



Tonga

INCOME TAX (AMENDMENT) ACT 2015

Act 9 of 2015



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INCOME TAX (AMENDMENT) ACT 2015

Act 9 of 2015

AN ACT TO AMEND THE INCOME TAX ACT TO PROVIDE FOR THE TAXATION OF EXTRACTIVE INDUSTRIES AND OTHER MINOR MATTERS

I assent,
TUPOU VI,
19th November 2015.

BE IT ENACTED by the King and Legislative Assembly of Tonga in the
Legislature of the Kingdom as follows:

1 Short title and commencement

- (1) This Act may be cited as the Income Tax (Amendment) Act 2015.
- (2) This Act shall come into force on a date to be specified by the Minister for Revenue by Notice published in the Gazette.
- (3) In this Act, “Principal Act” means the Income Tax Act 2007 as amended.

2 Section 2 amended

Section 2 of the Principal Act is amended –

- (a) in the definition of “income tax” by inserting at the end of the definition “and includes a seabed mining royalty or petroleum royalty”;
- (b) by inserting the following definitions in correct alphabetical order –

“**arm’s length transaction**” means a transaction between independent persons dealing with each other at arm’s length;

“**financial institution**” has the meaning in the National Reserve Bank of Tonga Act;

“**immovable property**” includes -

(a) a mining right or mining information as defined in section 67A; or

(b) a petroleum right or petroleum information as defined in section 67M;

“**international financial reporting standards**” means the most recent International Financial Reporting Standards issued by the International Accounting Standards Board or any successor entity taking over the role of issuing International Financial Reporting Standards;

“**petroleum royalty**” means the petroleum royalty imposed by section 67N; and

“**seabed mining royalty**” means the seabed mining royalty imposed by section 67B;

3 Section 12 amended

Section 12 of the Principal Act is amended by treating the existing section as subsection (1) and inserting the following subsection –

“(2) In this section, “business asset” includes shares in a company, or an interest in a partnership or trust, if the shares or interest derive 50% or more of their value, directly or indirectly, from immovable property.”.

4 Section 26 amended

Section 26(1)(l) of the Principal Act is amended by deleting the number “5” and replacing it with “10”.

5 Section 60 amended

Section 60 of the Principal Act is amended by –

(a) inserting the following subsection after subsection (11) –

“(12) An amount shall be Tongan-source income if the amount is derived on disposal of –

(a) immovable property in Tonga; or

- (b) shares in a company, or an interest in a partnership or trust, if the shares or interest derive 50% or more of their value, directly or indirectly, from immovable property in Tonga.”;
- (c) renumbering existing subsection (12) as subsection (13);
- (d) renumbering existing subsection (13) as subsection (14) and deleting the reference to “subsection (12)” and substituting a reference to “subsection (13)”;
- (e) renumbering existing subsection (14) as subsection (15).

6 Section 65A inserted

The Principal Act is amended by inserting new section 65A after section 65 –

“65A Thin Capitalisation

- (1) Subject to subsections (2) and (3), if a foreign-controlled resident company, other than a financial institution, has a debt-to-equity ratio in excess of 2 to 1 at any time during a fiscal year, a deduction is disallowed for the interest paid by the company during that year on that part of the debt that exceeds the 2 to 1 ratio for the period the ratio was exceeded.
- (2) If the debt-to-equity ratio of a foreign-controlled resident company exceeds 2 to 1 for a fiscal year, subsection (1) does not apply if, at all times, during the year, the amount of the debt of the company does not exceed the arm’s length debt amount.
- (3) This section applies to a non-resident company that has a permanent establishment in Tonga on the basis of the following -
 - (a) the permanent establishment is treated as a foreign-controlled resident company; and
 - (b) the debt-to-equity ratio of the permanent establishment is computed by reference to -
 - (i) the debt obligations of the non-resident company attributable to the permanent establishment; and
 - (ii) the equity of the non-resident company attributable to the operations of the company conducted through the permanent establishment.
- (4) In this section –

“**arm’s length debt amount**”, in relation to a foreign-controlled resident company, means the amount of debt that a financial institution that is not related to the company would be prepared to lend to the company having regard to all the circumstances of the company;

“**debt**”, in relation to a foreign-controlled resident company, means the greatest amount, at any time during a fiscal year, of the debt obligations of the company on which interest is payable as determined according to international financial reporting standards;

“**debt obligation**” means an obligation to make a repayment of money to another person, including an obligation arising under a promissory note, bill of exchange, or bond, but not including accounts payable or an obligation to make a repayment of money in respect of which no interest is payable;

“**equity**”, in relation to a foreign-controlled resident company, means the greatest amount, at any time during a fiscal year, of the equity of the company as determined according to international financial reporting standards and includes an obligation to make a repayment of money in respect of which no interest is payable; and

“**foreign-controlled resident company**” means a resident company in which fifty per cent or more of the beneficial ownership of the company is controlled by a non-resident person either alone or together with an associate or associates.”.

