

## **INCOME TAX BILL 2004**

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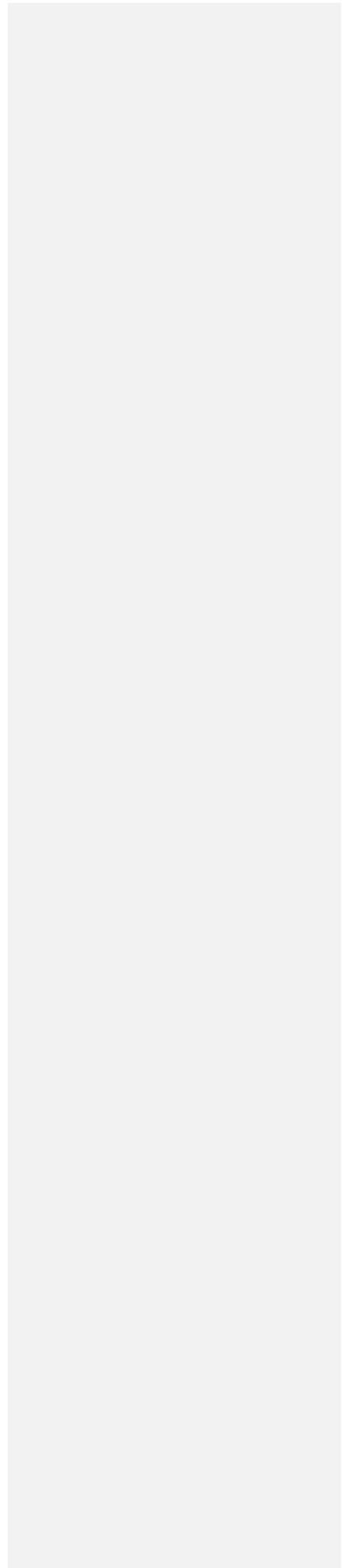
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**A BILL****for****AN ACT TO CONSOLIDATE AND MAKE PROVISION FOR INCOME TAX**

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

**PART I  
PRELIMINARY**

<b>Short Title and commencement</b>	1.	(1) This Act may be cited as the Income Tax Act 2004.
		(2) This Act shall come into force on a day to be proclaimed by His Majesty –in Council and shall apply to fiscal years as set out in the proclamation.
<b>Interpretation</b>	2.	In this Act, unless the context requires otherwise –
		“amount” includes an amount-in-kind;
		“approved retirement fund” means a retirement fund approved by the Chief Commissioner in accordance with the regulations;
		“associate”, in relation to a person, means any other person who acts or may act in accordance with the directions, requests, suggestions, or wishes of the first-mentioned person, and the second-mentioned person shall be an associate of the first-mentioned person;
		“business” includes any profession, trade, manufacture, or undertaking (including an undertaking in the nature of trade) conducted for pecuniary profit, but shall not include employment;
		“business asset” means any asset, whether of a revenue or capital nature, used or held ready for use in a business, including goodwill, trading stock, a depreciable asset, or an intangible;
		“business income” has the meaning in section 12;
		“chargeable income” has the meaning in section 10;
		“company” means –
		(a) a body or association of persons corporate or unincorporate whether incorporated, created, or formed in Tonga or elsewhere;
		(b) a foreign association of persons that the Chief Commissioner has declared to be a company for the purposes of this Act; or
		(c) a partnership,
		but does not include a trust;
		“consideration received”, in relation to the disposal of an asset, has the meaning in section 47;
		“consumption tax” means the consumption tax imposed under the Consumption Tax Act 2003;

“cost”, in relation to an asset, has the meaning in sections 45 and 46;

“debt” means an amount owing, including accounts payable and amounts owing under a promissory note, bill of exchange, debenture, security, bond, or similar financial instrument;

“depreciable asset” has the meaning in section 27;

“dividend” means –

- (a) any distribution of profits by a company to a shareholder or a partnership to a partner;
- (b) any amount returned to a shareholder in respect of a share on a partial reduction in capital to the extent that the amount returned exceeds the amount by which the nominal value of the share was reduced; or
- (c) any amount distributed to a shareholder on redemption or cancellation of a share (including in liquidation) to the extent the amount distributed exceeds the nominal value of the share;

“employee” means an individual engaged in employment;

“employer” means a person who engages or remunerates an employee;

“employment” includes –

- (a) a directorship or other office in the management of a company;
- (b) a position entitling the holder to a fixed or ascertainable remuneration; or
- (c) the holding or acting in any public office;

“employment income” has the meaning in section 13;

“exempt income” means income described as exempt income in this Act and as a consequence not included in gross income;

“fair market value” has the meaning in section 3;

“fiscal year” means –

- (a) in the case of a company, the period of twelve months ending on the date of the annual balance of its accounts; or
- (b) in any other case, the period of twelve months ending on 30<sup>th</sup> June;

“gross income” means amounts defined as gross income in section 11 and other amounts included in gross income under this Act;

“income tax” means any tax imposed under this Act;

“insurance premium” includes a premium in relation to reinsurance;

“intangible” means –

- (a) any patent, invention, design or model, secret formula or process, trademark, copyright, or other like property or right;
- (b) contractual rights with a benefit for a period of more than one year; or
- (c) any expenditure that provides an advantage or benefit for a period of more than one year, other than expenditure incurred to acquire any tangible movable or immovable property;

“interest” means –

- (a) an amount, described as interest, discount, premium, or otherwise, whether periodical or a lump sum, as consideration for the use of money or being given time to pay;
- (b) an amount that is functionally equivalent to an amount referred to in paragraph (a);
- (c) any amount treated as interest under section 43; or
- (d) a commitment, guarantee, service, or similar fee payable in respect of a debt or other instrument or agreement giving rise to interest under paragraphs (a), (b), or (c);

“liaison office”, in relation to a person, means an office of the person the sole activity of which is representation;

“member”, in relation to a company, means a shareholder, partner in a partnership, or any other person with a membership interest in the company;

“membership interest”, in relation to a company, means a share, an interest of a partner in a partnership, and any other ownership interest in the company;

“natural resource amount” means –

- (a) an amount (including a premium or like amount) as consideration for the right to take minerals or a living or non-living resource from land or sea; or
- (b) an amount calculated in whole or part by reference to the quantity or value of minerals or a living or non-living resource taken from land or sea;

“non-resident person” has the meaning in section 4(2);

“partnership” means two or more persons carrying on business jointly for common profit;

“permanent establishment” means a fixed place of business through which the business of a person is wholly or partly carried on, and includes –

- (a) a place of management, branch, office, factory, warehouse, or workshop, other than a liaison office;

- (b) a mine, oil or gas well, quarry, or other place of extraction of natural resources;
- (c) a building site, or a construction, assembly or installation project, or supervisory activities connected with such site or project, but only if the site, project or activities continue for more than ninety days;
- (d) the furnishing of services, including consultancy services, by any person through employees or other personnel engaged by the person for such purpose, but only if activities of that nature continue for the same or a connected project within Tonga for a period or periods aggregating more than ninety days within any twelve-month period;
- (e) a person (referred to as an “agent”) acting in Tonga on behalf of another person, if the agent –
  - (i) has and habitually exercises an authority to conclude contracts on behalf of the other person; or
  - (ii) habitually maintains a stock of goods or other merchandise from which the agent regularly delivers goods or merchandise on behalf of the other person; or
- (f) any substantial equipment used by a person;

“person” means an individual, trust, company, government, or public international organisation;

“presumptive income taxpayer” means a person liable for income tax under section 8;

“property income” has the meaning in section 14;

“quarter” means a period of three months ending on September 30, December 31, March 31, or June 30;

“received”, in relation to a person, includes –

- (a) applied on behalf of the person either at the instruction of the person or under any law;
- (b) reinvested, accumulated, or capitalised;
- (c) credited to an account, or carried to any reserve, sinking, or insurance fund; or
- (d) made available to the person;

“rent” means any consideration for the use or occupation of, or the right to use or occupy any land or building, including any premium, fine, or like amount;

“resident company” has the meaning in section 4(6);

“resident individual” has the meaning in section 4(3)-(5);

“resident person” has meaning in section 4(1);

“resident trust” has the meaning in section 4(7);

“royalty” means an amount, however described, whether periodical or a lump sum, as consideration for –

- (a) the use of, or right to use any patent, invention, design or model, secret formula or process, trademark, or other like property or right;
- (b) the use of, or right to use any copyright of a literary, artistic, or scientific work (including films or video tapes for use in connection with television or tapes in connection with radio broadcasting);
- (c) the receipt of, or right to receive, any visual images or sounds, or both, transmitted by satellite, cable, optic fibre, or similar technology in connection with television, radio, or internet broadcasting;
- (d) the supply of any technical, industrial, commercial, or scientific knowledge, experience, or skill;
- (e) the use of or right to use any industrial, commercial, or scientific equipment;
- (f) the supply of any assistance that is ancillary and subsidiary to, and is furnished as a means of enabling the application or enjoyment of, any property or right referred to in paragraphs (a) through (e); or
- (g) the disposal of any property or right referred to in paragraphs (a) through (e);

“taxable business income” means business income included in gross income;

“taxpayer” means a person liable for income tax under this Act and includes a person who has a business loss for a fiscal year;

“technical services fee” means an amount, however described, whether periodical or lump sum, as consideration for the rendering of any managerial, technical, or consultancy services, including the services of technical or other personnel, but does not include employment income;

“trading stock” means anything produced, manufactured, purchased, or otherwise acquired for manufacture, sale, or exchange for the purposes of producing taxable business income, and includes any materials or supplies to be consumed in the production or manufacturing process, and livestock;

“trust” means a trust established under statutory law or the laws of equity and includes a testamentary estate;

“trustee” includes the executor of a testamentary estate; and

“turnover”, in relation to a person for a fiscal year, means the gross revenue (including the gross proceeds from the disposal of a business asset) derived

by the person during the year, but not including –

- (a) exempt income;
- (b) an amount subject to separate taxation under section 6 or 7; or
- (c) an amount for which withholding tax under section 91 is a final tax.

