

DEMOCRATIC REPUBLIC OF TIMOR-LESTE

NATIONAL PARLIAMENT

Law No. 5 /2002, of 20 September

REVENUE SYSTEM AMENDMENT ACT

The tax system of Timor-Leste has evolved from UNTAET Regulation No. 2000/18, of 30 June, which is based on the Income Tax Law from Indonesia.

That instrument has undergone a number of specific modifications during its period of effectiveness, of which the latest one is contained in UNTAET Regulation No. 2001/20, of 21 July.

The alterations made were predicated on the principle of equity and efficiency and aimed at increasing tax revenues. Nonetheless, they proved to be insufficient to address the growing needs of the fledgling economy of Timor-Leste, which lacks tax revenues to fund the most urgent public expenditures.

The approval of a legal instrument reflecting these two situations has become compelling in the wake of the needs identified and the restoration of the territory's independence on 20 May 2002.

The key innovations are as follows:

1. 1. The connotative expressions of the transitional regime have been either deleted or replaced by others. For instance, the wording "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" gave way to the "Timor Sea Treaty", signed on 20 May 2002 between the Government of the Democratic Republic of Timor-Leste and the Government of Australia; the term "Transitional Administrator" has been replaced by "Prime Minister";
2. 2. Rules have been introduced to determine the date of import and production of goods;
3. 3. The minimum income tax payable by any taxpayer carrying on business activities in each tax year has been introduced; the applicable tax is 1% on the total of his or her turnover;
4. 4. The rate of services tax, of sales tax and of import duty was increased by 20%, rising to 12%, 6% and 6%, respectively;

5. 5. With relation to selective excise tax, which suffered a 20% rate increase, the incidence of the tax rate shall now fall on the sum of the customs value of the goods plus import duty;
6. 6. The systematics of wage income tax for taxpayers who are residents of Timor-Leste has been replaced by a credit granting methodology; monthly income of up to US \$ 550 is subject to a rate of 10%, but income of up to US \$ 100 benefits from a credit of US \$ 10; income in excess of US \$ 550 are subject to a rate of 30%, which falls on its excess increased by US \$55;
7. 7. With relation to the rates of income tax, a change of taxes applicable to corporate bodies, except for natural persons, has occurred;
8. 8. Criteria for deducting interest charges have been defined and deduction of an instalment from reserves considered.

With these alterations, the general structure of the revenue system of Timor-Leste is now more attuned to its economy, and is expected to form a solid basis for the establishment, in the future, of the independent tax legislation of Timor-Leste.

Meanwhile, when compared with tax rates from other countries of the same pool, the rates of excise tax in Timor-Leste are lower than the ones applied either internationally or in the region. On the other hand, since the bulk of the domestic revenue is generated by excise taxes, an increase in such taxes might have a relative impact on the revenue.

The present tax law rests on the fact that the share of domestic revenues in the composition of revenues for the next budgets will be small. Hence, there is an urgent need to find ways and means to help fund budgetary expenditures over that period, until such a time as oil and gas revenues can ensure adequate budgetary funding.

Until it becomes possible, efforts must be made to increase the domestic capacity to fund budgetary expenditures, in such a manner that as many resources as possible can be earmarked for addressing the needs of the population, especially of its poorest and most needy segment. However, taking into consideration the current economic circumstances of the country, there exist but a few realistic options to mobilise significant revenue amounts without resorting to an increase in excise taxes.

These are the fundamentals upon which the proposed increase of the rates of excise taxes rests. According to estimates, such an increase might generate an additional US \$ 2.60 million in annual revenue, that is, approximately 17% above the US \$ 15 million in domestic tax revenue collected in 2001.

It should be noted that the proposed tax increase does not run counter to the poverty reduction objectives contained in the National Development Plan, as the Government is thereby seeking to secure additional resources to fund budgetary actions to that effect. On the other hand, this measure will have a redistributive effect in the sense that its effects will fall more acutely on goods and services that are sought by the higher-income segments of the population.

