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

"Adeus Conflito, Bemvindo Desenvolvimento"

Public Ruling 2011-11

Taxation of gains in connection with the Alienation of Property or Shares or comparable interest in a Company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Joint Production Development Area (JPDA)

National Directorate of Petroleum Revenue

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 in respect of matters connected with the taxation of the proceeds arising from the sale of property, shares and or a comparable interest in a company with principal asset within the JPDA.

Advice has been requested by certain interested parties concerning the ambit/application of Article 11 of Annex G to the Timor Sea Treaty (TST) and the tax consequences attendant to the sale of property, shares and or comparable interest in a company with a presence in the JPDA.

This Public Ruling is intended to address the ambit of Article 11, Annex G to the TST and address the Timor-Leste tax consequences of transactions within the ambit of the said Article 11.

LAW AND ANALYSIS

The taxation of income from the JPDA (Annex F) is governed by:

- Timor Sea Treaty (including Annex G-Taxation Code);
- Directive 2001/2*
- Indonesian Income Tax Law (as at October 25,1999)
- UNTAET Reg. 2000/18

The taxation of income from the Non- Annex F part of the JPDA is governed by:

- Timor Sea Treaty (including Annex G-Taxation Code);

- Directive 2001/2*
- Petroleum Taxation Act*[1]
- The Taxes and Duties Act, Law No. 8/2008 (more particularly Chapter IX); and
- UNTAET Reg. 2000/18.

Since the fiscal regime applicable to taxable Article 11 (Annex G, TST) transactions in Annex F portion of the JPDA is significantly different from that of the Non-Annex F part, the discussion relating to the taxability of Article 11 transactions within the JPDA is separated below for clarity.

Annex F, JPDA-Law & Analysis

Some taxpayers within Annex F of the JPDA have variously represented to the National Directorate of Petroleum Revenue (NDPR) that gains associated with the alienation of property, shares and or comparable interest in a company with principal asset in the JPDA are not subject to the regular petroleum taxation regime or alternatively that any gains from such transactions are subject only to the withholding tax regime of Article 26(2) of the Indonesian Law of Income Tax (1994).

Some taxpayers cited previous positions of the Timor Leste Revenue Services (TLRS) issued variously in 2001 indicating that indirect disposals or transfers of interests are not subject to tax in Timor-Leste. The TST (including Annex G) became law in Timor Leste only in May of 2002 and it is inconceivable that TLRS will issue an *Ex-ante* opinion on a law that was not in effect. Assuming such opinions were in fact rendered by the TLRS, such opinions are hereby are declared null and void and are no longer valid effective from May 20, 2002[2].

Furthermore, any interpretations or decisions of the TLRS relating to the issue of capital gains within the JPDA are not valid for the purposes of laws enacted or Treaties subsequent to such determinations and or decisions, and which are inconsistent with the subsequent laws and Treaties. Any such interpretations and or decisions are now repudiated and void.

Finally, some other taxpayers informed NDPR that Australian courts have found that such provisions like Article 11 of Annex G to the TST do not "impose" tax or create taxable income.

NDPR does not accept Australian courts' decisions relating to taxation or any other matter as judicial authorities in Timor-Leste.

The decisions of Australian Courts are neither persuasive nor of any relevance in Timor-Leste. The governing tax laws in Australia are dissimilar from the Timor-Leste tax legislations. Timor-Leste is a sovereign nation and not a subdivision of another sovereign.

Furthermore, such an argument is at best frivolous in view of the unambiguous provision of Article 4(b) of the TST. The existing taxes to which the Taxation Code (Annex G) shall apply are: in East Timor:

(i) The income tax, including either the tax on profits after income tax or the additional profits tax, as applicable to a specified petroleum project or part of a project;

(ii) The value added tax and sales tax on luxury goods ("value added tax"); and

[1]. *Parts of the laws were repealed and some parts reincorporated into the Taxes and Duties Act, Law No. 8, 2008.

[2] The day the TST became effective in Timor Leste.

(iii) The sales tax,
Imposed under the law of East Timor.

The gains accruing from the disposition of assets in anywhere in Annex F part of the JPDA is eminently subject to tax under Articles 4(1) and 4(1)(d) of the Indonesian Law of Income Tax (as at October 25,1999). The taxes imposed by the provisions of Articles 4(1) and 4(1)(d) of the said Indonesian Law of Income Tax are also taxes imposed under the law of Timor-Leste.
A combined reading of Article 4 of the TST and the relevant provisions of the Indonesian Income Tax Law creates the jurisdiction to impose tax on any gains associated with Article 11(Annex G) transactions within Annex F of the JPDA.

Based on the taxation laws of Timor-Leste, the position of NDPR is that generally, the gains from such transactions within Annex F of the JPDA are subject to 30% tax in Timor Leste.

A "Tax Object" is defined under Article 4(1) of the Indonesian Law of Income Tax Law, Law No. 10 (1994) to mean an increase in economic capability received or accrued by a Taxpayer, in whatever name or form and originating from within or without Indonesia, which can be used for consumption or to increase the wealth of the Taxpayer concerned.
The gains accrued by a corporation, partnership or other body through the transfer of property to shareholders, partners or members are includible as part of a Tax Object[3].

