



República Democrática de Timor-Leste

National Parliament

**Law No. 3/2003
of 1 July**

TAXATION OF BAYU-UNDAN CONTRACTORS ACT

The Timor Sea Treaty signed by Timor-Leste and Australia on 20 May 2002 and ratified by the National Parliament on 17 December 2002 permits development of petroleum resources to proceed in the area of the Timor Sea called the JPDA.

The Timor Sea Treaty permits, with certain limitations, each of the two governments to apply its tax regime to the petroleum activities in the JPDA. Under the Treaty, Timor-Leste may apply its tax regime to 90 percent of the petroleum activities; Australia may apply its tax regime to 10 percent.

The Bayu-Undan field is the largest discovery in the JPDA so far. The production and tax revenues from this field will represent a very significant portion of Timor-Leste's national budget and GDP from mid-2004, when the field is scheduled to go into production.

This Law establishes a tax regime for the development of the Bayu-Undan field.

The purpose of this Law is to encourage the Bayu-Undan contractors to proceed with the gas phase of the project, in addition to the liquids phase. Development of the gas phase of the project will permit Timor-Leste to maximize its total revenues from the Bayu-Undan field.

This Law enters into force when the Joint Commission has approved Production Sharing Contracts JPDA 03-12 and JPDA 03-13 (including annexes thereto providing for the valuation of natural gas), the Development Authority has approved the amendment to the Development Plan relating to the export of gas, and contracts for the transportation and sale of natural gas by the contractors have become binding and effective with conditions precedent satisfied.

The National Parliament decrees, in accordance with article 92, part b) of paragraph 2 of article 95, and paragraphs 1 and 2 of article 139 of the Constitution of the Republic, with the weight of the law, the following:

PART 1 – PRELIMINARY

Article 1 Short Title

This Act may be cited as the Taxation of Bayu-Undan Contractors Act, 2003.

Article 2 Definitions

1. In this Act:

“Bayu-Undan” means the Bayu-Undan discovery area as defined in Production Sharing Contracts JPDA 03-12 and JPDA 03-13;

“Commissioner” means the Commissioner of the East Timor Revenue Service;

“contractor” means a Tax Subject that:

- (a) has entered into Production Sharing Contract JPDA 03-12 or JPDA 03-13 or a successor Production Sharing Contract pursuant to Annex F to the Timor Sea Treaty; or
- (b) is a successor or assignee of a Tax Subject referred to in paragraph (a) as permitted under Production Sharing Contract JPDA 03-12 or JPDA 03-13, as the case may be,

and is registered as a contractor under the *Petroleum Mining Code*;

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

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

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

“Joint Commission” means the Joint Commission established under Article 6 of the Timor Sea Treaty;

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

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

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

“petroleum” means:

- (a) Any naturally occurring hydrocarbon, whether in a gaseous, liquid, or solid state;
- (b) Any naturally occurring mixture of hydrocarbons, whether in a gaseous, liquid, or solid state;
- (c) Any naturally occurring mixture of one or more hydrocarbons, whether in a gaseous, liquid, or solid state, as well as other substances produced in association with such hydrocarbons,

and includes any petroleum as defined in paragraphs (a), (b), and (c) that has been returned to a natural reservoir;

“petroleum activities” means all activities undertaken to produce *petroleum*, authorized or contemplated under a contract, permit, or licence, and includes exploration, development, initial processing, production, transportation, and marketing, as well as the planning and preparation for such activities;

“Petroleum Mining Code” means the Code referred to in Article 7 of the *Timor Sea Treaty*;

“petroleum project” means *petroleum activities* undertaken in relation to *Bayu-Undan* and does not include *petroleum activities* undertaken in relation to *Elang Kakatua Kakatua North*;

“subcontractor” means any Tax Subject supplying goods or services directly or indirectly to a *contractor* in respect of the petroleum project;

“Timor-Leste”, when referring to a geographic area, means the territory of República Democrática de Timor-Leste as defined in Section 4 of the Constitution of the República Democrática de Timor-Leste and the East Timor Maritime Zones Act; and

“Timor Sea Treaty” means the Timor Sea Treaty dated 20 May 2002 between the Government of Timor-Leste and the Government of Australia.

2. Unless the context indicates otherwise, terms used in this Act and not defined in sub-article 1 have the same meaning as in the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, and

Law on General Tax Provisions and Procedures (as these laws apply in *Timor-Leste*), UNTAET Regulation No. 2000/18 (as amended), and the *Timor Sea Treaty*, as the case may be.

3. In the event of a conflict between this Act and the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, *Law on General Tax Provisions and Procedures* (as these laws apply in *Timor-Leste*) or UNTAET Regulation No. 2000/18 (as amended), this Act prevails.

PART 2- TAXATION REGIME FOR CONTRACTORS UNDERTAKING THE PETROLEUM PROJECT

Article 3

Taxation of a Contractor Undertaking the Petroleum Project

1. A *contractor* undertaking the *petroleum project* is subject to tax in accordance with the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, and the *Law on General Tax Provisions and Procedures*, as modified by UNTAET Regulation No. 2000/18 (as amended), and subject to the modifications in this Part.
2. The application of the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, and the *Law on General Tax Provisions and Procedures* to *contractors* undertaking the *petroleum project* is in accordance with UNTAET Regulation No. 1999/1.
3. The rate of corporate tax applicable to a *contractor* for a fiscal year is 30%.
4. Notwithstanding sub-article 1, Tax Subjects are exempt from *Timor-Leste* taxes, including taxes applicable pursuant to the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, and the *Law on General Tax provisions and Procedures*, as modified by UNTAET Regulation No. 2000/18 (as amended) with respect to income and activities relating to the construction, installation and operation of an *export pipeline*.