The other measures that comprise the present law are designed to improve the tax system in order to avoid distortions that might negatively impact the budgetary revenue.

Finally, it must be pointed out that the present law refers to the first step in the improvement process of the tax legislation of Timor-Leste. With the approval of such law, the tax legislation introduced by UNTAET through UNTAET Regulation No. 2000/18, of 30 June, including the subsequent modifications thereof, is amended and adjusted.

Pursuant to subsection 1 and subsection *p*) of subsection 2 of section 95 and subsection 2 of section 144, of the Constitution, the National Parliament enacts the following that shall have the force of law:

PART I PRELIMINARY PROVISIONS

Section 1 Short title

The present law may be referred to as “Revenue System Amendment Act 2002”.

Section 2 Definitions

In the present law:

“UNTAET Directive No. 2001/2” is UNTAET Directive No. 2001/2, of 31 de March 2001, on the calculation of taxable income of taxpayers and administrative matters relating to the income tax; and

“UNTAET Regulation 2000/18” is UNTAET Regulation No. 2000/18, of 30 June 2000, on a Taxation System for East Timor, as amended by UNTAET Regulation No. 2000/32, of 29 September 2000, UNTAET Regulation No. 2000/35, of 20 December 2000, by UNTAET Regulation No. 2001/16, of 21 July 2001, by UNTAET Regulation No. 2001/17, of 21 July 2001, and by UNTAET Regulation No. 2001/20, of 21 July 2001.

PART II COMMON MODIFICATIONS

Section 3 Modifications to definitions

1. Section 3 of UNTAET Regulation No. 2000/18 and section 1 of UNTAET Directive 2001/2 are modified in the definition “East Timor” by deleting the words: “or 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”.

2. Section 3 of UNTAET Regulation No. 2000/18 is modified as follows:

a) The following definition is inserted after the definition of the term “Law on Income Tax”:

“Minister” means the Minister of Planning and Finance;

b) The following definition is inserted after the definition of the term “telecommunications services”:

“Timor Sea Treaty” is the Timor Sea Treaty entered into between the Government of the Democratic Republic of Timor-Leste and the Government of Australia and dated 20 May 2002.

PART III MODIFICATIONS TO UNTAET REGULATION N° 2000/18

Section 4

Deletion of references to the Transitional Administrator, the National Council, the Central Fiscal Authority and the Memorandum of Understanding

1. 1. UNTAET Regulation No. 2000/18 is modified by replacing the term “Transitional Administrator”, whenever used therein (except in sections 8. 4 and 99.4), by the word “Minister”.

2. 2. UNTAET Regulation No. 2000/18 is modified by replacing the term “National Council”, wherever used therein, by the term “Council of Ministers”.

3. 3. UNTAET Regulation No. 2000/18 is modified by replacing the expression “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”, entered into between UNTAET, on behalf of East Timor, and the Government of Australia”, wherever used therein (except in the definition of “East Timor” in section 3), by the term “Timor Sea Treaty”.

4. 4. UNTAET Regulation No. 2000/18 is modified by replacing the term “Head of the Central Fiscal Authority”, wherever used therein (except in sections 4.2, 85.2 and 94.2), by the expression “Minister of Planning and Finance”.

5. 5. UNTAET Regulation No. 2000/18 is modified by replacing the terms “Central Fiscal Authority”, in sections 4.1 and 94.1, by the terms “Ministry of Planning and Finance”.

6. 6. Sections 4.2, 85.2 and 94. 2, of UNTAET Regulation No. 2000/18, are modified by deleting the following expression “ and on advice of the Head of the Central Fiscal Authority”.

7. Sections 8.4 and 99.4, of UNTAET Regulation No. 2000/18, are modified by replacing the terms “Transitional Administrator” by the terms “Council of Ministers”.