Article 26(2) of the Indonesian Law of Income Tax Law provides:
"With the exception of a sale of property under Article 4 section (2), income from the sale of property in Indonesia which is received or accrued by a non-resident Taxpayer other than a permanent establishment in Indonesia, and insurance premiums paid to a foreign insurance company, shall be subject to withholding tax of 20 percent (twenty percent) on the estimated net income."
Article 26(3) provides that the implementation of the provisions in section 4(2) shall be stipulated by the Minister of Finance.
On or about August 24, 1999 the Minister of Finance issued a Decision (KEP 434/KMK.04/1999) interpreting the ambit of Section 26(2). The Decision provides as follows:
The Minister of Finance Republic of Indonesia,
Considering:

a. whereas in accordance with Article 26 paragraph (2) to paragraph (3) of Law Number 7 Year 1983 concerning Income Taxes as most recently amended by Law Number 10 Year 1994, income derived from the sale of property in Indonesia received or earned by Non-resident Taxpayers (WPLN) other than Permanent Establishments (BUT) is subjected to the withholding of Income Tax (PPh) of 20% (twenty percent) of the total estimated net income, the implementation of which is stipulated by the Minister of Finance;
b. whereas on the basis of the provision in the above-referenced letter and, in order to provide certainty in respect of the provision of tax on income received or earned by WPLN other than BUT from the sale of shares, it is deemed necessary to regulate the withholding of PPh on the said income with a Decision of the Minister of Finance;

In view of:

[3] Article 4(2)-Indonesian Income Tax Law, 1994.

1. law Number 6 Year 1983 concerning General Provisions and Procedures of Taxation State Gazette Year 1983 Number 49, Supplement to State Gazette Number 3262), as most recently amended by Law Number 9 Year 1994 (State Gazette Year 1994 Number 59, Supplement to State Gazette Number 3566);
2. Law Number 7 Year 1983 concerning Income Tax (State Gazette Year 1983 Number 50, Supplement to State Gazette Number 3263) as most recently amended by Law No 10 Year 1994 (State Gazette Year 1994 Number 60, Supplement to State Gazette Number 3567);
3. Law Number 1 Year 1995 concerning Limited Liability Companies (State Gazette Year 1995 Number 13, Supplement to State Gazette Number 3587);
4. Presidential Decree Number 122/M Year 1998;

HAS DECIDED:

To stipulate:

THE DECISION OF THE MINISTER OF FINANCE OF THE REPUBIC OF INDONESIA CONCERNING THE WITHHHOLDING OF ARTICLE 26 INCOME TAX ON INCOME RECEIVED OR EARNED BY NON-RESIDENT TAXPAYERS OTHER THAN PERMANENT ESTABLISHMENTS ON INCOME IN THE FORM OF PROFITS FROM THE SALE OF SHARES

Article 1

Referred to in this Decision as Companies shall be Domestic Limited Liability Companies whose shares are traded by shareholders which are Non-resident Taxpayers (WPLN) and are not issuers or Public Companies as intended in Law Number 8 Year 1995 concerning Capital Market.

Article 2

1. Income from the sale of shares of Companies earned by WPLN other than BUT shall be subject to the withholding of tax of 20% (twenty percent) of the estimated net income.
2. On WPLN domiciled in countries having Agreements on the Avoidance of Double Taxation (P3B) with Indonesia, the withholding of the tax intended in paragraph (1) shall only be made if on the basis of the P3B in force, the taxation right on the disposal is in Indonesia.
3. The total estimated net income intended in paragraph (1) shall be 25% (twenty five percent) of the sales price, that the total Article 26 Income Tax is 20% X 25% or 5% (five percent) of the sales price.
4. The payment of the PPh (Income Tax) intended in paragraph (1) shall be final.

The following conclusions can be drawn from the provisions of KEP434/KMK.04/1999, namely:

1. The Decision is inapplicable outside the narrow scope relating to the sale of shares or comparable interest in a company. In a sale of asset transaction, the withholding tax regime of KEP434/KMK.04/1999 becomes irrelevant ;
2. the Decision is limited only to the sale of shares of a publicly traded domestic (Indonesian) Limited Liability Companies;
3. the Decision is limited only to WPLN other than Permanent Establishments;
4. the withholding tax regime is not available to issuers of the affected shares as defined under Article 1 of Law Number 8, Year 1995; and

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5. the withholding tax regime is not available to Public Companies as defined in Article 1 of Law Number 8, Year 1995.

The gains arising from the sale of shares or other comparable interest (within Annex F of the JPDA) in a company with principal asset as described in Article 11 of Annex G to the TST is subject to the withholding tax regime of KEP 434/KMK.04/1999 where the recipient Non-resident taxpayer (WPLN) can demonstrate the fulfillment of Article 1 above

The other exemption from the application of the 30% tax rate to Article 11 (Annex G, TST) transactions is as contained in Law No. 4, 1995, relating to the income of Venture Capital Companies earned from the sale of shares or the transfer of capital participation in their business partner companies.
Qualifications for the withholding tax regime stipulated in Article 1(3) of Law No.4, 1995 are:

1. that the recipient taxpayer is a Venture capital company; and
2. that the proceed was earned from the sale of shares or transfer of capital participation in a business partner company[4].