7 Parts 7A and 7B inserted

The Principal Act is amended by inserting the following new Parts after Part 7 –

“PART 7A – TAXATION OF MINING OPERATIONS

DIVISION 1 – INTERPRETATION

67A Interpretation

In this Part, unless the context otherwise requires –

“**commencement of commercial production**” means the first day of the first period of thirty (30) consecutive days during which the average level of production on the twenty-five (25) highest production days in the thirty-day period reaches a level as determined by the Chief Executive Officer with the advice of the Minister responsible for Lands;

“**farm-out agreement**” means an agreement to which section 67F applies;

“**licensed area**” means the area of land, including seabed, covered by a mining right;

“**licensee**” means a person who has been issued with a mining right;

“**minerals**” has the meaning in the Minerals Act, and includes seabed minerals, but excludes petroleum as defined in section 67M;

“**Minerals Act**” means the Minerals Act (Cap. 133) or any successor legislation dealing with mining;

“**mining additional profits tax**” means the mining additional profits tax imposed by section 67J;

“**mining development activities**” means authorised activities undertaken by a licensee in the extraction of minerals from their natural state pursuant to a mining development licence;

“**mining development expenditure**” means capital expenditure incurred by a licensee in undertaking development activities, other than expenditure incurred in acquiring a depreciable asset, and includes the following -

- (a) expenditure incurred in acquiring –
 - (i) an interest in a mining right, other than an interest referred to paragraph (a)(i) of the definition of “mining exploration expenditure”; or
 - (ii) mining information, other than mining information referred to paragraph (a)(i) of the definition of “mining exploration expenditure”;
- (b) social infrastructure expenditure incurred in accordance with a mining development licence;

“**mining development licence**” means –

- (a) a mining licence issued under the Seabed Minerals Act; or
- (b) a mining lease issued under the Minerals Act;

“**mining exploration activities**” means authorised activities undertaken by a licensee in the search for minerals pursuant to a mining exploration licence;

“**mining exploration expenditure**” means capital expenditure incurred by a licensee in undertaking exploration activities, other than expenditure incurred in acquiring a depreciable asset, and includes the following -

- (a) expenditure incurred in acquiring –
 - (i) an interest in a mining exploration licence, but only when the licence is acquired from the Government or under a farm-out agreement; or
 - (ii) mining information related to mining exploration activities, but only when the information is acquired from the Government or under a farm-out agreement;
- (b) social infrastructure expenditure incurred in accordance with a mining exploration licence;

“**mining exploration licence**” means –

- (a) a prospecting permit or exploration licence granted under the Seabed Minerals Act; or
- (b) an exploration or prospecting licence granted under the Minerals Act;

“**mining information**” means information relating to a mining right;

“**mining operations**” means mining exploration or mining development activities undertaken under a mining right;

“**mining right**” means a mining exploration licence or a mining development licence;

“**seabed minerals**” has the meaning in the Seabed Minerals Act; and

“**Seabed Minerals Act**” means the Seabed Minerals Act 2014 or any successor legislation dealing with seabed minerals activities;

“**social infrastructure expenditure**” means capital expenditure that a licensee is required to incur under a mining right on the construction of a public school, hospital, road, or similar social infrastructure;

“**Tonga Seabed Minerals Authority**” means the Tonga Seabed Minerals Authority established under Seabed Minerals Act; and

“**uplift factor**” means 120%.

DIVISION 2 – SEABED MINING ROYALTIES

67B Imposition of seabed mining royalties

- (1) There is hereby imposed a seabed mining royalty on a licensee at the rate of 3% of the export value of seabed minerals recovered under a mining right or at such higher rate as may be specified in an agreement between the licensee and the Tonga Seabed Minerals Authority.
- (2) Seabed mining royalties are payable at the time of disposal of the recovered seabed minerals and shall be accounted for to the Chief Executive Officer on a monthly basis in accordance with section 67C(3).
- (3) The export value of seabed minerals recovered by a licensee shall be the free-on-board price received or receivable by the licensee for the seabed minerals.
- (4) If a seabed mineral is exported on the basis of a cost-insurance-freight price, the export value of the seabed mineral shall be the cost insurance freight price reduced by the cost of ocean freight and insurance.
- (5) The export value of seabed minerals recovered by a licensee but lost or destroyed before sale or other disposal is such amount as determined by the Chief Executive Officer.
- (6) If the Chief Executive Officer is satisfied that the price charged for seabed minerals is not consistent with the price charged in an arm’s length transaction, the Chief Executive Officer may substitute the price charged in an arm’s length transaction.

- (7) Section 66 shall apply, with the necessary changes made, in determining the price charged in an arm's length transaction.
- (8) This section applies also to a person who recovers seabed minerals even though the person has no authority to recover such minerals.

67C Procedure relating to seabed mining royalties

- (1) A licensee liable for seabed mining royalties under section 67B shall lodge a seabed mining royalty return for each month stating the export value of seabed minerals disposed of during the month and the seabed mining royalties payable thereon.
- (2) A seabed mining royalty return for a month shall be lodged within 28 days after the end of the month and shall be in the form and manner prescribed in the Regulations.
- (3) Seabed mining royalties payable by a licensee for a month are due on the due date for lodging the licensee's seabed mining royalty return for the month.
- (4) If a licensee lodges a seabed mining royalty return for a month –
 - (a) the Chief Executive Officer shall be treated as having made an assessment of the export value of seabed minerals disposed of by the licensee during the month and the seabed mining royalties payable thereon equal to those respective amounts as specified in the return; and
 - (b) the seabed mining royalty return lodged under this section shall be treated for all purposes of this Act and the Revenue Services Administration Act 2002 as a notice of the assessment served on the licensee by the Chief Executive Officer on the day the return was lodged with the Chief Executive Officer.
- (5) If a licensee fails to lodge a seabed mining royalty return for a month –
 - (a) the Chief Executive Officer may, based on any available information and according to the Chief Executive Officer's best judgment, make an assessment of the export value of seabed minerals disposed of by the licensee during the month and the seabed mining royalties payable thereon; and
 - (b) as soon as possible after making an assessment under paragraph (a), the Chief Executive Officer shall serve the licensee with a notice of the assessment stating the following –
 - (i) the export value of seabed minerals disposed of by the licensee for the month;
 - (ii) the amount of seabed mining royalties due;
 - (iii) the amount of any penalty and interest payable in respect of the seabed mining royalties due;
 - (iv) the time, place and manner of objecting to the assessment.

