EAST TIMOR REVENUE SERVICE

SERVIÇOS DE RECEITAS DE TIMOR LOROSA'E

ETRS/SRTL
Public Ruling 2001/9

Public Ruling: Apportioning expenses when some income is not subject to withholding tax

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.

Introduction

1. A single business may derive income from the supply of different types of services where some of the income is subject to withholding tax and some is not but instead is subject only to ordinary assessment. Of the income subject to withholding tax, some may be subject to final withholding tax and some may be subject to a non-final withholding tax. Where income is subject to a non-final withholding tax, it will also be subject to ordinary assessment. Depending on whether the withheld tax is greater or less than the tax due based on the ordinary assessment calculations, further tax may be payable by the taxpayer or some withholding tax may be refunded to the taxpayer following an ordinary assessment.

2. Where a taxpayer derives income subject to final withholding tax and other income that is subject to ordinary assessment (whether or not it is also subject to a non-final withholding tax), it is necessary to attribute expenses incurred by the taxpayer to the derivation of the income subject to final withholding and to income subject to ordinary assessment. If deductions are allowed for the expenses attributed to income subject to ordinary assessment, those expenses can be taken into account when calculating taxable income in respect of that income.

3. It will be clear in many cases whether expenses incurred by a taxpayer are related to the derivation of income subject to final withholding tax or to the derivation of income subject to ordinary assessment. Difficulties may arise, however, where contrary to the taxpayer's hopes, expenses do not lead to the production of income. Attribution may also be difficult in the case of expenses such as overhead expenses attributable to the general operation of a business rather than specific income-earning activities. This ruling explains how expenses, and in particular the latter two types of expenses should be allocated where a taxpayer derives income subject to final withholding tax and income subject to ordinary assessment. The

second (next) part of this ruling addresses the question of expenses that can be attributed directly to the derivation of one type of income or the other. The third part of this ruling addresses the question of expenses attributable to the general operation of a business rather than specific income-earning activities. The fourth part of this ruling explains how expenses do not lead to the production of income.

Expenses that can be attributed directly to the derivation of a type of income

4. Expenses that can be attributed directly to the derivation of a particular type of income must be treated as incurred to derive that income. If expenses are incurred to derive income subject to final withholding tax, they cannot be taken into account when calculating taxable income under the ordinary assessment system.

5. For example, expenses incurred by a construction company for the wages of workers who have been employed on a particular construction project cannot be taken into account when calculating the company's income from other activities because the income from the construction project will have been subject to a final withholding tax.

General expenses that cannot be attributed directly to the derivation of a type of income

6. Where a business carries on more than one type of activity, it may incur general expenses that are not directly attributable to the derivation of a particular type of income. Where an expense is attributable to more than one type of income, it must be apportioned between the different types of income on a pro-rata basis. If it is not possible to directly attribute expense to different types of income, attribution must be done on a pro-rata basis.

7. Where expenses are subject to general deduction restrictions, the effect of these restrictions are applied to expenses before the expenses are attributed to particular types of income.

Example:

Brisbane Construction and Retailing Company has a paid up capital of $10,000 and debt of $40,000. It incurs the following expenses in 2001:

$3,000 interest expenses
$5,000 wage expenses of construction workers who work exclusively on construction projects
$6,000 wage expenses of retail shop assistants who work exclusively in the retail operations of the company

$9,000 general operating expenses for the head office, including manager's salary

In 2001 the company derives $30,000 from its retail operations and $20,000 from its construction activities. The income from construction activities is subject to final withholding tax. The income from retailing operations is subject to ordinary assessment.

The wage expenses are directly attributable to different types of income. Accordingly, the wages of the construction activities workers cannot be deducted when calculating taxable income under the ordinary assessment rules. The wages of the retail workers can be deducted (so long as the company properly withheld wage income tax from the wages).

The general operating expenses for the head office are pro-rated between the construction income and the retail income. Thus, one-third of the general operating expenses (or $3,000) is deductible when calculating taxable income under the ordinary assessment rules.

Before the interest expenses can be apportioned, Section 16 of Directive 2001/2 must be applied to find the amount of interest that can be treated as incurred by the taxpayer. In this case, the taxpayer is treated as not incurring interest expenses on debt in excess of $20,000. Thus, it will be treated as having incurred one-half its interest expenses or $1,500. This expense will then be apportioned between the retail and construction income so one-third ($500) is deductible when calculating taxable income under the ordinary assessment rules.

Date of effect

8. This Ruling has effect from 31 March 2001.

Thomas Story
Commissioner of East Timor Revenue Service
31 March 2001