



DIRECTIVE NO. 2001/2

**ON THE CALCULATION OF TAXABLE INCOME OF TAXPAYERS AND
ADMINISTRATIVE MATTERS RELATING TO THE INCOME TAX**

The Special Representative of the Secretary-General (hereinafter: Transitional Administrator),

Pursuant to the authority given to him under United Nations Security Council resolution 1272 (1999) of 25 October 1999,

Taking into account United Nations Transitional Administration in East Timor (UNTAET) Regulation No. 1999/1 of 27 November 1999 on the Authority of the Transitional Administration in East Timor,

Pursuant to UNTAET Regulation No. 2000/18 of 30 June 2000 (as amended) on a Revenue System for East Timor, and in order to give guidance to persons regarding the income tax provisions referred to in section 34.1 of that Regulation

Promulgates the following:

Part I	Interpretation
Part II	Tax Subjects
Part III	Taxable Income
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Part V	International
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Part VII	Administration
Part VIII	Commencement and Transitional Rules

PART I
INTERPRETATION

Section 1
Definitions

In the present Directive:

“associate” has the meaning in Section 2;

“bank” means any legal person in the business of accepting deposits from the public in East Timor 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;

“business activities” means any commercial, industrial, or handicraft undertaking, the conduct of a profession, or any other work rendering an income (including every service activity referred to in Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18), or the leasing of movable or immovable property, but does not include any employment in East Timor;

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

“debt obligation” means the obligation to make a repayment of money to another person, including accounts payable and the obligations arising under promissory notes, bills of exchange, and bonds;

“dividend” means any distribution of profits by a legal person to another person as a result of participation in the capital of the legal person;

“East Timor”, when referring to a geographic area, means the territory of East Timor and its territorial waters, the economic zone off the coast of East Timor recognized under the law of the sea and, to the extent allowed by treaty or the Memorandum of Understanding dated 10 February 2000 between UNTAET, acting on behalf of East Timor, and the Government of Australia on arrangements relating to the Timor Gap, in the area covered by that Memorandum;

“East Timor-source income” has the meaning in Section 3;

“employment in East Timor” has the meaning in Section 3 of UNTAET Regulation No. 2000/18;

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

“foreign-source income” has the meaning in Section 3;

“government” includes the East Timor Transitional Administration (ETTA) or its successor as may be provided in UNTAET regulations and a government of a foreign country;

“interest” means:

- (a) any amount (including a premium or discount) paid or accrued under a debt obligation that is not a repayment of capital; or
- (b) any amount that is functionally equivalent to an amount referred to in paragraph (a), such as an amount paid or accrued under an interest rate swap agreement or as defaulted interest under a guarantee agreement;

“International Accounting Standards” means the most recent International Accounting Standards issued by the International Accounting Standards Committee;

“international agreement” means a double taxation convention having force of law in East Timor;

“legal person” means:

- (a) any body incorporated, formed, organized, or established in East Timor or elsewhere as a limited company, limited partnership, other partnership, affiliation, association, firma, kongsi, cooperative, foundation, trust or similar organization, institute, or any other forms of business or non-governmental organization; or
- (b) a government, a political or administrative subdivision of a government in whatever name or form, or a public international organization;

“natural person” means any individual;

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

“non-resident” means any person who is not a resident of East Timor;

“person” means any natural or legal person;

“resident” means:

- (a) a natural person who is present in East Timor for more than 182 days in a tax year, unless the person’s permanent place of abode is not in East Timor;
- (b) an undivided estate of a natural person who was a resident immediately before death;

(c) a legal person incorporated, formed, organized, or established in East Timor; or

(d) the East Timor Transitional Administration (ETTA) or its successor as may be provided in UNTAET regulations, or any political or administrative subdivision of that Administration;

“royalty” means any amount paid or payable, however described or computed, whether periodical or not, as consideration for:

(a) the use of or right to use any copyright, patent, design or model, secret formula or process, trademark, or other like property or right;

(b) the use of 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 industrial, commercial, or scientific equipment;

(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 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);

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

“taxable business activities” means business activities giving rise to income.

Section 2 **Associate**

- 2.1 For the purposes of the definition of “associate” in Section 3 of UNTAET Regulation No. 2000/18 and this Directive, the two persons referred to in that definition are treated as associates of each other. Two persons are also treated as associates if both persons act or are likely to act in accordance with the wishes of a third person. Two

persons are not treated as associates solely by reason that one person is the employer of the other person.

2.2 Without limiting the generality of Section 2.1, the following are treated as associates for the purposes of UNTAET Regulation No. 2000/18 and this Directive:

- (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 persons if a third person owns directly or indirectly 50% or more, by value or number, of the capital or voting rights in each legal person.

2.3 For the purposes of Section 2.2, “relative” means, in relation to a natural person:

- (a) an ancestor, a descendant of any of the grandparents, or an adopted child of the person or of the spouse of the person; or
- (b) a spouse of the person or of any person referred to in paragraph (a).