- (6) Section 71 shall apply to a seabed mining royalties assessment with the necessary changes made.
- (7) Section 92 shall apply to seabed mining royalties on the basis that the reference to “tax” includes a reference to “seabed mining royalties”.

DIVISION 2 – APPLICATION OF INCOME TAX TO MINING OPERATIONS

67D Taxation of licensees

- (1) A licensee shall be subject to income tax in accordance with this Act but subject to the modifications in this Part.
- (2) If there is an inconsistency in the taxation of a licensee under the income tax as between this Part and the other Parts of this Act, this Part shall prevail.
- (3) The rate of income tax applicable to a licensee is 25%.

67E Mining exploration and development expenditure

- (1) This Act shall apply to mining exploration expenditure incurred by a licensee in relation to a licensed area on the basis that it is an intangible with –
 - (a) a useful life equal to one year; and
 - (b) a cost equal to the amount of the expenditure.
- (2) Subject to subsection (3), this Act shall apply to mining development expenditure incurred by a licensee in relation to a licensed area on the basis that it is an intangible with –
 - (a) a useful life equal to the expected life of the mining development activities to which the mining development expenditure relates; and
 - (b) a cost equal to the amount of the expenditure.
- (3) If a licensee incurs mining development expenditure or expenditure to acquire a depreciable asset for use in mining development activities before the commencement of commercial production, this Act applies on the basis that the expenditure was incurred at the time of commencement of commercial production.
- (4) Subject to subsection (5), if a licensee disposes of an interest in a mining right (other than under a farm-out agreement), any gain arising on the disposal is reduced by any mining development expenditure relating to the right incurred by the licensee that has not been deducted or recouped by the licensee.

- (5) The reference in subsection (4) to “mining development expenditure” includes only such expenditure that is not included in the cost of an asset.
- (6) Subject to subsection 67H(7), if a licensee commenced mining operations before the commencement of the Income Tax (Amendment) Act 2015, this section applies from the commencement of those operations.

67F Mining farm-out agreements

- (1) This section applies if the following conditions are satisfied –
 - (a) a licensee (referred to as the “transferor”) has entered into an agreement with a person (referred to as the “transferee”) for the transfer of an interest in a mining right; and
 - (b) the consideration given by the transferee for the interest wholly or partly includes the transferee undertaking some or all of the transferor’s work commitments in respect of the interest in the right retained by the transferor.
- (2) If this section applies:
 - (a) the value of any work undertaken by the transferee in relation to the part of the interest retained by the transferor is not included in:
 - (i) the consideration received by the transferor for the transferred interest; or
 - (ii) the gross income of the transferor; and
 - (b) the following applies to any amount in money received or receivable by the transferor for the transferred interest:
 - (i) section 52 applies to the amount in money on the basis that it is a reimbursement or recovery by the transferor of any deductions allowed for expenditure incurred by the transferor in respect of the transferred interest; and
 - (ii) if the amount in money exceeds the amount of deducted expenditure to which section 52 applies, the excess is treated as consideration received for the transferred interest.

67G Contributions to a mining rehabilitation fund

- (1) A contribution made by a licensee to a rehabilitation fund as required under the terms of a mining right granted to the licensee shall be allowed as a deduction in the fiscal year in which the contribution was made.
- (2) Subject to subsection (3), expenditure incurred by a licensee in carrying out remedial work to a licensed area as required under a mining right granted to the licensee shall be allowed as a deduction in the fiscal year in which the expenditure is incurred.

- (3) A deduction shall not be allowed under subsection (2) to the extent that the remedial work is paid for, directly or indirectly, from money made available out of the licensee's rehabilitation fund.
- (4) Amounts accumulated in a rehabilitation fund or withdrawn from a rehabilitation fund to pay for remedial work as required under a mining right shall be exempt income.
- (5) Any surplus in a rehabilitation fund of a licensee at the time of completion of all mining operations to which the fund relates shall be included in the taxable business income of the licensee for the fiscal year in which the operations are completed.
- (6) In this section, "**rehabilitation fund**" means a fund or account required to be established under a mining right to provide for the future payment of remedial work to the licensed area covered by the mining right and is managed jointly by the Minister responsible for Lands and the licensee.

