, both direct and indirect production costs must be taken into account in the computation of inventoriable costs in accordance with the “full absorption” method of inventory costing. Under the full absorption method of inventory costing production costs must be allocated to goods produced during the taxable year, whether sold during the taxable year or in inventory at the close of the taxable year determined in accordance with the taxpayer's method of identifying goods in inventory;
- (b) the taxpayer must include as inventoriable costs all direct and indirect production costs ;
- (c) costs are considered to be production costs to the extent that they are incident to and necessary for production or manufacturing operations or processes. Production costs include direct production costs and fixed and variable indirect production costs;
- (d) costs classified as “direct production costs” are generally those costs which are incident to and necessary for production or manufacturing operations or processes and are components of the cost of either direct material or direct labor. Direct material costs include the cost of those materials which become an integral part of the specific product and those materials which are consumed in the ordinary course of production or manufacturing and can be identified or associated with particular units or groups of units of that product;
- (e) direct labor costs include the cost of labor which can be identified or associated with particular units or groups of units;
- (f) the term “indirect production costs” includes all costs which are incident to and necessary for production or manufacturing operations or processes other than direct production costs (as defined in subparagraph (d) of this paragraph). Indirect production costs may be classified as to kind or type in accordance with acceptable accounting principles so as to enable convenient identification with various production or manufacturing activities or functions and to facilitate reasonable groupings of such costs for purposes of determining unit product costs.

Section 11  
**Withholding Tax**

11.1

Pursuant to the provisions of Article 23.1(3) and Section 8 of the Taxation of Bayu-Undan Contractors Act, royalty or similar payment made by a Contractor or Subcontractor to a resident taxpayer or permanent establishment in respect of any petroleum project shall be subject to withholding tax at five decimal four percent (5.4%), being 6% of ninety percent (90%) of the gross amount.

11.2

Pursuant to the provisions of Article 26.1(c) and (d) and Section 8 of the Taxation of Bayu-Undan Contractors Act, payments such as royalties, rent, income connected with the use of property, compensation for services, work and activities made by a Contractor or Subcontractor to a non-resident taxpayer other than a permanent establishment in Timor-Leste and in respect of any petroleum project shall be subject to withholding tax at seven decimal two (7.2%), being 8% of ninety percent (90%) of the gross amount.

11.3

Notwithstanding the provision of paragraph 10.2, compensation or remuneration paid by Contractors or Subcontractors under Article 26.1(d) of the Law on Income Tax, to dependent non-resident employees, for services connected with a petroleum shall be subject to withholding tax at eighteen percent (18%), being 20% of ninety percent (90%) of the gross amount.

11.4

The net income of a permanent establishment carrying on petroleum and natural gas exploration (drilling) activities in respect of a petroleum project shall be subject to withholding tax at five decimal four percent (5.40%), being 6% of ninety percent (90%) of the gross income, and that sum shall be the basis for the monthly tax installment payments prescribed under Section 25 of the Law on Income Tax.

11.5

The net income of a permanent establishment providing shipping or air transportation services in respect of a petroleum project shall be subject to withholding tax at two decimal sixteen (2.16%), being 2.4% of ninety percent (90%) of the gross income, and that sum shall be the basis for the monthly tax installment payments prescribed under Section 25 of the Law on Income Tax.

Section 12  
**Obligations of a Person Withholding Tax from a Payment**

12.1

A Contractor or Subcontractor who has the obligation to withhold tax under Articles 21, 23 and 26 of the Law on Income Tax and or Section 8 of TBUCA, and who has withheld tax accordingly, shall remit the tax withheld to the Petroleum Fund account held by the Timor-Leste Central Bank within fifteen (15) days after the end of the month in which the payment was made.

## 12.2

At the time of the payment, the payer must issue to the recipient of the payment a withholding tax notice setting out the amount of the payment made and the amount of tax withheld from such payment.

## 12.3

A contractor or Subcontractor who fails to withhold tax in accordance with any enabling laws or under the present Regulations from a payment made by the person is personally liable to pay the amount of the tax which has not been withheld.

## 12.4

A Contractor or Subcontractor who has been personally held liable under subparagraph 12.3 above and who has made a payment of the tax due to the Timor-Leste government is entitled to recover the amount of the tax from the recipient of such payment.

## 12.5

For the limited purpose of the present Regulations, Section 8 of the Taxation of Bayu-Undan Contractors Act and Articles 21, 23 and 26 of the Law on Income Tax, any Contractor and or the Subcontractor obligated to withhold withholding tax shall be treated as an agent of the Tax Administration of Timor-Leste to the extent of such taxes required to be withheld.

### 12.5(a)

In the event of the liquidation, merger, acquisition or bankruptcy of the person holding or having control over the tax withheld, the Tax Administration and or the Government of Timor-Leste shall have a first claim of right to the tax withheld before any distribution or transfer of property is made.

## 12.6

The legal regime applicable in relation to the collection and recovery of tax shall apply to any amount withheld or required to be withheld in accordance with this Section.

## 12.7

The provisions of Sections 72 to 74 of the UNTAET Regulation 2000/18 shall be applied separately and jointly by the Tax Administration to any understatement or underpayment in respect of any tax owed and which is connected with withholding tax obligations of any person.

## Section 13

### **Non-Deductible Expenses in respect of Income Tax**

#### 13.1

In determining the taxable income of an income taxpayer, non-deductible items shall be:

- (a) distribution of profits such as dividends and by whatever name or form;
- (b) penalties of any kind, penal or administrative;
- (c) excessive compensation paid by a legal person for work performed and paid to shareholders or related parties as compensation;
- (d) incentives, pension fund payments, and insurance premiums for personal interest and/or the families of expatriate employees, management and shareholders;

- (e) losses arising from a transaction with a related party where transactions were determined by the Commissioner not to be at arm's-length;
- (f) costs incurred for the benefit of a related party or shareholders;
- (g) bad debts;
- (h) exploration and development costs incurred before the commencement of commercial production and which are required to be capitalized;
- (i) reserves, other than approved deactivation cost reserve under Section 4 of the Taxation of Bayu-Undan Contractors Act;
- (j) salaries paid to members of an association, limited or unlimited partnerships without share capital;
- (k) costs incurred by a Contractor and not in connection with a Contract Area as defined under the relevant Production Sharing Contract;
- (l) if an income taxpayer is required to withhold tax from a payment that is deductible as necessary and ordinary business expense of the taxpayer, including payment of wages, the deduction is not allowed until the taxpayer pays the withheld tax to the Tax Administration;
- (m) a fine or other monetary penalty imposed for violation of any law, rule or regulations;
- (n) a bribe or any similar amount;
- (o) an expenditure or loss incurred to the extent recoverable under a policy of insurance or contract of indemnity;
- (p) the acquisition costs of an asset having a useful life of more than one (1) year;
- (q) payments made by a permanent establishment to a head office or related party as royalties or other similar compensation in connection with property, patents or other similar rights;
- (r) compensation in connection with management services between related parties;
- (s) gifts, donations, aid
- (t) interest payments made by a permanent establishment to a head office or related party except when connected with a debt or loan from a bank and directly connected with a petroleum project in Timor-Leste and approved by the Designated Authority;
- (u) the following payments made by permanent establishment to a head office or related party:
  - 1) long-term corporate planning;
  - 2) policy;
  - 3) public and government relations
  - 4) finance\treasury;
  - 5) advertising, donations, sponsorship;
  - 6) entertaining;
  - 7) legal;
  - 8) intra-group relations; and
  - 9) any payments whatsoever failing to meet the requirements and conditions stipulated in KEP-62

Section 13A  
**Substantiation**

- i. excepting for *de minimis* amount, defined to be five thousand US dollars (US\$5,000) or less, a taxpayer claiming an amount as deductible business expense may be required by the Tax Administration to provide the proof of payment and evidence establishing the character of the expense, as a pre-condition for deductibility;
- ii. proof of payments may include invoices and accompanied with receipts, cancelled checks, evidence of electronic bank transfers and or bank statements;
- iii. invoices alone shall not operate as evidence of payment for substantiation purposes;
- iv. it is irrelevant for tax purposes that such expense or deductible cost was authorized under any contractual agreements between the taxpayer and a third party or third parties; and
- v. any contractual provision between a taxpayer and other parties authorizing an amount as a deductible expense for tax purposes shall not operate as a barrier against the substantiation requirement of the present Regulations.

Section 13B  
**Disallowance of Unsubstantiated Business Expenses**

- (a) If the substantiation requirements of Section 13A of the present Regulations are not met, the Tax Administration may completely disallow the amount claimed as business deduction and subject the affected taxpayer to additional income tax, penalties and interest.
- (b) Any person, or any person required to file a return of information with respect to income under the applicable tax laws as stated in Section 3.1 of the Taxation of Bayu-Undan Contractors Act, other than an individual wage earner, shall keep such permanent books of account or business record, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any tax return or information.
- (c) The books or records required by this Section shall be kept at all times available for inspection by authorized Tax Administration officers or employees and or third party agents, and shall be retained so long as the contents thereof may become material in the administration of any applicable tax laws in Timor-Leste.
- (d) All records required by the present Regulations in this part shall be kept, by the person required to keep them, at one or more convenient and safe locations in Timor-Leste, accessible to the Tax Administration officers, employees and or authorized agents, and shall at all times be available for inspection by the Tax Administration.

Section 14  
**Transfer of Rights or Stakes in a Petroleum Project**

14.1

A Right or Stakes in a Petroleum Project is deemed to be transferred or assigned in whole by a Contractor where;

- (a) 100% of the voting rights or value of the Contractor is transferred or sold directly or indirectly, to another person, including an entity controlled by the Contractor or controlling the Contractor,
- (b) all or substantially all of the assets of the Contractor is sold or transferred to another person;
- (c) statutory or de facto merger, acquisition, reorganization, amalgamation, liquidation, change of name followed by or preceded by transfer of more than 50% of the voting shares or value of the Contractor to another person.

#### 14.2

Insofar as there is continuity of the business purpose of the transferor Contractor, the transferee Contractor shall succeed to the balance of deferred tax asset of the transferor contractor and continue to amortise any Exploration or Development Expenditure in the manner and on the same basis as the original transferor Contractor.