Other than allowing for the exceptions immediately above (where applicable) in the Annex F part of the JPDA, the view of the NDPR is that the tax consequences attendant to the alienation of shares or comparable interest in a company within the JPDA are substantially the same.
The gains from such transactions falling within Article 11 are subject to 30% capital gains tax in Timor-Leste.

- The fundamental difference in the tax treatments between the alienation of shares or comparable interest in a company within and without Annex F part of the JPDA as discussed above is limited to the cases where such transactions are subject to the withholding tax regime contained in certain relevant Indonesian tax laws discussed above;
- The Contractors doing business within Annex F of the JPDA at the time of the issuance of this Public Ruling cannot claim any benefits from the applicable Indonesian withholding tax regime for reasons discussed above; and
- Therefore, the tax consequences (including the 30% tax) attendant to any Article 11 (Annex G, TST) asset/property sale transaction is the same in both Annex F and Non-Annex F parts of the JPDA.

Pursuant to Article 2 (1) (c) of the Law of Income Tax, No. 10, 1994, a Permanent Establishment (PE) is a Timor-Leste domestic Tax Subject. A foreign entity doing business through a PE or merely receiving or obtaining income from Timor-Leste , other than from a PE, may be characterized as a foreign Tax Subject within the meaning of Article 2 (4). Both the domestic and foreign Tax Subjects are subject to tax under Article 2(2).

Article 4 (1) of the Law of Income Tax, No. 10/1994 defines a Tax Object to mean:

[4] Article 1(2) of Law No.4, 1995 defines "Business partner companies" as companies which (a) constitute small-or-medium-sized companies or companies engaged in business sectors as determined by the Minister of Finance; and (b) do not trade their shares on the Indonesian Stock Exchanges.

Any increase in economic capability received or accrued by a Taxpayer, in whatever name or form and originating from within or without Indonesia, which can be used for the consumption or to increase the wealth of the Taxpayer concerned, including:

a. any reimbursement or compensation in compliance with the works or services received or obtained, including salary, wage, allowance, honoraria, commission, bonus, gratuity, pension payment or other compensation in any form whatsoever, unless otherwise stipulated in this Law;

b. prize of a lottery or any work or any activity, and reward;

c. business profit;

d. profit due to sale or transfer of property, including:

    1) profit due to transfer of property to a company, association, or other body/entity in exchange for shares or capital participation;

    2) profit obtained by a company, association or other body/entity due to transfer of property to shareholders, partners or members;

    3) profit due to liquidation, merger, consolidation, expansion, division, or acquisition;

    4) profit due to transfer of property in the form of grant, aid or donation, unless given to family of the same blood in one degree of straight descent line, and religious institutions or educational institutions or social institutions or small-scale entrepreneurs, including cooperatives as stipulated by the Minister of Finance, as long as they do not have any relationship with the business, work, ownership or authority between the relevant parties;

e. refund of tax payments which are already calculated as cost;

f. interest including premiums, discounts, and compensations due to loan repayment guaranty;

g. dividends, under any name and form whatsoever, including dividends by an insurance company to policy holders, and distribution of the remaining business profits of a cooperative;

h. royalty;

i. rent or other income relating to the utilization of property;

j. receipt or acquisition of periodical payment;

k. profits due to debt exemption;
l. profits due to the difference of foreign exchange rate;

m. surplus of assets re-evaluation;

n. insurance premiums;

o. any contribution received or obtained by any association from its members which consist of Taxpayers performing business or freelance work, as long as such contributions are determined in accordance with the business volume or freelance work of its members;

p. any increase of net assets originating from income before tax.

Pursuant to Article 5 (Fiscal Arrangement and Taxes) of the TST, and more importantly Article 5(iii), Timor-Leste is entitled to impose taxation on its Article 4 proportionate share of petroleum revenue accruing from the JPDA activities in accordance with the laws and taxation code applicable only in Timor-Leste.
Article 5(b) of the Timor Sea Treaty provides:
"Consistent with the formula contained in Article 4 of this Treaty, East Timor and Australia may, in accordance with their respective laws and the taxation code, impose taxes on their share of the revenue from petroleum activities in the JPDA and relating to activities referred to in Article 13 of this Treaty."

Article 13 (Application of taxation law) of the TST provides in part:
(a) For the purposes of taxation law related directly or indirectly to:
i. the exploration for or the exploitation of petroleum in the JPDA; or
ii. acts, matters, circumstances and things touching, concerning arising out of or connected with such exploration and exploitation the JPDA shall be deemed to be, and treated by, East Timor and Australia, as part of that country.

Further to the provisions of Article 4(b) of the Taxation Code (Annex G) to the TST, the existing taxes in Timor-Leste covered by the Taxation Code are:

i. the income tax, including either the tax on profits after income tax or the additional profits tax, as applicable to a specified petroleum project or part of a project;
ii. the value added tax and sales tax on luxury goods ("value added tax"); and
iii. the sales tax,

imposed under the law of Timor-Leste.