**Fair market value** 3.

- (1) For the purposes of this Act, the fair market value of any asset, service, or benefit at a particular time shall be the ordinary open market value of the asset, service, or benefit at that time.
- (2) If the fair market value of any asset, service, or benefit cannot be determined under subsection (1), the fair market value shall be the amount determined by the Chief Commissioner.

**Residents and Non-residents** 4.

- (1) A person shall be a resident person at a particular time if, at that time, the person is a resident individual, resident company, resident trust, or the Government.
- (2) A person who is not a resident person at a particular time shall be a non-resident person at that time.
- (3) Subject to subsections (4) and (5), an individual shall be a resident individual for a fiscal year if the individual –
  - (a) has his home in Tonga at any time during the year;
  - (b) is present in Tonga for a period of, or periods amounting in aggregate to, one hundred eighty-three days in any twelve month period that commences or ends during the year; or
  - (c) is an employee of the Government posted abroad at any time during the year.
- (4) An individual who is a resident individual under subsection (3) for a fiscal year, in this section referred to as the “current fiscal year”, but who was not a resident individual for the preceding fiscal year shall be treated as a resident individual in the current fiscal year only for the period commencing on the day on which the individual was first present in Tonga.
- (5) An individual who is a resident individual for the current fiscal year but who is not a resident individual for the following fiscal year shall be treated as a resident individual in the current fiscal year only for the period ending on the last day on which the individual was present in Tonga.
- (6) A company shall be a resident company for a fiscal year if the company –
  - (a) is incorporated, created, or formed in Tonga;
  - (b) has the centre of its administrative management in Tonga at any time during the fiscal year; or

- (c) is a partnership with a partner who is a resident person at any time during the year.
- (7) A trust shall be a resident trust for a fiscal year if –
  - (a) the trust was settled or established in Tonga; or
  - (b) a trustee of the trust is a resident person at any time during the year.

**PART II**  
**IMPOSITION OF INCOME TAX**

**Tax on chargeable income**

5. (1) Subject to this Act, income tax shall be imposed for each fiscal year at the rate or rates specified in the First Schedule on a person who has chargeable income for the year.
- (2) The income tax imposed under subsection (1) for a fiscal year shall be computed by applying the rate or rates of tax applicable to the person under the First Schedule to the chargeable income of the person for the year, and any tax credits allowed to the person for the year are subtracted from the resulting amount.
- (3) If a person is allowed more than one tax credit for a fiscal year, the credits are applied in the following order –
- (a) the foreign tax credit allowed under section 62; then
  - (b) the tax credits allowed under sections 90 and 92.
- (4) In lieu of taxation under subsection (1), certain classes of income (including the income of certain classes of persons) may be subject to –
- (a) income tax as provided in section 6, 7, or 8; or
  - (b) withholding of tax as a final tax as provided in section 91.

**Tax on certain payments to non-residents**

6. (1) Subject to this Act, income tax shall be imposed on a non-resident person who has received Tongan-source –
- (a) interest income;
  - (b) royalties;
  - (c) technical services fees;
  - (d) dividends; or
  - (e) insurance premiums.
- (2) The income tax imposed under subsection (1) shall be –
- (a) 5% of the gross amount of the insurance premium; or
  - (b) 15% of the gross amount of the interest, royalty, dividend, or technical services fee.

**Comment [LC1]:** Purpose of (4), is a sign post provision, saying that this imposes income tax but there may be situations where that may not apply, but saying that tax may be imposed anyway.

**Comment [LC2]:** (2), the figures, necessary lower rate for insurance, because tax on gross basis (expenses), needs to be low so don't over tax, with the other, no expenses so appropriate to impose higher right. (b) interest? Eg interest paid on a debt, local company paying interest to non-resident is 15% on it, same as old rate.

**Tax on shipping and air transport income of a non-resident person**

**Presumptive income tax**

- (3) This section does not apply to –
  - (a) any interest if the debt claim or other instrument or agreement giving rise to the interest is effectively connected with a permanent establishment in Tonga of the non-resident person;
  - (b) any royalty if the property, right, or supply giving rise to the royalty is effectively connected with a permanent establishment in Tonga of the non-resident person;
  - (c) any technical services fee or insurance premium if the services giving rise to the fee or premium are rendered through a permanent establishment in Tonga of the non-resident person; or
  - (d) any interest, royalty, technical services fee, dividend, or insurance premium that is exempt income of the non-resident person.
- (4) Any interest, royalty, technical services fee, or insurance premium described in subsection (3)(a), (b), or (c) shall be treated as income attributable to the permanent establishment and shall be taxable under section 5.
- (5) The tax payable under this section is discharged if the tax has been withheld from the payment of the income under section 80.
- 7. (1) Subject to this Act, income tax shall be imposed on a non-resident person operating a ship or aircraft.
- (2) The income tax imposed under subsection (1) shall be 3% of the gross amount derived by the non-resident person for the carriage of passengers, livestock, mail, merchandise, or goods embarked in Tonga.
- (3) This section does not apply to any amount that is exempt income.
- (4) The tax payable under this section is discharged if the tax has been paid in accordance with section 74 or 75.
- 8. (1) Subject to this Act, presumptive income tax shall be imposed for each quarter on a person carrying on business –
  - (a) who is not registered or treated as registered for Consumption Tax; and
  - (b) whose annual turnover is less than \$100,000.
- (2) The presumptive income tax payable by a person for a quarter shall be 3% of the person’s turnover for the quarter.
- (3) A person to whom subsection (1) applies may apply, in writing, to the Chief Commissioner for section 5 to apply instead of this section.
- (4) If the Chief Commissioner is satisfied that a person who has lodged an application under subsection (3) will keep proper records, the Chief Commissioner may grant the application subject to such conditions as the Chief Commissioner may specify by notice in

**Comment [LC3]:** Section 6, query a constitutional question that diff treatment for diff classes of people ie residents and non-residents. Has been done that way before. All taxed, just different taxes. Crown Law ok.

**Comment [LC4]:** Current rate is low by international norms, 3% is normal international standards.

**Comment [LC5]:** Eg of exempt income, is defined probably does not apply here, but in future tonga might have double tax treaties, where normally only country of interest can tax it, anticipating future treaties, no use now.

**Comment [LC6]:** Why 3% as figure comparable to normal tax treatment? Done with assistance of economists, exp is that small traders dealing in goods, 2-3% is right coz have to buy goods first and no expenses, larger stores have higher margins 4%, = middle

writing to the applicant.

**General provisions relating to income taxes imposed under sections 6, 7, and 8**

9. Subject to this Act, the tax imposed under sections 6, 7, and 8 on a person shall be a final tax on the income in respect of which it is imposed and -
- (a) the income shall not be included in -
    - (i) gross income in computing the chargeable income of the person for any fiscal year; or
    - (ii) turnover in computing the minimum income tax liability of the person for any fiscal year;
  - (b) no deduction shall be allowable under this Act for any expenditure incurred in deriving the income;
  - (c) the amount on which tax is imposed under section 6(2), 7(2), or 8(2) shall not be reduced by any loss; and
  - (d) the tax payable by the person under section 6, 7, or 8 shall not be reduced by any tax credits allowed under this Act.

**PART III – COMPUTATION OF CHARGEABLE INCOME**

**Division I – Chargeable Income**

- Chargeable income** 10. The chargeable income of a person for a fiscal year shall be the gross income of the person for the year reduced by the total amount of deductions allowed to the person for the year.

**Division II – Gross Income**

- Gross income** 11. (1) Subject to this Act, the gross income of a person for a fiscal year shall be the total amount of -
- (a) business income;
  - (b) employment income;
  - (c) property income; and
  - (d) any other income,
- derived by the person during the year, other than exempt income.
- (2) For the purposes of subsection (1) -
- (a) the gross income of a resident person includes income derived from all sources within and outside Tonga; and
  - (b) the gross income of a non-resident person includes only Tongan-source income.
- (3) Unless the Act provides otherwise, the rules in Division V of this Part apply in determining when an amount is derived for the purposes of this Act.
12. Business income means -

**Business income**

- (a) the gross receipts, whether of a revenue or capital nature, arising from the conduct of business, including the gross proceeds from the disposal of trading stock and any consideration for accepting a restriction on the capacity to carry on business, but not including any amount taken into account in the computation of business income under paragraph (b) or (c);
- (b) any balancing charge under section 32; and
- (c) any gain arising on the disposal of a business asset, other than an asset dealt with under paragraph (a) or (b), computed as the consideration received on disposal less the cost of the asset at the time of disposal.

**Comment [LC7]:** tax on capital? With business income, if there is capital gain there is taxed, but no general capital gains tax, eg sell business and there is gain, this is business income and taxed, ie everything business earns, similarly if loss, there is deduction so similarity of treatment. If sells houses more than once, based on facts can be seen as trading in houses, but if renting, income is investment income. Has to be some repetition of activity to be carrying out a business, old principles still apply.

**Employment income**

13. (1) Employment income means any amount, whether of a revenue or capital nature, arising from employment, including -
- (a) any salary, wages, or other remuneration provided to an employee, including leave pay, payment in lieu of leave, overtime pay, bonus, commission, fees, gratuity, or work condition supplements;
  - (b) the value of any benefit-in-kind, whether convertible to money or not, as determined under the Second Schedule;
  - (c) the amount of any allowance provided by an employer to an employee, including a cost of living, subsistence, rent, utilities, education, entertainment, meeting, or travel allowance, but not including any allowance solely expended in the performance of the employee's duties of employment;
  - (d) the amount of any expenditure incurred by an employee that is paid or reimbursed by the employer, other than expenditure incurred on behalf of the employer in the performance of the employee's duties of employment;
  - (e) any amount as consideration for the agreement by a person to -
    - (i) enter into employment;
    - (ii) any conditions of employment or any changes to the employee's conditions of employment; or
    - (iii) a restrictive covenant in respect of any past, present, or prospective employment;
  - (f) any amount received on termination of employment, whether paid voluntarily or under an agreement, including any compensation for redundancy or loss of employment and golden handshake payments; or
  - (g) any pension, annuity, or supplement to a pension or annuity received in relation to employment.
- (2) For the purposes of this Act, an amount shall be treated as arising from the employment of an employee regardless of whether it is

**Comment [LC8]:** How to keep record of travel allowances for tax purposes, would come within the exemption because used solely for employment, ie here in tonga allowances, eg private sector give allowance on home leave, is not part of work but if going to nz for work would not be income. Defn travel allowance? Is the per diem. Also catches those who are over paid and used to take income out of the country (private sector). Travel allowance is the per diem, allowance given to you to cover the cost of the travel, ie hotel plus food etc is exempt, but there will be some travel allowances that will be taxable. Will also have tax ruling eg saying that if travel allowance is equal to un rate will be exempt. Covers situation where company tongan but decide hold board meeting in Australia? on face of it will be covered as long as not excessive per diem. Genuine meeting but not necessary to have it in Australia, trad position, not for ird to tell buisn how much to spend, issue here would be if genuine buisn be conducted.