Section 5
Date of import or production

Section 19 of UNTAET Regulation No. 2000/18 shall now apply with the wording as follows:

“Section 19
Date of import or production”

1. For the purposes of the present Regulation, goods are imported the moment they enter Timor-Leste and a Customs Control Form 1, dully completed, or other report on the goods as required under the present Regulation or a customs procedure directive is provided to an officer of the Customs Service.

2. For the purposes of the present Regulation:

a) In the case of goods supplied to a third person, goods are produced the moment one of the following events occurs earlier:

- i) issuance of a supply invoice,
- ii) delivery or availability of goods to the recipient of the supply,
- iii) receipt of payment for the supply;

b) In the case of goods consumed by the producer, goods are produced the moment they are consumed.”

Section 6
Minimum income tax

The following section is inserted after section 36 of UNTAET Regulation No. 2000/18:

“Section 36-A
Minimum income tax”

1. Every taxpayer conducting business activities shall be liable for a minimum income tax for each tax year. The amount of minimum income tax payable for a tax year is one percent (1%) of the taxpayer’s total turnover for that year.

2. The income tax payable by a taxpayer for a tax year under the present Regulation shall be credited against the minimum income tax payable by the taxpayer for that year. Where the income tax payable exceeds the minimum income tax payable, no amount shall be payable under subsection 1 above for that year.
3. Minimum income tax shall be treated for all purposes of the present Regulation as income tax.
4. For the purposes of this section, “total turnover” does not include any amount that is subject to a final withholding tax under section 38.3.

Section 7 Withholding tax

Section 38 of UNTAET Regulation No. 2000/18 is modified as follows:

- a) The following wording is inserted at the end of section 38.3:
 - b) “In the case of an amount of dividends, interest, royalties, or rent on land and buildings referred to in paragraph (a)(i) of Part A of Section 6 of Schedule 1, this subsection applies only where the amount is received by a natural person.”
- b) Section 38.8 is replaced by the following subsection:

“8. The instalments of income tax payable by a taxpayer are determined under Section 38 of UNTAET Directive No. 2001/2.”

Section 8 Transactions between associates

Section 91 of UNTAET Regulation No. 2000/18 is modified by replacing the phrase “ could be expected to be used had the persons not been associates” by the phrase “could be expected had the persons been dealing with each other at arm’s length”.

Section 9 Rates of services tax

Part A of Section 1 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified as follows:

- a) In paragraph a)-ii), the rate of “10%” is replace by the rate of “12%”;
- b) In paragraph b)-ii), the rate of “10%” is replaced by the rate of “12%”.

Section 10
Rates of selective excise tax

Part A of Section 2 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified as follows:

- a) In the Table:
 - i) The expression “customs value”, wherever used therein, is replaced by the expression “tax value”;
 - ii) As for items 1704, 1806, 2009, 2105, 2106, 3304, 3305, 3307, 3701-3707, 4203, 4301-4304, 7101-7112, 7113-7118, 8412, 8415, 8418, 8422, 8519-8524, 8525 20 100, 8528, 8529 10, 8529 90, 8707, 8711, 9005, 9006, 9101-9114, 9501-9508, 9601, 9613, 9614, 9616 and 9701-9706 of the Harmonised Classification System, the rate of “10%” is replaced by the rate of “12%”;
 - iii) As for item 2202 of the Harmonised Classification System, the value “US \$ 0.50” is replaced by the value “US \$ 0.65”;
 - iv) As for item 2203 of the Harmonised Classification System, the value “US \$ 1.50” is replaced by the value “US \$ 1.90”;
 - v) As for items 2204-2206 of the Harmonised Classification System, the value “US \$ 2.00” is replaced by the value “US \$ 2.50”;
 - vi) As for items 2207 and 2208 of the Harmonised Classification System, the value “US \$ 7.00” is replaced by the value “US \$ 8.90”;
 - vii) As for items 2401-2403 of the Harmonised Classification System, the value “US \$ 15.00” is replaced by the value “US \$ 19.00”;
 - viii) As for item 2710 of the Harmonised Classification System, the value “US \$ 0.05” is replaced by the value “US \$ 0.06”;
 - ix) As for item 3303 of the Harmonised Classification System, the rate of “15%” is replaced by the rate of “18%”;
 - x) As for items 3604 and 9301-9307 of the Harmonised Classification System, the rate of “100%” is replaced by the rate of “120%”;
 - xi) As for item 8703 of the Harmonised Classification System, the rate of “30%”, wherever used therein, is replaced by the rate of “36%”, and the value “US \$ 400” is replaced by the value “US \$ 500”;