Article 11 (Alienation of property) of Annex G of the TST, provides:

1. Where a gain or loss of a capital nature accrues to or is incurred by a person, other than an individual who is a resident of a Contracting State, from the alienation of property situated in the JPDA or of shares or comparable interests in a company, the assets of which consist (directly or indirectly, including for example a chain of companies), wholly or principally of property situated in the JPDA, the amount of gain or loss shall, for

purposes of the law of a Contracting State, be an amount equivalent to the framework percentage of the amount that would be the gain or loss but for this paragraph.

By the combined effects of Articles 2(2) and 2(4) of the Indonesian Law of Income Tax, No. 10, 1994 and Article 11 of Annex G to the TST, the holder of the shares of a company doing business within the JPDA with an Article 11 transaction (sale of shares directly or indirectly or the sale of the asset of the company within the JPDA), will effectively subject the holder to the Timor-Leste tax jurisdiction.

It is irrelevant that such a holder may be a foreign entity in its characterization as a non-resident Tax Subject, where the holder is:

a) A body which is not established or domiciled in Timor-Leste, conducting business or carrying out activities through a permanent establishment in Timor-Leste; or
b) A body which is not established or domiciled in Timor-Leste, receiving or accruing income from Timor-Leste other than from conducting business or carrying out activities through a permanent establishment in Timor-Leste.

Transactions in the Non-Annex F part of the JPDA from 2005 to December 31, 2007

Prior to the passage of the Taxes and Duties Act (TDA) in 2008, the taxation of petroleum revenue in the JPDA (other than the Annex F part) , Directive 2001/2 (Calculation of Income Tax & Administrative Matters relating to Income Tax) and the Petroleum Taxation Act (PTA) were the primary governing laws for income taxes in Timor-Leste.
The Directive and the PTA were repealed through Section 93.1 of the TDA. Section 93.3 preserved the application of the Directive and the PTA to the transactions commenced before the commencement of the TDA. The TDA became effective from January 1, 2008.

Section 3.1 (Source of Income) of Directive 2001/2 provides:
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 section26;
b) income from 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 alienation of any property or right referred to in paragraph(c) or from the alienation of any 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.

Section 3.2 of Directive 2001/2 provides:

"Notwithstanding Section 3.1, any amount taxable in East Timor under an international agreement is East Timor-source income."

The sale of property, shares or comparable interest in a Permanent Establishment, the assets of which consist (directly or indirectly, including for example a chain of companies), wholly or principally of property situated in the JPDA, by a resident or non-resident shareholder is subject to tax in Timor-Leste. Such transactions are clearly within the provisions of Sections 3(c) and (d) of the Directive 2001/2.

The interest held by a Contractor in a Production Sharing Contract (PSC) within the JPDA is interpreted as a right to explore for, or exploit, natural resources, in East Timor, and the sale of such right (wholly or partly and regardless of the form) is tantamount to the alienation of an ownership interest in a legal person, the assets of which consisted wholly or principally of property or right to explore for, or exploit, natural resources, in East Timor.
A PSC confers on the Contractors the right to explore for, or exploit, natural resources in Timor-Leste. A Contractor is defined under Section 2 of the Petroleum Taxation Act to mean: "a person with whom the Ministry or Designated Authority, as the case may be, has a Petroleum Agreement."
A "Petroleum Agreement" means:

a) A contract, licence, permit or other authorization made or given pursuant to Petroleum Act, except for a seepage Use Authorization; or
b) An authorization or production sharing contract made under the Code.

Natural resources are defined in Section 1 of the Directive 2001/2 to mean: mineral, petroleum, or any other living or non-living resource that may be taken from the land or sea.

The TST is an international agreement as defined pursuant to Section 1 (Definitions). Section 1 of the Directive 2001/2 defines "international agreement" to mean: "a double taxation convention having force of law in East Timor."

Pursuant to the provision of Section 3.2 of the Directive 2001/2, the TST (including Annex G), any item taxable pursuant to the TST is equally taxable in East Timor, irrespective of the fact that the item may not be within the purview of Section 3.1 (source of income).
The TST by operation of law (Section 3 of the Directive 2001/2) confers the jurisdiction to tax any such gain arising out of a Timor-Leste sourced income as provided for in Article 11 of Annex G to the Timor Sea Treaty.

Some taxpayers have argued that Section 34.1 of the UNTAET Reg. 2000/18 excludes the application of the entire Directive 2001/2 within the JPDA. The said taxpayers further argued that the **express and sole** intent of the Directive is to modify Regulation 2000/18. That view is incorrect for a number of reasons.