Section 3 **Source of Income**

3.1 An amount is East Timor-source income to the extent to which the amount is:

- (a) income from business activities carried on:
 - (i) by a resident in East Timor; or
 - (ii) by a non-resident through a permanent establishment in East Timor as determined under section 26;
- (b) income from the alienation of any movable property used in deriving East Timor-source income referred to in paragraph (a);
- (c) income from the lease of immovable property in East Timor whether improved or not, or from any other interest in or over immovable property, including a right to explore for, or exploit, natural resources, in East Timor;
- (d) income from the alienation of any property or right referred to in paragraph (c) 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 (c);
- (e) a dividend paid by a resident legal person; or
- (f) interest, royalties, a management fee, annuity, or any other income paid by a resident or borne by a permanent establishment in East Timor of a non-resident.

- 3.2 Notwithstanding Section 3.1, any amount taxable in East Timor under an international agreement is East Timor-source income.
- 3.3 Income is foreign-source income to the extent to which it is not East Timor-source income.

PART II TAX SUBJECTS

Section 4 Tax Subjects

The following are Tax Subjects for the purposes of the income tax:

- (a) a natural person;
- (b) an undivided estate as a unit in lieu of the beneficiaries;
- (c) a limited company incorporated in East Timor;
- (d) any other public or private legal person that has been incorporated, formed, organized, or established in East Timor, including an enterprise owned by the East Timor Transitional Administration (ETTA) or its successor as may be provided in UNTAET regulations or a political or administrative subdivision of that Administration, a limited partnership, other partnership, affiliation, association, firma, kongsi, cooperative, a foundation or similar organization, institute, or any other forms of business or non-governmental organization;
- (e) any legal person founded under a foreign law and organized in a manner comparable to entities or bodies referred to in paragraphs (c) or (d) above, including a trust; or
- (f) any other body of persons formed under foreign law.

PART III TAXABLE INCOME

Section 5 Jurisdiction to Tax

- 5.1 The Tax Object of a resident Tax Subject includes all income wherever arising.
- 5.2 The Tax Object of a non-resident Tax Subject includes only East Timor-source income.

Section 6

Exempt Income

For the purposes of Section 39 of UNTAET Regulation No. 2000/18, the reference to “\$20,000” is a reference to a “taxable income of \$20,000”.

Section 7

Taxable Income from the Conduct of Business Activities

The determination of the gross income and deductions of a taxpayer from the conduct of business activities for a tax year shall be based on the taxpayer’s net profit for financial accounting purposes for the year prepared in accordance with the International Accounting Standards (other than IAS 39), and subject to the modifications in this Directive. A taxpayer’s net profit shall include the results of all business activities conducted by the taxpayer during the tax year, including the alienation of any asset in the course of, or at the end of, those activities.

Section 8

Basis of Accounting

- 8.1 Subject to Section 8.2, every taxpayer shall account for income tax on an accrual basis.
- 8.2 A taxpayer whose annual gross turnover is less than \$US100,000 may account for income tax on either a cash or accruals basis.
- 8.3 If a taxpayer’s basis of accounting has changed as a result of the operation of Section 8.2, the taxpayer shall make adjustments to items of income, deduction, or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.
- 8.4 A taxpayer accounting for income tax on a cash basis recognizes income when it is received or made available to the taxpayer and incurs expenses when paid.
- 8.5 A taxpayer accounting for tax on an accrual basis recognizes income when it is receivable and incurs an expense when it is payable.
- 8.6 Subject to this Directive, an amount is receivable by a taxpayer when the taxpayer becomes entitled to receive it even if the time for discharge of the entitlement is postponed or the entitlement is payable by instalments.
- 8.7 Subject to this Directive, an amount is payable 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 occurs. Economic performance occurs:
 - (a) in the case of acquisition of services or assets, at the time the services or assets are provided;

- (b) in the 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 9 **Inventory**

- 9.1 Inventories shall be measured at cost. Cost shall be determined according to the absorption-cost method.
- 9.2 Where particular items of inventory are not readily identifiable, a taxpayer may account for inventory under the first-in-first-out or weighted average cost method. A taxpayer may change its inventory recognition method only with the written permission of the Commissioner and subject to any conditions that the Commissioner may impose to ensure that no item is omitted and no item is taken into account more than once.