Article 4

Decommissioning Costs Reserve

1. For the purposes of calculating the taxable income of a *contractor* for a fiscal year and notwithstanding Article 9(1)(c) of the *Law on Income Tax*, the *contractor* is allowed a deduction for the year for the amount carried to the decommissioning costs reserve for the year in respect of the *petroleum project*.
2. A deduction is not allowed for any decommissioning expenditure incurred by a *contractor* in a fiscal year (referred to as the “current fiscal year”) except to the extent that the total amount of decommissioning expenditure incurred by the *contractor* in the current fiscal year and previous fiscal years exceeds the amount calculated according to the following formula:

(A + B) - C

Where:

- A** is the total amount allowed to the *contractor* as a deduction under sub-article 1 in the current fiscal year and previous fiscal years;
- B** is the total amount allowed to the *contractor* as a deduction under this sub-article in previous fiscal years; and
- C** is the total amount included in the *contractor's* taxable income in the current fiscal year and previous fiscal years pursuant to sub-article 5.
3. The decommissioning costs reserve is calculated by reference to the Total Approved Decommissioning Costs. The amount carried to the reserve for a fiscal year is the amount allowed to the *contractor* for that year under the Production Sharing Contract between the *Designated Authority* and the *contractor* governing the project.
 4. No deduction is allowed under sub-article 1 for any fiscal year prior to 1 January 2008.
 5. Where, at any time, the total amount allowed as a deduction under this article exceeds the Total Approved Decommissioning Costs, the amount of the excess is included in the gross income of the *contractor* for the fiscal year in which such excess occurs.
 6. In this Article:

“Decommissioning Plan”, in relation to the *petroleum project*, means the Decommissioning Plan approved by the *Designated Authority* under the Production Sharing Contract between the *Designated Authority* and the *contractor* governing the project;

“Development Plan”, in relation to the *petroleum project*, means the Development Plan approved by the *Designated Authority* under the Production Sharing Contract between *Designated Authority* and the *contractor* governing the project; and

“Total Approved Decommissioning Costs”, means the total decommissioning costs approved by the *Designated Authority* in accordance with the *Decommissioning Plan* for the *petroleum project*, as revised from time to time.

Article 5

Depreciation and Amortization

1. The following modifications apply to Article 11 of the *Law on Income Tax* as it applies to a *contractor* undertaking the *petroleum project*:

- (a) The depreciation of tangible property used in *petroleum activities* in respect of the project is calculated individually on a straight-line basis only;
- (b) The straight-line depreciation rates applicable to tangible property used in *petroleum activities* in respect of the project are as follows:

<u>Useful life of the property</u>	<u>Depreciation rate</u>
1 - 4 years	25%
more than 4 years	20%

- (c) The depreciation of tangible property referred to in paragraph (a) acquired or constructed before first production commences from the date of first production; and
- (d) Subject to sub-articles 4 and 5, the amount of depreciation allowed as a deduction for a fiscal year in respect of an item of tangible property is calculated according to the following formula:

$$A \times B$$

where:

A is the cost of the property; and

B is the depreciation rate determined under paragraph (b).

2. The following modifications apply to Article 11A of the *Law on Income Tax* as it applies to a *contractor* in respect of the *petroleum project*:

- (a) The amortization of intangible property and other expenditure of an intangible nature (hereafter referred to as an “intangible”) relating to *petroleum activities* in respect of the project is calculated individually on a straight-line basis only;
- (b) The straight-line amortization rates applicable to an intangible used in *petroleum activities* in respect of the project are as follows:

<u>Useful life of the intangible</u>	<u>Amortization rate</u>
1 - 4 years	25%
more than 4 years	20%

- (c) The amortization of an intangible acquired, developed, or incurred before first production commences from the date of first production; and

- (d) Subject to sub-article 4 and 5, the amount of amortization allowed as a deduction for a fiscal year in respect of an intangible is calculated according to the following formula:

$$\mathbf{A \times B}$$

where:

A is the cost of the intangible; and

B is the amortization rate determined under paragraph (b).

3. The following provisions apply where *petroleum activities* in *Elang Kakatua Kakatua North* have ceased, the *contractor* has made a loss for income tax purposes in respect of the activities, and the *contractor* has undertaken the *petroleum project*:

- (a) The amount of the loss that has not been deducted under Article 6(2) of the *Law on Income Tax* is treated as expenditure incurred by the *contractor* in respect of the project;
- (b) The expenditure is treated as having been incurred at the later of:
- (i) The date on which the *Elang Kakatua Kakatua North* activities ceased; or
- (ii) The date of first production for the *petroleum project*;
- (c) The expenditure is treated as having a useful life of five years; and
- (d) The expenditure is amortized under Article 11A of the *Law on Income Tax*, as modified by Article 5(2) of this Act, on a straight-line basis.

4. In the fiscal year in which first production occurs, the amount allowed as a deduction under sub-article 1(d) and 2(d) is computed according to the following formula:

$$\mathbf{A \times B/C}$$

where:

A is the amount computed under sub-article 1(d) or 2(d), as the case may be;

B is the number of days from the date of first production to the end of the fiscal year in which first production occurs; and

C is the number of days in the fiscal year.

5. In the last fiscal year of depreciation or amortization, the amount allowed as a deduction under sub-article (1)(d) and 2(d), as the case may be, for any tangible property or intangible to which sub-article 4 applied is calculated according to the following formula:

A – B

A is the amount computed under sub-article 1(d) or 2(d), as the case may be, for the fiscal year of first production without regard to sub-article 4; and

B is the amount allowed as a deduction for the fiscal year of first production under sub-article 1(d) or 2(d), as modified by sub-article 4.

6. For the purposes of this Article –

- (a) First production occurs where there has been a minimum of thirty days commercial production and the commencement of first production is on the first day of the thirty day period; and
- (b) The last fiscal year of depreciation or amortization –
- (i) in the case of any tangible property or intangible with a useful life of 1 – 4 years, is the fourth fiscal year after the fiscal year of first production; or
- (ii) in the case of any tangible property or intangible with a useful life of more than 4 years, is the fifth fiscal year after the fiscal year of first production.

Article 6
Special Calculation Norm

1. For the purposes of Article 15 of the *Law on Income Tax*, the net income of a permanent establishment engaged in oil and gas drilling activities for the *petroleum project* is six percent (6%) of gross income. This is the basis for calculating the tax installment payments of the permanent establishment under Article 25 of the *Law on Income Tax*.
2. For the purposes of Article 15 of the *Law on Income Tax*, the net income of a permanent establishment engaged in shipping or air service activities for the *petroleum project* is two point four percent (2.4%) of gross income. This is the basis for calculating the tax installment payments of the permanent establishment under Article 25 of the *Law on Income Tax*.