- The matters covered under the Directive are substantially larger than the matters covered (modifications of certain provisions and not all provisions of the Directive) under Chapter VIII of UNTAET Reg. 2000/18 and for which Section 34.2 is relevant, ***Expressio unius est exclusio alterius*** ("the express mention of one thing excludes all others");

- There is no limiting language in the Directive, if the Timor-Leste parliament intended a complete exclusion of the Directive to the area known as JPDA, an express and explicit language would have been inserted accordingly,
- Following the principle of ***ejusdem generis*** (of the same kind), the limiting language of Section 34.2 cannot be extended beyond matters covered by Chapter VIII of the UNTAET Reg. 2000/18
- Section 36.8, forming part of the excluded Chapter VII, preserves the continuous application of Section 38 of the Directive without any limiting language;
- Section 1 of the UNTAET Reg. 2000/18 supports a purposeful interpretation of the Regulation and rejects any interpretation that frustrates the intended purpose
- The definition of "East Timor" as contained in Section 1 of the Directive includes the area subject (the ZOCA) to the Memorandum of Understanding dated 10 February, 2002 and made between Timor-Leste and Australia; AND
- Implicitly, Sections 93 (Repeal) and 94 (Saving) of the TDA preserves the continuous application of the Directive 2000/2 and all other laws in effect and which are applicable to certain taxpayers within Annex F of the JPDA.

Section 5.2 (Jurisdiction to Tax) of the Directive provides:
"The Tax Object of a non-resident Tax Subject includes only East-Timor-source income."
Tax Subjects are defined in Section 4 of the Directive to mean:

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, affiliation, association, firma, kongsi, cooperative, a foundation or similar organization, or any other forms of business or non-governmental organization;
e) any legal person founded under a foreign law and or any other 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.

- With respect to transactions consummated in the non-Annex F part of the JPDA for the period between May 2002 and December 31 2007, the TST, PTA and the Directive 2001/2 apply with equal force to the alienation of property or shares or comparable interest in a company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Joint Production Development Area (JPDA).

The gains that accrued to the transferors (residents and non-residents alike) of such property or shares are subject to tax at 30% in Timor-Leste.[5]

Finally, Article 6.4 of the Petroleum Taxation Act contemplates the imposition of capital gains tax on Contractors by excluding certain items of income in a specific case from taxation.

[5] Article 6.1., PTA, Section 6(b)(ii) of Schedule 1, UNTAET Reg. 2000/18

Transactions in the Non-Annex F part of the JPDA from January 1 2008

Aside from the TST, the other primary taxation law governing income tax and Supplemental Petroleum Tax (SPT) in the non-Annex F part of the JPDA is the TDA[6].
Effective from January 1 2008, the TDA became the governing law in Timor-Leste for both Contractors and Subcontractors in all matters touching and concerning the TST.[7]
Chapter IX of the TDA is applicable exclusively to Contractors and Subcontractors in the Timor-Leste Exclusive Area (TLEA) and the JPDA, excepting the area covered by the PSC described in Annex F of the TST.[8]
A substantial part of the repealed PTA was incorporated as Chapter IX of the TDA.[9]

Section 3 (Ambit of the Act) of the TDA provides:
Subject to Section 94, this Act applies to the territory of Timor-Leste, including its territorial sea, and to its exclusive economic zone and continental shelf, and applies to the Joint Petroleum Development Area, except that -
(a) Chapter II does not apply to matters covered by the Timor Sea Treaty;
(b) Chapters III and IV do not apply to goods covered by the Timor Sea Treaty;
(c) Chapter V does not apply to imports covered by the Timor Sea Treaty;
(d) Chapter VI does not apply to wages received in the territory covered by the Timor Sea Treaty; and
(e) Chapter VII does not apply to the territory covered by the Timor Sea Treaty.

Chapter VII (Income Tax) of the TDA governs a taxable person, characterization and computation of taxable income but the entire JPDA is excluded from its application.[10]
Section 91 of the TDA provides that no taxes or duties have effect in Timor-Leste unless they are included in, or authorised by the present law.

Section 92 of the TDA provides that the legal regime relating to the collection and recovery of tax shall be set out in a Decree-Law to be adopted by the Government. No such Decree-Law has been adopted to date. However, Section 93.4 provides;
"The legal regime relating to the collection and recovery of tax shall remain in effect until such time as when a new legal regime is adopted".
The TDA does not provide any definition as to what amounts to a "legal regime relating to the collection and recovery of tax." Both the Directive and PTA contained administrative provisions relating to the collection and recovery of tax but the two laws, save for periods before January 1, 2008 were effectively repealed via Section 93.1 of the TDA. Section 93 (repeal) enumerates the laws that were consequentially repealed as:

- UNTAET Regulation No. 2000/18, as amended
- UNTAET Directive No. 2001/2, as amended; and
- PTA

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[6] Section 70, TDA
[7] Section 96.3, TDA
[8] Section 69, TDA
[9] Section 4, TDA
[10] Section 3(e), TDA

If the UNTAET Regulation 2000/18 is preserved as a result of the saving provision of Section 93.5, the same argument can also be made for the portions of UNTAET Reg. 2001/2 and the PTA relating to the "collection and recovery of tax," until the passage of a decree-law regulating tax procedure and which encompasses the sundry collection and recovery of tax provisions that were scattered in the three (3) separate laws.
The effect of that position is that there will be no changes whatsoever to the treatment of gains connected with the alienation of property or shares or comparable interest in a company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Joint Production Development Area (JPDA). Such gains would be taxable to both residents and non-residents in Timor-Leste at 30%.