Section 10 **Depreciation**

- 10.1 A taxpayer shall be allowed a deduction for the depreciation of the taxpayer's depreciable assets and business buildings during the tax year in accordance with this section.
- 10.2 A taxpayer's depreciable assets and business buildings are depreciable assets and business buildings:
 - (a) owned by the taxpayer; or
 - (b) used and controlled by the taxpayer if the owner is not allowed a deduction in the tax year for depreciation of the assets or business buildings
- 10.3 The acquisition or construction costs, and the cost of improvement, renewal, and reconstruction, of business buildings shall be depreciated individually on a straight-line basis at the rate specified in Part A of Schedule I. The cost of a business building does not include the cost of the land on which the building is situated.
- 10.4 Depreciable assets may be depreciated either individually on a straight-line basis or under a pooling system on a declining balance basis. The same method of depreciation shall apply to all depreciable assets of a taxpayer. A taxpayer may change its method of depreciation only with the written permission of the Commissioner and subject to any conditions that the Commissioner may impose with respect to the change. The classification of assets into pools and the specification of the straight-line and declining balance depreciation rates are in Part B of Schedule I.
- 10.5 The depreciation deduction for each depreciation pool for a tax year shall be calculated by applying the depreciation rate for the pool to the written down value of the pool at the end of the tax year. The written down value of a depreciation pool at

the end of a tax year shall be the written down value at the end of the previous tax year (after allowing for the deduction under this section for that year):

(a) increased by the capital cost of depreciable assets in the pool, during the tax year; and

(b) decreased by the consideration received or receivable for assets in the depreciation pool alienated during the tax year, including any compensation received for the loss of such assets due to natural calamities or other involuntary disposals.

- 10.6 Where the written down value at the end of a tax year of a depreciation pool is a negative amount, that amount shall be included in the income of the taxpayer for the year, and the written down value of the pool shall be zero.
- 10.7 Where the written down value at the end of a tax year of a depreciation pool is less than \$US100, a further deduction for the tax year shall be allowed equal to the amount of that written down value. The written down value of the pool at the end of the tax year shall be zero.
- 10.8 If all the depreciable assets in a depreciation pool are alienated before the end of the tax year, a deduction shall be allowed for the amount of the written down value (if any) of the pool at the end of the year. The written down value of the pool at the end of the tax year shall be zero.
- 10.9 Where a depreciable asset is acquired to be used only partly in the conduct of taxable business activities and partly for another purpose, the capital cost of the asset to be included in a depreciation pool shall be proportionately reduced.
- 10.10 If a taxpayer revalues a business building or depreciable asset, no depreciation deduction shall be allowed for the amount of the revaluation.
- 10.11 The following rules apply to a depreciable asset depreciated on a straight-line basis and to a business building:
- (a) where the cost of a depreciable asset is less than \$100, the depreciation deduction in the year that the asset is acquired is equal to the cost of the asset and no depreciation deduction is allowed for that asset in a subsequent year;
- (b) the cost of an improvement, renewal, or reconstruction of a depreciable asset or business building shall be treated as the cost of a new asset with a useful life equal to the original useful life of the asset or building;
- (c) where the depreciable asset or business building is used only partly in the conduct of taxable business activities and partly for another purpose, the amount of depreciation allowed as a deduction shall be reduced by the proportion of the non-business use;
- (d) where the depreciable asset or business building is acquired and put in service in the conduct of taxable business activities in a tax year, the amount of depreciation allowed as a deduction in that year is reduced by a fraction equal to the fraction of the year prior to the time the asset or building was put in service and the amount reduced

shall be allowed as a deduction in the year after the asset or building has been depreciated; and

(e) where the depreciable asset or business building is alienated by a taxpayer, the cost of the asset or building shall be reduced by the depreciation deductions allowed under this section.

10.12 In this section:

“business building” means any building used wholly or partly in the conduct of taxable business activities;

“capital cost” of a depreciable asset in a pool means:

(a) in the case of an asset acquired during the tax year, a fraction of the cost of acquisition equal to the fraction of the year from the time the asset is put in service in the conduct of taxable business activities until the end of the year;

(b) in the case of an asset added to the pool in the preceding year, the fraction of the cost of acquisition not treated as capital cost in the previous year; and

(c) for any asset in the pool, the cost of improvement, renewal, and reconstruction of the asset to the extent the cost is not otherwise deducted; and

“depreciable asset” means any tangible movable property of a taxpayer that:

(a) has a useful life exceeding one year;

(b) is likely to lose value as a result of wear and tear, exploitation, or obsolescence; and

(c) is used wholly or partly in the conduct of taxable business activities.

Section 11 **Amortization of Intangibles**

11.1 A taxpayer is allowed a deduction for the amortization of the taxpayer’s intangibles during the tax year in accordance with this section.

11.2 The acquisition or creation cost, and the cost of improvement or renewal, of intangible assets for use by a taxpayer shall be amortized individually on a straight-line basis at the relevant rate specified in Part C of Schedule I .

11.3 The amount of any intangible expenditure with a useful life exceeding one year incurred by a taxpayer in the conduct of taxable business activities shall be amortized individually on a straight-line basis at the rate specified in Part C of Schedule I.

