



**DIRECÇÃO GERAL RECEITAS E ALFÂNDEGAS**  
**Direcção Nacional Receitas Petrolíferas**

*"Adeus Conflito, Bemvindo Desenvolvimento"*

Dili, 05 June 2012

**PROPOSED Chapter IX (Taxes and Duties Act, 2008) REGULATIONS, 2012**

**Invitation for Comments**

The National Directorate of Petroleum Revenue (NDPR) is proposing the Regulations below in respect of certain taxpayers carrying on Petroleum Operations within the JPDA (non-Annex F) and the Timor-Leste Exclusive Area. NDPR is now seeking comments from interested parties, and more particularly stakeholders in Petroleum Operations within the areas indicated above. Such comments must be directly related to the provisions of the proposed Regulations and not generic and or extraneous.

All comments should be made via email or registered/ hand delivered /mails

**A. By hand or registered mail for the attention of:**

Ms. Monica da Cruz Rangel

NDPR, National Director

Ministry of Finance, Ground Floor, Palacio do Governo

Building No. 5

Dili, Timor Leste

Or

**B. Attachments (if submitted via email) to: [mrangel@mof.gov.tl](mailto:mrangel@mof.gov.tl):**

cc: [bbove@mof.gov.tl](mailto:bbove@mof.gov.tl); [dominic.lucas@opusbest.com](mailto:dominic.lucas@opusbest.com)

The period for public comments ends at 5 pm on June 20, 2012.

Mónica Rangel Da Cruz  
NDPR National Director



# **Chapter IX (Taxes and Duties Act, 2008) REGULATIONS, 2012**

## Interpretation

### Section 1

#### **Purposive interpretation**

Where Sections in the present Regulation are capable of alternative interpretations, the interpretation that best achieves the intended purpose of Chapter IX of the Taxes and Duties Act 2008 shall be adopted and any interpretation that frustrates the intended purpose of the legislation shall be rejected.

### 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 to the Joint Petroleum Development Area, other than the area covered by the Production Sharing Contracts described in Annex F of the Timor Sea Treaty.

The present Regulations shall also apply only to a Contractor or Subcontractor, and any person receiving an amount for goods or services supplied to a Contractor or Subcontractor or by a Contractor or Subcontractor to any person in connection with Petroleum Operations in Timor-Leste, excluding the area designated as Annex F of 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 Subcontractor (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 or Subcontractor or any such persons as the case may be;

“**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; 3 of the UNTAET Regulation 2000/18; 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

“**Approval**” means a written authorization;

“**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 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;

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

**“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 Section 73 of the Taxes and Duties Act, 2005, excluding interest expense carryover under Section 74.3 of the Taxes and Duties Act;

**“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 and Customs 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 with whom the responsible Ministry or Designated Authority, as the case may be, has made a Petroleum Agreement;

**“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;

**“Contractor”** means a person with whom the responsible Ministry or Designated Authority, as the case may be, has made a Petroleum Agreement;

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

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

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

**“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”** means the plan for the development and production of petroleum or gas resources in the Contract Area approved by the responsible Ministry or Designated Authority, as the case may be;

**“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;

**“Employee”** means:

- a) a natural person who is in employment; or
- b) a natural person whose provision of services is substantially similar to the provision of services by a person who is in employment

**“Employer”** means a *person* who hires an employee pays periodic *wages* to an *employee*;

**“Employment in Timor-Leste”** means the provision of personal services in Timor-Leste:

- (a) in the course of an *employer* and *employee* relationship;
- (b) as director of a company;
- (c) as the holder of a public office; or
- (d) as an official of the government of Timor-Leste posted overseas;

**“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;

**“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 intangible 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);

For the purposes of Section 74 of the Taxes and Duties Act, 2008 as amended or modified, the interest referred to in paragraphs (a)-(c) must be charged by a bank.

**“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;

**“Law on Income Tax”** means the Taxes and Duties Act, 2008, including any amendments thereunder, and such other laws applicable in Timor-Leste under 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;

“**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;

“**Permanent Establishment**” means:

- (a) a place of management;



- (b) a branch;
- (c) a representative office;
- (d) an office;
- (e) a factory;
- (f) a workshop;
- (g) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources, including any place of drilling for mineral exploration;
- (h) a fishery, place where animal husbandry is conducted, farm, plantation, or forest’
- (i) a construction, installation, or assembly project;
- (j) the furnishing of services through employees or other personnel, if conducted for more than sixty days in any 12-month period;
- (k) a natural legal person acting as a dependent agent; or
- (l) an agent or employee of a non-resident insurance company, if the agent or employee collects premium, or insures risks, in Timor-Leste;

**“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;

**“Petroleum”** means:

- (a) any naturally occurring hydrocarbon, whether in a gaseous, liquid or solid state;
- (b) any mixture of naturally occurring hydrocarbons, whether in a gas, liquid or solid state; or
- (c) any petroleum (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 Operations”** means authorized activities 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;

**“State-Owned Contractor”** means the Contractor incorporated under the laws of Timor-Leste, which is controlled directly or indirectly, by Timor-Leste;

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

**“Tax Administration”** means the National Directorate of Petroleum Revenues or any other public bodies or central services charged under the laws of Timor-Leste to carry out the enforcement of petroleum tax laws and collect petroleum taxes and duties, Commissioner or the Minister of Finance or another competent member of the Government, when exercising their administrative 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 tax withholders of certain taxes be it income or wages related, those required to make tax payments in relation to oil and gas business in certain designated areas but excluding the Annex 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;

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

**“Tax Form”** means:

- (a) an annual income tax form;
- (b) an annual Supplemental petroleum tax form;
- (c) an annual wage income tax withholding information form;
- (d) an excise tax form;
- (e) the income and Supplemental 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); 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, 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, 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 recognized under the law of the sea and, to the extent allowed by treaty;

**“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 East Timor and the Government of Australia;

**“Total Approved Decommissioning Costs”** means the total decommissioning costs approved by the responsible Ministry or Designated Authority in writing, as the case may be, in accordance with the Decommissioning Plan provided under the Petroleum Agreement, as revised or amended from time to time;

**“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-Lest

## Section 5.1 **Sources of Income**

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

- (a) income from petroleum operations 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 Section 6 of the present Regulation
- (c) income from the alienation of any movable property of a Contractor used in deriving Timor-Leste-source income referred to in paragraphs (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;
- (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

### **Permanent Establishments**

#### 6.1.

The taxable income of a non-resident carrying on business activities in connection with petroleum operations through a permanent establishment as a Contractor or Subcontractor in Timor-Leste shall be determined by reference to the income attributable to:

- (a) the permanent establishment
- (b) any sales in Timor-Leste of goods or merchandise or the performance of services in Timor-Leste of the same or similar kind as those effected through the permanent establishment;

#### 6.2.

The taxable income of a non-resident carrying on business activities in connection with petroleum operations through a permanent establishment as a Contractor or Subcontractor as the case may be in Timor-Leste shall include the income attributable to:

- (a) capital gains arising in connection with the alienation of any property within the JPDA and or Timor-Leste exclusive area, including asset, shares or comparable interest, held directly or indirectly in the permanent establishment that is a Contractor;
- (b) the following principles apply in the determination of the taxable income of a Timor-Leste permanent establishment:
  - i. the profit of the permanent establishment shall be calculated on the basis that the permanent establishment is separate and distinct legal entity engaged in the same or similar services under the same or similar conditions and dealt with wholly independently from the non-resident person of which it is a permanent establishment;

- ii. subject to the present Regulations and Section 75 of the Taxes and Duties Act 2008, deductions may be claimed for necessary and ordinary expenses incurred for the purposes of the business activities of the permanent establishment including allowable head office expenditures so incurred, whether in Timor-Leste or elsewhere;
  - iii. no deduction is allowable to the permanent establishment except where the deductions claimed by the permanent establishment as payment to the head office or another permanent establishment of the non-resident person, other than for the reimbursement of actual expenses incurred by the non-resident person to third parties (not including related party), by way of:
    - 1. royalties, fees, or similar payments for the use of intangible or tangible asset by the permanent establishment;
    - 2. compensation for any services, including management services performed for the permanent establishment;
    - 3. interest on moneys lent to the permanent establishment, except in connection with a transaction involving a bank or banks;
- (c) no account is taken in the determination of the gross income of a permanent establishment of amounts charged by the permanent establishment to the head office or to another permanent establishment of the non-resident person, other than towards reimbursement of actual expenses incurred by the permanent establishment to third parties (not including related parties), by way of:
- 1. royalties, fees, or similar payments for the use of intangible or tangible asset by the permanent establishment;
  - 2. compensation for any services, including management services performed for the permanent establishment;
  - 3. interest on moneys lent to the permanent establishment, except in connection with a transaction involving a bank or banks.

The assessable income of the non-resident person under Section 6 of this Regulation shall be subject to 30% tax in Timor-Leste.

## Section 7 **Tax Subjects**

### 7.1

For the purposes of Section 70, Chapter IX of the Taxes and Duties Act, including any amendments, the following are Tax Subjects;

- (a) a natural person;
- (b) an undivided estate as a unit in lieu of the beneficiaries;
- (c) a body in the form of a limited company, formed in Timor-Leste;
- (d) a partnership, limited or unlimited, formed in Timor-Leste;
- (e) any other forms of business, whether private or public, incorporated or formed under Timor-Leste laws;
- (f) any legal person established under foreign laws and organized in a manner comparable to entities referred to in paragraphs (c)-(d) above, including trust; or

(g) any other body of persons formed under foreign law.

#### 7.1.1

Exclusions from Tax Subjects: The following persons are excluded from the definition of Tax Subjects:

- (a) a representative of a foreign government;
- (b) diplomatic and consular representatives or other foreign officials;
- (c) international bodies as determined by the Minister of Finance provided they do not conduct business or engage in other for-profit activities in Timor-Leste.

#### 7.2.

- (a) the tax obligations of a natural person shall commence at the time the individual is born, present or intends to reside in Timor-Leste and shall cease at the time of death of the individual or leaves Timor-Leste permanently;
- (b) the tax obligation of a person other than a natural person, however formed, shall commence at the time the person is established or domiciled in Timor-Leste and shall cease at the time the person is dissolved or is no longer domiciled in Timor-Leste;
- (c) the tax obligations of a person or body shall commence at the time the person or body initiates business or engages in business as individual or body, whether as a permanent establishment or not and shall cease at the time the business or activities are terminated.

Notwithstanding the provisions of Section 7, an existing tax liability of a person or body will survive the death, dissolution, cessation and or termination of business activities, as the case may be.

### Section 8 **Taxable Income**

Taxable income is any economic increase arising from the business activities of a taxpayer and which is received or accrued by the taxpayer, in whatever name or form and originating from within or without Timor-Leste, including but not limited to:

- (a) gains from alienation of property, including:
  - i. gains from the transfer of property to a corporation, partnership and other body in exchange for shares or capital participation;
  - ii. gains accrued by a corporation, partnership or other body through the transfer of property to shareholders, partners or members;
  - iii. gains from liquidation, merger and or acquisition, consolidation, expansion, separation, transfer or takeover of a business;
  - iv. gains from the transfer of property in the form of gift, aid or donation, except when given to a related party (by blood or ownership structure);
- (b) refunds of tax payments already deducted as expenses;
- (c) interest, including premiums, discounts and compensation from loan repayment guarantees;
- (d) dividends, in whatever name or form;
- (e) royalties;



- (f) rent or other income related to the use of property;
- (g) gains from cancellation or forgiveness of debt;
- (h) gains from foreign currencies;
- (i) reimbursements from insurance in respect of losses already deducted as expenses;
- (j) lottery prizes or awards;
- (k) profits arising from the conduct of any business activities ;
- (l) remuneration, wages or other consideration, whether in cash or a property, received or accrued in connection with work or services including salary, allowance, honorarium, commission, bonus, gratuity, and pension.
- (m) Income from the business or activities of a permanent establishment and from property it owns or control in Timor-Leste;
- (n) Income of a head office and or a related party arising from the sale of goods or performance of services in Timor-Leste of the same type as those undertaken by the permanent establishment in Timor-Leste;
- (o) any income received or accrued by the head office and or related party, provided the property or activities which produce the income are effectively connected to the permanent establishment.

8(b)

Expenses associated with income as stipulated in subparagraphs (n) and (o) above may be deducted from the income of the permanent establishment.

## Section 9 Exempt Income

The following income is exempt from taxable income:

- (a) aid or donations, provided the donor are not related parties, whether by blood or ownership structure,;
- (b) property (including cash) received by a legal person in exchange for shares or capital contribution, provided the contribution was made as part of the capitalization of the legal person and evidenced as a subscription for shares in the books of the legal person
- (c) an amount paid by an insurance company to reimburse the taxpayer for a loss, other than a loss that has been previously deducted.

