



REPÚBLICA DEMOCRÁTICA DE TIMOR LESTE
MINISTÉRIO DAS FINANÇAS
DIRECÇÃO GERAL DE RECEITAS E ALFÂNDEGAS
DIRECÇÃO NACIONAL RECEITAS PETROLIFERAS



"Adeus Conflito, Bemvindo Desenvolvimento"

National Directorate of Petroleum Revenue

Public Ruling: Withholding Tax: Section 81 of the Taxes and Duties Act, No. 8/2008

Public Ruling 2010-81

Relying on this Ruling

This is a public ruling within the meaning of section 66 of Regulation 2000/18. Information in this ruling may be relied upon by taxpayers as the basis for determining their tax liability.

Criteria or tests to be met in determining whether a payment was made by a Contractor or Subcontractor as compensation arising out of Timor-Leste source services (other than as an employee) acquired for Petroleum Operations and therefore subject to the withholding tax regime of section 81 of the Taxes and Duties Act, No.8/2008.

Advice has been requested concerning the criteria or tests to be met in determining when a payment made by a Contractor or Subcontractor as compensation for Timor-Leste source services is made pursuant for services acquired for Petroleum Operations.

This Public Ruling is intended to address the ambit of section 81 of the Taxes and Duties Act.

LAW AND ANALYSIS

Section 81 of the Taxes and Duties Act provides, in part, as follows

81.1. A contractor or Subcontractor paying 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 paid.

81.2. 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.

81.3. If a lump sum is paid for services and goods, the amount shall be treated as paid for services to the extent that the Tax Administration considers reasonable having regard to all the circumstances.

81.4. If an amount described in Section 81-1 has been correctly subject to withholding tax under this Section, 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 on 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;
- (d) There is no deduction, including depreciation or amortisation deduction, for any expenditure or loss incurred in earning the gross income.

Following the omnibus language of Section 81.1, the only ground upon which a payment made by a Contractor or Subcontractor as compensation arising out of Timor-Leste source services (other than as an employee) may be exempt from the withholding tax regime of Section 81.1 is where such payment was made for services not acquired primarily for Petroleum Operations. The determination of the type of payment subject to the withholding tax of Section 81 is made from the perspective of the company acquiring the services. The nature of the business of the service provider is irrelevant where the service in question is acquired for petroleum operation. In any case, it is unlikely that a Contractor and Subcontractor will procure services in furtherance of their core business from a non-petroleum service provider.

Support services such as accounting, legal and other similar services procured for the purposes of fulfilling statutory obligation of the Contractors and Subcontractors to any governmental agency or any other regulatory body are considered to be in furtherance of core business.

In other for a payment made by a Contractor or Subcontractor as compensation arising out of Timor-Leste source services to be exempt from the withholding tax regime of section 81.1, the beneficiary or the payer must, among other things, show that it meets any or all of the following specific requirements:

1. that the payment is not an income under any applicable Timor-Leste taxation laws and or
2. that the Timor-Leste sourced services were not *acquired* for Petroleum Operations.

The term "Petroleum Operations" is defined in Chapter IX, section 68 of the Taxes and Duties Act to mean "authorised activities under a Petroleum Agreement." Petroleum Agreement is defined pursuant to section 68 to mean:

- a) A contract, license, permit, or other authorization in relation to petroleum operations made or given pursuant to the Timor-Leste Petroleum Act, except for a Seepage Use Authorisation; or
- b) An authorisation or production sharing contract under the Code.

Article 1 (definitions) of the Petroleum Act defines “Petroleum Operations” to mean activities for the purposes of:

- i. prospecting for Petroleum;
- ii. exploration for, development, exploitation, sale or export of Petroleum, or
- iii. construction, installation or operation of any structures, facilities or installations for the development, exploitation and export of Petroleum, or decommissioning or removal of any structure, facility or installation.

Section 1.1 of the Petroleum Mining Code for the Joint Petroleum Development Area (JPDA) defines the term “Petroleum Operations” to mean any activity authorised by the Designated Authority, and includes:

- a. the exploration for, development and exploitation of Petroleum in the Contract Area, and the export of that Petroleum from the Contract Area;
- b. the construction, installation and operation of structures, facilities, installations, equipment and other property, and the carrying out of other works, necessary for the purposes mentioned in paragraph (a) above;
- c. Decommissioning, including removal of items referred to in paragraph (b) above;
- d. the marketing of that Petroleum; and
- e. planning and preparation for the activities mentioned in paragraphs (a), (b), (c) and (d) above.