- 11.4 Where an intangible asset or expenditure is used only partly in the conduct of taxable business activities, the amount allowed as a deduction under this section shall be reduced by the proportion of the non-business use. Where an intangible asset or expenditure is used only for part of the tax year in the conduct of taxable business activities, the amount allowed as a deduction shall be reduced by the proportion of the tax year that the asset was not used in the conduct of taxable business activities.
- 11.5 Where an intangible asset has been alienated by a taxpayer during a tax year, the cost of the asset shall be reduced by any deductions allowed under this section in respect of the asset.
- 11.6 Expenditures with a useful life of more than one year incurred before the commencement of taxable business activities shall be capitalized and amortized individually on a straight-line basis at the rate specified in Part C of Schedule I. Examples of such expenditures include the cost of feasibility studies, construction of prototypes, and trial production activities. This section does not apply to the cost of acquiring land, or to expenditures depreciated or amortized under Section 10 or under another provision of this section.
- 11.7 In this section:

“intangible asset” means any property (other than tangible movable property or immovable property) that:

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

“intangible expenditure” means any expenditure incurred other than in the acquisition of any tangible or intangible movable or immovable property.

Section 12 **Reserves**

- 12.1 Subject to this section, no deduction shall be allowed for any amount retained by a taxpayer from profits to create a reserve or provision for expected expenses or losses.
- 12.2 A bank shall be allowed a deduction for its provision for doubtful debts provided the amount of the provision has been determined in accordance with the prudential requirements prescribed by instruction of the Central Payments Office under Section 26 of UNTAET Regulation No. 2000/8.

Section 13 **Bad Debts**

- 13.1 A taxpayer shall be allowed a deduction in a tax year for a bad debt if the following conditions are satisfied:

- (a) the amount of the debt was previously included in the taxable income of the taxpayer;
 - (b) the debt is written off in the accounts of the taxpayer during the tax year; and
 - (c) the taxpayer has reasonable grounds for believing that the debt will not be recovered.
- 13.2 This section shall not apply to a bank entitled to a deduction for its provision for doubtful debts under Section 12.2.

Section 14 **Long-term Contracts**

- 14.1 Subject to this Directive, the percentage-of-completion method shall apply in determining the annual profit arising from a long-term contract.
- 14.2 A “long-term contract” is a contract for manufacture, installation, 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.

Section 15 **Finance Leases**

- 15.1 A finance lease shall be treated as a sale and purchase of the leased asset. The lessor is treated as having made a loan to the lessee equal to the purchase price of the asset and the lessee is treated as the owner of the asset. Each payment by the lessee to the lessor is treated as in part a repayment of principal and in part a payment of interest. The interest part shall be calculated on the principal outstanding at the time each payment is made.
- 15.2 A lease is a finance lease if:
- (a) the lease term (including any period under an option to renew) is 75% of the useful life of the asset for depreciation purposes;
 - (b) the lessee has an option to purchase the asset for a fixed or determinable price at the expiration of the lease;
 - (c) the estimated residual value of the asset at the expiration of the lease is less than 20% of its market value at the start of the lease;
 - (d) in the case of a lease that commences before the last 25% of the useful life of the asset, the present value of the minimum lease payments equals or exceeds 90% of the market value of the asset at the commencement of the lease term; or
 - (e) the asset is custom made for the lessee and, after the expiration of the lease, the asset will be of no practical use to any person other than the lessee.

Section 16
Interest Expense

Interest paid by a legal person on loans and advances shall not be deductible to the extent that the total loans and advances to the person exceed on average during the tax year twice the amount of capital of the person. This section does not apply to financial institutions.

Section 17
Losses

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 (until expired) for a maximum of five tax years. Where a taxpayer has a loss carried forward for more than one tax year, the loss for the earliest year shall be deducted first.

Section 18
Recouped Deductions

Where a previously deducted expense, loss, or bad debt is recovered by a taxpayer, the amount recovered shall be included as income in the calculation of the taxable income of the taxpayer for the tax year in which the amount was recovered.

Section 19
Assets

- 19.1 For the purposes of calculating taxable income:
- (a) any gain arising on the alienation of an asset is the excess of the gross consideration received over the cost of the asset; and
 - (b) any loss arising from the alienation of an asset is the excess of the cost of the asset over the gross consideration received.
- 19.2 Subject to this Section and Sections 10 and 11, the cost of an asset is the total amount paid or incurred by a taxpayer in the acquisition, creation, or construction of the asset. It includes any non-deductible incidental expenditures incurred in acquiring the asset and the market value of any in-kind consideration given for the asset. Non-deductible expenditures incurred to alter or improve an asset shall be added to the cost of the asset.
- 19.3 Subject to this section, the consideration received on alienation of an asset is the total amount received or receivable for the asset. It includes any non-deductible incidental expenditures incurred in alienating the asset and the market value of any in-kind consideration received for the asset.

