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Reporter: Stephen Long

The Timor Sea is rich with oil and gas but East Timor is struggling to get the taxes and royalties it feels are due to it.

LEIGH SALES, PRESENTER: Australians have long had an emotional attachment to East Timor. The images of violence when the Timorese forged their independence from Indonesia more than a decade ago are hard to forget.

Now East Timor has a new battle on its hands. It's fighting some of the world's biggest oil and gas companies for back taxes that could run into the billions.

In the lead-up to the country's general election this weekend, Stephen Long prepared this report.

STEPHEN LONG, REPORTER: It waged a long struggle for independence and won. Now the little country to our north has a new fight on its hands.

ALFREDO PIRES, EAST TIMOR SECRETARY OF STATE OF NATURAL RESOURCES: It is a David and Goliath fight.

STEPHEN LONG: A battle between big oil and a poor, fledgling nation.

ALFREDO PIRES: The importance of the petroleum revenue in general is vital for Timor-Leste.

STEPHEN LONG: A decade after independence, the country is still struggling to lift its people out of poverty.

The Timor Sea holds a bounty of oil and gas and that's a blessing and a curse for Timor-Leste. Its generated \$10 billion dollars in royalties and taxes, invested in a sovereign wealth fund.

PIERRE-RICHARD PROSPER, LEGAL ADVISOR: It is the monies that will help stabilise the country. It is the monies that will help educate the people, feed people, give health care to those that are in need.

STEPHEN LONG: But its fragile economy is almost completely dependent on that petroleum revenue. 90 per cent of its taxes come from a handful of foreign resources companies. For years they got away without paying all that was due. Authorities in Timor-Leste didn't even audit them, taking the corporate giants at their word. But that changed about 18 months ago with audits going back as far as 2005.

PIERRE-RICHARD PROSPER: And as part of that auditing process they are discovering that there are areas where there were some discrepancies and they're beginning to look at that more closely. And as they already discovered that the tax officials from Timor are raising those issues with the various corporations, operators and are beginning to say, "We believe that there are taxes due. Please pay them. If you have an objection, please state why."

STEPHEN LONG: Millions of dollars in back taxes have already been paid after 28 adverse assessments. But that may be just a drop in the ocean.

ALFREDO PIRES: Let's just say hundreds of millions and possibly into the billion amount.

STEPHEN LONG: But big oil is fighting back. ConocoPhillips, one of the world's major energy companies, is challenging the tax regime in court in Dili in what may be a precedent setting case.

Alfredo Pires' family fled to Australia in '75 after Indonesia invaded and occupied East Timor. He studied geology and now heads the natural resources portfolio in Timor-Leste.

The tax battle is considered so important that just days out from this weekend's election he flew in to Australia to brief 7.30 on the issue.

What kind of difference could it make on the ground in East Timor? What would you be looking at that going to?

ALFREDO PIRES: A lot. A lot. Housing, education, essential housing, basic (inaudible). We have now a program to give the most poorest people of our country some very simple housing and we like to expand that.

STEPHEN LONG: You have got a huge steak.

ALFREDO PIRES: Well let's just say I've got a lot of things on my plate.

(Laughter from both men).

STEPHEN LONG: You can say that again. Indeed.

The day after our meeting there a whiff of scandal. News broke of a secret tape recording of Ollie De Castro, the man advising Timor-Leste on how to invest its oil and gas revenues. He was in conversation with Australian associates in Darwin. The talk turned from Swiss bank accounts to offers of kickbacks from shady Singapore businessmen.

MAN: What happened to that private jet?

OLLIE DE CASTRO: I refused to accept it, thank God.

MAN: And the apartment?

OLLIE DE CASTRO: I'd refuse. Anything I'd refuse.

MAN II: And what happened with that English trip? Bloody, all expenses paid, first class, \$10,000 bottles of f***in' wine.

MAN: What do you mean refused? You told me you were gonna get it next year.

STEPHEN LONG: Ollie de Castro issued a statement via his lawyer saying, "Any fair minded person listening to the tape would conclude that Mr de Castro had discharged his professional duties with complete integrity."

The recording is political dynamite, leaked days before the election with the apparent aim of raising fears about the sovereign wealth fund.

The Government and the Opposition disagree on how the funds should be invested, but on the tax battle against big oil and gas, they're at one and Timor-Leste has some powerful backing.

ALFREDO PIRES: We do have very good friends in very high places who are willing to do that extra effort.

STEPHEN LONG: Among them, this man. Pierre-Richard Prosper was the United States ambassador-at-large for war crimes and the UN's special ambassador for war crimes in Rwanda. His law firm's fighting ConocoPhillips in the courts for Timor. The company says it's complied with all its obligations.

PIERRE-RICHARD PROSPER: Our view is that the taxes were owed. Our view was that they knew they should have paid the taxes.

STEPHEN LONG: Although the two countries share the tax revenue, with 10 per cent going to Australia, Australian authorities refused to sign a memorandum allowing Timor liberal access to Australia to audit the records of resources giants, citing concerns about national sovereignty.

How do you feel about the attitude of the Australian taxation authorities?

PIERRE-RICHARD PROSPER: Well it's puzzling. I think that's probably the best way to put it.

ALFREDO PIRES: These are two countries very close to each other, but we are a smaller country and can expect that big brother helps us a little bit here and there.

STEPHEN LONG: Even without that help, Timor is confident of gaining big money in back taxes. The broader question is: how does Timor-Leste diversify its economy, because, like the resources themselves, the money from oil and gas won't last forever.

LEIGH SALES: Stephen Long with that report.