Article 7
Estimated Net Income

The estimated net income determined under Article 23(2) of the *Law on Income Tax* for the purposes of Article 23(1)(c)(2) of the *Law on Income Tax* applicable to –

- (a) Compensation paid by a *contractor* or *subcontractor* for oil and gas drilling support services acquired for the *petroleum project* is twelve percent (12%) of gross compensation;
- (b) Compensation paid by a *contractor* or *subcontractor* for technical, management, accounting and bookkeeping, legal consulting, and tax consulting services acquired for the *petroleum project* is sixteen percent (16%) of gross compensation; and
- (c) Compensation paid by a *contractor* or *subcontractor* for rent or other income pertaining to the use of property for the *petroleum project* is sixteen percent (16%) of gross compensation.

Article 8 Withholding Tax

1. The withholding tax rate for the purposes of Article 23(1)(a)(3) of the *Law on Income Tax* shall be six percent (6%) of the gross amount paid by a *contractor* or *subcontractor* with respect to the *petroleum project*.
2. The withholding tax rates determined under Article 4(2) of the *Law on Income Tax* applicable to compensation paid for services acquired for the *petroleum project* shall be as follows:
 - (a) Zero point eight percent (0.8%) with respect to construction services; and
 - (b) One point six percent (1.6%) with respect to consulting services.
3. The withholding tax rate for the purposes of Article 26(1)(c) and (d) of the *Law on Income Tax* applicable to compensation paid by a *contractor* or *subcontractor* for services acquired for the *petroleum project* is eight percent (8%) of the gross amount of the compensation.
4. Notwithstanding sub-article 3, the withholding tax rate for the purposes of Article 26(1)(d) of the *Law on Income Tax* applicable to compensation paid by a *contractor* or *subcontractor* to employees for services acquired for the *petroleum project* is twenty percent (20%) of the gross amount of the compensation.

Article 9 Branch Profits Tax

Article 26(4) of the *Law on Income Tax* does not apply to a *contractor* or *subcontractor* in respect of income derived from the *petroleum project*, including income from the disposal of an interest in the project.

Article 10 Value of Gas

1. For the purposes of calculating the taxable income of a *contractor* undertaking the *petroleum project*:
 - (a) The valuation of natural gas produced and saved, and not used in field operations, is made in accordance with the Production Sharing Contract between the *Designated Authority* and the *contractor* governing the project; and
 - (b) No deduction is allowed for any export cost charge incurred by a *contractor* in a fiscal year except to the extent that the export cost charge has not been taken into account in the determining the valuation of natural gas produced and saved pursuant to paragraph (a).

2. In this Article:

“export cost charge”, in relation to a *contractor* in respect of the *petroleum project*, has the meaning in the Production Sharing Contract between the *Designated Authority* and the *contractor* governing the project; and

“natural gas” means all gaseous hydrocarbons, including wet mineral gas, dry mineral gas, casinghead gas and residue gas remaining after the extraction of liquid hydrocarbons from wet gas.

PART 3 - ADDITIONAL PROFITS TAX

Article 11 Imposition of Additional Profits Tax

1. A *contractor* undertaking the petroleum project that has a positive amount of accumulated net receipts for the project for a fiscal year is liable to pay additional profits tax.
2. The additional profits tax payable by a *contractor* for a fiscal year is calculated according to the following formula:

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

where:

A is the accumulated net receipts of the contractor for the year; and

r is the corporate rate of tax as specified in sub-article 3 of Article 3.

3. Additional profits tax imposed under this Article is in addition to the income tax imposed on the taxable income of the *contractor* for the fiscal year.
4. Additional profits tax paid by a *contractor* is allowed as a deduction in calculating the taxable income of the *contractor* in the fiscal year in which the tax was paid.

Article 12 Accumulated Net Receipts

1. The accumulated net receipts of a *contractor* for a fiscal year for the *petroleum project* is calculated according to the following formula:

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

where:

A is the *contractor's* accumulated net receipts for the project at the end of the previous fiscal year;

B is the *contractor's* net receipts for the project for the current fiscal year;

I is the interest expense and other financial charges paid by the *contractor* in respect of the project in the current fiscal year (and is entered in the formula as a negative number); and

r is the corporate rate of tax as specified in sub-article 3 of Article 3.

2. Where additional profits tax is payable by a *contractor* for a fiscal year, the amount of the accumulated net receipts of the *contractor* at the end of that year is zero for the purposes of calculating the accumulated net receipts of the *contractor* for the next year.
3. Where component $(A \times 116.5\%)$ of the formula in sub-article 1 is negative for a fiscal year, the subtraction of component $(I \times (1-r))$ for that year shall not reduce the amount of $((A \times 116.5\%) - (I \times (1-r)))$ to an amount that is less than **A**. The amount of any excess is not carried forward or carried back to any fiscal year.
4. The following provisions apply to a *contractor* to which Production Sharing Contracts JPDA 03-12 and JPDA 03-13 apply:
 - (a) The formula in sub-article 1 is to be applied to the *contractor* for the period 25 October – 31 December 1999 on the basis that the initial total accumulated net receipts of all *contractors* as at 25 October, 1999 was negative \$233 million;

- (b) The formula in sub-article 1 is to be applied to the *contractor* for the period 1 January – 31 December 2000 on the basis that the amount calculated under paragraph (a) is the accumulated net receipts of the *contractor* as at 31 December, 1999;
- (c) The formula in sub-article 1 is to be applied to the *contractor* for the period 1 January – 31 December 2001 on the basis that the amount calculated under paragraph (b) is the accumulated net receipts of the *contractor* as at 31 December, 2001; and
- (d) The amount calculated under paragraph (c) is the accumulated net receipts of the *contractor* as at 31 December, 2001 for the purposes of applying the formula in sub-article 1 to the *contractor* for the fiscal year commencing on 1 January, 2002.