**Comment [LC9]:** Eg c and d related, normal use of allowance is given, don't have to vouch for, other way, some empers require you to spend \$, bring receipts which they pay, eg outside buisn context, eg empers agreed to pay rent, but don't give you an allowance but you must produce receipt then paid. C and d to cover both these situations. School fees.

**Comment [LC10]:** (ii) eg aust award under labour agmt work 35 hrs wk, and some empers paid empees \$ as consid to give up and increase hours to 40 hrs, this is regarded as additional payment of income (iii) eg senior empee has knowledge and likely to go out a Eg c and d related, normal use of allowance is given, don't have to vouch for, other way, some empers require you to spend \$, bring receipts which they pay, eg outside buisn context, eg empers agreed to pay rent, but don't give you an allowance but you must produce receipt then paid. C and d to cover both these situations. School fees. nd set up own buisn to prevent this enter into agreement to pay \$ not to do that, which is additional remuneration and is taxable.

paid or provided by –

- (a) the employer of the employee, an associate of the employer, or by a third party under an arrangement with the employer or an associate of the employer; or
- (b) a past employer or a prospective employer.

**Property income** 14. Property income means –

- (a) any dividend, interest, royalty, rent, natural resource amount, or other amount arising from the provision, use, or exploitation of property; or
- (b) any pension, charge, or annuity, or any supplement to a pension, charge, or annuity,

but does not include an amount that is business or employment income.

**Division III – Exempt Income**

**Exempt income of King** 15. The income derived by His Majesty the King shall be exempt income.

- Exemptions provided for in other legislation**
- 16. (1) The income derived by an individual entitled to privileges under the Diplomatic and Consular Privileges Act shall be exempt income to the extent provided in that Act.
  - (2) The income derived by a public international organisation shall be exempt income to the extent provided in the [International Organisations (Privileges and Immunities) Act].
  - (3) The income derived by an individual entitled to privileges under the International Organisations (Privileges and Immunities) Act shall be exempt income to the extent provided in that Act.
  - (4) The income derived by the National Reserve Bank of Tonga shall be exempt income to the extent provided in the National Reserve Bank of Tonga Act.
  - (5) No provision in any other law providing an exemption from any income tax imposed under this Act shall have legal effect unless also provided for in this Act.

**Exemptions under international agreements** 17. Any employment income derived by an individual shall be exempt income to the extent provided for in an agreement between the Government and a foreign government or public international organisation for the provision of financial, technical, or administrative assistance to the Government.

- Exempt income of non-profit organisations**
- 18. (1) In this section –
 

“charitable purposes” includes the relief of poverty, advancement of education or religion, or any other purpose beneficial to the community; and

“non-profit organisation” means an institution, body, or trust of a public character that the Chief Commissioner has certified as conducting activities exclusively for charitable purposes.
  - (2) The income (other than business income) of a non-profit organisation

**Comment [LC11]:** Will this also covers HM as Tungi and all the income from other names. Any income that the King derives from wherever is taxed. Current wording. Covered in section 11(1)

**Comment [LC12]:** Providing by law for the exemption to technical assistance consultants etc expands section 11(j) of the current Act, needing PC approval. Agreements TA goes to cabinet or PC and is covered. Is standard practice. Once agmt entered into, reviewed by Cabinet is the protection etc so law enforces that agmt. Reason why agmt betw govt and private person is not included, noted that this is not usual, always comes through organisation. Clarity in exemptions. Disadvantage tongan residents? Eg. MOH, proj in hospital, tendered project for assessment report, overseas person got it and would be exempt, suppose local person got contract (policy agreement), depends on agreement between agencies that eg adb tonga reserves right to tax its residents. Why penalise tongan citizens (qualified)? Need to leave it to case by case basis, but wanted to take away discretion. Prob being resident, is that can be a resident quickly 183 day rule hence pegged it on the citizen issue. Take out words in brackets, agreed, leave it to the agmt. MOJ employed by govt to govt arrangement, expired and govt retained him, in agmt saying that terms no less than what was granted before, difficulty is that really raises possibility of exempt given to private persons, maybe too wide. Grossing up easiest way to deal with this.

shall be exempt income.

- |   |     |   |
|---|-----|---|
| <b>Exempt pensions</b>  | 19. | (1) A pension shall be exempt income if granted to – <ul style="list-style-type: none"> <li>(a) a member of the Tonga Defence Force for a disability suffered during any war; or</li> <li>(b) a dependent relative of an individual referred to in paragraph (a) if the individual was killed or suffered a disability during any war.</li> </ul> |
|   |     | (2) A pension or gratuity shall be exempt income if paid to an individual under the Pensions Act, Retirement Fund Act, or Legislative Assembly Act, or any other pension scheme approved by His Majesty in Council.   |
| <b>Exempt retirement and death gratuities</b>                         | 20. | Any amount derived as a retiring or death gratuity, or as consolidated compensation for death or injuries shall be exempt income.   |
| <b>Exempt Dividends</b>   | 21. | A dividend paid by a resident company to a member who is a resident person shall be exempt income.  |
| <b>Exempt income of retirement funds and life insurance companies</b> | 22. | (1) The income derived by an approved retirement fund shall be exempt income.   |
|   |     | (2) An amount contributed by an employer to a retirement fund for the benefit of an employee of the employer shall be exempt income of the employee.  |
|   |     | (3) Any premium derived by a life insurance company in respect of a life insurance policy shall be exempt income.   |
| <b>Exempt scholarships</b>  | 23. | Any scholarship granted to an individual to meet the cost of the individual's education shall be exempt income, other than if the scholarship is paid directly or indirectly by an associate.   |
| <b>Exempt maintenance payments</b>                                    | 24. | Any amount received as maintenance shall be exempt income.  |

#### Division IV – Deductions

- |  |     |   |
|--|-----|---|
| <b>General principles of deductibility</b> | 25. | (1) Subject to this Act, a person shall be allowed a deduction for – <ul style="list-style-type: none"> <li>(a) any expenditure to the extent incurred in deriving gross income;</li> <li>(b) any balancing allowance under section 32;</li> <li>(c) the cost of trading stock sold as determined under section 41; and</li> <li>(d) any loss on disposal of a business asset, other than an asset or intangible dealt with under paragraph (b) or (c), computed as the cost of the asset at the time of disposal reduced by the consideration received on disposal.</li> </ul> |
|  |     | (2) Subject to this Act, if the expenditure referred to in subsection (1) – <ul style="list-style-type: none"> <li>(a) is incurred in acquiring a depreciable asset or an intangible;</li> </ul>  |

or

(b) is preliminary expenditure,

the expenditure shall be deducted in accordance with section 27, 28, 29, 30 or 33.

(3) Unless the Act provides otherwise, the rules in Division V of this Part shall apply in determining when an amount is incurred for the purposes of this Act.

**Deductions not allowed**

26. (1) No deduction shall be allowed for any –
- (a) expenditure or loss to the extent to which it is of a domestic or private nature;
  - (b) expenditure or loss to the extent incurred in deriving employment income;
  - (c) capital withdrawn, or sum employed or intended to be employed as capital;
  - (d) expenditure or loss of a capital nature except as provided in this Division;
  - (e) amount carried to a reserve fund or capitalised in any way;
  - (f) expenditure or loss to the extent recoverable under a policy of insurance or contract of indemnity;
  - (g) income tax payable in Tonga or elsewhere, including any penalty, additional tax, or interest payable in respect of income tax due;
  - (h) fine or penalty imposed for violation of any law, rule, or regulation; or
  - (i) bribe, kickback, or similar amount.
- (2) A person required to withhold tax under section 80 in respect of an amount paid to a non-resident person shall not be allowed a deduction for the amount paid until the tax has been paid to the Chief Commissioner.

**Comment [LC13]:** If loss recoverable under insurance than is not allowed as a deduction.

**Comment [LC14]:** Why not allow person deduct interest imposed by RSAA, is deductible in Aust, but some places it is the penalty and often that interest is not market rate and it a penal rate is brings it under (h)

**Comment [LC15]:** (i) included in tax laws, try to claim it but call it something else.

**General principles of depreciation**

27. (1) In this section –
- “depreciable asset” means any tangible movable property or structural improvement to immovable property, owned by a person that –
- (a) has a useful life exceeding one year;
  - (b) is likely to lose value as a result of normal wear and tear, or obsolescence; and
  - (c) is used wholly or partly by the person in deriving taxable business income; and

“structural improvement”, in relation to immovable property, includes any building, road, driveway, car park, pipeline, bridge,

tunnel, airport runway, canal, dock, wharf, retaining wall, fence, power lines, water or sewerage pipes, drainage, landscaping, or dam.