- 19.4 Where a part of an asset is alienated, the cost of the asset shall be apportioned reasonably between the part of the asset retained and the part alienated.
- 19.5 Where an asset is transferred between associates in a non arm's length transaction, the transferor is treated as having received, and the transferee is treated as having given, the market value of the asset as consideration for the transfer.

Section 20 **Substituted Tax Year**

- 20.1 This section provides rules for the operation of Section 35 of UNTAET Regulation No. 2000/18.
- 20.2 A taxpayer wishing to use a substituted tax year shall apply in writing to the Commissioner setting out the reasons for the use of a substituted tax year.
- 20.3 A taxpayer granted permission under Section 35 of UNTAET Regulation No. 2000/18 to use a substituted tax year may apply, in writing, to the Commissioner to change the taxpayer's tax year to another twelve-month period (including the calendar year). The Commissioner may grant such application but only where the Commissioner believes it is necessary for the efficient operation of UNTAET Regulation No. 2000/18 and the *Law on Income Tax*.
- 20.4 The Commissioner shall give notice in writing to a taxpayer of the Commissioner's decision on the taxpayer's application to use, or change, a substituted tax year.
- 20.5 The Commissioner may, by notice in writing, withdraw a taxpayer's permission to use a substituted tax year.
- 20.6 Permission to use or change a substituted tax year takes effect from the date specified in the notice required under Section 20.4. For the purposes of Section 35.4 of UNTAET Regulation No. 2000/18, the period between the last day of a taxpayer's old tax year and the first day of the taxpayer's new tax year shall be treated as a separate tax year.
- 20.7 A taxpayer may only use a period other than the twelve-month period ending on 31 December as its tax year in accordance with this section and Section 35 of UNTAET Regulation No. 2000/18.
- 20.8 Any change in relation to the 1999 or 2000 tax year shall not result in the taxpayer obtaining the benefit of Section 39 of UNTAET Regulation No. 2000/18 more than once.

Section 21 **Currency Translation**

- 21.1 Any amount taken into account for income tax purposes shall be calculated in United States dollars.

- 21.2 Subject to Section 21.3, where an amount is in a currency other than United States dollars, the amount shall be converted at the Central Payment Office's mid-exchange rate applying between the currency and United States dollars on the date the amount is taken into account for tax purposes.
- 21.3 With the prior written permission of the Commissioner, a taxpayer may use the average rate of exchange for the tax year or a part of the tax year.

Section 22
Market Value

An amount-in-kind shall be accounted for at its fair market value on the date it is taken into account for tax purposes. The fair market value of an asset shall be determined without regard to any restriction on alienation.

Section 23
Deduction Denial

- 23.1 Where a person is required to withhold tax from a payment that is a deductible expense of the person (including a payment of wages to which Section 30 of UNTAET Regulation No. 2000/18 applies), the deduction is not allowed until the person pays the withheld tax to the Commissioner.
- 23.2 A person is not allowed a deduction for any commission, rebate, discount, spotters fee, or similar payment that is East Timor-source income of the recipient unless:
- (a) the person discloses the name and address of the recipient by notice in writing to the Commissioner; and
 - (b) the Commissioner is satisfied that tax has been or will be paid in respect of the payment.

Section 24
Foreign Currency Exchange Gains and Losses

A taxpayer shall account for transactions in foreign currency in accordance with International Accounting Standard IAS 21. No foreign currency exchange loss is recognized to the extent that the exposure to such loss is hedged.

PART IV
LEGAL PERSONS

Section 25
Legal Persons

A legal person shall be subject to tax separately from its owners.

Section 26
Permanent Establishments

- 26.1 The taxable income of a non-resident carrying on business activities in East Timor through a permanent establishment shall be calculated by reference to the income attributable to:
- (a) the permanent establishment;
 - (b) any sales in East Timor of goods or merchandise of the same or similar kind as those sold through the permanent establishment; and
 - (c) any other business activities carried on in East Timor of the same or similar kind as those effected through the permanent establishment.
- 26.2 The following principles shall apply in determining the taxable income of a permanent establishment of a non-resident person:
- (a) the profit of the permanent establishment shall be calculated on the basis that it is a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the non-resident person of which it is a permanent establishment;
 - (b) subject to this Directive, there shall be allowed as deductions expenses incurred for the purposes of the business activities of the permanent establishment including executive and administrative expenses so incurred, whether in East Timor or elsewhere;
 - (c) no deduction shall be allowed for amounts paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person (other than towards reimbursement of actual expenses incurred by the non-resident person to third parties) by way of:
 - (i) royalties, fees, or other similar payments for the use of any tangible or intangible asset by the permanent establishment;
 - (ii) compensation for any services (including management services) performed for the permanent establishment; or
 - (iii) interest on moneys lent to the permanent establishment, except in connection with a banking business; and
 - (d) no account shall be taken in the determination of the 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) by way of:

- (i) royalties, fees, or other similar payments for the use of any tangible or intangible asset;
- (ii) compensation for any services (including management services) performed by the permanent establishment; or
- (iii) interest on moneys lent by the permanent establishment, except in connection with a banking business.