67H Ring-fencing of mining operations

- (1) A deduction for expenditures incurred, wholly or partly, by a licensee in undertaking mining operations in a licensed area during a fiscal year shall be allowed only against the gross income derived by the licensee from such operations in the licensed area during the year.
- (2) If the total amount of deductions allowed under the Act to a licensee in respect of mining operations undertaken by the licensee in a licensed area during a fiscal year exceed the gross income derived from such operations in the licensed area for the year, the excess shall be carried forward and allowed as a deduction against amounts included in the gross income of the licensee from mining operations in the licensed area in the next following fiscal year of the licensee.
- (3) An amount that is not deducted under subsection (2) shall be carried forward to the next following fiscal year of the licensee and allowed as a deduction in accordance with subsection (2) in that year and so on until the amount has been fully deducted or all mining operations of the licensee in the licensed area cease.
- (4) If a licensee has an excess carried forward under subsection (2) for a licensed area for more than one fiscal year, the excess of the earliest period shall be allowed as a deduction first.
- (5) If a licensee has ceased mining exploration activities in relation to a licensed area and the licensee has a loss under subsection (2) in relation to the licensed area, the loss may be transferred to a licensed area in which the licensee undertakes mining development activities if the licensed area covered by the mining development activities falls wholly within the licensed area covered by the mining exploration activities.
- (6) When –
 - (a) a licensee has ceased mining operations in a licensed area;

- (b) the licensee has a loss under subsection (2) in relation to the licensed area; and
- (c) subsection (5) does not apply to the licensed area,

the licensee may elect, by notice in writing to the Chief Executive Officer, to treat the loss as a loss to which subsection (2) applies in relation to mining operations undertaken by the licensee in another licensed area.

- (7) If a licensee commenced mining operations before the commencement of the Income Tax (Amendment) Act 2015, this section applies from the commencement of those operations.

67I Disposal of an interest in an entity holding a mining right

- (1) This section applies if, during a fiscal year –
 - (a) company, or an interest in a partnership or trust;
 - (b) the shares or interest derive more than 50% of their value, directly or indirectly, from a mining right or rights held by a licensee; and
 - (c) the gain is Tongan-source business income under sections 12(1)(c) and 60(12).
- (2) If, as a result of a disposal referred to in subsection (1), there is a 10% or more change in the beneficial ownership of a licensee, the licensee shall immediately notify the Chief Executive Officer, in writing, of the change.
- (3) If a licensee has lodged a notice under subsection (2), the licensee shall be liable, as agent, for the income tax payable by the non-resident person in respect of the gain referred to in subsection (1).

DIVISION 4 – MINING ADDITIONAL PROFITS TAX

67J Imposition of mining additional profits tax

- (1) There is hereby imposed a mining additional profits tax on a licensee who has a positive cash balance in relation to mining operations in a licensed area for a fiscal year.
- (2) The mining additional profits tax payable by a licensee under subsection (1) for a fiscal year shall be 25% or such higher rate as may be specified in an agreement between the licensee and the Tonga Seabed Minerals Authority of the positive cash balance of the licensee for the licensed area for the year.
- (3) The mining additional profits tax payable by a licensee for a fiscal year is in addition to the income tax imposed on the chargeable income of the licensee for the year.

67K Mining cash balance

- (1) If a licensee has chargeable income in relation to mining operations in a licensed area for a fiscal year, the cash balance of the licensee for the licensed area for the year shall be the chargeable income of the licensee for the licensed area subject to the following adjustments –
- (a) the following amounts are deducted from the chargeable income of the licensee –
 - (i) expenditure incurred by the licensee during the year in acquiring a depreciable asset to the extent that the asset is used in deriving taxable business income in relation to the licensed area;
 - (ii) expenditure incurred by the licensee during the year in acquiring an intangible (other than mining exploration expenditure) to the extent that the intangible is used in deriving taxable business income in relation to the licensed area;
 - (iii) income tax paid or payable by the licensee on the chargeable income in relation to the licensed area for the year; and
 - (iv) the adjusted negative cash balance for the licensed area brought forward from the previous fiscal year as determined under subsection (3); and
 - (b) the following amounts are added to the chargeable income of the licensee –
 - (i) the total depreciation deduction allowed in computing the chargeable income of the licensee for the year in relation to the licensed area;
 - (ii) the total amortisation deduction (other than for mining exploration expenditure) allowed in computing the chargeable income of the licensee for the year in relation to the licensed area;
 - (iii) the total deduction allowed for interest and other financial charges in computing the chargeable income of the licensee for the year in relation to the licensed area;
 - (iv) the total deduction allowed in relation to a derivative financial instrument or a foreign currency hedge in computing the chargeable income of the licensee for the year in relation to the licensed area; and
 - (v) any excess carried forward under section 37 in relation to the licensed area for the year.

- (2) If a licensee has a business loss for mining operations in a licensed area for a fiscal year, the cash balance of the licensee for the licensed area for the year shall be the business loss subject to the following adjustments –
 - (a) the business loss shall be increased by the amounts specified in subsection (1)(a); and
 - (b) the business loss shall be reduced by the amounts specified in subsection (1)(b).
- (3) If the cash balance of a licensee for a licensed area for a fiscal year is negative, the adjusted negative cash balance of the licensee for the licensed area for the year shall be the negative cash balance increased by the uplift factor.
- (4) If the cash balance of a licensee for mining operations in a licensed area for a fiscal year is a positive amount, the cash balance for that year is treated as zero for the purposes of computing the cash balance of the licensee for the licensed area for the next following year.
- (5) If a licensee commenced mining operations in a licensed area before the commencement date of the Income Tax (Amendment) Act 2015, the cash balance of the licensee for the licensed area for the first fiscal year of the licensee commencing on or after that date shall be calculated on the basis that this Division applied from the commencement of the mining operations.