#### 14.3

For the purposes of paragraph 14.2 above, there is continuity of business purpose where the transferee Contractor is engaged immediately after the transfer of a Petroleum Agreement in an actively conducted trade or business which has been so conducted under the transferred Petroleum Agreement throughout the five-year period ending on the date of the transfer by the transferor Contractor in Timor-Leste.

#### 14.4

Where a Contractor's right or stakes in a Petroleum Operation is partially transferred or assigned to another Contractor, then:

- (a) The acquiring Contractor shall be deemed to have succeeded into the gross revenues and incurred the deductible expenses equal to the percentage of the right or stakes transferred or assigned by the transferor Contractor, immediately before the occurrence of the transfer or assignment; and
- (b) For the purposes of determining the accrued net revenues of the acquiring Contractor in the tax year in which the transfer or assignment occurred, the accrued net revenues of the transferor or assigning Contractor at the close of the tax year immediately preceding the year of the transfer or assignment, shall be multiplied by the "percentage transfer factor," as defined in Section 4 of the present Regulations.

## **Chapter II**

### **Section 15**

#### **Annual Income Tax Return**

The following persons are required to deliver a completed annual income tax form to the Tax Administration in the manner prescribed by the Commissioner:

- (a) person who is required to pay income tax under the present Regulations, Taxation of Bayu-Undan Contractors Act, Law on Income Tax, the General Tax Regime and Procedures, and UNTAET Regulation 2000/18 in connection with petroleum operation matters;
- (b) any person receiving an amount that has not been correctly subject to withholding tax, where applicable under the present Regulations, Taxation of Bayu-Undan Contractors Act, Law on Income Tax, the General Tax Regime and Procedures, and UNTAET Regulation 2000/18 in connection with petroleum operation matters; and
- (c) other persons or classes of persons as may be designated by the Tax Administration from time to time.

#### 15.1

An income taxpayer required to deliver a completed income tax form for a tax year to the Tax Administration shall deliver the form not later than the last day of the third-month, following the end of the tax year to which the tax form relates.

#### 15.2

A completed income tax return of a Contractor shall include:

- (a) a completed annual income tax form designated by the Tax Administration, including any additional information and or documents required on the face of the form;
- (b) profit and loss statement;
- (c) book to tax reconciliation;
- (d) reconciliation of the income tax return to production sharing contract return;
- (e) balance sheet, including information on any change in equity section from the previous year;
- (f) depreciation schedules; and
- (g) description of related party transactions, including amounts and the nature of the transaction, organizational chart.

#### 15.3

A completed income tax return of a Subcontractor shall include:

- (a) a completed annual income tax form designated by the Tax Administration, including any additional information required on the face of the form;
- (b) profit and loss statement;
- (c) book to tax reconciliation;
- (d) balance sheet, including information on any change in equity section from the previous year; and
- (e) description of related party transactions (where necessary); including amounts and the nature of the transaction and organizational chart (if any).

#### 15.4

A Contractor or Subcontractor may apply to the Tax Administration for an extension of time to deliver the annual income tax form required under this Section. The application for such an



extension of time must be signed by an officer of the taxpayer and the basis of the application must be clearly stated.

#### 15.5

An application made pursuant to subparagraph 15.4 above must be accompanied by proof of payment of the tax due in full and a calculation of the estimated tax due (if any).

#### 15.6

The Tax Administration may, by notice in writing, grant the application for extension of time to deliver the annual income tax form upon certain terms and conditions.

The granting of an extension to file the income tax return under this Section does not alter the due date for the payment of the tax due.

#### 15.7

The income tax due from a Contractor or Subcontractor and or any other person for a tax year is due and payable not later than the last day of the third-month, following the end of the tax year.

#### 15.8

Every person, other than individual wage earners, made liable for any tax imposed by Section 3.1 of the Taxation of Bayu-Undan Contractors Act and or the present Regulations shall make such returns or statements as required by the present Regulations in this part. The return shall include therein the information required by the applicable Regulations or forms.

#### 15.9

Copies of the prescribed return forms will so far as possible be provided to taxpayers by the Tax Administration. A taxpayer will not be excused from making a return however, by the fact that no return form has been furnished by the Tax Administration. Taxpayers not supplied with the proper forms should make an application to the Tax Administration in ample time to have their returns prepared, verified and filed on or before the due date.

#### 15.10

Each taxpayer must carefully prepare its return and set forth fully and clearly the information required to be included therein. Returns that are otherwise prepared will not be accepted as meeting the requirements of the present Regulations and other applicable tax laws.

#### 15.11

In the absence of prescribed form, a statement made by a taxpayer disclosing the gross income and the deductions therefrom may be accepted as a tentative return, and, if filed within the prescribed time, the statement so made will relieve the taxpayer from liability for the addition to tax imposed for delinquent filing of the return, provided that without unnecessary delay such a tentative return is supplemented by a return made on the proper form.

#### 15.12

Any return, statement, or other document required to be made with respect to tax imposed by Section 3.1 of the Taxation of Bayu-Undan Contractors Act or any applicable Regulations must be signed by the person required to file the return, statement, or other document, or by the person

required or duly authorized to sign in accordance with the Regulations, forms, or the instructions prescribed with respect to such return, statement, or document.

15.13

An individual's signature on such return, statement, or other document shall be prima facie evidence that the individual is authorized to sign the return, statement or other document.

## Section 16 **Contractor's Monthly Income Tax Obligations**

16.1

With respect to a Contractor's first year, the Contractor shall provide an estimate of the projected tax liability to the Tax Administration not later than the 15<sup>th</sup> day of the month following the first period of thirty (30) consecutive days during which the average level of regular production delivered for sale on the twenty five (25) highest days in the thirty-day period reaches a level of regular production delivered for sale as determined by the Tax Administration.

16.1(a)

In respect of the tax years subsequent to the Contractor's first year, every Contractor shall submit to the Tax Administration an estimated income tax liability for the current tax year no later than April 15<sup>th</sup>.

16.2

The projected tax liability of a Contractor for the first tax year as determined pursuant to subparagraph 15.1 shall be divided by twelve (12) and the Contractor shall pay a monthly instalment of one-twelfth ( $1/12^{\text{th}}$ ) on the fifteenth (15<sup>th</sup>) day of each month in the first tax year.

16.3

A contractor is liable for monthly instalments of estimated income tax for each tax year. The monthly instalment is due and payable on the fifteenth (15<sup>th</sup>) day following the month to which they relate.

16.4

Excepting where the Tax Administration decides otherwise and or the Contractor's first tax year as determined under subparagraph 16.1 above, the amount of each estimated monthly tax liability of a Contractor shall be equal to one-twelfth ( $1/12^{\text{th}}$ ) of the Contractor's income tax liability for the preceding tax year. The amount of instalment due before the due date for the delivery of the Contractor's income tax return for the preceding year shall be the higher of:

- (a) the amount of the instalment paid in the last month of the preceding tax year; or
- (b) the average monthly tax instalment payment for the preceding tax year.

16.4(a)

If in the opinion of a Contractor the use of the prior year tax liability is unlikely to accurately predict the current year liability and lead to a material underpayment of the income tax liability for the current tax year, the Contractor may, by an application made to the Commissioner submit a different estimated tax liability.

16.4(b)

There is a material underpayment of income tax liability where the aggregate of the monthly tax payments made for a tax year is less than 90% of the actual tax liability for the tax year.

16.4(c)

Upon the approval of an application made by a Contractor under subparagraph 16.4(a) of the present Regulations by the Commissioner, the new estimated tax liability shall form the basis of the subsequent monthly tax obligations of the Contractor. Any underpayment of tax for prior periods preceding the date of the substituted estimated tax liability of a Contractor must be paid in full within five (5) business days from the date the Contractor is notified in writing of the approval of the substituted estimated tax liability by the Commissioner.

16.5

The amount of tax instalment due and payable under this Section may be determined by the Tax Administration, where:

- (a) the income tax return of a Contractor for the preceding tax year is delivered after the due date, inclusive of any extension of time granted pursuant to Section 15.6 of the present Regulations;
- (b) there is a material change in the Contractor's circumstances, including merger or acquisition or a natural disaster;
- (c) a contractor's income tax return for the preceding year is amended, either as a result of a tax audit or self-amendment; and
- (d) a Contractor fails to provide the Tax Administration with estimated income tax liability as required under Section 16.1(a) above.

16.6

An estimated tax liability previously provided to the Tax Administration may be revised by the Contractor, provided the consent of the Tax Administration is sought and obtained in advance. An estimate of tax liability delivered to the Tax Administration, including any revised version is valid for the entire tax year.

16.7

Any amounts of underpayment arising pursuant to a revised calculation of the estimated tax liability of a Contractor under subparagraph 15.6 above shall become due and payable together with the first instalment due after the revised estimate is approved by the Tax Administration. If

there is an overpayment of tax arising from the revised estimate, such overpayment shall be applied as a credit against future monthly income tax liability of the Contractor.

16.8

If a Contractor's estimate made under subparagraph 16.1(a), including any revised estimate of income tax liability is less than ninety (90) percent of the Contractor's tax actual liability arising from a self-assessment and or tax audit, the Contractor shall be liable for penalty equal to:

(a) if the under-estimate is due to fraud or willful neglect, fifty (50) percent of the difference between the estimated tax liability and the actual tax liability (hereinafter called "the tax shortfall");

(b) in any other case, ten (10%) of the tax shortfall.

16.9

If the Tax Administration is satisfied that the reason for the shortfall was due to circumstances beyond the Contractor's control, such as natural disaster, material and or significant price fluctuations, and that the Contractor exercised all diligent and reasonable care in making the estimate, the tax penalties imposed pursuant to subparagraphs 15.8(a)-(b) may be waived.

### **Chapter III**

#### **Section 17**

#### **Additional Petroleum Tax**

17.1

Pursuant to Section 11 of the Taxation of Bayu-Undan Contractors Act, a Contractor executing a petroleum project and subject to Additional Petroleum Tax in a tax year shall determine such tax liability according to the following formula:

$$A \times 22.5\% / (1-r)$$

Where:

**A:**

is the Contractor's accumulated net receipts for Petroleum Operations income for the tax year; and

**r:**

is the corporate tax rate (30%) as stipulated in Section 3.3 of the Taxation of Bayu-Undan Contractors Act.