xii) As for private yachts and private aircraft, the expression “30% of the customs value in excess of US \$ 20,000” is replaced by the expression “12% of the tax value of up to US \$ 20,000, inclusive, and 36% of the tax value in excess of US\$ 20,000”;

b) The following is inserted after the Table:

“In this Table, “tax value” means the total of the customs value of goods increased by the value of any import duty payable on goods under section 27 of the present Regulation.”

Section 11
Rate of sales tax

Paragraph a) of Part A of Section 3 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified by replacing the rate of “5%” by the rate of “6%”.

Section 12
Rate of import duty

Part A of Section 4 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified by replacing the rate of “5%” by the rate of “6%”.

Section 13
Rates of wage income tax

Section 5 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified as follows:

a) The table under item i) of paragraph a) of Part A is replaced by the following table:

MONTHLY TAXABLE WAGES	RATE
0 – US \$ 550	10%
Above US \$ 550	US \$ 55 + 30% of the amount of wages above US \$ 550

b) The following paragraph is inserted after paragraph b) of Part A:

“c) Each employee is entitled to a personal tax credit of \$10 per month against the wages income tax payable for the month. Where the amount of the credit allowed to an employee for a month exceeds the amount of wages income tax payable by the employee in respect of wages for that month, the excess is neither refunded to the employee nor carried forward to the next month.”

Section 14
Rates of income tax

Paragraph b) of Part A of Section 6 of Schedule 1 to UNTAET Regulation No. 2000/18 is modified as follows:

a) The following item is inserted before the Table:

“i) In the case of a natural person:”

b) The following item is inserted after the Table:

“(ii) In the case of any other person, 30%.”

PART IV
MODIFICATIONS TO UNTAET DIRECTIVE No. 2001/2

Section 15
Reserves

Section 12.2 of UNTAET Directive No. 2001/2 is modified by inserting the following wording, at the end:

“The amount of the deduction allowed under this section shall be defined by the Government, in consultation with the Banking and Payments Authority.”

Section 16
Deduction for interest paid

Section 16 of UNTAET Directive No. 2001/2 shall now apply with the following wording:

“Section 16
Deduction for interest paid

1. The total amount of interest charges that may be deducted by the taxpayer in each tax year shall not exceed the equivalent to the sum of the interest received by the taxpayer in that year plus 50% (fifty per cent) of the taxpayer’s net income, excluding the interest received in that year; the taxpayer’s net expenditure, excluding the interest paid, is the taxpayer’s annual gross income (interest income excepted) minus the total value of the deductions allowed to the taxpayer in that year, excluding deduction for interest expense.

2. The amount of interest charges that has not been deducted in a tax year, under subsection 1 above, may be carried forward to the next tax year as interest expense incurred in that year. An amount carried forward under this section may be carried forward for a maximum

of five tax years. Where a taxpayer has an amount of interest expense carried forward for more than one tax year, the interest expense incurred in the first tax year shall be deducted first.

3. This section does not apply to financial institutions.”

Section 17 **Instalments of income tax**

Section 38 of UNTAET Directive No. 2001/2 shall now read:

“Section 38 Instalments of income tax”

1. Without prejudice to section 38. 2 below, a taxpayer shall pay in monthly instalments the income tax for that fiscal year. The amount of the each instalment is 1% (one per cent) of the taxpayer’s total turnover in a month.