## Section 10 Deductions Allowed against Income Tax

10.1

The amount of a taxable income of a taxpayer shall be determined based on the amount of gross income less the following deductions:

- (a) necessary and ordinary expenditures incurred, and losses connected with the alienation of assets used in Petroleum Operations within the Contract Area;

- (b) necessary and ordinary expenditures incurred in deriving an amount that is includible as part of gross income, including costs to purchase materials, costs connected with work or services including salaries, wages, honoraria, bonuses, gratuities directly connected with Petroleum Operations in a Contract Area;
- (c) interest payment on loans or obligations from a bank directly connected with Petroleum Operations in a Contract Area;
- (d) rent, insurance premiums directly connected with Petroleum Operations within a Contract Area;
- (e) administrative cost directly connected with Petroleum Operations in a Contract Area;
- (f) royalties paid or accrued directly in connection with Petroleum Operations in a Contract Area;
- (g) depreciation of tangible assets and amortization of intangible assets and other costs with a useful life of more than one (1) year as provided in Sections 77 and 78 of the Taxes and Duties Act, over which the Contractor has a claim of title in law and located within the working area of the Contractor in Timor-Leste;
- (h) loss arising from the sale or transfer of property owned and used in business or owned for the purpose of earning, recovering and securing income in connection with Petroleum Operations in Timor-Leste,; and provided the sale is conducted in open market and not below the fair market value of the property;
- (i) loss arising from fluctuations in foreign currencies directly connected with the Petroleum Operations of the Contractor in Timor-Leste;
- (j) costs of training, apprenticeship and scholarship awards to citizens of Timor-Leste not exceeding US\$50,000 per tax year and subject to the prior approval of the Minister of Finance;
- (k) charitable contributions to public institutions in Timor-Leste not exceeding US\$200,000 per tax year and subject to the prior approval of the Minister of Finance;
- (l) an amount approved in writing by the Designated Authority as the decommissioning cost reserve for the current tax year under 76.2 of the Taxes and Duties Act;
- (m) an amount of Timor-Leste Supplemental Petroleum Tax of a Contractor for the tax year calculated under Section 83 of the Taxes and Duties Act and or Section 32 of the present Regulations.

## 10.2

The amount that a Contractor may deduct under subparagraph 10.1 of the Regulations and Section 73 of the Taxes and Duties Act in relation to Petroleum Operations is limited to:

- (a) the gross income arising from such Petroleum Operations in the Contract Area in that year; and
- (b) the loss arising directly connected to the Petroleum Operations undertaken in the Contract Area for a tax year, and where the loss exceeds the taxable income for that tax year, such loss is carried forward to the next following year and deductible only against gross income arising from such Petroleum Operations in the Contract Area until the loss is exhausted within the Contract Area or the expiration of the Petroleum Agreement in respect of the Contract Area, whichever comes first.

### 10.3

Where a Production Sharing Contract (“original”) in respect of the JPDA (other than Annex F) entered into with a Contractor before January 1, 2008 is terminated and a new Production Sharing Contract (“successor”) is entered into with the same Contractor, any loss carry forward of the Contractor at the time of the termination of the original Production Sharing Contract in respect of the Contract Area covered by the Production Sharing Contract is deductible in the first year of the Contractor for the Contract Area covered by the successor Production Sharing Contract, provided:

- (a) the whole of the geographic area covered by the Contract Area of the successor Production Sharing Contract is within the Contract Area of the original Production Sharing Contract; and
- (b) no time lapse between the successor Production Sharing Contract and the original Production Sharing Contract

Time lapse as used in subparagraph 10.3(b) means more than one (1) business day.

## Section 11 Non-Deductible Expenses

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

- (a) distribution of profits such dividends and by whatever name or form;
- (b) penalties of any kind, penal or administrative;
- (c) additional taxes imposed under the present Regulations and Sections 72-74 of the UNTAET Regulations 2000/18;
- (d) excessive compensation paid by a legal person for work performed and paid to shareholders or related parties as compensation;
- (e) incentives, pension fund payments, and insurance premiums for personal interest and/or the families of expatriate employees, management and shareholders;
- (f) losses arising from a transaction with a related party where transactions were determined by the Commissioner not to be at arm’s-length;
- (g) costs incurred for the benefit of a related party or shareholders;
- (h) bad debts;
- (i) exploration and development costs incurred before the commencement of commercial production;
- (j) reserves, other than approved decommissioning cost reserve under Section 76 of the Taxes and Duties Act;
- (k) gifts, scholarship, apprenticeship, aids or donations other than those in accordance with Section 10 of this Regulation;
- (l) salaries paid to members of an association, limited or unlimited partnerships without share capital;
- (m) costs incurred by a Contractor outside a Contract Area of production Sharing Contract;
- (n) 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;

- (o) a fine or other monetary penalty imposed for violation of any law, rule or regulations;
- (p) a bribe or any similar amount;
- (q) an expenditure or loss incurred to the extent recoverable under a policy of insurance or contract of indemnity;
- (r) the acquisition costs of an asset having a useful life of more than one (1) year;
- (s) 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;
- (t) compensation in connection with management services;
- (u) 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 Petroleum Operations in Timor-Leste;
- (v) 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) tax;
  - 6) advertising, donations, sponsorship;
  - 7) entertaining;
  - 8) legal; and
  - 9) intra-group relations.

#### Section 11A **Allocation of Head Office Expenditures**

Subject to Section 11 of the present Regulations, if a Contractor is a non-resident person with a Timor-Leste permanent establishment, the amount of Head Office Expenditures deductible under Section 6.2(b)(ii) of the present Regulation and Section 75 of the Taxes and Duties Act, for a tax year shall be limited to a maximum of two-percent (2%) of the total deductible expenditures, excluding any depreciation and amortization deductions under this present Regulations and or the Taxes and Duties Act, 2008.

#### Section 12 **Limitation on Interest Deduction for Contractors**

12.1.

Notwithstanding the provision of Section 11(t) of the present Regulation, a Contractor is allowed a deduction for interest expense incurred in relation to petroleum operations where:

- (a) the cost of money to the Contractor is substantially the same as charged in the open market by banks for similarly situated persons;

(b) the deductible amount is limited to twenty-five percent (25%) of the Contractor's non-interest income for the tax year.

12.2.

A Contractor's net non-interest for the year is calculated according to the following formula:

$$(X-Y)-T \times 25\%$$

Where:

**X** is the Contractor's gross income for the tax year;  
**Y** is the interest income for the tax year; and  
**T** is the total deductions for the Contractor other than interest expense for the tax year  
**25%** is the apportionment factor

### Section 13

#### **Loss and Interest Expense Carry Forward**

13.1

Except for interest expense for a Contractor, if the determination of the taxable income of a taxpayer results in a loss for a tax year, that loss may be deducted as an expense in calculating the taxable income of the taxpayer in subsequent tax years until the loss is utilized in full or the Petroleum Operations in the Contract Area cease.

13.2

If a Contractor has an excess interest deduction under Section 74.2 of the Taxes and Duties Act, 2008 the excess interest deduction may be carried forward for a maximum of five (5) years from the tax year that the excess arose. Where a Contractor has an amount of interest expense carried forward for more than one tax year and which arose in different tax years, the interest expense incurred in the earliest year is deducted first

### Section 14

#### **Basis and Method of Accounting**

14.1

The determination of the gross income and deductions of a taxpayer from the conduct of business activities connected directly or indirectly with petroleum operations shall be based on the taxpayer's net profit for financial accounting purposes for the year. The profit and loss and the balance sheet must be prepared in accordance with the most updated version of the International Accounting Standards and subject to the modifications contained in this Regulation and the Taxes and Duties Act, 2008.

The profit and loss statement and balance sheet must be exhibited with the annual income tax return of the taxpayer.

14.2

Every taxpayer shall account for income tax on accrual basis. A taxpayer using the accrual method of accounting recognizes income when it is earned or receivable and incurs an expense

when its payable. Except for deviations permitted or required by such special accounting treatment under the tax applicable laws and regulations, taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes its income in keeping its books.