- (2) A person shall be allowed a deduction (referred to as a “depreciation deduction”) for the amount by which the value of the person’s depreciable assets has declined during a fiscal year by reason of wear and tear from use in deriving taxable business income.
- (3) Subject to subsection (4), a person may elect for the depreciation deduction allowed under subsection (2) to be computed according to the straight-line method under section 28 or the diminishing value method under section 29 and an election so made shall apply to all depreciable assets owned by the person.
- (4) The straight-line method only shall apply to a depreciable asset that is a structural improvement to immovable property.
- (5) The cost of a structural improvement to immovable property does not include the cost of the land.
- (6) A person may apply, in writing, to the Chief Commissioner for a change in the method of depreciation and the Chief Commissioner may, by notice in writing to the applicant, approve the application subject to such conditions as the Chief Commissioner may specify in the notice.
- (7) If a depreciable asset is used in a fiscal year partly in deriving taxable business income and partly for another use, the depreciation deduction for that year shall be the fair proportional part of the amount that would be allowed if the asset were wholly used to derive taxable business income.
- (8) If a depreciable asset is not used for the whole of the fiscal year in deriving taxable business income, the depreciation deduction for the year shall be computed according to the following formula –

$$A \times B/C$$

where –

- A** is the depreciation deduction computed under section 28 or 29 after taking into account subsection (7);
- B** is the number of days in the fiscal year the asset is used or available for use in deriving taxable business income; and
- C** is the number of days in the fiscal year.

**Comment [LC16]:** Straight line equal losing value, DMV treats losing value more in early years.

**Straight-line depreciation**

- 28. (1) The depreciation deduction allowed to a person for a fiscal year in respect of a depreciable asset under the straight-line method shall be computed by applying the rate specified in the Third Schedule against the cost of the asset.
- (2) The total deductions allowed, or that would be allowed but for section 27(7), to a person under this section in respect of a depreciable asset for the current fiscal year and all previous fiscal years shall not exceed the cost of the asset.

**Diminishing value**

- 29. The depreciation deduction allowed to a person for a fiscal year in respect of a

**depreciation**

depreciable asset under the diminishing value method shall be computed by applying the rate specified in the Third Schedule against the written down value of the asset at the beginning of the year.

**Amortisation of intangibles**

30. (1) In this section, “cost” means –
- (a) in relation to an intangible referred to in paragraph (a) or (b) of the definition of “intangible” in section 2, the total expenditure incurred in acquiring, creating, improving, or renewing the intangible; or
  - (b) in relation to an intangible referred to in paragraph (c) of the definition of “intangible” in section 2, the amount of the expenditure.
- (2) A person shall be allowed a deduction (referred to as an “amortisation deduction”) computed in accordance with this section for the cost of an intangible wholly or partly used by the person in a fiscal year in deriving taxable business income.
- (3) Subject to this section, the amortisation deduction of a person for a fiscal year shall be computed according to the following formula –

$$\frac{A}{B}$$

where –

**A** is the cost of the intangible; and

**B** is the useful life of the intangible in whole years.

- (4) An intangible –
- (a) with a useful life of more than ten years; or
  - (b) that does not have an ascertainable useful life,
- shall be treated as having a useful life of ten years.
- (5) If an intangible is used in a fiscal year partly in deriving taxable business income and partly for another use, the amortisation deduction for that year shall be the fair proportional part of the amount that would be allowed if the intangible were wholly used to derive taxable business income.
- (6) If an intangible is not used for the whole of a fiscal year in deriving taxable business income, the amortisation deduction for the year shall be computed according to the following formula –

$$A \times B/C$$

where –

**A** is the amortisation deduction computed under subsection (3) or (5), as the case may be;

**B** is the number of days in the fiscal year the intangible is used or available for use in deriving taxable business income; and

**Comment [LC17]:** New provisions, buisn capital expenditures with a life beyond a year is written off during the year, depreciation deals with tangible property, but buisn also acquire other assets that old law does not cater for eg intellc propty eg soft ware, patents or expendi of capital nature eg given distribution rights ie pay coke, not covered before now treated as intangible expendit and written off depending on life of asset, the formula is accounting proced ss(6) says that if written off depending on use, diff formula dep on diff assets.

C is the number of days in the fiscal year.

**Written down value of depreciable assets and intangibles**

- (7) The total amortisation deductions allowed, or that would be allowed but for subsection (5), to a person under this section in the current fiscal year and all previous fiscal years in respect of an intangible shall not exceed the cost of the intangible.
- 31. (1) Subject to subsection (2), the written down value of a depreciable asset or intangible of a person at the beginning of a fiscal year shall be –
  - (a) if the asset or intangible was acquired during the year, the cost of the asset; or
  - (b) in any other case, the cost of the asset or intangible as reduced by the total depreciation or amortisation deductions allowed to the person in respect of the asset or intangible in previous fiscal years.
- (2) If section 27(7) applies to a depreciable asset or section 30(5) applies to an intangible for a fiscal year, the written down value of the asset or intangible shall be computed on the basis that the asset has been used solely to derive taxable business income.

**Comment [LC18]:** Intangibles is new, the depreciation is old though modified.

**Disposal of a depreciable asset or intangible**

- 32. If a person disposes of a depreciable asset or an intangible in a fiscal year there shall be no depreciation or amortisation deduction for that year and –
  - (a) if the consideration received exceeds the written down value of the asset or intangible at the beginning of the year, the excess (referred to as a “balancing charge”) shall be business income included in the gross income of the person for that year; or
  - (b) if the consideration received is less than the written down value of the asset or intangible at the beginning of the year, the difference (referred to as a “balancing allowance”) shall be allowed as a deduction in computing the chargeable income of the person for that year.

**Comment [LC19]:** Only applies to DMV not to straight line.

**Amortisation of preliminary expenditure**

- 33. (1) In this section, “preliminary expenditure” means any expenditure incurred before the commencement of a business if the income to be derived by the business will be wholly and exclusively included in gross income, other than expenditure incurred in acquiring land, a depreciable asset or an intangible.
- (2) A person shall be allowed a deduction for preliminary expenditure in the fiscal year in which the expenditure is incurred and in the following three fiscal years.
- (3) The amount of the deduction allowed in each fiscal year shall be 25% of the expenditure.

**Comment [LC20]:** If see a depreciable asset and price is higher than dep value, than diff would be liable for tax (if buisn) coz you’ve been given the dep deductions and sold it for more so captured some of that dep deductions, and if sold for less, can claim that as a deduction.

**Comment [LC21]:** Why is land exempted, buildings holds value or increases, buildings depreciate. Follows normal accounting practice and deductions are allowed for losses. Bought a lease, but here can be exempted on other expenses by not the acquiring of land, lease deductible but not land, here meant for feasibility studies, prototypes, ie steps taken before buisn starts will be recognised. Engage a valuer to value land for purpose of acquiring land – is deductible? Those expenses are deemed as being capitalised and are captured in the value of the land ie the incidental costs in acquiring the land.

**Interest**

- 34. (1) Subject to subsection (2), a person shall be allowed a deduction for any interest incurred by the person in a fiscal year to the extent to which the person has used the proceeds or benefit of the debt or other instrument or agreement giving rise to the interest to derive income included in gross income.
- (2) The total amount of interest allowed to a person as a deduction under this section for a fiscal year shall not exceed the amount computed

**Comment [LC22]:** Claim in equal parts.

according to the following formula –

$$A + (50\% \times (B - C))$$

where –

**A** is the interest income derived by the person during the year;

**B** is the gross income of the person for the year, other than interest income; and

**C** is the total amount of deductions allowed to the person for the year, other than for interest incurred.

(3) If an amount of interest is not deducted in a fiscal year as a result of subsection (2), the interest shall be carried forward and treated as interest incurred in the next following fiscal year and deducted in accordance with this section in that year, and so on until the interest is fully deducted.

(4) Subsection (2) does not apply to a financial institution.

**Contribution to approved retirement fund**

35. (1) Subject to subsection (2), an employer shall be allowed a deduction for a contribution made in a fiscal year to a retirement fund only if –
- (a) the fund is an approved retirement fund; and
  - (b) the contribution is made in respect of an employee who is a resident individual.

(2) The amount of the deduction allowed under subsection (1) shall not exceed 20% of the employment income paid by the employer to the employee for the year.

**Bad debts**

36. (1) A person shall be allowed a deduction for a bad debt written off in a fiscal year if the following conditions are satisfied –
- (a) the amount of the debt –
    - (i) was previously included in the gross income of the person; or
    - (ii) is money lent by the person in the normal course of business for the purposes of deriving taxable business income;
  - (b) the debt or part of the debt is written off in the accounts of the person in the fiscal year; and
  - (c) there are reasonable grounds for believing that the debt is irrecoverable.

(2) The amount of the deduction allowed under this section for a fiscal year shall not exceed the amount of the debt written off in the accounts of the person for that year.

**Carry forward of business losses**

37. (1) If a person has a business loss for a fiscal year, the amount of the loss shall be carried forward to the following fiscal year and allowed as a deduction in computing the chargeable income of the person for that following year.

- (2) If a business loss is not wholly deducted under subsection (1), the excess shall be carried forward to the next following fiscal year and deducted as specified in subsection (1) in that year, and so on until the loss is fully deducted.
- (3) A person has a business loss for a fiscal year if the total amount of deductions allowed to the person in deriving taxable business income for the year (other than the deduction allowed under this section) exceeds the total amount of that income, and the amount of the excess shall be the amount of the business loss.

**Division V – Income Tax Accounting**

**Method of accounting for income tax**

- 38. (1) Subject to subsection (2), a person shall -
  - (a) account for business income and expenditures –
    - (i) in the case of a company, on an accrual basis; or
    - (ii) in any other case, on a cash or accrual basis, provided the same basis is used for both business income and expenditures; and
  - (b) account for any other income and expenditures on a cash basis.
- (2) The Chief Commissioner may specify that any class of persons shall account for income tax purposes on a cash or accrual basis.
- (3) Subject to this Act, a person shall use generally accepted accounting principles in accounting for income tax.
- (4) A person may apply, in writing, for a change in the person’s method of accounting and the Chief Commissioner may, by notice in writing, approve the application but only if satisfied that the change is necessary to properly compute the chargeable income of the person.
- (5) Subject to subsection (6), if a person’s method of accounting changes, the person shall make adjustments in the fiscal year of change to items of income, deduction, or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.
- (6) If an amount is added to the chargeable income of a person solely by reason of the adjustments required under subsection (5), one-third of the amount shall be included in the fiscal year in which the change occurs and the balance shall be included equally in the following two fiscal years.