PART V INTERNATIONAL

Section 27 Foreign Tax Credit

- 27.1 Subject to this section, a resident taxpayer shall be entitled to a credit for any foreign income tax paid by the taxpayer in respect of foreign-source income included in the taxable income of the taxpayer for a tax year. The credit shall be referred to as the “foreign tax credit”.
- 27.2 The foreign tax credit shall be calculated separately for each foreign country from which income is derived by a taxpayer. The rules in Section 3 shall apply in determining the country in which income is derived on the basis that the reference in Section 3 to East Timor is a reference to the relevant foreign country.
- 27.3 The amount of the credit in respect of income from sources in a foreign country shall be limited to the East Timor tax payable on that income. There is no deduction or carry forward of any excess foreign tax credit.
- 27.4 The amount of foreign tax paid shall be substantiated by appropriate evidence, such as payment under a tax assessment, a tax withholding certificate, or other similar document accepted by the Commissioner for this purpose.
- 27.5 Deductible expenses incurred in deriving income from sources in a foreign country shall be deducted only against that income. If deductible expenses exceed the income derived from sources in a foreign country for a tax year, the amount of the excess shall be a foreign country loss allowed as a deduction against income from sources in the foreign country (until expired) for a maximum of five tax years. Where a taxpayer has a foreign country loss carried forward for more than one year, the loss for the earliest year shall be deducted first.

PART VI WITHHOLDING TAX

Section 28 Payments for Services

- 28.1 This section applies to any amount paid by a person to a resident or an East Timor permanent establishment of a non-resident who is:

- (a) carrying on construction or building activities;
- (b) providing construction consulting services;
- (c) providing air, land, or sea transportation services;
- (d) carrying on petroleum and geothermal drilling activities, or drilling support services;
- (e) carrying on mining activities or mining support services; or
- (f) providing any service listed in paragraph (a)(ii) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

28.2 Every person (other than a natural person) making a payment to which this section applies shall withhold tax from the gross payment at the rate prescribed for the payment in Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

28.3 Where the person making a payment to which this section applies is a natural person or where the payer is the United Nations or its specialized agencies (other than the East Timor Transitional Administration), the recipient of the payment shall withhold tax from the gross payment received at the rate prescribed for the payment in Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

28.4 In this section:

“air, land, or sea transportation services” means any transportation of passengers or goods by sea, air, or road:

- (a) between two places in East Timor;
- (b) from a place in East Timor to a place outside East Timor; or
- (c) from a place outside East Timor to a place in East Timor;

“construction consulting services” means any consulting services relating to construction or building activities, including project management, engineering, design, architectural, surveying, and site supervision services;

“construction or building activities” means the construction, extension, alteration, improvement, or demolition of a building or other structure with a foundation on, above, or below land or water, including the clearing of land in preparation for the construction of a building or other structure, and the activity of dredging;

“drilling support services” means every service relating to petroleum or geothermal drilling other than technical, management, consulting, or architectural services;

“mining” means every 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; and

“structure” means any structural improvement to immovable property including, without limiting the generality of the foregoing, any road, driveway, car park, railway line, pipeline, bridge, tunnel, airport runway, canal, dock, wharf, retaining wall, fence, power lines, water or sewerage pipes, drainage, landscaping, or dam.

Section 29 **Dividends**

Every resident legal person paying a dividend to a resident or an East Timor permanent establishment of a non-resident shall withhold tax from the gross amount of the dividend at the rate prescribed in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

Section 30 **Interest and Royalties**

- 30.1 Every person (other than a natural person) paying interest or royalties to a resident or an East Timor permanent establishment of a non-resident shall withhold tax from the gross amount of the interest or royalties paid at the rate prescribed in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.
- 30.2 Where the person paying interest or royalties is a natural person, the recipient of the payment shall withhold tax from the gross payment received at the rate prescribed for the payment in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.
- 30.3 This section does not apply to interest paid to a financial institution.

Section 31 **Rent**

- 31.1 Every person (other than a natural person) making a payment to a resident or an East Timor permanent establishment of a non-resident of rent for the lease of land or buildings shall withhold tax from the gross amount of the rent paid at the rate prescribed in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.
- 31.2 Where the person paying rent for the lease of land or buildings is a natural person or where the payer is the United Nations or its specialized agencies (other than the East

Timor Transitional Administration), the recipient of the payment shall withhold tax from the gross payment received at the rate prescribed for the payment in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

- 31.3 Every person (other than a natural person) making a payment to a resident or an East Timor permanent establishment of a non-resident for the hiring or lease of movable property shall withhold tax from the gross amount of the rent paid at the rate prescribed in paragraph (a)(ii) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.
- 31.4 Where the person making a payment for the hiring or lease of movable property is a natural person or where the payer is the United Nations or its specialized agencies (other than the East Timor Transitional Administration), the recipient of the payment shall withhold tax from the gross payment received at the rate prescribed for the payment in paragraph (a)(ii) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

Section 32 **Prizes and Winnings**

Every person paying a prize (including a gambling winning) or lottery winning to a resident or an East Timor permanent establishment of a non-resident shall withhold tax from the gross amount of the payment at the rate prescribed in paragraph (a)(i) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.