Article 13 Net Receipts

The net receipts of a *contractor* for the *petroleum project* for a fiscal year is the gross receipts of the *contractor* for the project for the year less the total deductible expenditure of the *contractor* for the project for the year. The net receipts of a *contractor* for a fiscal year may be a negative amount.

Article 14 Gross Receipts

1. The gross receipts of a *contractor* for a fiscal year for the *petroleum project* is the sum of the following amounts:
 - (a) The gross income for income tax purposes accrued by the *contractor* in the year from the project, including amounts received from the hiring or leasing out of, or the granting of rights to use property, but not including interest income;
 - (b) The consideration received by the *contractor* in the year for the disposal, destruction, or loss of any property (including materials, equipment, plant, facilities, and intellectual property or rights) used in the project where the expenditure incurred in acquiring the property was deducted in computing the net receipts of the *contractor* for any fiscal year;
 - (c) Any amount received by the *contractor* in the year from the provision of information or data obtained from any survey, appraisal, or study relating to the project where the expenditure incurred in undertaking the survey, appraisal, or study was previously deducted in computing the net receipts of the *contractor* for any fiscal year;
 - (d) Any other amount received by the contractor in the year that is a reimbursement, refund, or other recoupment of an amount

previously deducted in computing the net receipts of the contractor for the project for any fiscal year; and

- (e) Where property has been destroyed or lost by a *contractor*, any compensation, indemnity, or damages received by the *contractor* in respect of the property under an insurance policy, indemnity agreement, settlement, or judicial decision.
2. Notwithstanding sub-article 1, and subject to Article 16, the gross receipts of a contractor does not include any amount received or accrued as consideration for the transfer of an interest in the petroleum project.
 3. Where an amount referred to in sub-article 1 is attributable to the *petroleum project* and some other activity of the *contractor*, only that portion that relates to the *petroleum project* is included in the gross receipts of the *contractor* in calculating the net receipts of that project.

Article 15 **Deductible Expenditure**

1. The total deductible expenditure of a *contractor* for a fiscal year for the *petroleum project* is the sum of the following amounts:
 - (a) Any expenditure incurred by the *contractor* in the year in respect of the project and allowed as a deduction (other than as a depreciation or amortization deduction) in computing taxable income, including interest and financing charges;
 - (b) Any capital expenditure incurred by the *contractor* in the year in acquiring or constructing a tangible or intangible asset for use in the project;
 - (c) Any exploration expenditure incurred by the *contractor* in the year in respect of the project; and
 - (d) An amount of *Timor-Leste* corporate income tax of the *contractor* for the year calculated by applying the corporate rate of tax as specified in sub-article 3 of Article 3 to the taxable income of the *contractor* for the year before deduction of additional profits tax.
2. Notwithstanding sub-article 1, and subject to Article 16, the deductible expenditure of a contractor does not include any amount incurred as consideration for the acquisition of an interest in the petroleum project.
3. Where an amount referred to in sub-article 1 is attributable to the *petroleum project* and to some other activity of the *contractor*, only that portion that relates to the *petroleum project* is allowed as deductible expenditure of the *contractor* in computing the net receipts of that project.

Article 16
Transfer of Interest in the Petroleum Project

1. Where the whole of a *contractor's* interest in the *petroleum project* is transferred to another *contractor*, the transferee *contractor* is treated as having the same gross receipts and deductible expenditures in respect of the interest as the transferor had immediately before the transfer. For the purposes of calculating the transferee *contractor's* accumulated net receipts for the fiscal year in which the transfer occurred, the transferor *contractor's* accumulated net receipts at the end of the previous fiscal year is treated as the transferee *contractor's* accumulated net receipts for that previous year.
2. Where part of a *contractor's* interest in the *petroleum project* is transferred to another *contractor*:
 - (a) The transferee *contractor* is treated as having the gross receipts and deductible expenditures in respect of that partial interest as the transferor *contractor* had in relation to the whole interest immediately before the transfer multiplied by the transferred percentage factor; and
 - (b) For the purposes of calculating the transferee *contractor's* accumulated net receipts for the fiscal year in which the transfer occurred, the transferor *contractor's* accumulated net receipts at the end of the previous fiscal year multiplied by the transferred percentage factor is treated as the transferee *contractor's* accumulated net receipts for that previous fiscal year.
3. In this Article, "transferred percentage factor" means the transferor *contractor's* percentage ownership in the *petroleum project* that is transferred divided by the transferor *contractor's* total percentage ownership in the *petroleum project* prior to the transfer.

Article 17
Procedure Relating to Additional Profits Tax

1. A *contractor* undertaking the *petroleum project* in a fiscal year shall deliver to the *Commissioner* an additional profits tax return for the year.
2. The additional profits tax return for a fiscal year shall be delivered in the same manner and by the same due date as the annual income tax return of the *contractor* for that year.
3. Additional profits tax for a fiscal year is due and payable by a *contractor* on the same date as the income tax of the *contractor* for that year is due and payable.

4. Subject to Article 18, the *Law on General Tax Provisions and Procedures*, as modified by UNTAET Regulation No. 2000/18 (as amended) applies, with any necessary changes made:
 - (a) To the assessment and collection of additional profits tax and additional tax imposed in respect of an additional profits tax liability, including the keeping of records and investigations;
 - (b) To appeals relating to a liability for additional profits tax or to additional tax imposed in respect of an additional profits tax liability; and
 - (c) To the application or refund of additional profits tax overpaid.
5. Chapter XI of UNTAET Regulation No. 2000/18 (as amended) applies to the additional profits tax on the basis that:
 - (a) The reference to “tax” in that Chapter includes the additional profits tax imposed under this Regulation; and
 - (b) The reference to “tax form” in that Chapter includes the additional profits tax return required to be delivered under sub-article 1.