**Comment [LC23]:** Accrual recognition when right to receive it and when need to pay it, cash basis, when receive it and when pay it. Companies have accrual, small business have cash basis. Difference in treatment, accrual recognition earlier.

**Comment [LC24]:** General instruction subject to changes in the Act, that general principles would be used, i.e. accounting standards here in Tonga, if nothing specific in Tonga than use international standards.

**Cash-basis accounting**

- 39. A person accounting for income tax purposes on a cash basis shall derive an amount when it is received and shall incur an expenditure when it is paid.

**Accrual-basis accounting**

- 40. (1) A person accounting for income tax purposes on an accrual basis shall derive an amount when it is due to the person and shall incur an expenditure when it is payable by the person.
- (2) Subject to this Act, an amount is due to a person at the time the person becomes entitled to receive it even if the time for discharge of the entitlement is postponed or the amount is payable by instalments.
- (3) Subject to this Act, an amount is payable by a person when all the events

that determine liability have occurred and the amount of the liability can be determined with reasonable accuracy, but not before economic performance occurs.

- (4) For the purposes of subsection (3), economic performance shall occur -
- (a) in the case of the acquisition of services or assets, at the time the services are provided or assets delivered;
  - (b) in the case of the use of assets, at the time the assets are used; and
  - (c) in any other case, at the time payment is made in full satisfaction of the liability.
- (5) If -
- (a) a person has been allowed a deduction for any expenditure incurred in deriving gross income; and
  - (b) the person has not paid the liability or a part of the liability to which the deduction relates within one year of the end of the fiscal year in which the deduction was allowed,

the unpaid amount of the liability shall be included in the gross income of the person for the first fiscal year following the end of the one-year period.

- (6) An amount to which subsection (5) applies has the same character as the income to which the deduction relates.
- (7) If the amount of an unpaid liability is included in gross income under subsection (5) and the person subsequently pays the liability or a part of the liability, the person shall be allowed a deduction for the amount paid in the fiscal year in which the payment is made.

#### Trading stock

41. (1) In this section -
- “absorption-cost method” means the generally accepted accounting principle under which the cost of an item of trading stock is the sum of direct material costs, direct labour costs, and factory overhead costs;
- “average-cost method” means the generally accepted accounting principle under which the valuation of trading stock is based on a weighted average cost of items of trading stock on hand;
- “direct labour costs” means labour costs directly related to the manufacture or production of trading stock;
- “direct material costs” means the cost of materials that become an integral part of the trading stock manufactured or produced, or which are consumed in the manufacturing or production process;
- “factory overhead costs” means the total costs of manufacturing or producing trading stock, other than direct labour and direct material costs;
- “first-in-first-out method” means the generally accepted accounting principle under which the valuation of trading stock is based on the assumption that trading stock is sold in the order of its acquisition;

“prime-cost method” means the generally accepted accounting principle under which the cost of trading stock is the sum of direct material costs, direct labour costs, and variable factory overhead costs; and

“variable factory overhead costs” means those factory overhead costs that vary directly with changes in the volume of trading stock manufactured or produced.

- (2) A person shall be allowed a deduction for the cost of trading stock disposed of by the person in a fiscal year.
- (3) The cost of trading stock disposed of by a person in a fiscal year shall be computed in accordance with the following formula –

$$(A + B) - C$$

where –

- A** is the opening value of the trading stock of the person for the year;
- B** is the cost of trading stock acquired by the person in the year; and
- C** is the closing value of trading stock for the year.

- (4) The opening value of trading stock of a person for a fiscal year shall be –
- (a) the closing value of the trading stock of the person for the previous fiscal year; or
- (b) if the person commenced business in the year, the value of any trading stock acquired by the person prior to the commencement of the business.
- (5) The value referred to in subsection (4)(b) shall be the lesser of –
- (a) cost of the trading stock; or
- (b) the fair market value of trading stock determined at the time the trading stock is brought into the business.
- (6) The closing value of the trading stock of a person for a fiscal year shall be the lower of cost or fair market value of the trading stock of the person on hand at the end of the year.
- (7) A person accounting for income tax purposes on a cash basis may compute the person’s cost of trading stock under the prime-cost method or absorption-cost method, and a person accounting for income tax purposes on an accrual basis shall compute the person’s cost of trading stock under the absorption-cost method.
- (8) If particular items of trading stock are not readily identifiable, a person may account for that trading stock on the first-in-first-out method or the average-cost method but, once chosen, a stock valuation method may be changed only with the written permission of the Chief Commissioner and in accordance with any conditions that the Chief Commissioner may impose.

**Comment [LC25]:** What importance of disposal order, tax saying that only deduc cost of stock sold in the year, not what acquired same as accounting treatment, only recog stock sold in the year, so use assumptions to work out value of what sold during the year.

**contracts**

“long-term contract” means a contract for manufacture, installation, or construction, or, in relation to each, the performance of related services, which is not completed within the fiscal year in which work under the contract commenced, other than a contract estimated to be completed within six months of the date on which work under the contract commenced; and

“percentage of completion method” means the generally accepted accounting principle under which income and expenditures arising under a long-term contract are recognised by reference to the stage of completion of the contract, as modified by subsection (3).

- (2) A person accounting for income tax purposes on an accrual basis shall compute the income arising under a long-term contract under the percentage of completion method.
- (3) The percentage of completion of a long-term contract in a fiscal year shall be determined by comparing the total costs allocated to the contract and incurred before the end of the year with the estimated total contract costs as determined at the commencement of the contract.
- (4) Where, in the fiscal year in which a long-term contract is completed, there is a final year loss, the Chief Commissioner may allow the loss to be carried back to the preceding fiscal years and applied against the amount included in business income in those years commencing with the year in which the contract was completed.
- (5) A person has a final year loss under a long-term contract if both the following conditions are satisfied –
  - (a) the total chargeable income estimated to be made under the contract for the purposes of the percentage of completion method exceeds the total actual chargeable income, if any, under the contract; and
  - (b) the amount of the excess under paragraph (a) exceeds the amount otherwise included in gross income under subsection (2) for the fiscal year in which the contract was completed,

and the amount of the excess under paragraph (b) shall be the amount of the final year loss.

**Financial leases**

43. (1)

In this section –

“blended loan” means a loan under which payments by the borrower represent in part a payment of interest and in part a repayment of principal where the interest part is calculated on the principal outstanding at the time of each payment;

“financial lease” means –

- (a) a hire purchase agreement; or
- (b) any lease that is treated under international accounting standards as a financial lease and is so accounted for by the lessor in financial accounts;

“hire purchase agreement” means an agreement for –

**Comment [LC26]:** Not clear that there were specific accounting standards in Tonga, diff from generally accepted accounting standards referred to above, alternative to specify these situations, was meant to be because this is specific.

- (a) hire of goods with an option to purchase; or
- (b) the purchase of goods by instalments (whether stated as rent, hire or otherwise), other than an agreement under which property in the goods passes at the commencement of the lease;

“lease term” includes any additional period of the lease under an option to renew;

“lessee” includes a hiree under a hire purchase agreement; and

“lessor” includes a hirer under a hire purchase agreement.

- (2) This section applies to an asset that is leased or hired under a financial lease.
- (3) If this section applies, this Act shall apply on the basis that –
  - (a) the lessee is the owner of the asset;
  - (b) the lessee acquired the asset at the commencement of the lease, except in cases where the lessee already was the owner of the asset; and
  - (c) the lessor has made a blended loan to the lessee at the commencement of the lease and each lease payment is in part repayment of principal and in part payment of interest under that loan.
- (4) The cost of the asset treated as owned by the lessee under subsection (3)(a) shall be –
  - (a) if the lessor and lessee are not associates and an amount is stated as the cost or value of the asset in the lease agreement, that amount; or
  - (b) if the lessor and lessor are associates, the fair market value of the asset at the commencement of the lease.
- (5) The amount of the loan referred to in subsection (3)(c) shall be the amount determined under subsection (4) as the cost of the asset.
- (6) The interest part of each payment made under the loan shall be computed by reference to the interest rate implicit in the lease agreement.

#### **Division VI –Assets**

#### **Disposal and acquisition of assets**

- 44. (1) In this section, “personal asset” means an asset held wholly for personal or domestic use.
- (2) Except as otherwise provided in this Act, this section establishes when an asset is disposed of or acquired for the purposes of this Act.
- (3) A person shall be treated as having made a disposal of an asset at the time the person parts with the ownership of the asset, including when the asset is -
  - (a) sold, exchanged, transferred, or distributed; or
  - (b) cancelled, redeemed, relinquished, destroyed, lost, expired, or

surrendered.

- (4) A disposal includes the disposal of a part of an asset.
  - (5) The transmission of an asset by succession or under a will shall be treated as a disposal of the asset by the deceased at the time the asset is transmitted.
  - (6) The application of a business asset to personal or domestic use shall be treated as a disposal of the asset by the owner at the time the asset is so applied.
  - (7) A person acquires an asset at the time the person begins to own the asset, including at the time the person is granted any right.
  - (8) The application of a personal asset to business use shall be treated as an acquisition of the asset by the owner at the time the asset is so used.
- Cost**
- 45. (1) In this section, “hedging agreement” means an agreement entered into for the purpose of eliminating or reducing the risk of adverse financial consequences that may arise from a foreign currency exchange rate fluctuation in relation to another agreement.
  - (2) Except as otherwise provided in this Act, this section establishes the cost of an asset for the purposes of this Act.
  - (3) Subject to this section, the cost of an asset purchased by a person shall be the sum of the following amounts -
    - (a) the total consideration given by the person for the asset, including the fair market value of any consideration in kind determined at the time the asset is acquired;
    - (b) any incidental expenditure incurred by the person in acquiring or disposing of the asset; and
    - (c) any expenditure incurred by the person to alter or improve the asset.
  - (4) Subject to this section, the cost of an asset produced or constructed by a person shall be the total of the costs incurred by the person in producing or constructing the asset plus any expenditure referred to in subsection (3)(b) and (c) incurred by the person.
  - (5) No amount shall be included in the cost of an asset under subsection (3)(b) and (c) to the extent to which it has been allowed as a deduction under this Act.
  - (6) If an asset has been acquired by a person and the price is denominated in a foreign currency or the person has acquired the asset using a loan denominated in a foreign currency, any increase or decrease in the price of the asset or the liability of the person under the loan as expressed in Tongan pa’anga from the time of acquisition until the time at which the purchase price is paid or the loan liability is discharged is added to or deducted from the cost of the asset, as the case may be.
  - (7) In determining whether the liability of a person has increased or decreased for the purposes of subsection (6), account shall be taken of the person’s position under any hedging agreement relating to the purchase price or the loan.