2. A taxpayer whose total turnover in the previous fiscal year is an amount of up to US \$ 1,000,000 pays income tax for that year in quarterly instalments. The instalments correspond to the quarters ended on 31 de March, 30 June, 30 September, and 31 December; the amount of each instalment is 1% (one per cent) of the taxpayer’s total turnover in that quarter.

3. Instalments of income tax shall be paid not later than the 15th day from the end of the period to which they apply.

4. Instalments of income tax payable by a taxpayer in a given tax year shall be credited against the taxpayer’s tax liability for income tax of that same year; where the amount of instalments exceeds the taxpayer’s tax liability for income tax, the excess is neither refunded to the taxpayer nor carried forward to the next tax year, but rather the amount shall be credited against the taxpayer’s liability for minimum income tax of that same year.

5. For the purposes of the this section, the taxpayer’s total turnover in a month does not include any amount received in that month and that is subject to withholding tax.”

Section 18 **Depreciation rates**

Part B of Schedule 1 to UNTAET Directive No. 2001/2 is modified as follows:

- a) In the table under subsection 1:
 - i) in the third line, “9-16” is replaced by “more than 9”;
 - ii) the fourth line is deleted;
- b) In the table under subsection 2, the fourth line is deleted;

- c) In the table under subsection 3:
- i) in the third line, “9-16” is replaced by “more than 9”;
- ii) the fourth line is deleted.

PART V
TRUST FUND FOR TIMOR-LESTE

Section 19
Exempt remuneration

UNTAET Regulation No. 2000/18 is modified by inserting the following section after section 38:

“Section 38^o-A
Exempt remuneration”

1. The remuneration received for services provided by natural persons shall be exempt from wages income tax and income tax where the remuneration is financed out of the Trust Fund for East Timor.

2. For the purposes of this section, “Trust Fund for Timor-Leste” means the Trust Fund for East Timor established under the Trust Fund for East Timor Agreement, dated 9 December 1999, between the United Nations Transitional Administration in East Timor and the International Development Association.”

PART VI
FINAL PROVISIONS

Section 20
Entry into force and application

1. The present law, with the exception of subsection 1 and paragraph b) of section 3.2 and section 4.3, shall enter into force on 1 July 2002.

2. Subsection 1 and paragraph b) of section 3.2 and section 4.3 shall enter into force on the date of ratification of the Timor Sea Treaty and shall apply as from 20 May 2002.

3. Sections 1, 2, 5, 7, 8 and 20 shall apply as from 1 July 2002.

4. Paragraph a) of section 3.2 and sections 4.1, 4.2, 4.4, 4.5, 4.6 and 4.7 shall apply as from 20 May 2002.

5. Section 9 shall apply to the specified services provided from 1 July 2002.

6. Section 10 shall apply to goods imported or produced from 1 July 2002.
7. Sections 11 and 12 shall apply to goods imported from 1 July 2002.
8. Section 13 shall apply to taxable income earned from 1 July 2002, inclusive.
9. Sections 6, 14, 15, 16 and 18 shall apply to tax years ending on 31 December 2002 and subsequent years; where a taxpayer is authorised to use a substituted tax year, sections 6, 14, 15, 16 and 18 shall apply to the first tax year ending after 31 December 2002.
10. Section 19 shall apply as from 1 January 2000.
11. Section 17 shall apply to tax years ending on 31 December 2003 and subsequent years; where a taxpayer is authorised to use a substituted tax year, section 17 shall apply to the first tax year ending after 31 December 2003.
12. For the purposes of this section:
 - a) “Timor Sea Treaty” means the Timor Sea Treaty dated 20 May 2002 between the Government of the Democratic Republic of Timor-Leste and the Government of Australia;”
 - b) For the purposes of determining the date of import and production of goods section 19 of UNTAET Regulation 2000/18 (as modified by the present law) shall apply.

Confirmed on 13 August 2002.

*The Speaker of the National Parliament,
Francisco Guterres ‘Lú-Olo’*

*Promulgated on 16 August 2002
To be published.*

*The President of the Republic
José Alexandre Gusmão ‘Kay Rala Xanana Gusmão’*