17.2

The Additional Petroleum Tax imposed on a Contractor pursuant to Sections 11 of the Taxation of Bayu-Undan Contractors Act and 17 of the present Regulations on a Contractor is a separate tax from the corporate income tax imposed under Section 3.3 of the Taxation of Bayu-Undan

Contractors Act Income and under the Law on Income Tax, and it is an addition to corporate income tax, where applicable.

17.3

The Additional Petroleum Tax paid by a Contractor in a tax year is an allowable deduction for the purposes of calculating the corporate income tax payable for the year in which both the corporate income tax and the Additional Petroleum Tax were paid or payable.

## Section 18 **Accumulated/Accrued Net Revenue**

18.1

The accumulated/accrued net revenue of a Contractor in respect of a petroleum project shall be determined in accordance with the following formula; namely:

$$((\mathbf{A} \times \mathbf{116.5\%}) - (\mathbf{1} \times (\mathbf{1-r}))) + \mathbf{B}$$

Where:

**A:**

is the Contractor's accumulated or accrued net receipts/revenue in relation to a petroleum project at the end of the previous tax year;

**B:**

is the Contractor's net receipts/revenue in relation to a petroleum project for the current tax year;

**1:**

is the interest expense and other financial charges paid by the Contractor in relation to a petroleum project in the current tax year and is entered as a negative number in the formula above; and

**r**

is 30% (being the corporate income tax rate specified in Section 3.3) of the Taxation of Bayu-Undan Contractors Act.

18.2

Where a Contractor is subject or liable for an Additional Petroleum Tax liability in a tax year in connection with a petroleum project as determined under the present Regulations and Section 11 of the Taxation of Bayu-Undan Contractors Act, the amount of the accumulated net receipts/revenue shall be nil for the purposes of calculating the Contractor's net revenue /receipts in the subsequent year.

18.3

In a tax year in which (**A x 116.5%**) component of the formula described in Section 17.1 above and Section 12.1 of the Taxation of Bayu-Undan Contractors Act is negative, the subtraction of (**1 x(1-r)**) component of the formula shall not operate in a manner to reduce the amount of (**(Ax116.5%) – (1x (1-r))**) to an amount that is less than the value of **A** component of the formula.

18.4

There shall be no carryover or carryback of any excess resulting from the application of the formula to a Contractor in any tax year.

#### Section 19

#### **Contractor's Net Revenue/Receipts**

19.1

For the purposes of the Additional Petroleum Tax, the net revenue/receipts of a Contractor in respect of petroleum project for a tax year is gross revenue/receipts of all includible income of the Contractor for the tax year less the total allowable deductible expenditures of the Contractor in respect of petroleum project for the year.

19.2

The net revenue/receipts of a Contractor arising from a petroleum project may be a negative sum in any tax year.

#### Section 20

#### **Gross Revenue/Receipts**

20.1

For the limited purposes of gross revenue/receipts in relation to the computation of the Additional Petroleum Tax of a Contractor in a given tax year, the gross receipts of a Contractor arising from petroleum project, is the aggregate of the following amounts:

- (a) all income items under the Taxation of Bayu-Undan Contractors Act, Articles 4 and 5 of the Law on Income Tax or any other applicable laws and or Treaty, earned or accrued in the year in connection with or from petroleum project but excluding interest income, earned or accrued during the tax year;
- (b) any consideration received by the Contractor in the year and in respect of the disposal, transfer, alienation or destruction, or loss of property, including materials, equipment, plant facilities, intellectual property or rights used in connection with petroleum project, if the expenditure incurred in acquiring the property has been deducted in computing the net revenue/receipts of the Contractor for any tax year;
- (c) any amount received by the Contractor in the tax year in respect of the provision of information and or data obtained from any survey, evaluation, appraisal, or study in connection with petroleum project where the related expenditure incurred in undertaking the survey, appraisal, or study has been deducted in computing the net revenue/receipts of the Contractor for any tax year;
- (d) any amounts received by the Contractor in the tax year that is a reimbursement, refund or other compensation, for an amount previously deducted, cash or otherwise, in computing the net revenue/ receipts of the Contractor for any tax year; and
- (e) any compensation, indemnity and or damages received from an insurance policy or similar instruments, indemnity agreement, settlement or judicial decision, by a

Contractor in respect of any property used in petroleum project where such property was destroyed and or damaged.

#### 20.2

An amount received or accrued as consideration for the transfer of an interest, right and or stakes in petroleum project is excluded from the computation of the gross revenue/receipts of a Contractor under paragraph 19.1 of the present Regulations and Section 14.1 of the Taxation of Bayu-Undan Contractors Act.

#### 20.3

For the purpose of calculating the net revenue/receipts of a Contractor in a tax year, the amounts includible as part of the gross receipts of a Contractor under subparagraph 19.1 is limited to the portion of such amounts attributable to the petroleum project of the Contractor.

### Section 21

#### **Deductible Expenses in respect of Additional Petroleum Tax**

For the limited purposes of calculating the Additional Petroleum Tax imposed under Section 11 of the Taxation of Bayu-Undan Contractors Act (including any amendments thereof), a Contractor may deduct the following items in a tax year:

- (a) permissible deductible expenditures incurred by the Contractor in a tax year in respect of the petroleum project, excluding the amounts allocable to depreciation and or amortisation deductions;
- (b) interest and other financing charges in connection with the petroleum project in a Contract Area as approved by the Designated Authority;
- (c) capital expenditure incurred in a tax year in respect of acquisition or construction of a tangible or intangible asset for use in the petroleum project in which the Contractor is engaged in a Contract Area, excluding an amount paid as consideration by a Contractor for the acquisition of an interest, right and or stake in a petroleum project;
- (d) operating expenditure incurred by the Contractor in the current year in respect of the petroleum operation in which the Contractor is engaged in a Contract Area; and
- (e) an amount of Timor-Leste corporate income tax calculated by applying the rate specified in Section 3.3 of the Taxation of Bayu-Undan Contractors Act to the taxable income of the Contractor, excluding any additional taxes or interest imposed under Sections 72-74 of the UNTAET Regulation 2000/18, or under the present Regulations.

#### 21.1

The amounts deductible under subparagraphs (a)-(e) are limited to those directly attributable to the petroleum project of the Contractor and in respect of a specific Contract Area.

#### 21.2

If any part of the amount of deductible expenses incurred by a Contractor and deductible under this Section is attributable to any other activity other than a petroleum project, only the portion of the deductible expenses relating specifically to the petroleum project shall be treated as a deductible expense in the computation of the net revenue in respect of the petroleum project.

## Section 22

### **Exclusion of the Consideration paid or imputed in connection with the acquisition of an Interest or Stake in a Petroleum Project**

Any consideration, including all transactions costs paid or accrued by a Contractor in respect of the acquisition of an interest, right and or stake in a petroleum project under Section 16 of the Taxation of Bayu-Undan Contractors Act shall be excluded from the permissible deductible expenditure under Section 21 of the present Regulations and Section 15 of the Taxation of Bayu-Undan Contractors Act.

## Section 23

### **Annual Additional Petroleum Tax Return**

#### 23.1

Every Contractor having an Additional Petroleum Tax obligation under Sections 16 of the present Regulations and 11 of the Taxation of Bayu-Undan Contractors Act shall deliver a completed annual Additional Petroleum Tax return form to the Tax Administration in the manner prescribed by the Commissioner.

#### 23.2

Any Contractor required to deliver a completed annual Additional Petroleum Tax return form to the Tax Administration shall deliver the form and any outstanding Additional Petroleum Tax liability not later than the last day of the third-month, following the end of the tax year to which the tax form and the tax liability relate.

#### 23.3

A completed annual Additional Petroleum Tax return of a Contractor means a completed annual Additional Petroleum Tax return form designated by the Tax Administration, including any additional information and or documents required on the face of the form, or by the Tax Administration.

#### 23.4

On or before the due date, a Contractor may apply to the Tax Administration for an extension of time to deliver the annual Additional Petroleum Tax return form required under this Section. The application for such an extension of time must be signed by an officer of the taxpayer and the basis of the application must be clearly stated on the face of the application.

#### 23.5

An application made pursuant to subparagraph 23.4 above must be accompanied by proof of the payment of the tax due in full and a calculation of the estimated tax due.



23.6

The Tax Administration may, by notice in writing, grant the application for extension of time to deliver the annual Additional Petroleum Tax return form upon certain terms and conditions. The granting of an extension to file the Additional Petroleum Tax return under this Section does not alter the due date for the payment of the tax due.

23.7

The Additional Petroleum Tax return due from a Contractor for a tax year is due and payable not later than the last day of the third-month, following the end of the tax year to which the tax relates.

23.8

Notwithstanding the provision of paragraph 23.4 above, a Contractor may apply to the Tax Administration for the extension of the time within which to file the annual Additional Petroleum Tax return after the expiration of the due date stipulated in subparagraph 23.1, provided that the Contractor making such application is able to show exceptional circumstances warranting the grant of such application.

23.8(a)

The Tax Administration may grant an application made under paragraph 23.8 above upon certain terms and conditions, including the payment of any outstanding tax liability of the Contractor making such application and or the payment of any prescribed fees.

## Section 24

### **Contractor's Monthly Additional Petroleum Tax Obligations**

24.1

Every Contractor having an Additional Petroleum Tax obligation under Section 17 of the present Regulations and Section 11 of the Taxation of Bayu-Undan Contractors Act shall be liable for monthly instalments of Additional Petroleum Tax.

24.2

Every Contractor having an Additional Petroleum Tax obligation under Section 17 of the present Regulations and Section 11 of the Taxation of Bayu-Undan Contractors Act shall deliver to the Tax Administration an estimate of Additional Petroleum Tax due for a tax year not later than the due date for payment of the first Additional Petroleum Tax instalment due for that tax year.

24.3

The estimated Additional Petroleum Tax liability of a Contractor for a tax year as determined pursuant to subparagraph 24. 2 shall be divided by twelve (12) and the Contractor shall pay a monthly instalment equal to one-twelfth (1/12<sup>th</sup>) on the fifteenth (15<sup>th</sup>) day of each month following the month in which they relate.