- (8) If a person disposes of a part of an asset, the cost of the asset shall be apportioned between the part of the asset retained and the part disposed of in accordance with their respective fair market values determined at the time the person acquired the asset.
- (9) The cost of an asset does not include the amount of any grant, subsidy, rebate, commission, or other assistance received or receivable by a person in respect of the acquisition of the asset, except to the extent to which the amount is included in the gross income of a person.
- (10) The reference to “other assistance” in subsection (9) does not include a loan repayable with or without interest.
- Determination of cost in special cases** 46. (1) The cost of an asset treated as acquired under section 44(8) shall be the fair market value of the asset determined at the date it is applied to business use.
- (2) If the acquisition of an asset by a person is the derivation of an amount included in gross income, the cost of the asset shall be the amount included plus any amount paid by the person for the asset.
- (3) If the acquisition of an asset by a person is the derivation of exempt income, the cost of the asset shall be the exempt amount plus any amount paid by the person for the asset.
- Consideration received** 47. (1) Except as otherwise provided in this Act, this section establishes the amount of consideration received on disposal of an asset for the purposes of this Act.
- (2) The consideration received by a person on disposal of an asset shall be the total amount received by the person for the asset, including the fair market value of any consideration received in kind determined at the time of disposal.
- (3) If an asset has been lost or destroyed by a person, the consideration received for the asset includes any compensation, indemnity, or damages received by the person as a result of the loss or destruction, including amounts received as a consequence of –
- (a) an insurance policy, indemnity, or other agreement;
- (b) a settlement; or
- (c) a judicial decision.
- (4) The consideration received for an asset treated as disposed of under section 44(6) shall be the fair market value of the asset determined at the time it is applied to personal or domestic use.
- (5) If two or more assets are disposed of by a person in a single transaction and the consideration received for each asset is not specified, the total consideration received by the person shall be apportioned among the assets disposed of in proportion to their respective fair market values determined at the time of the transaction.
- Non-arm’s length transaction** 48. For the purposes of this Act, if an asset is disposed of in a non-arm’s length transaction –
- (a) the person disposing of the asset shall be treated as having

received consideration equal to the fair market value of the asset determined at the time the asset is disposed of; and

- (b) the person acquiring the asset shall be treated as having a cost equal to the amount determined under paragraph (a).

**Gain or loss not recognised**

49. (1) For the purposes of this Act and subject to subsection (2), no gain or loss shall be taken to arise on the disposal of an asset -

- (a) between spouses as part of a divorce settlement or under an agreement to live apart;
- (b) by reason of the transmission of the asset on the death of a person to an executor or beneficiary; or
- (c) by reason of the compulsory acquisition of the asset under any law if the consideration received for the disposal is reinvested by the recipient in an asset of a like kind (referred to as a "replacement asset") within one year of the disposal.

(2) Subsection (1) does not apply if the person acquiring the asset (including a replacement asset) is a non-resident person at the time of the acquisition.

(3) If subsection (1)(a) or (b) applies, the person acquiring the asset shall be treated as acquiring an asset of the same character as the person disposing of the asset and -

- (a) in the case of a depreciable asset or intangible, acquiring the asset or intangible for a cost equal to the written down value of the asset at the time of the disposal as determined under section 31; and
- (b) in any other case, acquiring the asset for a cost equal to the cost of the asset for the person disposing of the asset at the time of the disposal.

(4) A person's cost of a replacement asset or intangible referred to in subsection (1)(c) shall be -

- (a) if the asset compulsorily acquired is a depreciable asset or intangible, the written down value of the asset or intangible at the time it is compulsorily acquired; or
- (b) in any other case, the cost of the asset or intangible at the time it is compulsorily acquired,

plus the amount by which any consideration given by the person for the replacement asset exceeds the consideration received by the person for the asset or intangible compulsorily acquired.

**Division VII – Miscellaneous Provisions Relating to Income and Deductions**

**Income of joint owners**

50. (1) For the purposes of this Act, if property is jointly owned by two or more persons, any income or expenditures relating to the property are apportioned among the owners according to their respective interests in the property.

(2) If the interests of the owners of jointly owned property cannot be ascertained, the owners of the property are treated as having an equal

interest in the property.

**Apportionment of deductions**

51. (1) Subject to this Act, expenditure relating to –
- (a) the derivation of more than one class of income; or
  - (b) the derivation of a class of income and to some other purpose,
- shall be apportioned on any reasonable basis taking account of the relative nature and size of the activities or purposes to which it relates.
- (2) The following are treated as a “class of income” –
- (a) taxable business income;
  - (b) any other income included in gross income; and
  - (c) exempt income.

**Recovered expenditure**

52. If a person has been allowed a deduction for any expenditure or loss incurred, or bad debt written off, in a fiscal year in the computation of the chargeable income of the person for the year and, subsequently, the person has received, in cash or in kind, any amount as a reimbursement or recovery of, or an indemnity for the expenditure, loss, or debt, the amount received shall be–
- (a) included in the gross income of the person in the fiscal year in which it is received; and
  - (b) treated as income of the same character as the income to which the deduction related.

**Cessation of source of income**

53. If –
- (a) any amount is derived by a person in a fiscal year from any business, activity, investment, or other source that had ceased before the amount was derived; and
  - (b) had the amount been derived before the business, activity, investment, or other source ceased it would have been included in the gross income of the person,

this Act shall apply to the amount on the basis that the business, activity, investment, or other source had not ceased at the time the amount was derived.

**Currency translation**

54. (1) An amount taken into account under this Act shall be expressed in Tongan pa’anga.
- (2) If an amount is in a currency other than Tongan pa’anga, the amount shall be translated to Tongan pa’anga at the National Reserve Bank of Tonga mid-exchange rate applying between the foreign currency and Tongan pa’anga on the date the amount is taken into account for the purposes of this Act.

## PART IV – APPLICATION OF INCOME TAX TO PERSONS

## Division I – Individuals

**Taxation of individuals** 55. The chargeable income of each individual shall be computed separately.

## Division II – Entities

- Taxation of trusts** 56. (1) In this section, “chargeable trust income”, in relation to a fiscal year, means –
- (a) in the case of a resident trust, the gross income of the trust for the year reduced by the sum of the following –
    - (i) any part of that amount to which subsection (3) applies for the year; and
    - (ii) the total deductions allowed to the trust for the year under this Act, other than amounts to which subsection (4) applies; or
  - (b) in the case of a non-resident trust, the total amount of Tongan-source income derived by the trust for the year included in gross income reduced by the sum of the following –
    - (i) any part of that amount to which subsection (3) applies for the year and in respect of which the beneficiary has paid tax; and
    - (ii) the total deductions allowed to the trust for the year under this Act that relate to the derivation of such income, other than amounts to which subsection (4) applies.
- (2) Income derived by the trustee of a trust during a fiscal year shall be taxed, in that year, either to the trustee or the beneficiary of the trust in accordance with this section.
- (3) An amount derived by a trustee of a trust shall be treated as derived by a beneficiary of the trust (other than a beneficiary under a legal disability) if the beneficiary has a vested right to the income.
- (4) A beneficiary shall be allowed a deduction in accordance with this Act for any expenditure or loss incurred by the trustee in deriving income referred to in subsection (3) that is included in the gross income of the beneficiary.
- (5) Income to which subsection (3) applies –
- (a) retains its character and geographic source in the hands of the beneficiary; and
  - (b) is treated as derived by the beneficiary at the time the amount was derived by the trustee.
- (6) The trustee of a trust shall be liable for tax for a fiscal year on the chargeable trust income of the trust for the year.
- (7) The gross income of a resident beneficiary includes a distribution

**Comment [LC27]:** 56(3) Can a beneficiary also be a tee? Not coz, under laws of equity can't, if benef has vested right in the trust income than is taxed on that as the ben income, standard treatment, income entitled to income accumulated in the trust is taxed to the tee. Can't get a deferral adv in the income of the trust in years, income taxed as it arises.

received by the beneficiary to the extent to which the distribution is foreign-source income not dealt with under subsection (3).

**Taxation of companies**

57. (1) A company shall be liable for tax separately from its members.
- (2) A social club, trade association, mutual insurance company, or other similar membership organisation shall be liable for tax under this Act in respect of its dealings with members.
- (3) The total deductions allowed to a company referred to in subsection (2) for a fiscal year in respect of the supply of goods or services to members shall not exceed the gross income derived from the members (including membership contributions) for the year.
- (4) If any expenditure is not deducted in a fiscal year as a result of subsection (3), the expenditure shall be carried forward and treated as incurred in the following year and deducted in accordance with this section in that year, and so on until the expenditure is fully deducted.

**Change in control of entity**

58. (1) In this section, –
- “carry forward loss” means an interest deduction carried forward under section 34, a business loss carried forward under section 37 or 57(4), or a foreign business loss carried forward under section 63;
- “entity” means a trust or company;
- “ownership interest” means an interest of a beneficiary in a trust or membership interest in a company; and
- “underlying ownership” in relation to an entity, means an ownership interest in the entity held, directly or indirectly through an interposed entity or entities, by an individual or by a person not ultimately owned by individuals.
- (2) If there is a change of 50% or more in the underlying ownership of an entity, any carry forward loss incurred for a fiscal year before the change shall not be allowed as a deduction in a fiscal year after the change, unless the entity –
- (a) carries on the same business after the change as it carried on before the change until the loss has been fully deducted; and
- (b) does not, until the loss has been fully deducted, engage in any new business or investment after the change if the principal purpose of the entity or the owners of the entity is to utilise the loss so as to reduce the income tax payable on the income arising from the new business or investment.