Alternatively, even if the UNTAET Reg. 2000/18 is the only law relating to the "collection and recovery of tax" that is preserved by the Section 93.4 of the TDA to the exclusion of other laws with administrative provisions connected with the collection and recovery of taxes, the alienation of property or shares or comparable interest in a company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Joint Production Development Area (JPDA) will still be taxable in Timor-Leste on the strength of Article 11 (Annex G) to the TST alone.

The position of NDPR is that without more, the omnibus provision of Article 11 is a sufficient legal basis to impose Timor-Leste taxation on any transaction amounting to an alienation of property or shares in the manner described therein. The TST is part of the laws of Timor Leste, effective from May 20, 2002.

After the ratification of the TST by the Timor-Leste sovereign government, the TST (including the annexure) became a statute of general application to petroleum operations, Contractors and Subcontractors alike in Timor-Leste.

Article 13(a) (Application of taxation law) of the TST provides that for the purposes of taxation law related directly or indirectly to the exploration for or the exploitation of petroleum in the JPDA; or acts, circumstances and things touching, concerning, arising out of or connected with such exploration and exploitation, the JPDA shall be deemed to be, and treated by, East Timor and Australia, as part of that country.

To be excludible from taxation in Timor-Leste, a person deriving a gain in the circumstances described in Article 11(Annex G) to the TST has a burden of showing that such a gain is specifically precluded from taxation in Timor-Leste.
Tax deductions, exemptions, credits or similar tax benefits are matters of legislative grace and a claimant/taxpayer has a burden of showing the statutory basis for such entitlements.

Article 4(b) of Annex G defines the Taxes covered under the TST as:

(i) the income tax, including either the tax on profits after income tax or the additional profits tax, as applicable to a specified petroleum project or part of a project;
(ii) the value added tax and sales tax on luxury goods ("value added tax"); and
(iii) the sales tax

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Is a gain derived from the alienation of property or shares or comparable interest in a company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Non-Annex part of the JPDA taxable in Timor Leste after December 31, 2007?

The position of NDPR is that such gain, attributable to Timor-Leste and which is connected with the disposition of shares or property in the manner described in Article 11 of Annex G to the TST is taxable to both residents and non-residents before or after December 31, 2007 at 30% in Timor-Leste.

Factual Examples

- **Situation 1**

Pontius Oil and Gas Corporation (PGC) is a Contractor and a holder of a 47% participating interest in a Production Sharing Contract 33-12 (PSC 33-12) within the JPDA. PGC is organized as a special purpose entity by Pontius Global Energy Corporation (PGE), a non-resident Japanese company. The principal asset of PGC is the 47% participating interest in PSC 33-12.

PGE sold 51% of the common shares or similar interest in PGC to Santana Oil Company (SANTANA) for US$70 million. The tax basis of PGE in the shares of PGC (is US$17 million. PGC is a Timor-Leste resident permanent establishment (PE).

The interest held in PSC 33-12 is the principal asset of PGC.

- **Situation 2**

Same facts as in Situation 1 above except that PGC and PSE either jointly or severally conveyed 51% of the 47% participating interest held in PSC 33-12 to Santana in exchange for US$ 70 million

- **Situation 3**

Armco Global Energy, Inc. (AGE), a US resident, owns 100% of the common stock and all of the outstanding preferred shares of Spark Consolidated Oil, Inc. (SCO). SCO is resident in Australia. SCO organized a special purpose entity named Hurricane Energy Resources, Ltd (HER). SCO owns 100% of the common shares of HER, and HER owns 50% of the participating interest in JPDA PSC 16X-P2. The 50% interest held in PSC 16X-P2 is the principal asset of HER.

The tax basis of AGE in SCO is US$45 million. The tax basis of SCO in HER is US$39 million. The principal asset of SCO is the stock of HER. The principal asset of HER is the 50% of the participating interest in JPDA PSC 16X-P2.

AGE sold 90% of the common stock and the outstanding preferred shares of SCO to Kitan Producing Corporation (KPC) for US150 million.

Situation 4

Same as above except:

1. The transaction was consummated before commercial discovery; and
2. The US$39 million claimed by SCO as its tax basis in HER represented the contribution to the joint venture as part of the Geological and Geophysical expenditure.

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In *Situation* 1,

Transaction in JPDA-Annex F

Article 26(2) of the Indonesian Law of Income Tax Law, KEP 434/KMK.04/1999 and Article 1(3) of Law No.4, 1995 (withholding tax) are inapplicable for reasons discussed above.

The capital gains tax payable on the transaction is approximately $18.4 million ($70 M-($17m X 51%) X 30%. The Timor Leste portion of the tax is $16.56 million ($18.4 m X 90%).

NDPR will hold both PGC and PGE as jointly and severally liable for the tax liability resulting from the transaction.

PGE will be required to establish the proof of capitalization of PGC PGE by demonstrating contemporaneous journal entries, bank statements, cancelled checks etc.

Transaction in JPDA- Non-Annex F

The capital gains tax payable on the transaction to Timor-Leste is the same as above ($16.56 million).

NDPR will hold both PGC and PGE as jointly and severally liable for the tax liability resulting from the transaction. PGE will be required to establish the capitalization of PGC by demonstrating contemporaneous journal entries, bank statements, cancelled checks etc.

