

**LAW No. 8/2005
Of 3 August**

PETROLEUM TAXATION LAW

PREAMBLE

According to international law, Timor-Leste has sovereign rights for the purpose of exploring, exploiting and managing its natural resources, including its petroleum resources. The right to tax petroleum activities is, therefore, one of the manifestations of such sovereign rights.

The Petroleum Taxation Law sets out a specific taxation regime for petroleum activities. It applies to petroleum activities authorized and regulated under Timor-Leste's Law on Petroleum Activities. It also applies to 90 percent of the petroleum activities authorised and regulated under the Timor Sea Treaty, with the exception of those activities to which Annex F to the Timor Sea Treaty refers.

Thus, pursuant to Section 95.1, paragraph p) of Section 95.2, Section 139.2 and Section 144 of the Constitution of the Republic, the National Parliament enacts the following to have the force of law:

CHAPTER I – GENERAL PROVISIONS

**Article 1
Short Title**

This Law may be cited as the Petroleum Taxation Law.

Fo.0001 Tc0.3141 Tt4 TD0.1ublic9(7355 Twkation)5.50

“Contract Area” means the area that is the 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 as originally granted;

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

“Crude Oil” means 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 by the Ministry or Designated Authority, as the case may be, under a Petroleum Agreement;

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

“Head Office Expenditures” means any executive, management, or general administration expenditures incurred by a

“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

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

CHAPTER III – PETROLEUM TAX REGIME

Article 4 Taxation of Contractors

A Contractor, a Subcontractor and any person receiving an amount for goods or services supplied to a Contractor or Subcontractor, are subject to tax in accordance with Timor-Leste Taxation Law, subject to the modifications in this Law.

CHAPTER IV – VALUE ADDED TAX

Article 5 Value Added Tax

The valued added tax that Timor-Leste is permitted to impose under the Timor Sea Treaty in the Joint Petroleum Development Area continues to apply in the Joint Petroleum Development Area.

CHAPTER – INCOME TAX

Article 6 Rate of Tax and Exclusions

- 6.1 The rate of corporate tax applicable to a Contractor for a tax year is thirty percent (30%).
- 6.2 The minimum income tax imposed under Section 36A of UNTAET Regulation No. 2000/18 does not apply to a Contractor.
- 6.3 Section 26(4) of the Law on Income Tax does not apply to a Contractor.
- 6.4 A Contractor shall not derive any income or capital gain or incur any loss for income tax purposes as a result of a decision by Timor-Leste under Article 22 of the Law on Petroleum Activities to participate in Petroleum Operations through a State-Owned Contractor.

Article 7 Limitation on Deductions

- 7.1 Subject to Subarticle 7.4, any amount that a Contractor may deduct under Timor-Leste Taxation Law in relation to Petroleum Operations undertaken by the Contractor in a Contract Area in a tax year is deductible only against the gross income arising from such Petroleum Operations in the Contract Area in that year.

7.2 If, in any tax year, the total deductions of a Contractor in relation to Petroleum Operations undertaken in a Contract Area exceeds the total gross income arising from those Petroleum Operations in the Contract Area, the excess is carried forward to the next following tax year and deductible in that year against gross income arising from such Petroleum Operations in the Contract Area.

7.3 Any amount not deducted under Subarticle 7.2 is carried forward to the next following tax year and deductible in that year in accordance with Subarticle 7.2, and so on until the excess is fully deducted or the Petroleum Operations in the Contract Area cease.

7.4 If a Production Sharing Contract (referred to as the “original PSC”) relating to the Joint Petroleum Development Area entered into or awarded to a Contractor prior to the coming into force of this Law is terminated and a new Production Sharing Contract (referred to as the “successor PSC”) is entered into with the same Contractor, any loss carry-forward of the Contractor under this Article at the time of termination for the Contract Area covered by the original PSC is deductible in the first tax year of the Contractor for the Contract Area covered by the successor PSC provided:

(a) The whole of the geographic area covered by the Contract Area of the successor PSC is within the Contract Area of the original PSC; and

(b) The successor PSC entered into force immediately following the termination of the original PSC.

Article 8 Interest Deduction

Section 16 of UNTAET Directive No. 2001/2 applies to a Contractor on the basis that the reference to “fifty percent (50%) is a reference to “twenty five percent (25%).