Section 33 **Non-resident Withholding Tax**

- 33.1 Every person making a payment of East Timor-source income to a non-resident to which Section 26 does not apply shall withhold tax from the gross amount of the payment at the rate prescribed in paragraph (a)(iii) of Part A of Section 6 of Schedule I to UNTAET Regulation No. 2000/18.
- 33.2 Section 33.1 shall not apply to any amount subject to withholding under any other section of this Part or to an amount referred to in section 30.3.

Section 34 **Obligations of a Person Withholding Tax from a Payment**

- 34.1 Every person who has withheld tax from a payment made by the person in accordance with this Part shall remit the tax withheld to the Central Payments Office or its nominated agent within fifteen days after the end of the month in which the payment was made. At the time of payment, the payer shall 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 the payment.
- 34.2 Any person who fails to withhold tax in accordance with this Part from a payment made by the person is personally liable to pay the amount of tax which has not been

withheld to the Central Payments Office or its nominated agent. Such person is entitled to recover this amount from the recipient of the payment.

- 34.3 Any person who has withheld tax under this Part from a payment made by the person and has remitted the amount withheld to the Central Payments Office or its nominated agent shall be treated as having paid the withheld amount to the recipient of the payment for the purposes of any claim by that person for payment of the amount withheld.
- 34.4 Any tax withheld by a person under this Part from a payment made by the person is held by the person as agent for the Commissioner. In the event of the liquidation or bankruptcy of the person, any amount of tax withheld does not form a part of the estate of the payer in liquidation or bankruptcy, and the Commissioner shall have a first claim to the tax withheld before any distribution of property is made.

Section 35 **Self-withholding**

Every recipient of payment who is required to withhold tax from the payment in accordance with this Part shall remit the tax withheld to the Central Payments Office or its nominated agent within fifteen days after the end of the month in which the payment was received.

Section 36 **General Provisions Relating to the Withholding of Tax**

- 36.1 This Part does not apply to any amount which is not subject to tax.
- 36.2 The amount of tax withheld from a payment under this Part is treated as income earned by the recipient of the payment at the time the tax was withheld.
- 36.3 Where the tax withheld is a final tax on the income of the recipient of the payment under Section 38.3 of UNTAET Regulation No. 2000/18:
- (a) no further income tax liability is imposed upon the recipient in respect of the income to which the tax relates;
 - (b) that income is not aggregated with the other income of the recipient for the purposes of ascertaining taxable income;
 - (c) no deduction (including a depreciation or amortization deduction) is allowed for any expenditure or losses incurred in earning the income; and
 - (d) no refund of tax shall be made in respect of the income.
- 36.4 The provisions of UNTAET Regulation No. 2000/18 relating to the collection and recovery of tax apply to any amount withheld or required to be withheld in accordance with this Part.

**PART VII
ADMINISTRATION**

**Section 37
Returns**

- 37.1 A taxpayer required to deliver a completed income tax form for a tax year to the Central Payments Office under Section 42 of UNTAET Regulation No. 2000/18 shall deliver the form not later than the fifteenth day of the third month after the end of the tax year.
- 37.2 The income tax form of a taxpayer conducting business activities shall be accompanied by the taxpayer's income statement, balance sheet, and cash flow statement for the tax year.
- 37.3 A taxpayer may apply in writing to the Commissioner for an extension of time to deliver an income tax form. An application must be accompanied by a statement estimating the amount of income tax due for the tax year and proof of settlement of the tax due. The Commissioner may, by notice in writing, grant the taxpayer's application for an extension of time for delivering an income tax form. The granting of an extension of time under this section does not alter the due date for payment of tax.

**Section 38
Instalments of Tax**

- 38.1 Taxpayers shall pay instalments of tax for a tax year on the 15th day of each month starting in the fourth month of the tax year and ending in the third month after the end of the tax year.
- 38.2 The amount of each instalment is one-twelfth of the amount of tax due for the previous tax year.
- 38.3 If a taxpayer commenced carrying on business activities in the previous tax year, the instalment for each month of the current tax year shall be the amount of tax due for the previous tax year divided by the number of months the taxpayer carried on business activities in that year.
- 38.4 If a taxpayer commenced carrying on business activities in the current tax year, the instalment for each month of the current year shall be the estimated tax for the current year divided by the number of months remaining in the current year.
- 38.5 If a taxpayer can substantiate at any time during a tax year to the Commissioner that the tax on taxable income for the year will be substantially lower than the tax due for the previous tax year, the Commissioner shall reduce the amount of each instalment accordingly.