24.4

Where the first obligation of a Contractor under Sections 16 of the present Regulations and 18 of the Taxation of Bayu-Undan Contractors Act commences in a month other than the month of January, the monthly instalments due and payable by the Contractor under subparagraph 23.3

above shall be calculated by dividing the remaining month(s) of that tax year by the estimated Additional Petroleum Tax determined under subparagraph 24.2 of the present Regulations.

#### 24.5

Excepting where the Tax Administration decides otherwise and or the Contractor's first Additional Petroleum Tax obligation commenced in a month other than the month of January in a tax year, the amount of each estimated monthly Additional Petroleum Tax liability of a Contractor shall be equal to one-twelfth ( $1/12^{\text{th}}$ ) of the Contractor's Additional Petroleum Tax liability for the preceding tax year. The amount of instalment due before the due date for the delivery of the Contractor's monthly Additional Petroleum Tax return for the preceding year shall be the higher of:

- (c) the amount of the instalment paid in for the last month of the preceding tax year; or
- (d) the average monthly tax instalment payment for the preceding tax year.

#### 24.6

The amount of tax instalment due and payable under this Section and Section 18 of the Taxation of Bayu-Undan Contractors Act may be determined by the Tax Administration, where:

- (a) the annual Additional Petroleum Tax return of a Contractor for the preceding tax year is delivered after the due date, inclusive of any extension of time granted pursuant to Section 22 of the present Regulations;
- (b) there is a material change in the Contractor's circumstances, including merger or acquisition or a natural disaster;
- (c) a contractor's Additional Petroleum Tax return for the preceding year is amended, either as a result of a tax audit and or self-amendment; and
- (d) a Contractor fails to provide the Tax Administration with estimated Additional Petroleum Tax liability as required under Section 24.2 above and under Section 18 of the Taxation of Bayu-Undan Contractors Act.

##### 24.6.1

An estimate of tax liability made by the Tax Administration under Section 24.6 above, including any revised version is valid for the entire tax year.

#### 24.7

An estimated Additional Petroleum Tax liability previously provided to the Tax Administration or an estimate made by the Tax Administration under Section 24.6 above may be revised by the Contractor, provided the consent of the Tax Administration is sought and obtained in advance. An estimate of tax liability delivered to the Tax Administration, including any revised version is valid for the entire tax year.

#### 24.8

Any amounts of underpayment arising pursuant to a revised calculation of the estimated tax liability of a Contractor under subparagraph 24.7 above shall become due and payable together with the first instalment due after the revised estimate is approved by the Tax Administration. If there is an overpayment of tax arising from the revised estimate, such overpayment shall be applied as a credit against future monthly Additional Petroleum tax liability of the Contractor.

#### 24.9

If in a tax year, a Contractor's estimate made under this Section and Section 18 of the Taxation of Bayu-Undan Contractors Act in respect of the Additional Petroleum Tax obligation of a Contractor, including any revised estimate, is less than ninety (90) percent of the Contractor's actual tax liability arising from a self-assessment and or tax audit, the Contractor shall be liable for penalty equal to:

- (a) if the under-estimate is due to fraud, scheme and or willful neglect, fifty (50) percent of the difference between the estimated tax liability and the actual tax liability (hereinafter called the "APT" shortfall"); or
- (b) in any other case, ten (10%) of the APT shortfall.

#### 24.10

If the Tax Administration is satisfied that the reason for the APT shortfall was due to circumstances beyond the Contractor's control, such as natural disaster, material and or significant price fluctuations, and that the Contractor exercised all diligent and reasonable care in making the estimate, the tax penalties imposed pursuant to subparagraphs 24.9(a)-(b) may be waived by the Tax Administration.

## **Chapter IV**

### **Section 25**

#### **Allocation and Reallocation of Income and Expenditures among Related Parties and or Associates/Anti-avoidance Rules & Policies**

The primary purpose of Section 25 of the present Regulation is to amplify the provisions of Sections 91-93 of the UNTAET Regulation 2000/18 and Article 18 of the Law on Income Tax to ensure that taxpayers clearly reflect income attributable to controlled transactions and to prevent the avoidance of taxes with respect to such transactions. The referenced Sections above are intended to put a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer. This Section sets forth general principles and guidelines to be followed in the determination of the true taxable income and expenditures in transactions involving associates or related parties.

#### 25.1

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the Timor-Leste, and whether or not affiliated) owned or controlled

directly or indirectly by the same interests, the Commissioner may distribute, apportion, reapportion, or allocate or reallocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes and or to clearly reflect the true taxable income of any of such organizations, trades, or businesses.

The Commissioner may make such a determination where terms and or conditions are made or imposed between the associated enterprises in their commercial or financial relations, which differ from those which would be made between independent enterprises.

#### 25.2

In the case of any transfer or license of intangible property between a Contractor and a party owned or controlled directly or indirectly by the same interest, the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible property.

#### 25.3

The Commissioner may make allocations between or among the members of a controlled group if a controlled taxpayer has not reported its true taxable income. In such case, the Commissioner may allocate income, deductions, credits, allowances, basis, or any other item or element affecting taxable income (referred to as allocations). The appropriate allocation may take the form of an increase or decrease in any relevant amount.

#### 25.4

Generally, in the process of the determination of the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same or identical circumstances (arm's length result).

#### 25.5

The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result.

#### 25.6

An arm's length result may be determined under any method without requesting a taxpayer to establish the inapplicability of another method, but if another method is subsequently shown to produce a more reliable measure of an arm's length result; such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm's length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm's length result.

#### 25.7

Evaluation of whether a controlled transaction produces an arm's length result is made pursuant to a method selected under the best method rule. Data based on the results of transactions between unrelated parties provides the most objective basis for determining whether the results of a controlled transaction are arm's length. Thus, in determining which of two or more available

methods (or applications of a single method) provides the most reliable measure of an arm's length result, the two primary factors to take into account are the degree of comparability between the controlled transaction (or taxpayer) and any uncontrolled comparables, and the quality of the data and assumptions used in the analysis. In addition, in certain circumstances, it also may be relevant to consider whether the results of an analysis are consistent with the results of an analysis performed under another method.

**Best method rule:**

The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result. Thus, there is no strict priority of methods, and no method will invariably be considered to be more reliable than others. An arm's length result may be determined under any method without establishing the inapplicability of another method, but if another method is shown subsequently to produce a more reliable measure of an arm's length result; such other method must be used. Similarly, if two or more applications of a single method provide inconsistent results, the arm's length result must be determined under the application that, under the facts and circumstances, provides the most reliable measure of an arm's length result.

25.8

In general, whether a controlled transaction produces an arm's length result is generally evaluated by comparing the results of that transaction to results realized by uncontrolled taxpayers engaged in comparable transactions under similar circumstances. For this purpose, the comparability of transactions and circumstances must be evaluated considering all factors that could affect prices or profits in arm's length dealings (comparability factors).

25.9

Comparability factors include:

(a) **Functions**

Determining the degree of comparability between controlled and uncontrolled transactions requires a comparison of the functions performed, and associated resources employed, by the taxpayers in each transaction. This comparison is based on a functional analysis that identifies and compares the economically significant activities undertaken, or to be undertaken, by the taxpayers in both controlled and uncontrolled transactions. A functional analysis should also include consideration of the resources that are employed, or to be employed, in conjunction with the activities undertaken, including consideration of the type of assets used, such as plant and equipment, or the use of valuable intangibles. A functional analysis is not a pricing method and does not itself determine the arm's length result for the controlled transaction under review. Functions that may need to be accounted for in determining the comparability of two transactions include— (A) Research and development; (B) Product design and engineering; (C) Manufacturing, production and process engineering; Product fabrication, extraction, and assembly; (E) Purchasing and materials management; (F) Marketing and distribution functions, including inventory management, warranty administration, and advertising activities; (G) Transportation and warehousing; and (H) Managerial, legal, accounting and finance, credit and collection, training, and personnel management services.

**(b) Material contractual terms and conditions**

Determining the degree of comparability between the controlled and uncontrolled transactions requires a comparison of the significant contractual terms that could affect the results of the two transactions. These terms include— ( 1 ) The form of consideration charged or paid; ( 2 ) Sales or purchase volume; ( 3 ) The scope and terms of warranties provided; ( 4 ) Rights to updates, revisions or modifications; ( 5 ) The duration of relevant license, contract or other agreements, and termination or renegotiation rights; ( 6 ) Collateral transactions or ongoing business relationships between the buyer and the seller, including arrangements for the provision of ancillary or subsidiary services; and ( 7 ) Extension of credit and payment terms. Thus, for example, if the time for payment of the amount charged in a controlled transaction differs from the time for payment of the amount charged in an uncontrolled transaction, an adjustment to reflect the difference in payment terms should be made if such difference would have a material effect on price. Such comparability adjustment is required.

1. Written agreement. The contractual terms, including the consequent allocation of risks, that are agreed to in writing before the transactions are entered into will be respected if such terms are consistent with the economic substance of the underlying transactions. In evaluating economic substance, greatest weight will be given to the actual conduct of the parties, and the respective legal rights of the parties. If the contractual terms are inconsistent with the economic substance of the underlying transaction, the Commissioner may disregard such terms and impute terms that are consistent with the economic substance of the transaction.
2. No written agreement. In the absence of a written agreement, the Commissioner may impute a contractual agreement between the controlled taxpayers consistent with the economic substance of the transaction. In determining the economic substance of the transaction, greatest weight will be given to the actual conduct of the parties and their respective legal rights. For example, if, without a written agreement, a controlled taxpayer operates at full capacity and regularly sells all of its output to another member of its controlled group, the Commissioner may impute a purchasing contract from the course of conduct of the controlled taxpayers, and determine that the producer bears little risk that the buyer will fail to purchase its full output. Further, if an established industry convention or usage of trade assigns a risk or resolves an issue, that convention or usage will be followed if the conduct of the taxpayers is consistent with it. For example, unless otherwise agreed, payment generally is due at the time and place at which the buyer is to receive goods.