#### 14.3

Subject to this Regulation, an amount is receivable by a taxpayer when all the events that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy, but not before economic performance. Economic performance occurs when:

- (a) in the case of acquisition of services or assets, at the time the services or assets are provided;
- (b) in case of use of assets, at the time the assets are used; and
- (c) in any other case, at the time the taxpayer makes payment in full satisfaction of the liability.

### Section 15 **Inventory**

#### 15.1

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.

#### 15.2.

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.

#### 15.2.2

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.

#### 15.2.3

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.

#### 15.3

- (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 15.1(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 16 **Depreciation**

### 16.1

The depreciation deductions allowable under Section 10(g) of the present Regulations 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. The legal right to depreciate the asset must not reside in a different taxpayer, even where related to the taxpayer.

#### 16.1(a)

The acquisition and or construction costs, improvements or repairs that enhance the value or convert the asset from one use to the other or prolong the life of a business building are required to be depreciated on a straight-line basis at the rate specified in Schedule X, Section A, Business Buildings.

#### 16.1(b)

The cost of acquiring the land upon which the business building is constructed or erected is excluded from the tax basis of the taxpayer in the business building and such must be excluded in the computation of the depreciation deductions under Section 77.1of the Taxes and Duties Act, 2008.

16.1(c)

A depreciable asset may be depreciated:

- (a) individually on a straight line basis or
- (b) by pooling of assets with similar life on a declining balance basis.

16.1(d)

Immediately after the date of the commencement of the present Regulations, Contractors are required to elect their depreciation method and inform the Commissioner in writing accordingly.

16.1(e)

The depreciation method elected by a taxpayer must be applied uniformly to all depreciable assets of the taxpayer.

16.1(f)

A taxpayer may change a method of depreciation previously elected upon a written application made to the Timor-Leste Tax Administration stating the basis of the application and affirm under oath that the change sought will not distort the income and expenses of the taxpayer.

The Tax Administration may approve the application subject to terms and conditions.

16.1(g)

If a taxpayer elects the classification of business building assets into pools of similar assets, the depreciation deduction for each depreciation pool for a tax year is calculated by applying the rates specified in Schedule X, Section B, parts 1 and 2 of the Taxes and Duties Act 2008, to the written down value of the assets.

16.1(h)

If a taxpayer elects the individual straight-line depreciation method in respect of business building assets, the depreciation deduction for a tax year is calculated by applying the rates specified in Schedule X, Section B, part 3 of the Taxes and Duties Act 2008.

16.1(i)

The Tax Administration may upon notice to taxpayers change the classification and the rates of depreciation for depreciable assets.

## Section 17 **Amortisation**

17.1

Exploration expenses, including those incurred by a Contractor prior to commercial production, is characterized as intangible expenditure with a useful life equal to the expected life of the Petroleum Operations under a Petroleum Agreement or five (5) years, whichever is the lesser, and accordingly.



17.1(a)

Development Expenditures incurred under a Petroleum Agreement is classified as intangible expenditure with a useful life equal to the expected life of the Petroleum Operations under the Agreement or ten (10) years, whichever is lesser.

17.1(b)

Exploration and Development Expenditures are required to be amortised on a straight-line basis only and the depreciation deductions for each tax year is calculated by applying the rates specified in Schedule X, Section C of the Taxes and Duties Act 2008.

17.1(c)

Any depreciable or intangible asset acquired, created, constructed or incurred before the commencement of commercial production is required to be capitalized and the depreciation or amortization deductions of such asset commences from the time commercial product commences.

17.1(d)

Commercial production is deemed to commence from the first day of 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 production days in a thirty-day period reaches a level of regular production delivered for sale as may be determined by the Minister of Finance or the Commissioner, upon the advice of the Designated Authority.

17.1(e)

In the tax year in which Commercial production commences, the depreciation or amortisation deduction for that year is calculated ratably by applying the formula specified in Section 77.6 of the Taxes and Duties Act, 2008.

## Section 18

### **Small Field: Depreciation and Amortisation**

18.1

If a field is determined by the Designated Authority to produce eighty percent (80) or more of the estimated Reserves within five (5) years from the date of the commencement of commercial production as determined under Section 77.5 of the Taxes and Duties Act 2008, then the Contractor may:

- (a) apply to the Commissioner, and upon approval of such application, elect the “units of production” methodology as the basis of depreciation and amortisation for all depreciable assets, including Exploration and Development expenditures. Such election must be made as part of the Development Plan and filed with the Tax Administration upon the approval of the Development Plan;

- (b) the depreciation or amortisation deduction for a tax year when calculated by using the “units of production” method, is determined by applying the formula specified in Section 78.3 of the Taxes and Duties Act, 2008;
- (c) the election under subparagraph (a) above, when granted, is applicable to all the depreciable assets used in the Petroleum Operations referred to in Sections 78.1-2 of the Taxes and Duties Act, 2008; and
- (d) where a Contractor has more than one Development Plan for a Contract Area, Section 17 of this Regulation applies separately to each Development Plan.

## Section 19

### **Decommissioning Costs Reserve and Decommissioning Expenditure**

#### 19.1

The amount of decommissioning expenditure allowable as deduction for a tax year under Section 76 of the Taxes and Duties Act, 2008, is the amount determined for that year under a Petroleum Agreement and arising from the Total Approved Decommissioning Costs agreed upon between the Designated Authority and the Contractor or Contractors.

#### 19.2

As a condition precedent to the tax deductibility of decommissioning cost allowable pursuant to Section 76.1 of the Taxes and Duties Act 2008 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 taxable income and or Supplemental Petroleum Tax.

#### 19.3

The amount of decommissioning costs deductible in a tax year shall be calculated on the basis of the formula prescribed pursuant to Section 76.3 of the Taxes and Duties Act, 2008.

#### 19.4

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

#### 19.5

The application of Section 18 of the present Regulations and Section 76 of the Taxes and Duties Act other than to the Contractor’s current tax year is hereby prohibited.

## Section 20

### **Transfer of a Petroleum Agreement**

#### 20.1

A Petroleum Agreement is deemed to be transferred by a Contractor where;

- (a) 50% or more 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; and
- (d) a mere change in identity, form, or place of organization of one corporation, however effected, if it is accompanied by either the exchange of shares for cash or other value or the transfer of asset connected with Petroleum Operations from one Contractor to the other.

#### 20.2

Insofar as there is continuity of the business purpose of the transferor Contractor, the transferee Contractor shall:

- (a) 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 that the original transferor Contractor; and
- (b) Sections 15-17 of the present Regulations and Sections 77-78 of the Taxes and Duties Act, 2008 shall apply to any other depreciable assets or intangibles at the rates specified therein.

#### 20.3

For the purposes of paragraph 19.2 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 transfer Contractor in Timor-Leste.