**PART V – APPLICATION OF INCOME TAX TO SPECIAL INDUSTRIES**

**Short-term insurance business**

59. The chargeable income of a company carrying on a short-term insurance business shall be computed in accordance with the Regulations.

**PART VI – APPLICATION OF INCOME TAX TO INTERNATIONAL TRANSACTIONS**

**Division I – Geographic Source of Income**

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|------------------------------------|-----|---|
| <b>Geographic source of income</b> | 60. | <p>(1) Employment income shall be Tongan-source income to the extent to which the income –</p> <p style="margin-left: 20px;">(a) is received from employment exercised in Tonga, wherever paid; or</p> <p style="margin-left: 20px;">(b) is paid by, or on behalf of, the Government, wherever the employment is exercised.</p> <p>(2) Business income derived by a resident person shall be Tongan-source income to the extent to which the income is derived from any business carried on in Tonga.</p> <p>(3) Business income derived by a non-resident person shall be Tongan-source income to the extent to which it is directly or indirectly attributable to –</p> <p style="margin-left: 20px;">(a) a permanent establishment of the non-resident person in Tonga;</p> <p style="margin-left: 20px;">(b) sales in Tonga of goods or merchandise of the same or similar kind as those sold by the person through a permanent establishment in Tonga; or</p> <p style="margin-left: 20px;">(c) any other business activity carried on in Tonga of the same or similar kind as that carried on by the person through a permanent establishment in Tonga.</p> <p>(4) If the business of a non-resident person comprises the rendering of independent services, the Tongan-source business income of the person shall include, in addition to any amounts treated as Tongan-source income under subsection (3), any remuneration –</p> <p style="margin-left: 20px;">(a) paid by a resident person, except remuneration for services utilised in a business carried on by the resident person outside Tonga through a permanent establishment; or</p> <p style="margin-left: 20px;">(b) that is deductible expenditure of a permanent establishment in Tonga of a non-resident person.</p> <p>(5) Any gain from the disposal of an asset shall be Tongan-source income to the extent that the asset has been used in deriving business income that is treated as Tongan-source income under this section.</p> <p>(6) A dividend shall be Tongan-source income if it is paid by a resident company.</p> <p>(7) Interest shall be Tongan-source income if it is –</p> <p style="margin-left: 20px;">(a) paid by a resident person, except when the debt or other instrument or agreement giving rise to the interest is utilised in a business carried on by the person outside Tonga through a permanent establishment; or</p> <p style="margin-left: 20px;">(b) deductible expenditure of a permanent establishment in Tonga of a non-resident person.</p> |
|------------------------------------|-----|---|

- (8) A royalty shall be Tongan-source income if it is –
- (a) paid by a resident person, except when the right, property, or supply giving rise to the royalty is utilised in a business carried on by the person outside Tonga through a permanent establishment; or
  - (b) deductible expenditure of a permanent establishment in Tonga of a non-resident person.
- (9) Rent shall be Tongan-source income if it is derived from –
- (a) the lease of land in Tonga; or
  - (b) the lease of a building or other structural improvement to land in Tonga.
- (10) A pension, charge, annuity, management fee, or insurance premium shall be Tongan-source income if it is paid by a resident person or is deductible expenditure of a permanent establishment in Tonga of a non-resident person.
- (11) A natural resource amount shall be Tongan-source income if it relates to the taking of minerals or a living or non-living resource from land in, or territorial waters of, Tonga.
- (12) An amount of any kind not mentioned in the preceding subsections shall be Tongan-source income if it is paid by a resident person or is deductible expenditure of a permanent establishment in Tonga of a non-resident person.
- (13) If an amount may come within subsection (2) or (3) and another subsection, other than subsection (12), this section shall apply –
- (a) by first determining whether the amount is Tongan-source income under that other subsection; and
  - (b) if the amount is not Tongan-source income under that other subsection, then determining whether it is Tongan-source income under subsection (2) or (3).
- (14) An amount shall be foreign-source income to the extent it is not Tongan-source income.

#### Division II – Taxation of Foreign-source Income of Resident Persons

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|---|-----|-----|---|
| <b>Foreign-source employment income of resident individuals</b> | 61. | (1) | Any foreign-source employment income that is received by a resident individual shall be exempt income if the individual has paid foreign income tax in respect of the income.   |
|   |     | (2) | A resident individual shall be treated as having paid foreign income tax in respect of foreign-source employment income if tax has been withheld from the income by the individual's employer.  |
| <b>Foreign tax credit</b>                                       | 62. | (1) | In this section –<br><br>“average rate of Tongan income tax” in relation to a resident person for a fiscal year, means the percentage that the income tax payable by that person under this Act (before the allowance of any tax credit under this Act) is of the chargeable income of the person for the year; |

**Comment [LC28]:** 62(1) lawyer working here would be better off declaring income here for lower rate of tax, but depend on what the home country treats this, if it is a consultant depend on relief rules and may be subject to foreign tax credit in that pay tax here and also pay tax difference in home country.

“foreign income tax” includes a foreign withholding tax, but does not include any penalty, additional tax, or interest payable in respect of any foreign income tax;

“net foreign-source income” in relation to a resident person for a fiscal year, means the total taxable foreign-source income of the person for the year, as reduced by any deductions allowed to the person under this Act for the year that –

- (a) relate exclusively to the derivation of the foreign-source income; and
- (b) are apportioned to the derivation of foreign-source income in accordance with section 51 on the basis that foreign-source income is a separate class of income; and

“taxable foreign-source income” means foreign source income included in gross income.

- (2) If a resident person derives taxable foreign-source income in respect of which the person has paid foreign income tax, the person shall be allowed a tax credit (referred to as a “foreign tax credit”) of an amount equal to the lesser of –
  - (a) the foreign income tax paid; or
  - (b) the Tongan income tax payable in respect of the income.
- (3) For the purposes of subsection (2)(b), the Tongan income tax payable in respect of taxable foreign-source income derived by a resident person in a fiscal year shall be computed by applying the average rate of Tongan income tax applicable to the person for the year against the net foreign-source income of the person for the year.
- (4) The foreign tax credit of a resident person for a fiscal year shall be computed separately for foreign-source business income and the other foreign-source income of the person.
- (5) Where subsection (4) applies, deductions shall be apportioned for the purposes of paragraph (b) of the definition of “net foreign-source income” in accordance with section 51 on the basis that foreign-source business income and other foreign-source income are separate classes of income.
- (6) A foreign tax credit shall be allowed under this section only if the foreign income tax is paid within two years after the end of the fiscal year in which the foreign-source income to which the tax relates was derived by the resident person.
- (7) A foreign tax credit allowed under this section shall be applied in accordance with section 5(3).
- (8) Any foreign tax credit or part of a foreign tax credit allowed under this section for a fiscal year that is not credited under section 5(3) shall not be refunded, carried back to the preceding fiscal year, or carried forward to the following fiscal year.

**Foreign losses**

63.

- (1) In this section,
 

“foreign business loss”, for a fiscal year, is the excess of deductions

allowed to the person in deriving taxable foreign-source business income for the year over the amount of that foreign-source business income;

“taxable foreign-source business income”, in relation to a resident person, means foreign-source business income included in the gross income of the person; and

“taxable foreign-source non-business income”, in relation to a resident person, means foreign-source income (other than foreign-source business income) included in the gross income of the person.

- (2) Any amount that a resident person is allowed as a deduction under this Act in deriving taxable foreign-source business income shall be deductible only against that income.
- (3) If a resident person has a foreign business loss for a fiscal year, the amount of the loss shall be carried forward to the following fiscal year and allowed as a deduction against the person’s foreign-source business income derived in that following year.
- (4) If a foreign business loss is not wholly deducted in a fiscal year under subsection (3), the undeducted amount shall be carried forward to the next following fiscal year and applied as specified in subsection (3) in that year, and so on until the loss is fully deducted.
- (5) Any amount that a resident person is allowed as a deduction under this Act in deriving taxable foreign-source non-business income shall be deductible only against that income.
- (6) If the total amount of deductions referred to in subsection (5) for a fiscal year exceeds the person’s taxable foreign-source non-business income for the year, the amount of the excess shall not be carried forward to the following fiscal year.

### Division III – Taxation of Non-resident Persons

#### Taxation of non-residents with Tongan permanent establishments

64. (1) Subject to this section, this Act applies to a non-resident person with a permanent establishment in Tonga on the basis that the permanent establishment is a separate person engaged in the same or similar activities under the same or similar conditions and dealing independently with that non-resident person.
- (2) The gross income of a permanent establishment in Tonga of a non-resident person for a fiscal year is the total Tongan-source income of the person for the year as determined under section 60.
- (3) Subject to subsection (4), no deduction is allowed for amounts paid or payable by the permanent establishment to its head office or to another permanent establishment of the non-resident person as -
  - (a) royalties, fees, or other similar payments for the use of any tangible or intangible asset;
  - (b) compensation for any services, including management services, performed for the permanent establishment; or
  - (c) interest on moneys lent to the permanent establishment, except in connection with a banking business.
- (4) Nothing in subsection (3) prevents a deduction for an amount paid or

**Comment [LC29]:** 64(2) perm estab, defined for a business basic id a signif eco presence of comp in country to justify taxing it eg anz here. Only when have perm estab can tax it, if not cant, r/s too remote. For professionals, for short periods won't have perm estab, if office here than would and come regularly would be taxed.

payable by a permanent establishment as a reimbursement of actual expenditures incurred by the non-resident person to third parties if the reimbursement is otherwise deductible under this Act.

- Foreign-source income of non-resident persons** 65. The foreign-source income of a non-resident person shall be exempt income.

#### **PART VII – ANTI-AVOIDANCE**

- Transactions between associates** 66. (1) The Chief Commissioner may, in respect of any transaction between persons who are associates, distribute, apportion, or allocate income, deductions, or tax credits between the persons as is necessary to reflect the income that the persons would have realised in an arm's length transaction.

- (2) In making any adjustment under subsection (1), the Chief Commissioner may determine the geographic source of income and the nature of any income, payment, or loss as revenue, capital, or otherwise.