Article 9 Allocation of Expenditures

If a Contractor is a non-resident person with a Timor-Leste permanent establishment, the amount of Head Office Expenditures deductible under Section 26.2(b) of UNTAET Directive No. 2001/2 for a tax year shall not exceed two percent (2%) of the total deductible expenditures (other than expenditures giving rise to depreciation and amortisation deductions) of the permanent establishment for the year excluding Head Office Expenditures.

Article 10 Decommissioning Costs Reserve and Decommissioning Expenditure

10.1 Notwithstanding Section 12 of UNTAET Directive No. 2001/2, the amount that a Contractor carries to the decommissioning costs reserve for a tax year in respect of Petroleum Operations is deductible in calculating the Contractor’s taxable income for that

year. An amount is first deductible under this Article in the tax year in which estimates of the monies required for funding of a Decommissioning Plan are first charged as a

- 11.5 Notwithstanding Sections 10 and 11 of UNTAET Directive No. 2001/2, a depreciable asset acquired, created, or constructed by a Contractor before commercial production is depreciated from the commencement of commercial production. Commercial production commences on 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 the thirty-day period reaches a level of regular production delivered for sale determined by the Commissioner, with the advice of the Ministry or Designated Authority, as the case may be.
- 11.6 In the tax year in which commercial production commences, the amount of the depreciation deduction in respect of a depreciable asset acquired, created, or constructed by a Contractor before commercial production is calculated according to the following formula:

$$A \times B/C$$

where:

- A** is the depreciation deduction if commercial production commenced on the first day of the tax year;
- B** is the number of days from the date of commencement of commercial production to the end of the tax year in which commercial production commences; and
- C** is the number of days in the tax year.

Article 12

Small Field Depreciation and Amortisation

- 12.1 This Article applies to a Contractor if, under the Development Plan for Petroleum Operations, eighty percent (80%) or more of the Reserves is estimated to be produced within five (5) years of the date of commencement of commercial production as determined under Subarticle 11.5. The estimate of Reserves must be approved by the Ministry or Designated Authority, as the case may be.
- 12.2 A Contractor to whom this Article applies may elect for depreciable assets or intangibles (including Exploration Expenditure and Development Expenditure) to be depreciated or amortised under the units of production method.
- 12.3 The depreciation of depreciable assets and amortisation of intangibles for a tax year under the units of production method is calculated according to the following formula:

$$A \times B$$

where -

- A** is the cost of the asset reduced by the total depreciation or amortisation deductions in respect of the asset or intangible in previous tax years; and

- 14.4 In this Article, the price payable is the price that would be payable by the buyer if the petroleum were delivered by the Contractor and taken by the buyer, without set-off, counterclaim or other withholding of any nature.

Article 15 Withholding Tax

- 15.1 A Contractor or Subcontractor paying or making available an amount of Timor-Leste source services income to a person (other than as an employee) for services acquired for Petroleum Operations shall withhold tax from the payment at the rate of 6% of the gross amount paid.
- 15.2 Services income is Timor-Leste source services income if the income is paid by a resident person or a Timor-Leste permanent establishment of a non-resident person.
- 15.3 If a lump sum amount is paid for services and goods, the amount shall be treated as paid for services to the extent that the Commissioner considers reasonable having regard to all the circumstances.
- 15.4 If an amount described in Subarticle 15.1 has been correctly subject to withholding tax under this Article, the tax withheld is a final tax on the income of the recipient represented by the payment and:
- (a) no further income tax liability is imposed upon the recipient in respect of the gross income to which the tax relates;
 - (b) that gross income is not aggregated with the other gross income of the recipient for the purposes of ascertaining the recipient's taxable income; and
 - (c) there is no deduction (including a depreciation or amortisation deduction) for any expenditure or loss incurred in earning the gross income.
- 15.5 Section 34 of UNTAET Directive No. 2001/2 applies to an amount withheld or required to be withheld under this Article.
- 15.6 Sections 28 and 30 of UNTAET Directive No. 2001/2, and Article 15 and Subarticle 23.2 of the Law on Income Tax do not apply to any amounts to which this Article applies.
- 15.7 Section 29 of UNTAET Directive No. 2001/2 does not apply to dividends paid by a resident Contractor out of profits arising from Petroleum Operations and such dividends are exempt from income tax.

Article 16 Instalments of Tax

for the whole of the Contractor's first tax year unless revised by the Contractor in accordance with Subarticle 16.6.