Article 18

Instalments of Tax

1. A *contractor* shall pay monthly instalments of additional profits tax for each fiscal year. Instalments of additional profits tax are payable by the 15th day after the end of the month to which they relate. Where the due date for payment of an instalment of additional profits tax does not fall on a business day, the due date is the next business day.
2. The amount of each instalment is one-twelfth of the amount of additional profits tax estimated by the *contractor* to be due for the fiscal year. Every *contractor* shall deliver to the *Commissioner* an estimate of additional profits tax for a fiscal year by the due date for payment of the first instalment for the year.
3. An estimate delivered under sub-article 2 remains in force for the whole of the fiscal year unless the *contractor* delivers a revised estimate to the *Commissioner*. A revised estimate applies to the calculation of instalments of additional profits tax due both before and after the date the revised estimate was delivered. The amount of any underpayment of instalments made prior to the revised estimate shall be paid by the *contractor* together with the first instalment due after the revised estimate is delivered. The amount of any overpaid instalments shall be refunded to the *contractor* within 30 days of the revised estimate being delivered.

4. Where a *contractor* fails to deliver an estimate of additional profits tax as required under sub-article 2, the estimated additional profits tax of the *contractor* for the year is such amount as estimated by the *Commissioner*. The *Commissioner's* estimate remains in force for the whole of the fiscal year unless revised by the *contractor* in accordance with sub-article 3.
5. Where a *contractor's* estimate (including any revised estimate) of additional profits tax for a fiscal year is less than ninety percent of the contractor's assessed additional profits tax liability for that year, the contractor is liable for additional tax –
 - (a) if the under-estimate is due to fraud or wilful neglect, fifty percent (50%) of the amount by which the actual additional profits tax liability exceeded the estimated liability for the year; or
 - (b) in any other case, ten (10%) percent of the amount by which the actual additional profits tax liability exceeded the estimated liability for the year.

PART 4 - FINAL PROVISIONS

Article 19 Regulations

The Minister responsible for finance may make regulations for the effective carrying out of the provisions of this Act.

Article 20 Entry into Force and Application

1. This Act enters into force on the date when all of the following are satisfied-
 - (a) the Timor Sea Treaty has entered into force;
 - (b) the Joint Commission has approved Production Sharing Contracts JPDA 03-12 and JPDA 03-13, including annexes thereto providing for the valuation of natural gas;
 - (c) the Designated Authority has approved the amendment to the Development Plan for *Bayu-Undan* (providing for export of gas through the *export pipeline* and relevant contracts for the transportation and sale of natural gas by the contractors); and
 - (d) the contracts for the transportation and sale of natural gas referred to in paragraph (c) have become binding and effective with conditions precedent satisfied.

2. This Act applies from 1 January 2002.
3. The additional profits tax imposed under Article 11 applies for the fiscal year commencing 1 January 2002 and subsequent fiscal years.

Approved on 3 June 2003

The President of the National Parliament

Francisco Guterres “Lu-Olo”



República Democrática de Timor-Leste

TAXATION OF BAYU-UNDAN CONTRACTORS ACT

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides an explanation of the Taxation of Bayu-Undan Contractors Act (referred to as the “the Act”), which provides for the taxation of contractors undertaking petroleum projects in Bayu-Undan. The basic effect of the Act is to preserve the existing income tax treatment of such contractors subject to the modifications provided for in the Act, including the imposition of additional profits tax.

1. Short Title

This article provides that the Act may be cited as the Taxation of Bayu-Undan Contractors Act, 2003.

2. Definitions

This article provides for the interpretation of words and terms used in the Act.

Sub-article 1 provides definitions of commonly used terms in the Act. The definitions of “petroleum” and “petroleum activities” are the same as in the Timor Sea Treaty. “Petroleum project” is defined to mean petroleum activities taking place in Bayu-Undan. It is expressly provided that petroleum activities taking place in Elang Kakutua Kakutua North do not constitute a petroleum project for the purposes of the Act. This is particularly relevant for article 5 of the Act.

A “contractor” is defined to mean a Tax Subject that has entered into Production Sharing Contract JPDA 03-12 or 03-13, or a successor contract. The definition also includes any successor or assignee of such a Tax Subject. For a Tax Subject to be a contractor, it must be registered as a contractor under the Petroleum Mining Code.

Sub-article 2 provides that terms not defined in sub-article 1 have their ordinary meaning under the *Law on Income Tax*, *Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods*, *Law on General Tax Provisions and*

Procedures, UNTAET Regulation No. 2000/18 (as amended) and the Timor Sea Treaty, as the case may be. As regards the Law on Income Tax, Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods, and the Law on General Tax Provisions and Procedures, terms have the meaning in those laws to the extent that those laws are applicable in East Timor as determined under UNTAET Regulation No. 1999/1.

Sub-article 3 provides a priority rule in the event of a conflict between the Act and *Law on Income Tax, Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods, Law on General Tax Provisions and Procedures* (as these laws apply in *Timor-Leste*) or UNTAET Regulation No. 2000/18 (as amended). In the event of such conflict, the Act prevails.

3. Taxation of a Contractor Undertaking a Petroleum Project

This article states the general principle of taxation of contractors undertaking the petroleum project.

Sub-article 1 provides that a contractor is subject to tax in accordance with the *Law on Income Tax, Law on Value Added Tax on Goods and Services and Sales Tax on Luxury Goods, and Law on General Tax Provisions and Procedures*. This is subject to several qualifications. First, sub-article 2 makes it clear that it is only to the extent that those Laws apply in East Timor. This is determined in accordance with *UNTAET Regulation 1999/1*. Secondly, the application of the Laws is subject to the modifications in *UNTAET Regulation 2000/18 (as amended)*. See, in particular, Chapters VII (wages income tax), X (taxation procedure) and XI (additional tax, offences and penalties). Thirdly, the application of those Laws is also subject to the modifications in Part 2 of the Act explained in these notes.

Sub-article 3 provides that the rate of corporate tax applicable to a contractor is 30%.

Sub-article 4 exempts Tax Subjects from tax with respect to income and activities relating to the construction, installation and operation of an export pipeline (as defined in article 2).

4. Decommissioning Costs Reserve

This article allows a contractor to claim a deduction for the amount carried to the decommissioning costs reserve for a fiscal year in respect of a petroleum project.