The definition of the term “Petroleum Operations” as contained in Section 1 of the Model Production Sharing Contract (PSC) is exactly the same as the definition of the term contained in the Petroleum Mining Code.

By its definition, the ambit of the term “Petroleum Operations” as contained in the Taxes and Duties Act, the Petroleum Act, Petroleum Mining Code and the Model PSC is fairly broad. It covers literally all activities permissible to an oil and gas enterprise and which are primarily connected to petroleum operations.

In enacting Section 81, the Timor-Leste Parliament was concerned with situations in which taxpayers (especially non resident) performing services for Contractors and or Subcontractors involved with Petroleum Operations might receive income without reporting same and making the tax payments due from such income. That also is the rationale for making the withheld tax as a “final” tax on the gross income of the recipient as contained in section 81.4 of the Taxes and Duties Act.

In addition, the Parliament was also concerned with situations in which the persons performing services for and receiving payments from a Contractor and or Subcontractor may take a tax

position that the services were not performed for the purposes of Petroleum Operations and therefore not subject to the withholding tax regime of Section 81.

The Parliament in its wisdom was of the view that the type of payment subjected to the withholding tax regime of Section 81 is better defined from the perspective of the Contractors and subcontractors requesting such services rather than allowing the recipient to make such determination, and thereby create an opportunity for tax avoidance.

The legislative solution was to guard against the possibility of such tax manipulation by subjecting all payments (other than as an employee) made by Contractors and Subcontractors to service providers to the withholding tax regime of section 81, insofar as the acquirer of the services for which the payment was made is connected with Petroleum Operations as defined by law.

The scope of Section 81 thus extends to virtually every service that a Contractor and or Subcontractor involved with any Petroleum Operation may require in running the core business, and which services are sourced within Timor-Leste. For the purposes of section 81 withholding tax regime and for practical reasons, the core business of a Contractor or Subcontractor is interpreted by the National Directorate of Petroleum Revenue (NDPR) to mean only the services acquired in furtherance of any permissible business under the petroleum agreement applicable to the Contractor and Subcontractor making the payment.

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

The list of services covered by section 81 includes (so long as they are connected with the core business and not tangential) but not limited to:

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

- r) Labour/Personnel supply;
- s) Security;
- t) Construction services (except turnkey)
- u) Transportation (air, land or sea)
- v) Courier services

For the purposes of Section 81 of the Taxes and Duties Act, supporting services in the field of oil and gas shall include but not limited to:

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

With respect to payments made by a Contractor or Subcontractor for services combined with goods and or reimbursable expenses and the determination of the value to be appropriated to the service portion of the transaction, Section 81.3 of the Taxes and Duties Act requires the Tax

Administration of Timor Leste to “unbundle” the transaction in a reasonable manner, after considering all the circumstances.

When a single payment is made by a Contractor or Subcontractor for a bundled transaction, only the portion allocated to pure services as opposed to payment for goods and or reimbursable expenses is subject to the withholding tax regime of section 81 where:

- a. the various components are specified in the invoice presented to the Contractor or subcontractor; and
- b. such an arrangement is evidenced in the contract.

FACTS

Situation 1.

XYZ company enters into a personnel supply agreement with a Contractor. Pursuant to the terms of the said agreement, XYZ will receive reimbursement of the salaries paid to personnel supplied to the Contractor plus 10% markup. The contract further provides that XYZ is an independent contractor and that the persons furnished to the Contractor are regarded as employees of XYZ.

The monthly invoice from XYZ separates the reimbursement portion from the mark up fees.

Situation 2.

ABC, a service company, enters into a personnel supply agreement with a Subcontractor. ABC sends a monthly invoice to the Subcontractor without separating the cost from the mark up fees added to the salaries paid to the personnel supplied to the Subcontractor. The rates and the mark up fees are clearly stated in the contract.

The persons supplied by ABC to the Subcontractor are characterized as independent contractors under the contract between ABC and the affected persons.

Situation 3.

Tamara Power Company sold an electric generator to a Contractor under a lease - purchase agreement. The agreement also included a maintenance plan. The monthly payments including principal plus interest and maintenance fees are spread over a fixed period. Tamara Power Company issues a monthly invoice covering the principal plus interest charge and maintenance fees without separating one from the other.