### Section 21

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

The primary purpose of Section 21 of the present Regulation is to amplify the provisions of Sections 91-93 of the UNTAET Regulation 2000/18 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 income and expenditures in transactions involving associates or related parties.

#### 21.1

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 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.

#### 21.2

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.

#### 21.3

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.

#### 21.3

In general, the determination 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).

#### 21.4

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.

#### 21.5

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 subsequently is 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.

#### 21.6

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 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 subsequently is 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.

#### 21.7

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 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).

#### 21.8

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 lacks 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.

### **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.

#### 21.10

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.

#### 21.11

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 so 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 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 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 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.

21.12

**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 22

### **Transfer Pricing Methods in Connection with the Transfer of Tangible and Intangible Properties**

#### 22.1(a)

In general. The arm's length amount charged in a controlled transfer of tangible 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 21 of the present Regulations, including the best method rule, the comparability analysis of and the arm's length range of as described in Section 21 above.

#### 22.1(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.

#### 22.1(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 20 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 20 above.

22.1(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.

22.1(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.

22.1(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.

22.1(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.

22.1(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.

22.1(i)

#### **Unspecified (other) Methods**

Other the arm's length standards mentioned specifically in Section 21 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 23

#### **Transfer Pricing Enforcement and Penalties**

23(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 *underpayment* of tax arising from any transfer pricing adjustment made by the Tax Administration under the present Regulations or any other applicable laws.

23(b)

The provisions of Sections 22(a) and 22(b) above are applicable concurrently and independent of each other.

23(c)

**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 Section 21 of the present Regulations and Sections 91 and 93 of the UNTAET Regulation 2000/18

Section 24

**Documentation Requirements**

24(a)

A taxpayer having a related party transaction or transactions in the sum of Two Million Dollars (US\$2,000,000) 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\$2,000,000 or more.

24(b)

The transfer pricing documentation requirement of subparagraph 24(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 21 of the present Regulations and provides that documentation to the Tax Administration within sixty (60) 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.

The principal documents to be maintained by a taxpayer with related party transaction(s) falling within the threshold stipulated in subparagraph 24(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 21 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; and
- vii. An explanation of the economic analysis and projections relied upon in developing the method.

## Section 25 Value of Petroleum

### 25.1

Petroleum shall be valued free on board (f.o.b.) at the point at which petroleum from a Contract Area leaves the Contract Area, or at 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.

### 25.2

The value of Crude Oil sold and or exchanged is:

- (a) f.o.b. or equivalent circumstances at the Field Export Point in transaction between parties that are at arm's length is the price agreed between the parties and payable by the buyer; or
- (b) other than f.o.b. or equivalent circumstances at the Field Export Point in transaction between parties that are at arm's length is the price payable by the buyer, less such fair and reasonable proportion of such price that relates to the transportation and delivery of the petroleum downstream of the Field Export Point;
- (c) other than as described in subparagraphs 25(a) and (b), is the price that would have been payable having regard to all relevant circumstances and similar arm's length transactions;
- (d) the burden of establishing that the pricing in subparagraphs 25(a) to (c) is at arm's length and consistent with Section 21 of the present Regulations is on the seller.

### 25.3

The value of Natural Gas is the price payable

- (a) under the contract approved by the Designated Authority; or
- (b) as may be otherwise be provided in the Development Plan; or
- (c) as may be otherwise provided in a Petroleum Contract.

### 25.4

The price payable for petroleum or Natural Gas under this section shall be the respective fair market value, or the price that would be payable by the buyer if the petroleum or the Natural Gas were delivered by the Contractor and taken by the buyer, without conditions such as set off, counterclaim, novation, claim of right or other withholding of any description, nature or form.

Section 26  
**Withholding Tax**

26.1

Any payment made by a Contractor or Subcontractor in respect of any Timor-Leste source services income to a person, other than a payment made to an employee in circumstances where there is an employer-employees relationship, in respect of services acquired for Petroleum Operations, shall be subject to withholding tax at 6% of the gross amount paid.

26.2

Whether or not a particular service is acquired for Petroleum Operations is determined not by the nature of the business of the provider but that of the Contractor or the Subcontractor, insofar as the payment is made for services connected with Petroleum Operations.

26.3

Payments made for tangential services and which are not connected with the core business of a Contractor or Subcontractor engaged in Petroleum Operations is not subject to the withholding tax regime of section 81.

26.4

the core business of a Contractor or Subcontractor is interpreted by the Tax Administration of Timor Leste to mean only the services acquired in furtherance of any permissible business under the Petroleum Agreement applicable to the Contractor and or the Subcontractor making the payment

26.5

The list of services covered by this Section and Section 81 of the Taxes and Duties Act, includes but not limited to:

- a) Accounting/bookkeeping, Tax and legal services;
- b) Logging services;
- c) Pest extermination and cleaning;
- d) Drilling services and supporting of mining oil and natural gas, except what is carried out by permanent establishments;
- e) Supporting services in the field of oil and gas;
- f) Sound dubbing services and/or film mixing;
- g) Catering services;
- h) Cleaning services;
- i) Brokerage services;
- j) Appraisal services;
- k) Actuarial services;
- l) Supplies;
- m) Medical services;
- n) Repairs and or Maintenance;
- o) Engineering;
- p) Consultancy;
- q) Lease and Rental services;
- r) Labour/Personnel supply;

- s) Security;
- t) Construction services (except turnkey);
- u) Transportation (air, land or sea); and
- v) Courier services.

## 26.6

Supporting services in the field of oil and gas shall include but not limited to:

- a. primary cementing service, which is the placement of liquid cement between the cover pipes and opening of the well;
- b. remedial cementing services, which is the placement of liquid cement for the following purposes;
- c. the re-plugging of empty formation and zone producing water;
- d. rectification of a failed or damaged primary cementing;
- e. the sealing/closing off of a well;
- f. sand control services, which are services which guarantee that parts of the formation which are not consolidated shall not be included in the production of the series of production pipes and eliminate the possibility of getting the pipe blocked;
- g. matrix acidizing services, which are activities to increase the productivity by way of eliminating the unwanted blockage material;
- h. hydraulic fracturing services, which is the work performed in the event the matrix acidizing is not successful, e.g. the maintenance at the formation which has a very small perforating power;
- i. nitrogen and coil tubing services, which are services rendered to eliminate the artificial liquid which is in the completed well, thereby causing the flow which occurred pursuant to the original pressure of the formation and thereafter becomes enlarged as a result of the nitrogen gas which has been pumped into the artificial liquid in the well;
- j. drill stem testing services, temporary completion of a new well, in order to evaluate the production capacity;
- k. pump services;
- l. installation and maintenance services;
- m. replacement services of equipment/material;
- n. mud logging services;
- o. stimulation and secondary recovery services;
- p. well logging services and perforating services;
- q. stimulation and secondary recovery services;
- r. well testing and wire line services;
- s. services in regard to off-shore navigational equipment which is related to drilling;
- t. maintenance services for the drilling activities;
- u. mobilization services and demobilization of drilling extension; and
- v. other similar services in the field of drilling oil and gas.