**(c) Risks**

1. Determining the degree of comparability between controlled and uncontrolled transactions requires a comparison of the significant risks that could affect the prices that would be charged or paid, or the profit that would be earned, in the two transactions. Relevant risks to consider include— ( 1 ) Market risks, including fluctuations in cost, demand, pricing, and inventory levels; ( 2 ) Risks associated with the success or failure of research and development activities; ( 3 ) Financial risks,

including fluctuations in foreign currency rates of exchange and interest rates; ( 4 ) Credit and collection risks; ( 5 ) Product liability risks; and ( 6 ) General business risks related to the ownership of property, plant, and equipment.

2. Identification of taxpayer that bears risk. In general, the determination of which controlled taxpayer bears a particular risk will be made in accordance with the material provisions of the contractual terms as indicated in Section 20.8(b) above. Consequently, the allocation of risks specified or implied by the taxpayer's contractual terms will generally be respected if it is consistent with the economic substance of the transaction. An allocation of risk between controlled taxpayers after the outcome of such risk is known or reasonably knowable may indicate the lack of economic substance. In considering the economic substance of the transaction, the following facts are relevant;
  - (a) whether the pattern of the controlled taxpayer's conduct over time is consistent with the purported allocation of risk between the controlled taxpayers; or where the pattern is changed, whether the relevant contractual arrangements have been modified accordingly;
  - (b) whether a controlled taxpayer has the financial capacity to fund losses that might be expected to occur as the result of the assumption of a risk, or whether, at arm's length, another party to the controlled transaction would ultimately suffer the consequences of such losses; and
  - (c) the extent to which each controlled taxpayer exercises managerial or operational control over the business activities that directly influence the amount of income or loss realized. In arm's length dealings, parties ordinarily bear a greater share of those risks over which they have relatively more control.

**(d) Economic condition**

Determining the degree of comparability between controlled and uncontrolled transactions requires a comparison of the significant economic conditions that could affect the prices that would be charged or paid, or the profit that would be earned in each of the transactions. These factors include— (a) the similarity of geographic markets; (b) the relative size of each market, and the extent of the overall economic development in each market; (c) the level of the market (e.g., wholesale, retail, etc.); (d) the relevant market shares for the products, properties, or services transferred or provided; (e) the location-specific costs of the factors of production and distribution; (f) the extent of competition in each market with regard to the property or services under review; (g) the economic condition of the particular industry, including whether the market is in contraction or expansion; and (h) the alternatives realistically available to the buyer and seller.

**(e) Nature of property or services involved in the transaction**

Evaluating the degree of comparability between controlled and uncontrolled transactions requires a comparison of the property or services transferred in the transactions. This comparison may include any intangible property that is embedded in tangible property or services being transferred. The relevance of product comparability in evaluating the relative reliability of the results will depend on the method applied.

## 25.10

### **Standard of comparability.**

In order to be considered comparable to a controlled transaction, an uncontrolled transaction need not be identical to the controlled transaction, but must be sufficiently similar that it provides a reliable measure of an arm's length result. If there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results.

## 25.11

A material difference is one that would materially affect the measure of an arm's length result under the method being applied. Where practicable, adjustments must be made by the taxpayer to cure the effect of such material differences on prices or profits if such effects can be ascertained with reasonable accuracy to improve the reliability of the results.

If adjustments for material differences cannot be made, the uncontrolled transaction may be used as a measure of an arm's length result, but the reliability of the analysis will be reduced.

## 25.12

### Arm's length range:

- (a) Generally, the application of a pricing method will produce a single result that is the most reliable measure of an arm's length result. In other cases, application of a method may produce a number of results from which a range of reliable results may be derived. A taxpayer will not be subject to adjustment if its results fall within such range (arm's length range).
- (b) Determination of arm's length range
  1. **Single method.** The arm's length range is ordinarily determined by applying a single pricing method selected under the best method rule to two or more uncontrolled transactions of similar comparability and reliability. Use of more than one method may be appropriate for the purposes of determining the best method.
  2. **Selection of comparables.** Uncontrolled comparables must be selected based upon the comparability criteria relevant to the method applied and must be sufficiently similar to the controlled transaction that they provide a reliable measure of an arm's length result. If material differences exist between the controlled and uncontrolled transactions, adjustments must be made to the results of the uncontrolled transaction if the effect of such differences on price or profits can be ascertained with sufficient accuracy to improve the reliability of the results. The arm's length range will be derived only from those uncontrolled



comparables that have, or through adjustments can be brought to, a similar level of comparability and reliability, and uncontrolled comparables that have a significantly lower level of comparability and reliability will not be used in establishing the arm's length range.

3. **Comparables included in arm's length range.** Generally, the arm's length range will consist of the results of all of the uncontrolled comparables that meet the following conditions: the information on the controlled transaction and the uncontrolled comparables is sufficiently complete that it is likely that all material differences have been identified, each such difference has a definite and reasonably ascertainable effect on price or profit, and an adjustment is made to eliminate the effect of each such difference.
4. **Adjustment of range to increase reliability.** If there are no uncontrolled comparables described in this Section, the arm's length range selected from the results of all the uncontrolled comparables, should achieve a similar level of comparability and reliability. In such cases the reliability of the analysis must be increased, where it is possible to do so, by adjusting the range through application of a valid statistical method to the results of all of the uncontrolled comparables. The reliability of the analysis is increased when statistical methods are used to establish a range of results in which the limits of the range will be determined such that there is a 75 percent probability of a result falling above the lower end of the range and a 75 percent probability of a result falling below the upper end of the range. The interquartile range ordinarily provides an acceptable measure of this range; however a different statistical method may be applied if it provides a more reliable measure.
5. **Interquartile range.** For purposes of this section, the interquartile range is the range from the 25th to the 75th percentile of the results derived from the uncontrolled comparables. For this purpose, the 25th percentile is the lowest result derived from an uncontrolled comparable such that at least 25 percent of the results are at or below the value of that result. However, if exactly 25 percent of the results are at or below a result, then the 25th percentile is equal to the average of that result and the next higher result derived from the uncontrolled comparables. The 75th percentile is determined analogously.
6. **Adjustment if taxpayer's results are outside arm's length range.** If the results of a controlled transaction fall outside the arm's length range, the Commissioner may make allocations that adjust the controlled taxpayer's result to any point within the arm's length range. If the interquartile range is used to determine the arm's length range, such adjustment will ordinarily be to the median of all the results. The median is the 50th percentile of the results, which is determined in a manner analogous to that described in paragraph 20.11(b)(5) of this Section (Interquartile range). In other cases, an adjustment normally will be made to the arithmetic mean of all the results.

7. **Arm's length range not prerequisite to allocation.** The rules of this Section and Sections 91-93 of the UNTAET Regulations 2008/18 do not require that the Commissioner establish an arm's length range prior to making an allocation and or reallocation between related parties. Thus, for example, the Commissioner may properly propose an allocation on the basis of a single comparable uncontrolled price if the comparable uncontrolled price method has been properly applied. However, if the taxpayer subsequently demonstrates that the results claimed on its income tax return are within the range established by additional equally reliable comparable uncontrolled prices, then then no allocation will be made.

**8. Scope of review:**

The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer is other than it would have been had the taxpayer, in the conduct of its affairs, been dealing at arm's length with an uncontrolled taxpayer.

i. **Intent to evade or avoid tax not a prerequisite:** In making allocations under this Section or the relevant parts of UNTAET Regulation 2000/18, the Commissioner is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances.

ii. **Realization of income not a prerequisite:** The Commissioner may make an allocation under Sections 91 and or 93 of the UNTAET Regulation 2000/18 even if the income ultimately anticipated from a series of transactions has not been or is never realized. For example, if a controlled taxpayer sells a product at less than an arm's length price to a related taxpayer in one taxable year and the second controlled taxpayer resells the product to an unrelated party in the next taxable year, the Commissioner may make an appropriate allocation to reflect an arm's length price for the sale of the product in the first taxable year, even though the second controlled taxpayer had not realized any gross income from the resale of the product in the first year. Similarly, if a controlled taxpayer lends money to a related taxpayer in a taxable year, the Commissioner may make an appropriate allocation to reflect an arm's length charge for interest during such taxable year even if the second controlled taxpayer does not realize income during such year. Finally, even if two controlled taxpayers realize an overall loss that is attributable to a particular controlled transaction, an allocation under this Section or under the UNTAET Regulations 2008/18 is not precluded.

iii. **Non-recognition provisions may not bar allocation:** If necessary to prevent the avoidance of taxes or to clearly reflect income, the Commissioner may make an allocation under this Section and or under the UNTAET Regulations with respect to transactions that otherwise

qualify for non-recognition of gain or loss under applicable provisions of Timor-Leste tax laws.

25.13

**Rules relating to determination of true taxable income.**

The following rules must be taken into account in determining the true taxable income of a controlled taxpayer:

- 1) **Aggregation of transactions:** The combined effect of two or more separate transactions (whether before, during, or after the taxable year under review) may be considered, if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the arm's length consideration for the controlled transactions. Generally, transactions will be aggregated only when they involve related products or services.
- 2) **Allocation based on taxpayer's actual transactions:** The Commissioner will evaluate the results of a transaction as actually structured by the taxpayer unless its structure lacks economic substance. However, the Commissioner may consider the alternatives available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances. In such cases the Commissioner may adjust the consideration charged in the controlled transaction based on the cost or profit of an alternative as adjusted to account for material differences between the alternative and the controlled transaction, but will not restructure the transaction as if the alternative had been adopted by the taxpayer.
- 3) **Multiple year data:** The results of a controlled transaction ordinarily will be compared with the results of uncontrolled comparables occurring in the taxable year under review. It may be appropriate, however, to consider data relating to the uncontrolled comparables or the controlled taxpayer for one or more years before or after the year under review. If data relating to uncontrolled comparables from multiple years is used, data relating to the controlled taxpayer for the same years ordinarily must be considered. However, if such data is not available, reliable data from other years may be used.
- 4) **Allocations apply to results, not methods:** In evaluating whether the result of a controlled transaction is arm's length, it is not necessary for the Commissioner to determine whether the method or procedure that a controlled taxpayer employs to set the terms for its controlled transactions corresponds to the method or procedure that might have been used by a taxpayer dealing at arm's length with an uncontrolled taxpayer. Rather, the Commissioner will evaluate the result achieved rather than the method the taxpayer used to determine its prices.