Sub-article 1 states the principle of deductibility. It is expressly provided that sub-article 1 overrides Article 9(1)(c) of the *Law on Income Tax*, which provides that no deduction shall be allowed for the establishment or accumulation of a reserve fund. The amount allowed as a deduction for a fiscal year is the amount carried to the decommissioning costs reserve for the year. Decommissioning costs actually incurred during a fiscal year are either deductible under Article 6 of the *Law on Income Tax* or amortized under Article 11A of the *Law on Income Tax*, depending on the useful life of the costs incurred.

Sub-articles 3 and 4 provide for two important limitations on the deduction. First, sub-article 3 provides that the establishment and carrying of amounts to the decommissioning costs reserve must be based on the total decommissioning costs approved by the Designated Authority in accordance with the contractor's Decommissioning Plan. This includes any revision of the total decommissioning costs estimated to be incurred, provided the Designated Authority approves the revised amount. The amount carried to the reserve is determined under the relevant Production Sharing Contract.

Secondly, sub-article 4 provides that no deduction is to be allowed for amounts carried to the decommissioning costs reserve for any fiscal year prior to 1 January 2008.

The deduction allowed under sub-article 1 is for amounts carried to the decommissioning costs reserve. Sub-article 2 ensures that there is no double deduction when decommissioning costs are actually incurred. In broad terms, there is no deduction for actual costs incurred unless they exceed the amount carried to the reserve.

Sub-article 5 applies if, at any time, the total amount allowed as a deduction under this article exceeds the total approved decommissioning costs. In this case, the amount of the excess is included in the contractor's gross income for the fiscal year in which the excess occurs.

5. Depreciation and Amortization

This article provides for the depreciation of tangible property, and the amortization of intangible property and other expenditure in respect of the petroleum project.

Sub-article 1 applies to the depreciation of tangible property. The effect of the sub-article is that the depreciation rules in Article 11 of the *Law on Income Tax* apply to tangible property acquired by a contractor for use in exploration in respect of a petroleum project subject to the modifications in paragraphs (a)-(d).

Under Article 11 of the *Law on Income Tax*, a taxpayer may use either the diminishing value or straight-line methods of depreciation for tangible property. The depreciation is to be based on the useful life of the asset and is calculated on the basis of pooling of assets. Paragraphs (a) – (d) set out four modifications in the calculation of the amount of depreciation in relation to tangible property -

- (1) Paragraph (a) limits contractors to straight-line depreciation calculated on a single asset basis.
- (2) Paragraph (b) sets out the depreciation rate schedule.
- (3) Paragraph (c) provides that the depreciation of any property acquired before first commercial production commences from the date of first commercial production. This is determined under sub-article 6(a).

- (4) Paragraph (d) provides for the calculation of the amount of depreciation. As stated above, this is straight-line depreciation on a single asset basis.

Sub-article 2 makes equivalent modifications to Article 11A of the *Law on Income Tax* in its application to intangible property used, and other expenditures incurred by a contractor in relation to the petroleum project.

Sub-article 3 provides for the treatment of a terminal loss incurred by a contractor in respect of petroleum activities in Elang Kakutua Kakutua North. If the contractor has undertaken a petroleum project, the undeducted amount of the loss is treated as an amount of notional expenditure incurred by the contractor in respect of the project. The expenditure is treated as having been incurred at the later of the date the Elang Kakutua Kakutua North activities ceased or the date of first commercial production for the Bayu-Undan project. This means that the loss cannot be amortized before the date of first commercial production for the Bayu-Undan project. The expenditure is treated as having a useful life of five years and is amortized under Article 11A of the *Law on income Tax* in calculating the contractor's taxable income for the Bayu-Undan project.

Sub-article 4 provides for apportionment of the amount allowed as a deduction under sub-article 1(d) or 2(d) in the fiscal year of first production. Sub-article 5 provides for an adjustment in the last fiscal year of depreciation or amortization (as defined in sub-article 6(b)) to ensure that relevant asset or expenditure is fully depreciated or amortized.

6. Special Calculation Norm

This article specifies a Special Calculation Norm for the purposes of calculating the taxable income of a permanent establishment of a contractor in certain circumstances.

Article 15 of the *Law on Income Tax* provides that Special Calculation Norms may be specified for the purposes of calculating the net income of certain taxpayers. The Special Calculation Norms apply in priority to the normal rules for the calculation of taxable income under Article 16 of the *Law on Income Tax*.

Sub-article 1 provides that the net income of a permanent establishment of a contractor engaged in oil and gas drilling activities for the petroleum project is 6% of the gross income. Sub-article 2 provides that the net income of a permanent establishment of a contractor engaged in shipping and air service activities for the petroleum project is 2.4% of the gross income. "Gross income" and "permanent establishment" have their meanings in the *Law of Income Tax*. It is expressly provided that the Special Calculation Norm applies for the purposes of calculating the tax instalment payments of the permanent establishment under Article 25 of the *Law on Income Tax*.

7. Estimated Net Income

This Article provides for the calculation of the estimated net income applicable to compensation paid by a contractor for certain services relating to petroleum projects for the purposes of Article 23(1)(c)(2) of the *Law on Income Tax*.

Paragraph (a) applies to compensation paid by a contractor or subcontractor for oil and gas drilling support services, acquired for the petroleum project. It reduces the estimated net income from 30% to 12% of the gross compensation. Tax under Article 23 of the *Law on Income Tax* is withheld at the rate of 15%. This means that the amount to be withheld from such compensation is 1.8% of the gross compensation.

Paragraph (b) applies to compensation paid by a contractor or subcontractor for technical, management, accounting and book-keeping, legal consulting and tax consulting services acquired for the petroleum project. It reduces the estimated net income from 40% to 16% of the gross compensation. Tax under Article 23 of the *Law on Income Tax* is withheld at the rate of 15%. This means that the amount to be withheld from such compensation is 2.4% of the gross compensation.

Paragraph (c) applies to compensation paid by a contractor or subcontractor for rent or other income relating to the use of property for the petroleum project. The estimated net income is reduced to 16%. Tax under Article 23 of the *Law on Income Tax* is withheld at the rate of 15%. This means that the amount to be withheld from such compensation is 2.4% of the gross compensation.