## 26.7

With respect to lump sum payments made by a Contractor or Subcontractor for services combined with the sale of goods and or reimbursable expenses, the Tax Administration may upon reasonable ground, apportion any part of such payments as subject to the withholding tax under this Section and Section 81 of the Taxes and Duties Act.

Section 27  
**Finality of Withholding Tax**

27(a)

The finality of the taxes withheld pursuant to Section 26 above as full and complete discharge of the liability of the recipient is limited to the value or payments received as consideration for services, and which was correctly subject to section 81 withholding tax regime.

27(b)

If the beneficiary earned any separate income (e.g. from the sale of goods or interest income, whether combined with services or not) other than arising in connection with the performance of services and which has been correctly subject to the withholding tax regime under Section 26 above, such a person will be required to file an income tax return in Timor-Leste and make the consequential tax payment (if any) accordingly.

The beneficiary will be entitled to exclude the portion of the income already subject to withholding tax from other income reported in the tax return.

27(c)

No deductions for expenditures or loss by whatever name called are allowed against the income subject to withholding tax under the present Regulations and the Taxes and Duties Act. The amount subject to withholding tax is the gross amount paid by the Contractor or the Subcontractor..

Section 28  
**Withholding Tax on Wages Income**

The wage income tax imposed under Section 72.2 of the Taxes and Duties Act and at the rates set out in Schedule IX, is imposed on employees performing services in Timor-Leste, for a Contractor or Subcontractor in respect of an employment in connection with Petroleum Operations in the Timor-Leste Exclusive Area and in the JPDA (excepting Annex F). The tax and at the rates specified in Schedule IX of the Taxes and Duties Act shall be withheld at source by the employer.

Section 28A  
**Other Income subject to Withholding Tax**

Generally, the following income, in whatever name or form, paid by or due from a Contractor or Subcontractor to a non-resident person, shall be subject to withholding tax of 15 percent (15%) of the gross income by the party obliged to pay:

- (a) dividends paid or credited to a Timor-Leste resident company or resident person in connection in connection with profits arising with Petroleum Operations;
- (b) dividends paid or credited to a Timor-Leste Permanent Establishment of a non- resident Australian person in connection with profits arising from Petroleum Operations;

- (c) interest including premiums, discounts and compensation for loan repayment guarantee paid by a Contractor or Subcontractor to a Timor-Leste resident person;
- (d) royalties, except those paid or credited by a Contractor or Subcontractor to a Timor-Leste non-resident person, being an Australian resident and which is subject to withholding tax at 10%; and
- (e) royalties credited by a Contractor or Subcontractor to a Timor-Leste non-resident person, other than an Australian resident and which is subject to withholding tax at 13.5%.

Interest payments on loan repayment guaranteed paid by a Contractor or Subcontractor to a Timor-Leste P.E of a non-resident person, being an Australian resident shall be subject to ten percent (10%) withholding tax, and thirteen and a half (13.5%) in all other cases, other than as stipulated in Section 28A(c).

#### Section 28B

Dividends, other than in circumstances specified under Section 28A above, in whatever name or form, paid by or due from a Timor-Leste resident company and Timor-Leste P.E of a non-resident person out of JPDA profits to:

- (a) a Timor-Leste P.E. of a non-resident person, other than an Australian resident person;
- (b) a Timor-Leste P.E. of a company that is not a resident of Australia; and
- (c) Timor-Leste P.E. of a non-resident person

shall be subject to withholding tax of thirteen and a half percent (13.5%) of the gross income by the party obliged to pay:

#### Section 28C

##### **Other Withholding Taxes**

The following category of payments is subject to withholding tax as the rates specified below:

- (a) gifts and rewards to employees by employers, other than those on which an employee income tax has been withheld are hereby subject to withholding tax at thirteen and a half percent (13.5%);
- (b) payments made in connection with drilling or in support of drilling by a Contractor is subject to a withholding tax at 5.4% within the JPDA (except Annex F) and 6% within the Timor-Leste Exclusive Area
- (c) rental payments for lease of land or building made to a natural person by a Contractor or Subcontractor carrying on Petroleum Operations in the JPDA (except Annex F) shall be subject to withholding tax at nine percent (9%), and when made by a Contractor or Subcontractor within the Timor-Leste Exclusive area shall be subject to withholding tax at ten percent (10%);
- (d) rental or lease payments in connection with the use of properties within the JPDA (other than in Annex F) is subject to withholding tax at 5.4 %, similar payment in respect of similar properties within the Timor-Leste Exclusive Area is subject to withholding at six percent (6%);
- (e) drilling services and drilling support services, other than those performed by a Timor-Leste Permanent Establishment within or without the JPDA (except Annex F) is subject to withholding at 5.4%, similar payment for similar services is subject to six percent (6%) when performed within the Timor-Leste Exclusive Area,

- (f) rental payments for lease of land or building made to a legal owner other and or a natural person by a Contractor or Subcontractor carrying on Petroleum Operations in the JPDA (except Annex F) shall be subject to withholding tax at nine percent (9%), and when made by a Contractor or Subcontractor within the Timor-Leste Exclusive area whether legal or natural person, shall be subject to withholding tax at ten percent (10%);
- (g) payment made by a Contractor or Subcontractor carrying on business within the JPDA (except Annex F) in respect of shipping services commencing and ending in Timor-Lester or anywhere is subject to a withholding tax at 5.4% ;
- (h) payment made by a Contractor or Subcontractor carrying on business within the Timor-Leste Exclusive Area in respect of shipping services commencing and ending in Timor-Leste or anywhere else is subject to a withholding tax at 6%;
- (i) payment made by a Contractor or Subcontractor carrying on business within the JPDA (except Annex F) in respect of air transportation services commencing and ending in Timor-Lester or anywhere is subject to a withholding tax at 5.4% ;
- (j) payment made by a Contractor or Subcontractor carrying on business within the Timor-Leste Exclusive Area in respect of air transportation services commencing and ending in Timor-Leste or anywhere else is subject to a withholding tax at six percent (6%);
- (k) payment made by a Contractor or Subcontractor carrying on business within the JPDA a (except Annex F) in respect of construction services and or construction consulting services is subject to a withholding tax at 5.4%, payment for similar services within the Timor-Leste Exclusive Area is subject to withholding tax at six percent (6%);
- (l) payment received for the performance of technical services, management services, accounting, bookkeeping legal, tax consulting, brokerage, appraisal, actuary, film dubbing/mixing, manpower supply, pest control, cleaning services, logging and timber cutting within the JPDA (except Annex F) is subject to withholding tax at 5.4%, similar payment for similar services within the Timor-Leste Exclusive Area is subject to withholding tax at six percent (6%);
- (m) payment received for the performance of architectural services, interior services and landscape design within the JPDA (except Annex F) is subject to withholding tax at 5.4%, similar payment for similar services within the Timor-Leste Exclusive Area is subject to withholding tax at six percent (6%); and
- (n) payment for any other services not specifically mentioned above and procured in connection with Petroleum Operations within the JPDA (except Annex F) and the Timor-Leste Exclusive Area is subject to six percent (6%) withholding tax.