- 5) **Collateral adjustments with respect to allocations under this Section and or Sections 91-93 of the UNTAET Regulations.** In general, the Commissioner will take into account appropriate collateral adjustments with respect to allocations made with respect to related party transactions. Appropriate collateral adjustments may include correlative allocations, tax credit, conforming adjustments, and setoffs.

## Section 26

### **Transfer Pricing Methods in Connection with the Transfer of Properties**

#### 26.1(a)

In general. The arm's length amount charged in a controlled transfer of property must be determined under one of the six methods listed in this paragraph. Each of the methods must be applied in accordance with all of the provisions of Section 23 of the present Regulations, including the best method rule, the comparability analysis of and the arm's length range as described in Section 25 above.

#### 26.1(b)

The transfer pricing methods in connection with the transfer of tangible property are:

- (a) the comparable uncontrolled price method;
- (b) the resale price method;
- (c) the cost plus method;
- (d) comparable profit method;
- (e) profit split method; and
- (f) Unspecified methods.

#### 26.1(c)

##### **Comparable Uncontrolled Price Method (“CUP”)**

The comparable uncontrolled price method evaluates whether the amount charged in a controlled transaction is arm's length by reference to the amount charged in a comparable uncontrolled transaction. Provided that the comparability requirement is satisfied, the results derived from applying the CUP method generally will be the most direct and reliable measure of an arm's length price.

The CUP may be ascertained based on comparable purchases and sales either between the taxpayer and unrelated parties or sales between two unrelated parties. While no two sales are the same, the Tax Administration is of the view that sufficient comparability exists if similar products are sold under the circumstances that are substantially the same, and any differences in the products or circumstances either have no effect on prices or have differences that can be measured and eliminated with a reasonable number of adjustments as indicated in Section 23 above.

A proposed CUP methodology may be adjusted for many factors, including:

- (a) quality of the product;
- (b) contractual terms like warranty, credit terms, sales volume, or delivery terms;

- (c) level of the market-wholesale or resale;
- (d) geographic market;
- (e) date of the transaction
- (f) intangible property associated with the sale;
- (g) foreign currency risks; and
- (h) purchaser or buyer alternatives.

The CUP method is also allowed where data from public exchanges or quotation media is available for the property. This type of data is useful typically to price intercompany transactions involving commodities products like oil, gas, minerals etc. The following requirements must be met in order to use such data, namely:

1. the data is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled sales;
2. the data is used to set prices in the controlled transaction in the same way that it is used by uncontrolled taxpayers in the industry; and
3. the amount charged in the controlled transaction is adjusted to reflect differences in product quality and quantity, contractual terms, transportation costs, market conditions, risks borne, and other factors that affect the price that would be agreed to by the uncontrolled taxpayers.

Taxpayers should note however, that if there are material products differences for which reliable adjustments cannot be made, the CUP method will not satisfy the best method rule as described in Section 25 above.

26.1(d)

#### **Resale Price Method (RPM)**

The resale price method (RPM) is an arm's length evaluation of price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (resale price) is then reduced by an approximate gross margin on this price ("resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and in the light of the functions performed (taking into consideration assets used and quantum of risk assumed), make an appropriate profit. Essentially, the price is determined under the RPM by subtracting the "appropriate gross profit" from the "applicable resale price" of the item involved.

What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm's length price for the original transfer of property between associated enterprises.

The RPM establishes an arm's length price for the sale between a supplier and a related reseller by applying the gross margin achieved in a comparable transaction, but not necessarily involving exactly similar products, to the resale price of the affiliated reseller. Also, the RPM earned by an independent enterprise in comparable uncontrolled transactions may serve as a guide.

Based on the principles established in Section 20 above, an uncontrolled transaction is comparable to a controlled transaction for purposes of the RPM if one or two conditions are met, namely:

- 1) none of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the resale price margin in the open market; or
- 2) reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Other specific factors that may be appropriate for consideration when a taxpayer elects to use the RPM are:

- 1) contractual terms;
- 2) functions performed
- 3) inventory and turnover rates;
- 4) corresponding risks;
- 5) sales, marketing, advertising programs; and
- 6) market level-wholesale or retail.

In cases where the RPM used is that of an unrelated independent enterprise in a comparable transaction, the reliability of the RPM may be affected if there are material differences in the ways the associated enterprises and the unrelated enterprises execute their businesses. Such differences may impact the costs taken into consideration, and consequently affect the profitability level of an enterprise but may not necessarily affect the price at which it buys and sells its goods or services in the market place.

Peculiar circumstances like those mentioned in this paragraph should be analyzed in determining whether an uncontrolled transaction is comparable for purposes of applying the RPM.

26.1(e)

#### **Cost-Plus Method**

Generally, the cost-plus method determines an arm's length charge by examining the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services rendered to an associated purchaser. An appropriate markup is then added to this cost. The cost plus the added markup may be regarded as an arm's length price of the original controlled transaction. The cost plus markup of the supplier in the controlled transaction should ideally be established by reference to the cost plus markup that the same supplier earns in comparable uncontrolled transactions. In addition, the cost plus markup that would have been earned in comparable transactions by an independent enterprise may serve as a guide

The cost plus method is used mainly in manufacturing, assembly, or other production of goods that are sold to associated enterprises. In determining the arm's length benchmark, adjustments should be made for material differences between uncontrolled and controlled transactions where it can be determined that such differences have definite and reasonably ascertainable effect on the margins. The extent and reliability of such adjustments will affect the relative reliability of the analysis under the cost plus method in certain cases.

Taxpayers using the cost plus method to establish arm's length price should pay particular attention in applying a comparable markup to a comparable cost basis. The cost plus method relies mostly upon a comparison of the markup on costs achieved in a controlled transaction and the markup on costs achieved in or more comparable uncontrolled transactions. In the

circumstances, differences between the controlled and uncontrolled transactions that have effect on the size of the markup must be analyzed to determine what adjustments should be made to the uncontrolled transactions respective markup.

Taxpayers using the cost plus method must consider the following factors:

1. complexity of manufacturing or assembly;
2. procurement, purchasing, and inventory-control activities;
3. testing functions;
4. operating and non-operating expenses; and
5. contractual terms.

26.1(f)

### **Comparable Profit Method (CPM)**

The determination of the arm's length price under the comparable profit method is predicated upon objective measures of profitability level indicators ("PLIs") that are derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. The method is acceptable so long as it is consistent with the Best Method and comparability rules discussed above.

Under the CPM, the arm's length is determined by calculating what a taxpayer's operating profit would have been on related party transaction if its profitability levels were equal to that of an uncontrolled comparable and then comparing that result with to the interquartile range calculated based on the results of the comparable enterprises. In calculating the taxpayer's operating profits, the selected PLIs should be applied solely to the taxpayer's financial data that is related to the controlled transactions.

Since the CPM is a profit based method, taxpayers are required to select which of the related parties that engaged in the controlled transactions will be the party whose profits will be tested for meeting the requirements of the arm's length standard. The tested party should be the related party whose operating profit margin attributable to the controlled transactions can be verified using the most accurate data and requiring the least adjustments, and for which reliable comparable data can be located.

In selecting a pool of comparables from which the PLI will be determined, the standards of comparability will allow for diversity of products and functions. Relevant comparability factors may include the size and scope of operations, lines of business, product and markets and balance sheet items. As a result of the peculiarity of this CPM, taxpayers should broaden the functional analysis to cover more dimensions of those business factors that affect profitability.

Taxpayer's choice of a particular PLI out of other PLIs should be based on the nature of activities under review, and on supporting data availability.

Once a particular PLI has been selected by the taxpayer, the arm's length range should be determined by calculating the interquartile range from the company operating profits. The interquartile range is the range from the 25<sup>th</sup> to the 75<sup>th</sup> percentile of the results derived from the uncontrolled comparables.

26.1(g)

**Comparable Profit Split Method**

The profit split method compares the allocation of the combined operating profit or loss attributable to controlled transactions to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. The profit or loss is then split amongst the associated enterprises on an economically valid basis that approximates the division of profits or loss that would have been anticipated and reflected in an agreement made at arm's length.

The comparative profit method generally divides the total operating income of the buyer and seller in the controlled transaction in a manner that is consistent with the way comparable unrelated parties divide their operating income in similar transactions.

The data on comparable transactions and the resulting profits splits between unrelated parties must be employed, if available. The data must address two independent parties, each having risks, functions, and intangibles substantially comparable to those of the uncontrolled parties. Locating comparable enterprises engaged in transactions that are similar to those of those the buyer and the seller and data distinguishing how the independent parties shared the combined profits from a comparable transaction is extremely difficult.

26.1(h)

**Residual Profit Split Method**

The residual profit method operates in a two-step process. The first step assigns an arm's length return to the conventional activities of the buyer and the seller in controlled transactions. This allocation is done by first granting the buyer and the seller an arm's length returns for functions performed that are contributory to the profits. These functions include manufacturing, advertising and marketing, distribution and the exploitation of intangibles (if any).

The second step involves the allocation of the residual profit between the buyer and the seller based on the corresponding value of their contributions of intangible property to the business activity. Taxpayers are allowed to allocate the residual profits between the buyer and the seller insofar as a discernible benchmark can be established as a basis of the allocation formula. Factors that a taxpayer may include in setting the allocation benchmark may include the capitalized cost of developing the intangibles, enhancements etc.

26.1(i)

**Unspecified (other) Methods**

Other the arm's length standards mentioned specifically in Section 25 of the present Regulations, taxpayers may use other methods to determine the transfer price prices charged for the exchange of goods or services between related enterprises. As with the other specified methods, taxpayers will be required to demonstrate that the unspecified method selected is consistent with the Best and comparability rules as described in Section 20 above.



Section 27  
**Transfer Pricing Enforcement and Penalties**

27(a)

**Civil penalties**

The provisions of Sections 73 and 74 of the UNTAET Regulations 2000/18 (including amendments) shall apply *in pari materia* for:

1. transfer pricing *underpayment* of tax arising from any transfer pricing adjustment made by the Tax Administration under the present Regulations or any other applicable laws; and
2. transfer pricing *understatement* of tax arising from any transfer pricing adjustment made by the Tax Administration under the present Regulations or any other applicable laws.