67L Procedure relating to mining additional profits tax

- (1) A licensee shall lodge a mining additional profits tax return for a fiscal year by the same date as the income tax return is due for that year.
- (2) A licensee shall lodge a mining additional profits tax return in the form and manner prescribed in the Regulations.
- (3) The mining additional profits tax payable by a licensee for a fiscal year shall be due on the same date as the income tax is due by the licensee for that year.
- (4) If a licensee lodges a mining additional profits tax return for a fiscal year –
 - (a) the Chief Executive Officer shall be treated as having made an assessment of the licensee's positive cash balance and mining additional profits tax payable thereon, or negative cash balance, for the year equal to those respective amounts as specified in the return; and
 - (b) a mining additional profits tax return lodged under subsection (1) shall be treated for all purposes of the Act and the Revenue Services Administration Act 2002 as a notice of the assessment served on the licensee by the Chief Executive Officer on the day the return was lodged with the Chief Executive Officer.

- (5) If a licensee fails to lodge a mining additional profits tax return for a fiscal year –
- (a) the Chief Executive Officer may, based on any available information and according to the Chief Executive Officer’s best judgment, make an assessment of the licensee’s positive cash balance and mining additional profits tax payable thereon, or negative cash balance, for the year; and
 - (b) as soon as possible after making an assessment under paragraph (a), the Chief Executive Officer shall serve the licensee with a notice of the assessment stating the following –
 - (i) the licensee’s positive or negative cash balance for the year, as the case may be;
 - (ii) the amount of mining additional profits tax (if any) due;
 - (iii) the amount of any penalty and interest payable in respect of the mining additional profits tax due;
 - (iv) the time, place and manner of objecting to the assessment.
- (6) Section 71 shall apply to a mining additional profits tax assessment with the necessary changes made.
- (7) Section 92 shall apply to mining additional profits tax on the basis that the reference to “tax” includes a reference to “mining additional profits tax”.

PART 7B – TAXATION OF PETROLEUM OPERATIONS

DIVISION 1 – PART 7B INTERPRETATION

67M Part 7B interpretation

- (1) In this Part, unless the context otherwise requires –
- “**commencement of commercial production**” means the first day of the first period of thirty (30) consecutive days during which the average level of production on the twenty five (25) highest production days in the thirty-day period reaches a level as determined by the Chief Executive Officer with the advice of the Minister responsible for Lands;
- “**contract area**” means the area of land covered by a petroleum right;
- “**contractor**” means a person who has entered into a petroleum agreement with the Government;
- “**cost petroleum**” means the share of petroleum that a contractor is permitted to take under a petroleum agreement to cover costs incurred in respect of petroleum operations;

“**development activities**” means authorised activities undertaken in the extraction of petroleum from its natural state under a petroleum agreement;

“**development expenditure**” means capital expenditure incurred by a contractor in undertaking development activities, other than expenditure incurred in acquiring a depreciable asset, and includes the following –

- (a) expenditure incurred in acquiring –
 - (i) an interest in a petroleum right, other than an interest referred to in paragraph (a)(i) of the definition of “exploration expenditure”; or
 - (ii) petroleum information, other than petroleum information referred to in paragraph (a)(ii) of the definition of “exploration expenditure”;
- (b) social infrastructure expenditure relating to development activities incurred in accordance with a petroleum right;

“**exploration activities**” means authorised activities undertaken in the search for petroleum under an exploration licence or a petroleum agreement;

“**exploration expenditure**” means expenditure incurred by a contractor in undertaking exploration activities, other than expenditure incurred in acquiring a depreciable asset, and includes –

- (a) expenditure incurred in acquiring –
 - (i) an interest in an exploration licence, or an interest in a petroleum agreement under which the exploration activities were undertaken, but only when the interest is acquired from the Government or under a farm-out agreement; or
 - (ii) petroleum information related to exploration activities, but only when the information is acquired from the Government or under a farm-out agreement;
- (b) social infrastructure expenditure relating to exploration activities incurred in accordance with a petroleum right;

“**exploration licence**” means an exploration licence issued under the Petroleum Mining Act;

“**farm-out agreement**” means an agreement mentioned in section 67R;

“**petroleum**” has the meaning in the Petroleum Mining Act;

“**petroleum additional profits tax**” means the petroleum additional profits tax imposed by section 67V;

“**petroleum agreement**” means a petroleum agreement entered into under the Petroleum Mining Act;

“**petroleum information**” means information relating to a petroleum right;

“**petroleum operations**” means exploration or development activities undertaken under a petroleum right;

“**petroleum right**” means an exploration licence or a petroleum agreement; and

“**uplift factor**” means 120%.

- (2) Subject to subsection (3), to the extent that there is any inconsistency between the operation of this Act and the terms of a petroleum agreement entered into before the commencement date of the Income Tax (Amendment) Act 2015, the petroleum agreement prevails.
- (3) For the avoidance of doubt, the requirement under a petroleum agreement entered into with a contractor prior to the commencement of the Income Tax (Amendment) Act 2015 that the Government’s share of petroleum under the agreement for a fiscal year is in full payment of the income tax payable by the contractor for the year does not apply to the following –
 - (a) the tax payable on any gain made by the contractor or any other person on a disposal, directly or indirectly, of an interest in an exploration licence or petroleum agreement;
 - (b) any tax that the contractor is liable to withhold from a payment made by the contractor.