8. Withholding Tax

This article modifies the withholding tax rates applicable to certain items of income.

Sub-article 1 reduces the withholding tax rate applicable under Article 23(1)(c)(3) of the *Law on Income Tax* on royalties paid by a contractor or subcontractor from 15% to 6% of the gross amount of the royalty paid.

Sub-article 2 provides that the withholding tax rates determined under Article 4(2) of the *Law on Income Tax* applicable to compensation for construction services acquired for the project is 0.8% and consulting services is 1.6%.

Sub-article 3 applies to compensation paid by a contractor or subcontractor for services acquired in respect of the petroleum project. It reduces the withholding tax rate under Article 26(1)(c) and (d) of the *Law on Income Tax* for such services from 20% to 8% of the gross amount of compensation. This is subject to sub-article 4, which provides that the withholding tax rate under Article 26(1)(d) applicable to compensation paid to employees is 20%.

9. Branch Profits Tax

This article provides that the branch profits tax in Article 26(4) of the *Law on Income Tax* does not apply to a contractor or subcontractor in respect of income derived from a petroleum project.

10. Value of Gas

This article provides for the valuation of natural gas (as defined in sub-article 2) for the purposes of calculating the taxable income of a contractor in respect of the petroleum project. Paragraph (a) of sub-article 1 provides that the valuation of natural

gas produced and saved, and not used in field operations, is to be made in accordance with the Production Sharing Contract governing the project. Paragraph (b) makes it clear that no deduction is allowed for any export cost charge except to the extent that the charge has not been taken into account in determining the valuation of natural gas produced and saved pursuant to paragraph (a).

11. Imposition of Additional Profits Tax

This article provides for the imposition of additional profits tax (“APT”) on a contractor undertaking the petroleum project.

Sub-article 1 imposes APT on a contractor who has a positive amount of accumulated net receipts for the project for a fiscal year. The accumulated net receipts of a contractor for a fiscal year is calculated according to the formula in article 12. By virtue of article 20, APT is imposed for the fiscal year commencing 1 January, 2002 and subsequent fiscal years.

Sub-article 2 provides for the calculation of the APT payable by a contractor a fiscal year. In broad terms, the APT payable is the accumulated net receipts of the contractor for the year multiplied by 22.5%, with the resulting amount grossed-up by the income tax rate specified in Article 3(3) (i.e., 30%).

Sub-article 3 makes it clear that any APT payable by a contractor for a fiscal year is in addition to the contractor’s ordinary income tax liability for the year.

Sub-article 4 provides that any APT paid by a contractor is a deduction in the calculation of the taxable income of the contractor for the fiscal year in which the APT is paid.

12. Accumulated Net Receipts

This Article provides for the calculation of the accumulated net receipts of a contractor for the petroleum project.

Sub-article 1 provides that the contractor’s accumulated net receipts for a fiscal year is calculated according to the specified formula. Component **A** is the contractor’s accumulated net receipts at the end of the previous fiscal year. Sub-article 2 provides that the amount of component **A** for a fiscal year is zero if the contractor paid APT for the previous fiscal year. This means that component **A** will always be either zero or a negative amount. Sub-article 4 provides a transitional measure for a contractor under Production Sharing Contracts JPDA 03-12 and 03-13. Component **A** of the formula for the fiscal year commencing on 1 January, 2002 (i.e., the first fiscal year of the APT) is to be calculated on the basis that the accumulated net receipts of the contractor as at 25 October, 1999 was negative \$233 million. The contractor is to notionally apply the formula in sub-article 1 for the period 25 October, 1999 – 31 December, 2001. The resulting amount is treated as component **A** of the formula for the fiscal year commencing 1 January, 2002,

Component **B** is the contractor’s net receipts for the current fiscal year. This is calculated in accordance with Article 13.

Component **I** is the total of any interest or other financial charges paid by the contractor for the current fiscal year. It is entered as a negative amount. Sub-article 3 provides that where component $(A \times 116.5\%)$ is negative for a fiscal year, the subtraction of component $I(1-r)$ for that year is not to reduce the amount of $((A \times 116.5\%) - I(1-r))$ to an amount that is less than component **A**. For example, if **A** is \$200m for a fiscal year, then the amount entered in the formula for the year as $I(1-r)$ is not to exceed \$33m. The amount of any excess is not carried forward or carried back to any fiscal year.

Component **r** is the corporate tax rate specified in Article 3(3).

13. Net Receipts

This article provides for the calculation of the net receipts of a contractor for a petroleum project for a fiscal year. The net receipts are the gross receipts of the contractor for the year less the total deductible expenditure of the contractor for the year. The gross receipts of the contractor are calculated in accordance with Article 14 and the total deductible expenditure is calculated in accordance with Article 15. It is expressly provided that the net receipts of a contractor for a fiscal year may be negative.

The net receipts of a contractor for a fiscal year is component **B** of the formula in article 12 for that year.

14. Gross Receipts

This article provides for the calculation of the gross receipts of a contractor for a fiscal year for the petroleum project. It is relevant to the calculation of the contractor's net receipts for the project for the year under Article 13.

Sub-article 1 provides that the gross receipts of a contractor for a fiscal year for the project is the sum of the following amounts –

- (1) Paragraph (a) includes the gross income of the contractor received in the fiscal year for the project. The reference to “gross income” is a reference to the concept of gross income that forms the basis for the computation of taxable income under Article 6 of the *Law on Income Tax*. This is basically the sum of the amounts specified in Article 4 of the *Law on Income Tax*. It is expressly provided that the contractor's gross income includes any amounts received from the hiring or leasing out of, or the granting of rights to use property. It is also expressly provided that gross income for the purposes of calculating gross receipts does not include the contractor's interest income.
- (2) Paragraph (b) includes the consideration received by the contractor in the year for the disposal, destruction or loss of any property used in the project where the expenditure incurred in acquiring the property was deducted under article 15 in calculating the net receipts of the contractor for any fiscal year. “Property” is to be interpreted broadly. It expressly includes any materials, equipment, plant facilities and intellectual property or rights.