In *Situation* 2

Transaction in JPDA-Annex F

Article 26(2) of the Indonesian Law of Income Tax Law, KEP 434/KMK.04/1999 and Article 1(3) of Law No.4, 1995 (withholding tax) are inapplicable for reasons discussed above.

The amount deductible against the receipt of $40 million proceed is dependent on the tax basis of PGC in the 47% interest held as the participating interest in PSC 33-12. The tax basis of PGE in PGC will be irrelevant in the computation of the capital gain tax attendant to the transaction as described.

PGC will also be required to establish the proof of funding or the investment in PSC 33-12

Transaction in JPDA-Non-Annex F

Same treatment as above.

In *Situation* 3

Transaction in JPDA-Annex F

Article 26(2) of the Indonesian Law of Income Tax Law, KEP 434/KMK.04/1999 and Article 1(3) of Law No.4, 1995 (withholding tax) are inapplicable for reasons discussed above.

The capital gains tax payable on the transaction is approximately $32.8 million ($150 M-($45m X 90%) X 30%. The Timor Leste portion of the tax is $29.5 million ($32.8 m X 90%).

NDPR will hold both PGC and PGE as jointly and severally liable for the tax liability resulting from the transaction.

Depending on the nature of the preferred stock, the value appropriated to the 90% of the common stock held by AGE in SCO may be revised downward and thereby reduce the tax basis.

NDPR will hold both AGE and SCO as jointly and severally liable for the tax liability resulting from the transaction. AGE will be required to establish the capitalization of SCO by demonstrating contemporaneous journal entries, bank statements, cancelled checks etc.

The value of the preferred stock held by AGE in SCO will be independently valued by NDPR.

Transaction in JPDA-Non-Annex F

Same as above in Annex F.

In *Situation* 4

Transaction in JPDA-Annex F

The issue here is whether NDPR will permit any amount invested by AGE in SCO or the amount invested in HER by SCO or through SCO as deductible tax basis in the circumstances described in Situation 4. To frame the question differently, if an Article 11(Taxation Code) transaction was consummated by AGE and SCO in the manner described in Situation 3 but before commercial discovery, will NDPR allow any amount as deductible as tax basis against the proceeds ($150 million) received from the alienation of 90 % of the shares of SCO by AGE?

The principal asset of SCO is HER and HER holds 50% participating interest in JPDA PSC 16X-P2. The sale of 90% of the shares of SCO to KPC as described in Situation 3 is tantamount to the alienation of shares in a Company with asset (wholly or principally, directly or indirectly, including for example a chain of companies) within the Joint Production Development Area (JPDA). The transaction is therefore within the ambit of Article 11 of the Taxation Code of the TST.

A substantial part of the pre-commercial discovery/pre-production expenditure of a Contractor is traditionally constituted by acquisition costs, geological and geophysical (G&G) costs, support equipment, explorative and development drilling costs etc. Such costs are required to be capitalized when incurred in Annex F of the JPDA[11]. Such intangible costs, developed or acquired, are only deductible from the date of the first production as stipulated in Sections 5(1)(c) and 5(2)(c) of TBUCA.

Furthermore, Section 16 (Transfer of Rights or Stakes in a Petroleum Project) of TBUCA provides:

1. In the event all the stakes held by a contractor in a petroleum project are transferred or assigned to another contractor, the acquiring contractor shall be treated as if he or she had the same gross revenues and deductible expenses, concerning the rights or stakes held by the transferor or assignor, just before the transfer or assignment occurred. For the purposes of calculating the accrued net revenues of the acquiring contractor in the tax year in which such transfer or assignment occurs, the accrued net revenues of the transferring or assigning contractor, at the closure of the previous tax year, shall be treated as the accrued net revenues of the acquiring contractor in the previous tax year.

2. In the event that just a portion of the contractor's rights or stakes in a petroleum project is transferred or assigned to another contractor:

(a) The acquiring contractor shall be treated as if he or she had received the gross revenues and incurred the deductible expenses pertaining to that portion of the rights or stakes held by the transferring or assigning contractor, in relation to the totality of a right or stake, just before the occurrence of the transfer or assignment, multiplied by the percent transfer factor; and

(b) For the purposes of calculating the accrued net revenues of the acquiring contractor in the tax year in which the transfer or assignment occurred, the accrued

[11] Section 5(1)(c) & 5(2)(c), Taxation of Bayu-Undan Contractors Act, Law No. 3/2003.

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net revenues of the transferring or assigning contractor, at the closure of the previous tax year, multiplied by the percent transfer factor, shall be treated as the accrued net revenues of the acquiring contractor in relation to the previous tax year.
3. For the purposes of this section, "percentage factor of transfer" is the percentage of a right or stake held by the transferring or assigning contractor, in a petroleum project, which is either transferred or assigned, divided by the total percentage of the right or stake held by the assigning contractor in the petroleum project before the occurrence of the transfer or assignment.