DIVISION 2 – PETROLEUM ROYALTIES

67N Imposition of petroleum royalties

- (1) Subject to this section, there is hereby imposed a petroleum royalty on a contractor at the rate of 10% or such higher rate as may be specified in a petroleum agreement of the export value of petroleum recovered under a petroleum agreement.
- (2) Petroleum royalties are payable at the time of disposal of the recovered petroleum and shall be accounted for to the Chief Executive Officer on a monthly basis in accordance with section 67O(3).
- (3) The export value of petroleum recovered by a contractor shall be the free-on-board price received or receivable by the person for the petroleum.
- (4) If petroleum is exported on the basis of a cost-insurance-freight price, the export value of the petroleum shall be the cost-insurance-freight price reduced by the cost of ocean freight and insurance.
- (5) The export value of petroleum recovered by a contractor but lost or destroyed before sale or other disposal is such amount as determined by the Chief Executive Officer.
- (6) If the Chief Executive Officer is satisfied that the price charged for petroleum is not consistent with the price charged in an arm’s length

transaction, the Chief Executive Officer can substitute the price charged in an arm's length transaction.

- (7) Section 66 shall apply, with the necessary changes made, in determining the price charged in an arm's length transaction.
- (8) This section applies also to a person who recovers petroleum even though the person has no authority to do so.
- (9) This section shall not apply if the petroleum agreement under which the petroleum is recovered provides for a limit on the annual amount of cost petroleum equal to 60% or less of the value of petroleum recovered for a year.

67O Procedure relating to petroleum royalties

- (1) A contractor liable for petroleum royalties under section 67N shall lodge a petroleum royalty return for each month stating the export value of petroleum disposed of during the month and the petroleum royalties payable thereon.
- (2) A petroleum royalty return for a month shall be lodged in the form and manner prescribed in the Regulations and shall be lodged within 28 days after the end of the month.
- (3) Petroleum royalties payable by a contractor for a month are due on the due date for lodging the contractor's petroleum royalty return for the month.
- (4) If a contractor lodges a petroleum royalty return for a month –
 - (a) the Chief Executive Officer shall be treated as having made an assessment of the export value of petroleum disposed of by the contractor during the month and the petroleum royalties payable thereon equal to those respective amounts as specified in the return; and
 - (b) the petroleum royalty return lodged under this section shall be treated for all purposes of this Act and the Revenue Services Administration Act 2002 as a notice of the assessment served on the contractor by the Chief Executive Officer on the day the return was lodged with the Chief Executive Officer.
- (5) If a contractor fails to lodge a petroleum royalty return for a month –
 - (a) the Chief Executive Officer may, based on any available information and according to the Chief Executive Officer's best judgment, make an assessment of the export value of petroleum disposed of by the contractor during the month and the petroleum royalties payable thereon; and

- (b) as soon as possible after making an assessment under paragraph (a), the Chief Executive Officer shall serve the contractor with a notice of the assessment stating the following –
- (i) the export value of petroleum disposed of by the contractor for the month;
 - (ii) the amount of petroleum royalties due;
 - (iii) the amount of any penalty and interest payable in respect of the petroleum royalties due;
 - (iv) the time, place and manner of objecting to the assessment.
- (6) Section 71 shall apply to a petroleum royalties assessment with the necessary changes made.
- (7) Section 92 shall apply to petroleum royalties on the basis that the reference in the section to “tax” includes a reference to “petroleum royalty”.

DIVISION 3 – APPLICATION OF INCOME TAX ACT TO PETROLEUM OPERATIONS

67P Taxation of petroleum contractors

- (1) A contractor shall be subject to income tax in accordance with this Act but subject to the modifications in this Part.
- (2) If there is an inconsistency in the taxation of a contractor under the income tax as between this Part and the other Parts of this Act, this Part shall prevail.
- (3) The rate of income tax applicable to a contractor is 25%.

67Q Petroleum exploration and development expenditure

- (1) This Act shall apply to exploration expenditure incurred by a contractor in relation to a contract area on the basis that it is an intangible with –
 - (a) a useful life equal to one year; and
 - (b) a cost equal to the amount of the expenditure.
- (2) Subject to subsection (3), this Act shall apply to development expenditure incurred by a contractor in relation to a contract area on the basis that it is an intangible with –
 - (a) a useful life equal to the expected life of the development activities to which the development expenditure relates; and
 - (b) a cost equal to the amount of the expenditure.

- (3) If a contractor incurs development expenditure or expenditure to acquire a depreciable asset for use in development activities before commencement of commercial production, this Act applies on the basis that the expenditure was incurred at the time of commencement of commercial production.
- (4) If a contractor disposes of an interest in a petroleum agreement (other than under a farm-out agreement), any gain arising on the disposal is reduced by any development expenditure incurred by the contractor that has not been deducted or recouped by the contractor.
- (5) The reference in subsection (4) to “development expenditure” includes only such expenditure that is not included in the cost of an asset.
- (6) Subject to section 67T(7), if a contractor commenced petroleum operations before the commencement of the Income Tax (Amendment) Act 2015, this section applies from the commencement of those operations.

67R Petroleum farm-out agreements

- (1) This section applies if the following conditions are satisfied –
 - (a) a contractor (referred to as the “transferor”) has entered into an agreement with a person (referred to as the “transferee”) for the transfer of an interest in a petroleum right; and
 - (b) the consideration given by the transferee wholly or partly includes the transferee undertaking some or all of the transferor’s work commitments in respect of the interest in the right retained by the transferor.
- (2) If this section applies –
 - (a) the value of any work undertaken by the transferee in relation to the part of the interest retained by the transferor is not included in:
 - (i) the consideration received by the transferor for the transferred interest; or
 - (ii) the gross income of the transferor; and
 - (b) the following applies to any amount in money received or receivable by the transferor for the transferred interest:
 - (i) section 52 applies to the amount in money on the basis that it is a reimbursement or recovery by the transferor of any deductions allowed for expenditure incurred by the transferor in respect of the transferred interest; and
 - (ii) if the amount in money exceeds the amount of deducted expenditure to which section 52 applies, the excess is

treated as consideration received for the transferred interest.