- 38.6 If the Commissioner estimates that the tax due for the current tax year to be more than 10% in excess of the tax due in the previous tax year, the Commissioner may adjust the instalments according to the estimated tax.
- 38.7 For taxpayers to whom Section 38.8 of UNTAET Regulation No. 2000/18 applies, instalments of tax calculated under this section shall be cumulated and paid by 15th May, 15th August, and 15th November of the current tax year, and 15th February of the following tax year.
- 38.8 In this section, “tax due” does not include tax collected by withholding and the amount of any foreign income tax paid to the extent a foreign tax credit is allowed under Section 27.

Section 39 **Tax Lien**

A reference to “interest” in Section 55.1 of UNTAET Regulation No. 2000/18 is a reference to additional tax imposed under that Regulation.

Section 40 **Creating and Retaining Records**

- 40.1 Records required to be created and maintained under Section 62 of UNTAET Regulation No. 2000/18 shall be maintained in East Timor unless the Commissioner has provided written approval to maintain records elsewhere.
- 40.2 Records may be kept in Tetum, English, Portuguese, or Bahasa Indonesia for the purposes of Section 62 of UNTAET Regulation No. 2000/18.

PART VIII **COMMENCEMENT AND TRANSITIONAL RULES**

Section 41 **Transitional**

- 41.1 A deduction is allowed under section 10 only for business buildings that are constructed or acquired by a taxpayer after 1 January 2000 and in respect of which the taxpayer can establish legal title to the building.
- 41.2 A deduction is allowed under section 10 for depreciable assets acquired by a taxpayer before 1 January 2000 only if the taxpayer can establish the written down value of the asset at that date to the satisfaction of the Commissioner.
- 41.3 A deduction is allowed under section 11 only for intangible assets and expenditures acquired or incurred after 1 January 2000.
- 41.4 Subject to the operation of section 10, no gains or losses are recognized for income tax purposes in respect of assets acquired before 1 January 2000.

41.5 Notwithstanding section 38.8, for the purposes of calculating instalment amounts due in the period from 1 April 2001 to 31 March 2002, “tax due” shall be calculated:

(a) as if the transitional exempt income allowed under Section 39 of UNTAET Regulation No. 2000/18 had not applied; and

(b) so as not to include:

(i) amounts of tax that would have been withheld had those sources of income that became subject to withholding tax from 1 January 2001 had also been subject to withholding tax in the 2000 tax year;

(ii) amounts of any foreign income tax paid during the 2000 tax year to the extent any foreign tax credit would have been allowable under Section 27.

Section 42
Entry into Force

The present Directive shall enter into force on 31 March 2001.

Sergio Vieira de Mello
Transitional Administrator

SCHEDULES

SCHEDULE I

DEPRECIATION AND AMORTIZATION

**Part A
Business Buildings**

1. The rates of depreciation of business buildings are:

Type of Building	Useful Life	Straight-line Depreciation Rate
Permanent	20 years	5%
Non-permanent	10 years	10%

2. In this Part,

“permanent building” means any business building other than a non-permanent building; and

“non-permanent building” means any business building constructed of materials of a temporary nature, or for temporary purposes, including any movable building.

**Part B
Depreciable Assets**

1. Where pooling applies, depreciable assets shall be divided into the following depreciation pools:

Pool 1	Assets with a useful life of 1-4 years
Pool 2	Assets with a useful life of 5-8 years
Pool 3	Assets with a useful life of 9-16 years
Pool 4	Assets with a useful life of more than 16 years

2. Depreciation rates for depreciation pools:

Pool	Depreciation rate
1	50%
2	25%
3	12.5%
4	10%

3. Depreciation rates where assets are depreciated individually on a straight-line basis:

<u>Useful Life</u>	<u>Depreciation Rate</u>
Assets with a useful life of 1-4 years	25%
Assets with a useful life of 5-8 years	12.5%
Assets with a useful life of 9-16 years	6.25%
Assets with a useful life of more than 16 years	5%

4. The classification of depreciable assets in accordance with their useful life shall be determined by the Commissioner.

Part C
Intangible Assets and Expenditures, and Pre-commencement Costs

1. The rates of depreciation of intangible assets and expenditures are:

<u>Useful Life</u>	<u>Straight-line Depreciation Rate</u>
1-4 years	25%
5-8 years	12.5%
9-16 years	6.25%
16-20 years	5%

2. An intangible asset or intangible expenditure with a useful life of more than twenty years shall be treated as if it has a useful life of twenty years.
3. The useful life of an expenditure referred to in Section 11.6 shall be four years.
4. An intangible asset or intangible expenditure that does not have a defined useful life shall be treated as having a useful life of twenty years.