- (3) Paragraph (c) includes the consideration received by the contractor in the year from the provision of information or data obtained from any survey, appraisal or study relating to the project where the expenditure incurred in undertaking the survey, appraisal or study was deducted under article 16 in calculating the net receipts of the contractor for any fiscal year.
- (4) Paragraph (d) includes the total of any other amounts received by the contractor in the year that is a reimbursement, refund or other recoupment of an amount previously deducted in computing the net receipts of the contractor for any fiscal year.
- (5) Paragraph (e) includes the consideration received in respect of property includes any compensation, indemnity or damages received by the contractor for the loss or destruction of the property.

Sub-article 2 provides that the gross receipts of a contractor does not include any amount received as consideration for the transfer of an interest in the petroleum project. This is subject to Article 16.

Sub-article 3 provides for apportionment of any amount derived or received that is only partly attributable to a petroleum project.

15. Deductible Expenditure

This Article provides for the calculation of the total deductible expenditure of a contractor for a fiscal year for the petroleum project. It is relevant to the calculation of the contractor's net receipts for the project for the year under Article 14.

Sub-article 1 provides that the total deductible expenditure of a contractor for a fiscal year for the project is the sum of the following amounts –

- (1) Paragraph (a) includes the total of amounts incurred in the year by the contractor in respect of the project and allowed as a deduction under Article 6 of the *Law on Income Tax* in calculating the taxable income of the contractor. It is expressly provided that this includes interest expense and financing charges. Paragraph (a) does not include depreciation and amortization deductions as the full amount of the expenditure is deductible under paragraph (b).
- (2) Paragraph (b) includes the total capital expenditure incurred by the contractor in the year in acquiring assets (tangible and intangible) for use in the project.
- (3) Paragraph (c) includes the total exploration expenditure incurred by the contractor in the year in respect of the project.
- (4) Paragraph (d) includes the East Timor income tax of the contractor for the year calculated by applying the corporate specified in Article 3(3) (i.e., 30%) to the taxable income of the contractor for the year computed before allowance of the deduction of APT.

Sub-article 2 provides that the deductible expenditure of a contractor does not include any amount incurred as consideration for the transfer of an interest in the petroleum project. This is subject to Article 16.

Sub-article 3 provides for apportionment of any amount paid that is only partly attributable to a petroleum project.

16. Transfer of Interest in a Petroleum Project

This Article applies where a contractor disposes of its interest in a petroleum project. In this case, the transferee contractor takes over the transferor's gross receipts and deductible expenditure for the fiscal year in which the transfer takes place calculated as at the date of the transfer. The transferee contractor also takes over the transferor's component A of the formula in article 13 for the fiscal year in which the transfer takes place.

17. Procedure Relating to Additional Profits Tax

This article provides for procedural matters relating to the imposition of APT.

Sub-articles 1 and 2 oblige a contractor to lodge an APT return for a fiscal year. The return must be lodged by the same date as the contractor's annual income tax return for the year. According to Article 3 of the *Law on General Tax Provisions and Procedures*, this is three months after the end of the fiscal year.

Sub-article 3 provides that a contractor's APT for a fiscal year is due and payable on the same date as the contractor's income tax is due and payable for that year. APT is collected in instalments as determined under Article 18.

Sub-article 4 provides that the procedural rules in the *Law on General tax Provisions and Procedures* (as amended by *UNTAET Regulation No. 2000/18*) apply for the purposes of the assessment and collection of APT and any additional tax imposed in relation to an APT liability, and for appeals against a contractor's assessed liability for APT or additional tax.

Sub-article 5 provides that Chapter XI of *UNTAET Regulation No. 2000/18* applies for the purposes of APT. The combined operation of sub-article 5 and Chapter XI of *UNTAET Regulation No. 2000/18* results in the imposition of additional tax in the following cases –

- (1) A failure to lodge an APT return by the due date.
- (2) A failure to pay APT or an instalment of APT by the due date.
- (3) An understatement of the amount of APT declared in an APT return.
- (4) A failure to create and retain records for the purposes of APT.

The combined operation of sub-article 5 and Chapter XI of *UNTAET Regulation No. 2000/18* also results in the following offences –

- (1) A failure to create and retain records for the purposes of APT.
- (2) Obstructing or hindering the Commissioner in enforcing APT.
- (3) A failure to provide information or the provision of false information concerning APT.
- (4) Evasion of APT.

18. Instalments of Tax

This article provides for the payment of APT by instalments.

Sub-article 1 provides for monthly instalments of APT. Each instalment is due on the 15th day after the end of the month. The first instalment for the fiscal year is for the month of January and is due on 15 February. If that date is not a business day, then the APT is due on the next business day. This treatment mirrors that applicable to the payment of the ordinary income tax.

Sub-article 2 obliges a contractor to deliver to the Commissioner an estimate of contractor's additional profits tax liability for a fiscal year by the payment date of the first instalment for that year (i.e., 15 February). The amount of each instalment is one-twelfth of the estimate.

Sub-article 3 provides that the estimate remains in force for the whole of the fiscal year unless the contractor delivers a revised estimate to the Commissioner. A revised estimate applies to instalments due both before and after the revised estimate was delivered to the Commissioner. The sub-article also provides for the treatment of underpaid and overpaid tax as a result of a revised estimate.

Sub-article 4 provides that the Commissioner is to estimate the APT payable by a contractor for a fiscal year where the contractor fails to deliver an estimate as required under sub-article 2. The Commissioner's estimate remains in force for the whole of the year unless the contractor revises the Commissioner's estimate in accordance with sub-article 3.

Sub-article 5 provides for the imposition of additional tax where the contractor's APT estimate for a year is less than 90% of the actual APT payable by the contractor for the year.

19. Regulations

This article provides that the Minister responsible for finance has the power to make regulations for the effective carrying out of the provisions of the act.

20. Entry into Force and Application

This article provides that the Act enters into force upon satisfaction of the conditions specified in sub-article 1. APT applies for the fiscal year commencing on 1 January, 2002 and subsequent fiscal years.