## Section 29

### **Obligations of a Person Withholding Tax from a Payment**

#### 29.1

A Contractor or Subcontractor who has the obligation to withhold tax under Sections 26 , 28 and of 28A of the present Regulations and Sections 81 and 72.2 of the Taxes and Duties Act 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.

29.2

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.

29.3

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 to the Timor-Leste Central Bank

29.4

A Contractor or Subcontractor who has been personally held liable under subparagraph 28.3 above and who has made a payment of the tax due to the Central Bank is entitled to recover the amount of the tax from the recipient of the payment in respect of which he failed to withhold tax.

29.5

For the limited purpose of Sections 26, 28 and 28A of the present Regulations, the Contractor or the Subcontractor withholding tax under the present Regulations and or the Taxes and Duties Act, shall be treated as an agent of the Tax Administration to the extent of such taxes withheld. 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.

29.6

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

29.7

The provisions of Sections 72 to 74 of the UNTAET Regulation 2000/18 may be applied 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 30 **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 and UNTAET Regulation 2000/18 in connection with matters covered by and subject to Chapter IX of the Taxes and Duties Act;
- (b) any person receiving an amount that has not been correctly subject to withholding tax, where applicable under the present Regulations and UNTAET Regulation 2000/18 in connection with matters covered by and subject to Chapter IX of the Taxes and Duties Act; and



- (c) other persons or classes of persons as may be designated by the Tax Administration from time to time.

### 30.1

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.

### 30.2

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) balance sheet, including information on any change in equity section from the previous year;
- (e) depreciation schedules; and
- (f) description of related party transactions, including amounts and the nature of the transaction, organizational chart

### 30.2

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;
- (e) description of related party transactions,; including amounts and the nature of the transaction, organizational chart.

### 30.3

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.

### 30.4

An application made pursuant to subparagraph 30.3 above must be accompanied by proof of payment of the tax due in full and a calculation of the estimated tax due.

### 30.5

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.

30.6

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.

## Section 31

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

31.1

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.

31.2

The projected tax liability of a Contractor for the first tax year as determined pursuant to subparagraph 31.1 shall be divided by twelve (12) and the Contractor shall pay a monthly instalment of one-twelfth (1/12<sup>th</sup>) on the fifteenth (15<sup>th</sup>) day of each month in the first tax year.

31.2

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.

31.3

Excepting where the Tax Administration decides otherwise and or the Contractor's first tax year as determined under subparagraph 31.1 above, the amount of each estimated monthly tax liability of a Contractor shall be equal to one-twelfth (1/12<sup>th</sup>) 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 for the last month of the preceding tax year; or
- (b) the average monthly tax instalment payment for the preceding tax year.

31.4

The amount of tax instalment due and payable under this Section and Section 82 of the Taxes and Duties Act may be determined by the Tax Administration, where:

- (a) a contractor has a loss carried forward for the preceding tax year;
- (b) a Contractor derives irregular income;

- (c) 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 30.5 of the present Regulations;
- (d) there is a material change in the Contractor's circumstances, including merger or acquisition or a natural disaster;
- (e) a contractor's income tax return for the preceding year is amended, either as a result of a tax audit or self-amendment; and
- (f) a Contractor fails to provide the Tax Administration with estimated income tax liability as required under Section 31.1 above and under Section 82.5 of the Taxes and Duties Act.

### 31.5

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.

### 31.6

Any amounts of underpayment arising pursuant to a revised calculation of the estimated tax liability of a Contractor under subparagraph 31.5 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.

### 31.7

If a Contractor's estimate made under subparagraph 31.2, including any revised estimate of income tax for the Contractor's first year 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:

- (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.

### 31.8

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 31.1(a)-(b) may be waived.

Section 32  
**Supplemental Petroleum Tax**

32.1

Pursuant to Section 83.1 of the Taxes and Duties Act, a Contractor subject to Supplemental 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 72.1 of the Taxes and Duties Act

32.2

The Supplemental Petroleum Tax under Section 83 on a Contractor for a tax year is a separate tax from the corporate income tax imposed under Section 72.1 and it is an addition to corporate income tax, where applicable.

32.3

The Supplemental 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 Petroleum Supplemental Tax were paid

Section 33  
**Accumulated Net Receipts**

33.1

The accumulated net receipts of a Contractor shall be determined in accordance with the formula prescribed in Section 84.1 of the Taxes and Duties Act, namely:

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

Where:

**X:**

is the Contractor's accumulated net receipts for Petroleum Operations at the end of the previous tax year;

**B:**

is the Contractor's net receipts for Petroleum Operations for the current tax year;

**1:**

is the interest expense and other financial charges paid by the Contractor in respect of Petroleum Operations 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 72.1) of the Taxes and Duties Act

### 33.2

In a year in which a Contractor is liable for the Supplemental Petroleum Tax as determined under the present Regulations and Section 83.2 of the Taxes and Duties Act, for the purposes of calculating the accumulated net receipts of the Contractor for the Petroleum Operations for the next tax year, the amount of the accumulated net receipts shall be nil.

### 33.3

In a tax year in which  $(A \times 116.5\%)$  component of the formula described in subparagraph 33.1 above and Section 841 of the Taxes and Duties Act is negative, the subtraction of  $(1 \times (1-r))$  component of the formula shall not operate in a manner to reduce the amount of  $((A \times 116.5\%) - (1 \times (1-r)))$  to an amount that is less than the value of  $A$  component of the formula. 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 34 Contractor's Net Receipts

For the purposes of the Supplemental Petroleum Tax, the net receipts of a Contractor in respect of Petroleum Operations for a tax year is gross receipts of all includible income of the Contractor for the year less the total allowable deductible expenditures of the Contractor in respect of Petroleum Operations for the year.

## Section 35 Gross Receipts

### 35.1

For the limited purposes of gross income in relation to the computation of the Supplemental Petroleum Tax of a Contractor in a given tax year, the gross receipts of a Contractor arising from Petroleum Operations, is the aggregate of the following amounts:

- (a) all income items under Section 8 of the present Regulations earned or accrued in the year in connection with or from Petroleum Operations 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 Petroleum Operations, if the expenditure incurred in acquiring the property has been deducted in computing the net 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, appraisal, or study in connection with Petroleum Operations where the related expenditure incurred in undertaking the survey, appraisal, or study has been deducted in computing the net 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 in computing the net 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 Operations where such property was destroyed and or damaged.

### 35.2

Subject to the provisions of Section 88 of the Taxes and Duties Act, an amount received or accrued as consideration for the transfer of an interest in Petroleum Operations is excluded from the computation of the gross receipts of a Contractor under subparagraph 34.1 of the present Regulations.

### 35.3

For the limited purpose of calculating the net receipts of a Contractor in a tax year, the amounts includible as part of the gross receipts of a Contractor under subparagraph 34.1 is limited to the portion of such amounts attributable to the Petroleum Operations of the Contractor.