27(b)

The provisions of Sections 27(a) and 2(b) above are applicable concurrently and independently of each other.

27(c)

The civil penalties prescribed under this Section is applicable where the “net adjustment for a taxable year” exceeds a ten (10) per cent threshold of the gross receipts. In a case in which the “net adjustment for a taxable year” results in a ten (10) per cent or more, the inaccuracy is hereby designated as “substantial valuation misstatement.”

27(d)

The “net adjustment for a taxable year” is with respect to any taxable year, the net increase in taxable income for the taxable year (determined without regard to any amount carried to such taxable year from another taxable year) resulting from adjustments made under this Regulations and Section 91-93 of the UNTAET Regulations 2000/18 in the price for any property or services (or for the use of property). In determining the net increase in taxable income, increases resulting from collateral adjustments under the present Regulations are disregarded.

27(e)

The relevant adjustments are limited to adjustments to the amounts reported by a taxpayer on an income tax return (the original return or an amended return filed before the Tax Administration has contacted the taxpayer regarding the corresponding original return), notwithstanding whether the amount reported differs from the transaction price initially reflected on the taxpayer’s books and records.

27(f)

**Burden of proof**

In any related party transaction, the taxpayer shall be responsible for establishing that the transaction is consistent with the arm’s length standards as provided in Sections 25 and 26 of the present Regulations and Sections 91 and 93 of the UNTAET Regulation 2000/18.

Section 28  
**Documentation Requirements**

28(a)

A taxpayer with an aggregate related party transaction or transactions in the sum of Five Hundred Thousand US Dollars (US\$500,000) or more in a tax year is required to report and disclose such transaction(s) in the income tax return filed for the year in which the transaction(s) occurred. Taxpayers are also required to keep and maintain accessible books and records containing all relevant information about such transaction(s) for a period of seven (7) years, commencing from the date the information or tax return containing the disclosures is filed with the Tax Administration.

In addition, such taxpayers are required to compile transfer pricing documentation supporting the pricing of the related party transaction(s) in the sum of US\$500,000 or more.

28(b)

The transfer pricing documentation requirement of subparagraph 28(a) is met if the taxpayer maintains sufficient documentation to establish that the taxpayer reasonably concluded that, given the available data and the applicable pricing methods, the method (and its application of that method) provided the most reliable measure of an arm's length result under the principles of the Best Method Rule as described in Section 25 of the present Regulations and provides that documentation to the Tax Administration within thirty (30) days of a request for it in connection with an examination of the taxable year to which the documentation relates.

The documentation must be in existence when the return is filed. The Commissioner may, in his discretion, excuse a minor or inadvertent failure to provide required documents, but only if the taxpayer has made a good faith effort to comply and the taxpayer promptly remedies the failure when it becomes known.

28(c)

The principal documents to be maintained by a taxpayer with related party transaction(s) falling within the threshold stipulated in subparagraph 28(a) above includes:

- i. an overview of taxpayer's business, including an analysis of the economic and legal factors affecting pricing;
- ii. a description of taxpayer's organizational structure covering all related parties engaged in transactions potentially relevant under Section 25 of the present Regulations and Sections 91-93 of the UNTAET Regulation 2000/18;
- iii. a description of the method selected and an explanation why the method was selected;
- iv. a narrative of the alternative methods that were considered and the reasons for rejecting those alternatives methods;
- v. a description of controlled transactions and any internal data used to analyze those transactions;
- vi. a description of the comparables that were used, how comparability was evaluated, and what adjustments (if any) were made;
- vii. an explanation of the economic/functional analysis and projections relied upon in developing the method;

- viii. a description or summary of any relevant data that the taxpayer obtains after the end of the year and before filing a tax return, which would help determine if a taxpayer selected and applied a specified method in a reasonable manner; and
- ix. a general index of the principal and background documents and a description of the recordkeeping system used for cataloging and accessing those documents.

28(d)

Other tan items viii and ix under subparagraph 28(c) above, the documentation must have been in existence at the time the return was filed.

28(e)

A taxpayer with a Section 25 reporting obligation is required to use the most current reliable data available before the end of the taxable year in question and the documents are required to generally reflect the data.

28(f)

A transfer pricing documentation developed for a foreign tax jurisdiction is not sufficient for purposes of Sections 25 and 29 of the present Regulations.

Section 29

**UNTAET Regulation 2000/18**

Other administrative matters not expressly covered under the present Regulations, including but not limited to tax appeals shall continue to be governed by the UNTAET Regulations 2000/18 (including amendments thereto) and the Law on the General Tax Regime and Procedures, with the modifications contained in the present Regulations.

**Chapter V**

Section 30

**Tax Audit**

The Tax Commissioner shall to the extent he deems practicable, cause officers and employees of the Tax Administration under his supervision and control to proceed, from time to time, inquire after and concerning all persons therein who may be liable to pay any tax, and all persons owning or having the care and management of any objects with respect to which any tax is imposed.

- (a) the Tax Administration shall conduct periodic tax audits to test tax compliance and for other lawful purposes in the context of implementing and enforcing relevant provisions of tax laws;
- (b) a tax audit is commenced with an official tax audit notification issued by the Tax Administration and delivered to a taxpayer, or the taxpayer's representatives, as the case may be;
- (c) a taxpayer under tax audit shall, upon a written request by the Tax Administration;

- i. show and or submit books and records, or copies thereof, documents and or information specifically requested by the Tax Administration and forming the basis of the book and records, documents pertaining to income received, expenditures incurred, business activities, independent work of the taxpayer or the independent work performed for the taxpayer and connected with a petroleum project, directly or indirectly;
  - ii. grant access to enter such places or offices, factory, installations, platforms, Contract Area as is deemed necessary and material to carrying out the audit.
- (d) tax audits shall be undertaken on the basis of an annual plan, adopted by the Tax Administration, based on the tax risk profile and the significance of the taxpayer. When adopting the plan, the evaluation of the effect of tax audit and control on the efficiency of tax collection in relation to Petroleum Operations in future periods shall also be taken into consideration.

#### Section 30A

- (i) in general-For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any taxes administered by the Tax Administration (including interest, additional amount, penalties) or the liability at law of any transferee or fiduciary of any person in respect of any such taxes, collecting any such liability or inquiring into any offense connected with the administration or enforcement of the tax laws, any authorized officer or employee of the Tax Administration may examine the books, papers, records or other data which may be relevant or material to such inquiry, and take testimony of the person concerned, under oath, as may be relevant to such inquiry.
- (ii) for the purposes described in Sections 64 of the UNTAET Regulation 2000/18 and 34A(i) of the present Regulations, the Commissioner is authorized to summon the person liable for tax or required to perform the act, or any officer or employee of such person or any person having possession, custody, or care of books of accounts containing entries relating to the business of the person liable for tax or required to perform the act or any person deemed proper, to appear before one or more officers or employees of the Tax Administration at a time and place named in the summons and to produce such books, papers, records, or other data, and to give testimony, under oath, as may be relevant or material to such inquiry; and take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry. This summons power may be used in an investigation of either civil or criminal tax related liability.
- (iii) the Commissioner may designate one or more officers or employees of the Tax Administration as individuals before whom a person summoned pursuant to the present Regulations and or the UNTAET Regulation 2000/18 shall appear. Any such officer or employee is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records, or other data produced in compliance with the summons.

- (iv) for the purposes of this paragraph (iii), officer or employee of the Tax Administration means all officers, advisors and employees of the Timor-Leste government, who are engaged in the administration and enforcement of the tax laws and regulations pertaining and or relating to petroleum and mineral resources, and who are appointed, employed or subject to the directions, instructions, or orders of the Minister of Finance

### Section 31 **Tax Audit Methods**

Tax audit methods shall include:

- (a) desk or office controls;
- (b) field controls; and
- (c) referrals to the Prosecutor General's office or any other appropriate governmental agency with a view of determining the commission of a tax-related offense.

### Section 32 **Office Control**

Office control is a set of actions by means of which the Tax Administration verifies the accuracy, completeness, truthfulness and legal base of the data shown in tax or information returns of whatever description, as well as the tax balances, accounting statements and other statements or positions of the taxpayer, comparing the said data to data from tax accounting records and other official records kept by, or at the disposal of, the Tax Administration.

Office controls shall be undertaken in the premises of the Tax Administration by tax auditors or inspectors and or lawyers.

### Section 32A **Field Controls**

Field controls involve the examination of the taxpayer's books and records either at the taxpayer's premises or at the premises of the Tax Administration. An examiner will check the entire return filed by the taxpayer and will examine the books, papers, records and memoranda dealing with matters required to be included in the return. If the return presents an engineering or appraisal problem (e.g. depreciation or depletion deductions. Gains or losses upon the sale or exchange of property, or losses on account of abandonment, exhaustion, or obsolescence), it may be investigated by an engineer agent who makes a separate report.

### Section 32B

- i. If any information and or documents required by the Tax Administration in the course of any tax audit is in possession of a third party having a relationship by ownership or control to the taxpayer under tax audit, the party concerned shall be obliged to provide the information or document when so requested by the Tax Administration;
- ii. the service of a notice to produce any information and or document by the Tax Administration on the taxpayer under audit and which is related by ownership and or

- control to the third party in possession of such document or information, shall be deemed as a proper and effective service on the related third party; and
- iii. where the related third party has a duty to withhold the information and or document referred to in subparagraph (i) above, such a duty shall be ineffective and unenforceable for the purpose of a tax audit.

### Section 33

#### **Processing of Tax Returns and other Statements of the Taxpayer**

During the procedure of office controls of receipt and processing of a tax return:

- (a) the verification of the mathematical accuracy, formal accuracy and completeness or truthfulness of the tax return and other statements filed by the taxpayer shall be performed by the Tax Administration in accordance with all the applicable Laws and internal guidelines and procedures;
- (b) if during the processing of a tax return and other statements a mathematical error is detected, the Tax Administration shall correct such error and notify the taxpayer immediately to pay any difference or determine the amount of tax refund;
- (c) if during the processing of the tax return and other statements it is determined that they are formally incorrect, incorrectly filled out or incomplete, the tax auditor or inspector shall by a written notification instruct the taxpayer to remove any error or complete the tax return and other statements within fourteen (14) days; and
- (d) if the taxpayer does not proceed in accordance with the written instruction as indicated in subparagraph c above, it shall be considered that the tax return or other statements, as the case may be, were not filed with the Tax Administration.