By the combined effect of Sections 5(1)(c), 5(2)(c) and 16 of TBUCA, the transferor of a property subject to Article 11 of the Taxation Code of the TST and which property is located within Annex F part of the JPDA will not be allowed to claim the tax basis of the transferred property against the proceeds received if the transaction was consummated before the commencement of the first production. In Scenario 4 described above, KPC will "inherit" such intangible costs as stipulated in Section 16 of TBUCA. Effectively the entire proceed (less any transaction costs) received by AGE for the sale of 90% of the common stock of SCO to KPC will be subject to tax at 30%.

Some taxpayers have argued that the provisions of the TBUCA are inapplicable to the fact patter described in Situation 4. They argued that the provision of Section 116 is specific to Bayu Undan Contractors and **only** relevant to Additional Petroleum Tax (APT), and which has a special project taxation rule which ignores gains/losses on the sale and purchase of interests in projects.
NDPR rejects such a view as misleading and incorrect, both in law and in fact. The TBUCA is not exclusive to APT matters. It covers a whole gamut of tax issues unrelated to APT. For example, Section 2-10 of TBUCA has no direct bearing on APT.
NDPR will extend the application of Section 16 of TBUCA in the circumstances described in Situation 4. To do otherwise, NDPR will be facilitating a "double-dip" opportunity over the same tax asset for the transferor and the transferee inheriting the "deductible expenses" of the transferor under Section 16 (2)(a) of TBUCA. If the transferee is deemed to have inherited the G&G expenses of the transferor as stipulated under Section 16(2)(a) of TBUCA, and the same expenses may for part of the depreciable or amortizable asset after the commencement of production, it is inconceivable that the same "asset" will be allowed as a tax deductible basis to AGE and or SCO in the transaction and circumstances described in Situation 4.

In *Situation* 4
Transaction in JPDA- Non-Annex F
Other than the applicable laws, the tax consequences of the transaction described in Situation 4 in Annex F are exactly the as those in Non-Annex F in similar circumstances.
Section 77.5 of the TDA provides:
"Notwithstanding anything in Sections 36 and 37, a depreciable asset or intangible acquired, created, constructed, or incurred by a Contractor before commercial production is depreciated or amortised 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 Tax Administration, with the advice of the Ministry or Designated Authority, as the case may be."

Section 79 (Transfer of Interest in Petroleum Agreement) of the TDA provides:
"If a Contractor transfers an interest in a Petroleum Agreement:
(a) The transferee Contractor continues to amortise any Exploration or Development Expenditure in the manner and on the same basis that the original Contractor amortized the expenditure; and
(b) Sections 36 and 37 apply to any other depreciable assets or intangibles at the rates specified in the Schedule X."

Furthermore, Section 88 (Transfer of Interest in Petroleum Operations) of the TDA provides:
88.1. If the whole of a Contractor's interest in Petroleum Operations 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 contractor had immediately before the transfer.
For the purposes of calculating the transferee Contractor's accumulated net receipts for the tax year in which the transfer occurred, the transferor Contractor's accumulated net receipts at the end of the previous tax year is treated as the transferee Contractor's accumulated net receipts for that previous year.

Section 88.2: If part of a Contractor's interest in Petroleum Operations 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 tax year in which the transfer occurred, the transferor Contractor's accumulated net receipts at the end of the previous tax year multiplied by the transferred percentage factor is treated as the transferee Contractor's accumulated net receipts for that previous tax year.
88.3 In this Section, "transferred percentage factor" means the transferor Contractor's percentage ownership of the Petroleum Operations that is transferred divided by the transferor Contractor's total percentage ownership in the Petroleum Operations prior to the transfer.

In spite of the difference in language, the tax effect of Sections 77.5 and 88 is exactly on all fours with that of Sections 5(1)(c) and 4(2)(c) of TBUCA. Similar to the tax consequences in Annex F in Scenario 4 described above, KPC will "inherit" the intangible costs as stipulated in Section 77.5 of the TDA.
The entire proceed (less any transaction costs) received by AGE for the sale of 90% of the common stock of SCO to KPC in the circumstances described in scenario 4 above will be subject to tax at 30% if the transaction involved the alienation of property within the Non-Annex F part of the JPDA.

Some taxpayers have also challenged the basis of NDPR's position relating to the joint and several liability of any related entities involved with an Article 11(Annex G) transactions.
The principle of joint and several liability is well entrenched in common law jurisdiction as well as a good number of civil law countries (where it is described as "solidarity obligation") and it is applicable in cases where the right to demand payment of the whole claim from two related or similarly situated parties involved in the transaction creating the claim, and payment by one of them discharges the debtor completely. The paying party retains the right of subrogation.
Most Article 11(Annex G) transactions (transferring shares and or selling other properties) would ordinarily involve **both** the entity with a PE status in Timor-Leste and the "owners' of the shares of the PE or the "alter ego" of the PE.

The Principal author of this Public Ruling is Mr B.W. Boye Esq., Petroleum Revenue Legal Advisor, NDPR (bboye@mof.gov.tl).

Dated February 1, 2012

The effective date of this Public Ruling is May 20, 2002 and it is applicable to any and all transactions within Article 11 (Annex G) of the Timor Sea Treaty.

This Public Ruling is issued by:

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

Câncio de Jesus Oliveira
Director General & Tax Commissioner
Directorate of Revenue & Customs
Timor-Leste