## Section 36

### **Deductible Amounts for Supplemental Petroleum Tax**

For the limited purposes of calculating the Supplemental Petroleum Tax imposed under Section 83 of the Taxes and Duties Act 2008 (including amendments), for the current year, a Contractor may deduct the following items:

- (a) permissible deductible expenditures incurred by the Contractor in the current year in respect of the Petroleum Operations, excluding the amounts allocable to depreciation and or amortisation deductions, interest and other financing charges;
- (b) capital expenditure incurred in the current year in respect of acquisition or construction of a tangible or intangible asset for use in the Petroleum Operations 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 in Petroleum Operations;
- (c) exploration expenditure incurred by the Contractor in the current year in respect of the Petroleum Operations in which the Contractor is engaged in a Contract Area; and
- (d) an amount of Timor-Leste corporate income tax calculated by applying the rate specified in Section 72 of the Taxes and Duties 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.

### 36.1

The amounts deductible under subparagraphs (a)-(d) are limited to those directly attributable to the Petroleum Operations of the Contractor and in respect of a Contract Area.

## Section 37

Any consideration, including all transactions costs paid or accrued by a Contractor in respect of the acquisition of an interest in Petroleum Operations under Section 88 shall be excluded from

the permissible deductible expenditure under Section 36 of the present Regulations and Section 87.1 of the Taxes and Duties Act.

## Section 38 **Annual Supplemental Petroleum Tax Return**

### 38.1

Every Contractor having a Supplemental Petroleum Tax obligation under Section 32 of the present Regulations and Section 83 of the Taxes and Duties Act shall deliver a completed annual Supplemental Petroleum Tax return form to the Tax Administration in the manner prescribed by the Commissioner:

### 38.2

Any Contractor required to deliver a completed annual Supplemental Petroleum Tax return form 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.

### 38.3

A completed annual Supplemental Petroleum Tax return of a Contractor means a completed annual Supplemental 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.

### 38.4

A Contractor may apply to the Tax Administration for an extension of time to deliver the annual Supplemental 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.

### 38.5

An application made pursuant to subparagraph 38.4 above must be accompanied by proof of the payment of the tax due in full and a calculation of the estimated tax due.

### 38.6

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

### 38.7

The Supplemental 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.

Section 39  
**Contractor's Monthly Income Tax Obligations**

39.1

Every Contractor having a Supplemental Petroleum Tax obligation under Section 32 of the present Regulations and Sections 83 and 90 of the Taxes and Duties Act Tax shall be liable for monthly instalments of Supplemental Petroleum Tax.

39.2

Every Contractor having a Supplemental Petroleum Tax obligation under Section 32 of the present Regulations and Section 83 and 90 of the Taxes and Duties Act Tax shall deliver to the Tax Administration an estimate of Supplemental Petroleum Tax due for a tax year not later than the due date for payment of the first Supplemental Petroleum Tax instalment due for that tax year.

39.3

The estimated Supplemental Petroleum Tax liability of a Contractor for a tax year as determined pursuant to subparagraph 39.2 shall be divided by twelve (12) and the Contractor shall pay a monthly instalment of one-twelfth ( $1/12^{\text{th}}$ ) on the fifteenth ( $15^{\text{th}}$ ) day of each month following the month in which they relate.

39.4

Where the first obligation of a Contractor under Section 32 of the present Regulations and Section 90 commences in a month other than the month of January, the monthly instalments due and payable by the Contractor under subparagraph 39.3 above shall be calculated by dividing the remaining month(s) of that tax year by the estimated Supplemental Petroleum Tax determined under subparagraph 39.2 of the present Regulations.

39.5

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



### 39.6

The amount of tax instalment due and payable under this Section and Section 90 of the Taxes and Duties Act may be determined by the Tax Administration, where:

- (a) the annual Supplemental 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 38.6 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 Supplemental 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 Supplemental Petroleum Tax liability as required under Section 39.2 above and under Section 90.2 of the Taxes and Duties Act.

### 39.7

An estimated Supplemental Petroleum 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.

### 39.8.

Any amounts of underpayment arising pursuant to a revised calculation of the estimated tax liability of a Contractor under subparagraph 39.7 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 Supplemental Petroleum tax liability of the Contractor.

### 39.9

If a Contractor's estimate made under this Section and Section 90 of the Taxes and Duties Act in respect of the Supplemental Petroleum Tax obligation of a Contractor, including any revised estimate, 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 "SPT shortfall"; or
- (b) in any other case, ten (10%) of the SPT shortfall.

### 39.10

If the Tax Administration is satisfied that the reason for the SPT 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 39.9(a)-(b) may be waived.

Section 40  
**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.

Section 41  
**Tax Audit**

- (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 taxpayer, or the taxpayer's representatives, as the case may be;
- (c) A taxpayer under tax audit shall, upon 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
  - 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;
  - iii. 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 42  
**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 with a view of determining the commission of a tax-related offense.

#### Section 43

##### **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 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 44

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

During the procedure of office controls of receipt and processing:

- (a) the verification of the mathematical accuracy, formal accuracy and complexness or truthfulness of the tax return and other statements filed by the taxpayer is performed by the Tax Administration in accordance with the all the applicable Laws;
- (b) if during the processing of 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 45

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

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. 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 46

#### **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 be under the obligation to 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 sought from the Tax Administration;
- (d) the tax Administration is required to review the objection and make a determination within fourteen (14) business 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 a reasonable period of time; 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 47

#### **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;
- (d) the Tax Administration may postpone the commencement of field control if the taxpayers submits a written complaint immediately upon the receipt of the control order indicated in subparagraph 47(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 47(c); and

- (e) a written decision on the complaint indicated in subparagraph 47(d) of the present Regulation 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 48

#### **Location of Field Control**

- (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) the auditors, inspectors and representatives of the Tax Administration shall have the right to enter into the places indicated in subparagraph (a) where the taxpayer may be conducting its business;
- (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 make 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 samples of goods;
- (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 request data or control of documentation from employees of the taxpayer or other persons; and

- (k) the employees and other 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 49

##### **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 50

##### **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 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 on the field control within five (5) 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 five (5) business days; and
- (f) if it is determined on the basis of the report or additional report on field control that there is no basis for the amending of 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 51

##### **NDPR Public Ruling 2011/02**

Where relevant, NDPR Public Ruling 2011/02 shall apply to the calculation of the income tax (including value of pre-commercial discovery expenditure) and the Supplemental Petroleum Tax obligations of a Contractor *mutatis mutandi* in respect of all items of income and expenditure of Contractor.

Section 52  
**Commencement Date**

The provisions of this Regulations shall be applied retroactively from January 1, 2012 and is effective for tax year commencing on or after January 1, 2011

Issued under my hand in exercise of my administrative powers in relation to taxation matters in Timor Leste, this        day of June, 2012.

**Her Excellency Emilia Pires**  
**Minister of Finance**  
**Timor-Leste**