67S Contributions to a petroleum decommissioning fund

- (1) A contribution made by a contractor to a decommissioning fund as required under the terms of a petroleum right granted to the contractor shall be allowed as a deduction in the fiscal year in which the contribution was made.
- (2) Subject to subsection (3), expenditure incurred by a contractor in carrying out decommissioning work to a contract area as required under a petroleum right granted to the contractor shall be allowed as a deduction in the fiscal year in which the expenditure is incurred.
- (3) A deduction shall not be allowed under subsection (2) to the extent that the decommissioning work is paid for, directly or indirectly, from money made available out of the contractor's decommissioning fund.
- (4) Amounts accumulated in a decommissioning fund or withdrawn from a decommissioning fund to pay for decommissioning work as required under a petroleum right shall be exempt income.
- (5) Any surplus in a decommissioning fund of a contractor at the time of completion of all petroleum operations to which the fund relates shall be included in the taxable business income of the contractor for the fiscal year in which the operations are completed.
- (6) In this section, "**decommissioning fund**" means a fund or account required to be established under a petroleum right to provide for the future payment of decommissioning work to the contract area covered by the petroleum right and is managed jointly by the Minister responsible for Lands and the contractor.

67T Ring-fencing of petroleum operations

- (1) A deduction for expenditures incurred, wholly or partly, by a contractor in undertaking petroleum operations in a contract area during a fiscal year shall be allowed only against the gross income derived by the contractor from such operations in the contract area during the year.
- (2) If the total amount of deductions allowed under this Act to a contractor in respect of petroleum operations undertaken by the contractor in a contract area during a fiscal year exceed the gross income derived from such operations in the contract area for the year, the excess shall be carried forward and allowed as a deduction against amounts included in the gross income of the contractor from petroleum operations in the contract area in the next following fiscal year of the contractor.
- (3) An amount that is not deducted under subsection (2) shall be carried forward to the next following fiscal year of the contractor and allowed as

a deduction in accordance with subsection (2) in that year and so on until the amount has been fully deducted or all petroleum operations of the contractor in the contract area cease.

- (4) If a contractor has an excess carried forward under subsection (2) for a contract area for more than one fiscal year, the excess of the earliest period shall be allowed as a deduction first.
- (5) If a contractor has ceased exploration activities in relation to a contract area and the contractor has a loss under subsection (2) in relation to the contract area, the loss may be transferred to a contract area in which the contractor undertakes development activities if the contract area covered by the development activities falls wholly within the contract area covered by the exploration activities.
- (6) When –
 - (a) a contractor has ceased petroleum operations in a contract area;
 - (b) the contractor has a loss under subsection (2) in relation to the contract area; and
 - (c) subsection (5) does not apply to the contract area,

the contractor may elect, by notice in writing to the Chief Executive Officer, to treat the loss as a loss to which subsection (2) applies in relation to petroleum operations undertaken by the contractor in another contract area.

- (7) If a contractor commenced petroleum operations before the commencement of the Income Tax (Amendment) Act 2015, this section applies from the commencement of those operations.

67U Disposal of an interest in an entity holding a petroleum right

- (1) This section applies if, during a fiscal year –
 - (a) a non-resident person has made a gain on the disposal of shares in a company, or an interest in a partnership or trust;
 - (b) the shares or interest derive more than 50% of their value, directly or indirectly, from a petroleum right or rights held by a contractor; and
 - (c) the gain is Tongan-source business income under sections 12(1)(c) and 60(12).
- (2) If, as a result of a disposal referred to in subsection (1), there is a 10% or more change in the beneficial ownership of a contractor, the contractor shall immediately notify the Chief Executive Officer, in writing, of the change.
- (3) If a contractor has lodged a notice under subsection (2), the contractor shall be liable, as agent, for the income tax payable by the non-resident person in respect of the gain referred to in subsection (1).

DIVISION 4 – PETROLEUM ADDITIONAL PROFITS TAX**67V Imposition of petroleum additional profits tax**

- (1) There is hereby imposed a petroleum additional profits tax on a contractor who has a positive cash balance in relation to petroleum operations in a contract area for a fiscal year.
- (2) The petroleum additional profits tax payable by a contractor under subsection (1) for a fiscal year shall be 25% or such higher rate as may be specified in a petroleum agreement of the positive cash balance of the contractor for the contract area for the year.
- (3) The petroleum additional profits tax payable by a contractor for a fiscal year is in addition to the income tax imposed on the chargeable income of the contractor for the year.