### Section 33A

#### **Amendment of Tax Returns**

- i. on or before the commencement of a tax audit by the Tax Administration, a taxpayer may on its own submit a corrected or amended tax return within twenty four (24) months from the date the original tax return was due, or if there was a tax liability, from the end of the date the original tax liability became due; and
- ii. where a taxpayer initiates an amendment of a tax return resulting in an increase in the tax liability amount from a prior period, the taxpayer shall be subject to the provisions of Sections 73 and 74 of the UNTAET Regulation 2000/18.

### Section 34

#### **Participation of a Taxpayer in Office Control Procedure**

- (a) the taxpayer under tax audit shall be under the obligation to participate, directly or through a tax representative, in furtherance of the desk or office control tax audit, at a

request from the Tax Administration, and to give the requested explanations, documentations or information within the term specified by the Tax Administration; and

- (b) the failure of the taxpayer to respond is not a bar to further the desk or office tax audit in any manner determined by the Tax Administration until the process is completed in accordance with the applicable tax laws.

#### Section 35

#### **Change of Tax Liability upon Findings of Desk/Office Controls**

- (a) if there is a change of the amount of tax liability during the procedure of desk or office control, the tax auditor or inspector shall prepare a report of the summary of the facts and the findings in triplicates;
- (b) a copy of the summary report provided under subparagraph (a) shall be sent to the taxpayer within ten (10) business days from the date of the report;
- (c) the taxpayer shall have a right to file an objection against the report within five (5) business days after the receipt of the report. The objection must clearly state the ground(s) and the relief(s) sought from the Tax Administration;
- (d) the tax Administration is required to review the objection and make a determination within thirty (30) days from the date of the receipt of the objection;
- (e) if the objection filed by the taxpayer pursuant to subparagraph (c) above is granted, the Tax Administration shall issue a “No further action required” letter to the taxpayer within forty-five (45) days; and
- (f) if the objection filed by the taxpayer pursuant to subparagraph (c) above is dismissed, the Tax Administration shall issue a tax assessment accordingly, and the procedure set out in Section 69 of UNTAET Regulation 2000/18 in respect of tax appeals shall apply thereafter.

#### Section 35A

If the taxpayer does agree with the proposed changes the examining officer will invite the taxpayer to execute either Form 5000 or any other appropriate agreement form. The taxpayer's acceptance of an agreed additional assessment (including interest and penalties) does not prevent the taxpayer from filing an appeal and or bringing a lawsuit, nor does it preclude the Tax Administration from maintaining suit to recover an erroneous refund.

Section 36  
**Field Audit Controls**

- (a) field audits shall be undertaken within the premises of the taxpayer in Timor-Leste and or the offices of the Tax Administration or another location in Timor-Leste as may be determined by the Commissioner;
- (b) field control shall be undertaken by a team constituted for that purpose by the Tax Administration;
- (c) field control shall be undertaken on the basis of a control order or notice issued by the Tax Administration to the taxpayer;
- (d) the Tax Administration may postpone the commencement of field control if the taxpayer submits a written complaint immediately upon the receipt of the control order indicated in subparagraph 34(c) above, and state the factual and the legal reasoning showing that the control or notice is contrary to Law. Such a complaint must be delivered to the Tax Administration within three (3) business day from the date of the receipt of the control order or notice stipulated in subparagraph 34(c); and
- (e) a written decision on the complaint indicated in subparagraph 34(d) of the present Regulations shall be issued by the Tax Administration within fifteen (15) business days from the date of the receipt of the complaint. The decision of the Tax Administration shall be final and not subject to appeal.

Section 37  
**Field Control Procedure**

- (a) the taxpayer shall be under the obligation, if the field control is conducted in a premises occupied, owned, leased on controlled by the taxpayer under tax audit, to designate an appropriate working area at the disposal of the tax auditors, inspectors and or their representatives;
- (b) at any time during the pendency of the field audit and during the business hours of the taxpayer, the auditors, inspectors and representatives of the Tax Administration shall have the right to enter and remain in the places indicated in subparagraph (a) where the taxpayer may be conducting its business or a portion thereof;
- (c) the taxpayer or a representative of the taxpayer with a valid power of attorney may be present at all times during the inspection of the books and records of the taxpayer by the auditors, inspectors and their representatives;



- (d) if the taxpayer or representatives of the taxpayer are not present and the Tax Administration is prevented or delayed because of the absence of the taxpayer and or the representatives, a notation must be made accordingly in the audit record;
- (f) if the field control is not conducted in the business premises of the taxpayer, the auditor, inspectors and or the representatives of the Tax Administration may inspect the taxpayer's business premises and enter the report of the inspection in the audit records; the taxpayer shall be under the obligation to participate in the fact finding process relevant to taxation in such manner as to give information and statements at the written request of the Tax Administration;
- (g) the taxpayer shall be under the obligation to enable the tax auditors, inspectors and the representatives of the Tax Administration to obtain copies of relevant documents and or samples of goods (where appropriate);
- (h) if the taxpayer is unable to attend the field control, the taxpayer shall delegate a person to act as his agent or representative;
- (i) the failure and or neglect of the taxpayer to meet the obligation under subparagraph (h) above shall not delay the field audit;
- (j) the auditors, inspectors and or representatives of the Tax Administration may by writing notice request data or other documentation from employees of the taxpayer or other persons controlling such data or documentation; and
- (k) the employees and persons referred to in subparagraph (j) above shall be under the obligation to make the information or documentation at their disposal available to the Tax Administration.

Section 38  
**Time of Field Control**

Where a field control is conducted at the premises of the taxpayer, it shall be conducted only during the working hours of the taxpayer, and exceptionally after working hours as well, if the purpose of the control requires this and if the taxpayer consents.

Section 39  
**Report**

- (a) at the conclusion of a tax audit or any material part of thereof, the Tax Administration shall prepare a final report of the field control;
- (b) every page of the report must be marked by a serial number and be signed ;
- (c) a copy of the field control report shall be delivered to the taxpayer within twenty one (21) business days from the date of completion of the report by the Tax Administration;

- (d) the taxpayer may submit a written objection against the report of the field control within fifteen (15) business days from the date of the receipt from the Tax Administration;
- (e) the Tax Administration must review the taxpayer's complaint and if in the opinion of the Tax Administration there is new evidence and facts in the complaint that is sufficient to alter the factual and or legal basis of the report or any material parts thereof, the Tax Administration shall prepare additional report on such new evidence and or facts or of new legal evaluations and provide a copy to the taxpayer within forty five (45) days from the receipt of a written objection from the taxpayer; and
- (f) if it is determined on the basis of the report or additional report on field control that there is no basis for amending the tax liability, the taxpayer shall be informed in writing, within thirty (30) days from the date of delivering the report, or the additional report, as the case may be.

Section 39A  
**Tax Audit Conferences**

- i. A taxpayer who has been notified pursuant to Section 30 of the present Regulations of a pending tax audit may request for an opening conference with the Tax Administration for the purposes of:
  - (a) understanding the issues and breath of the tax audit;
  - (b) objectives;
  - (c) required documentation;
  - (d) calendaring; and
  - (e) any other matter relevant and material to the pending audit.
- ii. whether or not the taxpayer agrees with the final report of the examiner in respect of a field audit, the taxpayer may seek for a closing conference with the Tax Administration.
- iii. notwithstanding subparagraph (ii) of the present Regulations, a taxpayer under tax audit may at any stage of the audit and before the issuance of the final report, request for a conference with the Tax Administration to resolve any contentious material issues of law and or facts arising in the course of the audit. Such a request shall be made directly to the Commissioner or an officer performing similar functions, and must contain the statement of the facts, law and arguments with respect to the issue, and the reasons why the taxpayer believes that the matter should be resolved through conference.

Section 39B  
**Automatic Stay**

The commencement of a tax audit against any taxpayer shall operate as an automatic stay on any applicable statute of limitation. A tax audit is deemed to commence from the date the audit notice is served on a taxpayer or its representative.

Section 40  
**Appeals Procedure**

- (a) an appeal against an assessment, reassessment or any other decision of the Commissioner shall be submitted to the Appeals Office within 60 days from the day on which the assessment was delivered to the appellant as stipulated in Section 69 of the UNTAET Regulation 2000/18;
- (b) the notice of appeal and any accompanying documents shall be submitted in triplicate (three copies) to the Appeals Office;
- (c) the Appeals Office shall provide a copy of the notice of appeal and any documents received from the Appellant to the National Director of the National Directorate of Petroleum Revenue within two (2) business days from the date of receipt from the Appellant;
- (d) any fees prescribed by the Commissioner shall be paid on an appeal under these Regulations;
- (e) the notice of appeal must contain the following information:
  - i. the amount set by the respondent as chargeable income and amount of tax according to the assessment;
  - ii. the amounts which – according to the appellant's contention – should be set as chargeable income and tax;
  - iii. a narrative of the factual and legal reasoning forming the basis of the Appellant's disagreement with the disputed assessment, reassessment or the Commissioner's decision; and
  - iv. the relief sought by the Appellant.
- (f) the notice of appeal must be signed by the appellant or its representative;
- (g) a copy of the tax assessment, tax reassessment or the Commissioner's decision in dispute must be attached to the notice of appeal;
- (h) the National Director of the National Directorate of Petroleum Revenue shall submit to the Appeals Office – within fifteen (15) days after the day on which he was served a copy of the notice of appeal – a written notice specifying the reasons for the assessment (hereafter: reasons for assessment). A pre-assessment letter (if any) issued to the appellant and any subsequent correspondences between the National Director and or the Commissioner and the Appellant may be substituted as the written notice required by this sub-paragraph .

Section 41  
**Commencement Date**

The provisions of this Regulations shall be applied retroactively from January 1, 2013 and is effective for tax year commencing on or after January 1, 2013