- 16.8 If a Contractor's estimate (including any revised estimate) of income tax for the Contractor's first tax year is less than ninety percent (90%) of the Contractor's assessed income tax liability for that year (the difference is referred to as the "tax shortfall"), the Contractor is liable for a penalty equal to:
- (a) if the under-estimate is due to fraud or wilful neglect, fifty percent (50%) of the tax shortfall; or
 - (b) in any other case, ten (10%) percent of the tax shortfall.
- 16.9 No penalty is imposed under paragraph 16.8(b) if the Commissioner is satisfied that the reason for the tax shortfall was due to circumstances beyond the Contractor's control (such as a significant price fluctuation) and the Contractor took all reasonable care in making the estimate.
- 16.10 Instalments of income tax paid by a Contra

17.4 Supplemental Petroleum Tax paid by a Contractor is deductible in calculating the taxable

- (a) the gross income for income tax purposes accrued by the Contractor in the year from Petroleum Operations, 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, cession, destruction, or loss of any property (including materials, equipment, plant, facilities, and intellectual property or rights) used in Petroleum Operations if the expenditure incurred in acquiring the property was deducted in computing the net receipts of the Contractor for any tax 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 Petroleum Operations if the expenditure incurred in undertaking the survey, appraisal, or study was previously deducted in computing the net receipts of the Contractor for any tax 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 any tax year; and
- (e) If property used in Petroleum Operations 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.

20.2 Notwithstanding Subarticle 20.1, and subject to Article 22, the gross receipts of a Contractor do not include any amount received or accrued as consideration for the transfer of rights or interest in Petroleum Operations.

20.3 If an amount referred to in Subarticle 20.1 is attributable to Petroleum Operations and some other activity of the Contractor, only that portion that relates to the Petroleum Operations is included in the gross receipts of the Contractor in calculating the net receipts of the Petroleum Operations.

Article 21

Deductible Expenditure

21.1 Subject to Subarticle 21.2, the total deductible expenditure of a Contractor for Petroleum Operations for a tax year is the sum of the following amounts:

- (a) any expenditure incurred by the Contractor in the year in respect of the Petroleum Operations and deductible (other than as a depreciation or amortisation deduction) in computing taxable income, including interest and

- (b) any capital expenditure by the Contractor in the year in acquiring or constructing a tangible or intangible asset for use in Petroleum Operations;
- (c) any exploration expenditure incurred by the Contractor in the year in respect of

22.3 In this Article, “transferred percentage factor” means the transferor Contractor’s percentage

shall deliver to the Commissioner an estimate of Supplemental Petroleum Tax for a tax year by the due date for payment of the first instalment for the year.

- 24.3 An estimate delivered under Subarticle 24.2 remains in force for the whole of the tax year unless the Contractor delivers a revised estimate to the Commissioner. A revised estimate applies for a tax year to the calculation of instalments of Supplemental Petroleum Tax for that year 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 applied against future Supplemental Petroleum Tax instalments due.
- 24.4 If a Contractor fails to deliver an estimate of Supplemental Petroleum Tax as required under Subarticle 24.2, the estimated Supplemental Petroleum 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 tax year unless revised by the Contractor in accordance with Subarticle 24.3.
- 24.5 If a Contractor's estimate (including a revised estimate) of Supplemental Petroleum Tax for a tax year is less than ninety percent (90%) of the Contractor's assessed Supplemental Petroleum Tax liability for that year (the difference is referred to as the "tax shortfall"), the Contractor is liable for a penalty equal to:
- (a) if the under-estimate is due to fraud or wilful neglect, fifty percent (50%) of the tax shortfall; or
 - (b) in any other case, ten percent (10%) of the tax shortfall.
- 24.6 No penalty is imposed under paragraph 24.5(b) if the Commissioner is satisfied that the reason for the tax shortfall was due to circumstances beyond the Contractor's control (such as a significant price fluctuation) and the Contractor took all reasonable care in making the estimate.

CHAPTER VII – FINAL PROVISIONS

Article 25 Regulations

The Minister responsible for finance shall make regulations for the effective carrying out of the provisions of this Law, including regulations of a saving or transitional nature consequent upon the making of this Law.

Article 26
Entry into Force and Application

- 26.1 This Law applies for tax years commencing on or after January 1, 2005.
- 26.2 This Law enters into force on the day following the date of its publication in the Official