Situation 4.

Boston Engineering Services (BOSTON) was hired by a Contractor to plug an abandoned well. In the course of plugging the well in accordance with the terms of the contract, the Contractor added additional work outside the scope of the original contract but also connected with the plugging of the well. The Contractor enters into a separate contract to reimburse the expenses incurred by BOSTON for the additional work without any provision for a mark up.

BOSTON completed the additional work and presented its invoice as well as receipts from third parties (if any) without any mark up.

Situation 5

Rhapsody Petroleum Company (RPC) awarded a contract to FMK Engineering (FMK) for the manufacture, delivery and installation of subsea equipment at a fixed price. Progress billings and payments for the construction phase are done on a monthly basis. The billings for the delivery and installation would be done separately at end of the construction and upon delivery and installation.

In *Situation 1*, the entire invoice is subject to the withholding tax regime of section 81.1. The result would be different if the persons supplied by XYZ were also characterized as independent contractors of XYZ company. Depending on other factors such as the invoicing method, only the mark up portion may be subject to the withholding tax regime of section 81, if the persons supplied were indeed independent contractors of XYZ.

In *Situation 2*, the portion of the value of the invoice from ABC company to the Contractor appropriated to service and which is subject to the withholding tax regime of section 81.1 would be limited to the mark up portion.

In *Situation 3*, the portion of the value of the invoice from Tamara Power Company appropriated to service income would be determined by the *Tax Administration* of Timor-Leste. Tamara Power Company will be required to file an income tax return to report the taxable income associated with the portion appropriated to sale of goods and interest income.

In *Situation 4*, the value of the entire invoice for the additional work is not subject to the withholding tax regime of section 81. It would not matter even if BOSTON had issued its own commercial invoice to cover all the charges and without a third party receipts\invoices. On the other hand, the entire invoice for the additional work would be subject to withholding tax if the contractual arrangement between the Contractor and Boston had a provision for a mark up fee. Any labor charge in respect of the additional work by BOSTON would also be subject to the withholding tax regime.

In *Situation 5*, the monthly progress billings and payments would not be subject to withholding tax. FMK would be required to file income tax return during the manufacturing stage to report its taxable income from such payments.

On the other hand, if the contract provides for a fixed contract price payable upon installation of the equipment and FMK presented an invoice covering the manufacturing, delivery and installation, then section 81.3 would apply; so long as the manufacturing, delivery and installation are covered by the same contract. Same theory if FMK presented two or three separate invoices, as long as the manufacturing, delivery and installation are done pursuant to the same contract.

Section 81.4 relating to the finality of the taxes withheld as extinguishing the liability of the beneficiary is limited only to the value or payments received as consideration for services, and which was correctly subject to section 81 withholding tax regime.

If the beneficiary earned separate income (e.g. from the sale of goods or interest income, whether combined with services or not) other than arising in connection with the performance of services, such a person is not entitled to the benefits of section 81.4 and will be required to file an income tax return in Timor-Leste.

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

For the purposes of the reporting obligation of the taxpayer receiving payments or a thing of value in exchange for something other than services, NDPR does not accept a distinction between Contractors and Subcontractors. Section 72 of the Taxes and Duties Act would be interpreted to include Contractors and Subcontractors in that respect.

Both Contractors and Subcontractors alike are required to file an income tax return in Timor-Leste to report such income.

The sourcing rules applicable to the Production Sharing Contracts in the Joint Production Development Area (JPDA) shall be as specified in the Timor Sea Treaty and may be supplemented (where necessary) with any applicable Indonesian Income Tax Laws relating to sources of income. Other Production Sharing Contracts outside of the JPDA shall be subject to the sourcing rules of the Taxes and Duties Act.

This Public Ruling will take effect from June 1, 2011 and will apply to obligations arising on or after this date.

DRAFTING INFORMATION

The principal author of this public ruling is B. W. Boye Esq.; Petroleum Tax Law Adviser

REPÚBLICA DEMOCRÁTICA DE TIMOR-LESTE
MINISTÉRIO DAS FINANÇAS
COMISSÁRIO DOS SERVIÇOS DE RECEITAS

Câncio de Jesus Oliveira
Director General/Commissioner