67W Petroleum cash balance

- (1) If a contractor has chargeable income in relation to petroleum operations in a contract area for a fiscal year, the cash balance of a contractor for the contract area for the year shall be the chargeable income of the contractor for the contract area subject to the following adjustments –
 - (a) the following amounts are deducted from the chargeable income of the contractor –
 - (i) expenditure incurred by the contractor during the year in acquiring a depreciable asset to the extent that the asset is used in deriving taxable business income in relation to the contract area;
 - (ii) expenditure incurred by the contractor during the year in acquiring an intangible (other than exploration expenditure) to the extent that the intangible is used in deriving taxable business income in relation to the contract area;
 - (iii) income tax paid or payable by the contractor on the chargeable income in relation to the contract area for the year; and
 - (iv) the adjusted negative cash balance for the contract area brought forward from the previous fiscal year as determined under subsection (3); and
 - (b) the following amounts are added to the chargeable income of the contractor –

- (i) the total depreciation deduction allowed in computing the chargeable income of the contractor for the year in relation to the contract area;
 - (ii) the total amortisation deduction (other than for exploration expenditure) allowed in computing the chargeable income of the contractor for the year in relation to the contract area;
 - (iii) the total deduction allowed for interest and other financial charges in computing the chargeable income of the contractor for the year in relation to the contract area;
 - (iv) the total deduction allowed in relation to a derivative financial instrument or a foreign currency hedge in computing the chargeable income of the contractor for the year in relation to the contract area; and
 - (v) any excess carried forward under section 37 in relation to the contract area for the year.
- (2) If a contractor has a business loss for petroleum operations in a contract area for a fiscal year, the cash balance of the contractor for the contract area for the year shall be the business loss subject to the following adjustments –
- (a) the business loss shall be increased by the amounts specified in subsection (1)(a); and
 - (b) the business loss shall be reduced by the amounts specified in subsection (1)(b).
- (3) If the cash balance of a contractor for a contract area for a fiscal year is negative, the adjusted negative cash balance of the contractor for the contract area for the year shall be the negative cash balance increased by the uplift factor.
- (4) If the cash balance of a contractor for petroleum operations in a contract area for a fiscal year is a positive amount, the cash balance for that year is treated as zero for the purposes of computing the cash balance of the contractor for the next following year.
- (5) If a contractor commenced petroleum operations in a contract area before the date of commencement of the Income Tax (Amendment) Act 2015, the cash balance of the contractor for the contract area for the first fiscal year of the contractor commencing on or after that date shall be calculated on the basis that this Division applied from the commencement of the petroleum operations.

67X Procedure relating to petroleum additional profits tax

- (1) A contractor liable for petroleum additional profits tax shall lodge a petroleum additional profits tax return for a fiscal year by the same date as the income tax return is due for that year.
- (2) A contractor shall lodge a petroleum additional profits tax return in the form and manner prescribed in the Regulations.
- (3) The petroleum additional profits tax payable by a contractor for a fiscal year shall be due on the same date as the income tax is due by the contractor for that year.
- (4) If a contractor lodges a petroleum additional profits tax return for a fiscal year –
 - (a) the Chief Executive Officer shall be treated as having made an assessment of the contractor’s positive cash balance and petroleum additional profits tax payable thereon, or negative cash balance, for the year equal to those respective amounts as specified in the return; and
 - (b) a petroleum additional profits tax return lodged under subsection shall be treated for all purposes of the Act and the Revenue Services Administration Act 2002 as a notice of the assessment served on the contractor by the Chief Executive Officer on the day the return was lodged with the Chief Executive Officer.
- (5) If a contractor fails to lodge a petroleum additional profits tax return for a fiscal year –
 - (a) the Chief Executive Officer may, based on any available information and according to the Chief Executive Officer’s best judgment, make an assessment of the contractor’s positive cash balance and petroleum additional profits tax payable thereon, or negative cash balance, for the year; and
 - (b) as soon as possible after making an assessment under paragraph (a), the Chief Executive Officer shall serve the contractor with a notice of the assessment stating the following –
 - (i) the contractor’s positive or negative cash balance for the year, as the case may be;
 - (ii) the amount of petroleum additional profits tax (if any) due;
 - (iii) the amount of any penalty and interest payable in respect of the petroleum additional profits tax due;
 - (iv) the time, place and manner of objecting to the assessment.
(Section 71 shall apply to a petroleum additional profits tax assessment with the necessary changes made.)
- (6) Section 71 shall apply to petroleum additional profits tax on the basis that the reference to “tax” includes a reference to “petroleum additional profits tax”.

- (7) Section 92 shall apply to petroleum additional profits tax on the basis that the reference to “tax” includes a reference to “petroleum additional profits tax.”.

8 Section 79 amended

Section 79 of the Principal Act is amended in subsection (3) –

- (a) in the English version only, by inserting “, other than services to which subsection (2) applies,” after “services”; and
- (b) in the Tonga version only, by inserting “kehe ange mei he ngaahi ngaue, ‘oku ngaue’aki ki ai ‘a e kupu si’i (2),” after “tau’ataina.”.

9 Amendment to Second Schedule

The Second Schedule to the Principal Act is amended -

- (a) by making the existing Schedule paragraph 1;
- (b) in the English version only, in the second row of paragraph 1, by inserting after “mining” the words “development activities, petroleum development activities”;
- (c) in the Tongan version only, in the second row of paragraph 1, by deleting the word “keli maka koloa” and replacing it with the following “ngaahi ngaue fakalalakaka ki he ngaue keli, ngaahi ngaue fakalalakaka petoliume”;
- (d) by inserting the following row at the end of the table –

Plant and machinery that has its first use in undertaking mining exploration activities or petroleum exploration activities		100%
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- (e) by inserting the following paragraph after paragraph 1 –

“2. In this Schedule –

“**mining development activities**” has the meaning in section 67A;

“**mining exploration activities**” has the meaning in section 67A;

“**petroleum development activities**” means development activities as defined in section 67M; and

“**petroleum exploration activities**” means exploration activities as defined in section 67M.”.

Passed by the Legislative Assembly this 5th day of October 2015.