- Tax avoidance schemes** 67. (1) In this section, "tax avoidance scheme" means any transaction if one of the main purposes of a person in entering into the transaction is the avoidance or reduction of any person's liability to tax under this Act.

- (2) For the purposes of determining the liability to tax under this Act of any person, the Chief Commissioner may –

- (a) determine the character of a transaction or an element of a transaction that was entered into as part of a tax avoidance scheme;
- (b) disregard a transaction that does not have substantial economic effect; or
- (c) determine the character of a transaction if the form of the transaction does not reflect the substance.

#### **PART VIII – MINIMUM INCOME TAX**

- Minimum income tax** 68. (1) In addition to the income tax imposed under section 5 (referred to as the "normal income tax"), a person (other than a presumptive income taxpayer) carrying on business shall be liable for minimum income tax for each fiscal year.
- (2) The minimum income tax imposed under subsection (1) on a person for a fiscal year shall be 1% of the turnover of the person for the year.
- (3) The normal income tax payable by a person for a fiscal year, determined without taking into account any tax credits allowed under section 62, 90, or 92, shall be credited against the minimum income tax payable by the person for that year.
- (4) If the normal income tax paid by a person for a fiscal year is equal to or exceeds the minimum income tax payable for that year, no minimum income tax shall be payable for that year.
- (5) Minimum income tax payable under this section shall be treated as income tax for all purposes of this Act and the Revenue Services Administration Act 2002, other than this section and section 92(6).

**PART IX – INCOME TAX PROCEDURE****Division I – Income Tax Returns**

- Furnishing of income tax returns**
69. (1) Subject to section 70, a taxpayer, other than a presumptive income taxpayer, shall lodge an income tax return for each fiscal year within two months after the end of the year.
- (2) An income tax return shall be lodged in the form and manner prescribed in the Regulations.
- (3) The Chief Commissioner may, by notice in writing, require a taxpayer or the taxpayer's representative to lodge an income tax return by the date specified in the notice for a period of less than twelve months, if -
- (a) the taxpayer has died;
  - (b) the taxpayer has become bankrupt or gone into liquidation;
  - (c) the taxpayer is about to leave Tonga permanently;
  - (d) the taxpayer is otherwise about to cease carrying on business in Tonga; or
  - (e) the Chief Commissioner otherwise considers it appropriate to require such a return to be lodged.

- Income tax return not required**
70. A taxpayer shall not be required to lodge an income tax return under section 69 for a fiscal year if the only income derived by the taxpayer during the year is -
- (a) employment income from which tax has been withheld under section 77;
  - (b) interest income from which tax has been withheld under section 78;
  - (c) employment and interest income referred to in paragraphs (a) and (b); or
  - (d) income to which section 6 or 7 applies.

**Division II - Income Tax Assessments**

- Income Tax assessments**
71. (1) If a taxpayer lodges an income tax return under section 69 for a fiscal year, the Chief Commissioner shall be treated as having made an assessment of the taxpayer's -
- (a) chargeable income and income tax payable thereon, or business loss for the year; and
  - (b) if section 68 applies, turnover and minimum income tax payable thereon for the year,
- equal to those respective amounts as specified in the return.
- (2) An income tax return lodged under section 69 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 taxpayer by the Chief Commissioner on the day the return was lodged by the taxpayer.

- (3) If a taxpayer fails to lodge an income tax return under section 69 for a fiscal year, the Chief Commissioner may, based on any available information and according to the Chief Commissioner's best judgement, make an assessment of –
  - (a) the taxpayer's chargeable income and income tax payable thereon, or business loss, for the year; and
  - (b) if section 68 applies, the taxpayer's turnover and minimum income tax payable thereon for the year.
- (4) As soon as possible after making an assessment under subsection (3), the Chief Commissioner shall serve the taxpayer with a notice of the assessment stating -
  - (a) the amount of chargeable income or business loss of the taxpayer;
  - (b) if section 68 applies, the amount of turnover;
  - (c) the amount of any income tax and minimum income tax, if any, due;
  - (d) the amount of tax paid, if any;
  - (e) the amount of any penalty and interest payable in respect of the tax due; and
  - (f) the time, place, and manner of objecting to the assessment.

**Amendment of assessments**

72. (1) Subject to this section, the Chief Commissioner may amend an assessment made or treated as made under section 71 by making such alterations or additions to the assessment as the Chief Commissioner considers necessary to ensure that a taxpayer is liable for the correct amount of income tax for the fiscal year to which the assessment relates.
- (2) The amendment of an assessment under subsection (1) may be made –
  - (a) in the case of fraud or wilful neglect by or on behalf of the taxpayer, at any time; or
  - (b) in any other case, within five years of the date the Chief Commissioner served or is treated as having served notice of the assessment on the taxpayer.
- (3) The Chief Commissioner may require a taxpayer to lodge a revised return in accordance with section 3(2) of the Revenue Services Administration Act 2002.
- (4) A notice under section 3(2) of the Revenue Services Administration Act 2002 requiring a taxpayer to lodge a revised return may be made –
  - (a) in the case of fraud or wilful neglect by or on behalf of the

taxpayer, at any time; or

- (b) in any other case, within five years from the date the taxpayer lodged the return.
- (5) A taxpayer may, on the taxpayer's own motion, amend an assessment treated as made under section 71(1) by lodging a revised income tax return within five years of the date the original return was lodged.
- (6) If a taxpayer lodges a revised return in accordance with subsection (3) or (5), the Chief Commissioner shall be treated as having made an amended assessment of the taxpayer's –
- (a) chargeable income and tax payable thereon, or business loss, as set out in the revised return; and
  - (b) if section 68 applies, turnover and minimum income tax payable thereon as set out in the revised return.
- (7) The taxpayer's revised return shall be treated for all purposes of this Act and the Revenue Services Administration Act 2002 as notice of the amended assessment served on the taxpayer by the Chief Commissioner on the day the revised return was lodged by the taxpayer.
- (8) If a notice of assessment (hereinafter referred to as the "original assessment") has been amended under subsection (1) or (6), the Chief Commissioner may further amend the original assessment within the later of –
- (a) five years after the Chief Commissioner has served or is treated as having served notice of the original assessment on the taxpayer; or
  - (b) one year after the Chief Commissioner has served or is treated as having served notice of the amended assessment on the taxpayer.
- (9) As soon as possible after making an amended assessment under this section, the Chief Commissioner shall serve the taxpayer with notice of the amended assessment stating –
- (a) the amended chargeable income or business loss of the taxpayer;
  - (b) if section 68 applies, the amended turnover of the taxpayer;
  - (b) the amended amount of income tax or minimum income tax due;
  - (c) the amount of income tax paid, if any;
  - (d) the amount of any penalty and interest payable in respect of the income tax due; and
  - (e) the time, place, and manner of objecting to the amended assessment.
- (10) An amended income tax assessment shall be treated in all respects

as an income tax assessment for the purposes of this Act and the Revenue Services Administration Act 2002, other than subsection (1).

### Division III – Payment of Income Tax

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|--|-----|--|
| <b>Due date for payment of income tax</b>                                | 73. | Subject to this Act, the income tax payable by a taxpayer for a fiscal year shall be due by the due date for lodging the taxpayer's income tax return for the year.  |
| <b>Collection of tax from non-resident ship owners or charterers</b>     | 74. | <p>(1) Subject to subsection (3), before the departure of a ship owned or chartered by a non-resident person from a port in Tonga -</p> <p>(a) the master of the ship shall lodge with the Chief Commissioner a return showing the gross amount specified in section 7(2) in respect of the ship; and</p> <p>(b) the Chief Commissioner shall determine the amount of income tax due under section 7 in respect of the ship and, as soon as possible, notify the master, in writing, of the amount due.</p> <p>(2) The master of a ship shall be liable for the tax notified under subsection (1)(b) and the provisions of this Act and the Revenue Services Administration Act 2002 apply to such tax as if it were income tax due under an assessment.</p> <p>(3) If the Chief Commissioner is satisfied that the master of a ship or the owner or charterer of the ship who is a non-resident person is unable to lodge the return required under subsection (1) before the departure of the ship from Tonga, the Chief Commissioner may allow the return to be lodged within 30 days after departure of the ship provided the non-resident owner or charterer has made satisfactory arrangements for the payment of the tax due under section 7 in respect of the ship.</p> <p>(4) The Commissioner of Revenue shall not grant a port clearance for a ship owned or chartered by a non-resident person until satisfied that any tax due under section 7 in respect of the ship has been paid or that arrangements for its payment have been made to the satisfaction of the Chief Commissioner.</p> <p>(5) This section does not relieve the owner or charterer of the ship who is a non-resident person from liability to pay any amount due under this section that is not paid by the master of the ship.</p> |
| <b>Collection of tax from non-resident aircraft owners or charterers</b> | 75. | <p>(1) An owner or charterer of an aircraft liable for tax under section 7 shall lodge a return with the Chief Commissioner for each calendar month within fifteen days after end of each quarter.</p> <p>(2) The return shall be in the prescribed form and lodged in the prescribed manner.</p> <p>(3) Where a taxpayer lodges a return under subsection (1), the Chief Commissioner is treated as having made an assessment of the gross amount specified in section 7(2) for the month and the tax payable thereon, and to have served notice of the assessment on the day the return was lodged.</p> <p>(4) The tax payable by the non-resident person under section 7 shall be</p>   |

**Comment [LC30]:** 74 rate is 3% of gross tonnage and for carriage of passengers.

**Comment [LC31]:** 75 normally aircraft have presence here and all airlines have office here and collect from agent, old but strengthened to make it more effective, only to apply to non-residents.

collected monthly and shall be due on the due date for furnishing the return for each quarter.

- (5) Sections 71(3) and (4), and 72 apply for the purposes of this section.
- (6) If the tax referred to in subsection (4) is not paid within three months of the due date, the Chief Commissioner may issue to the Ministry of Civil Aviation a certificate specifying the name of the non-resident person and the amount of tax due, and the Ministry of Civil Aviation shall refuse clearance from any airport in Tonga to any aircraft owned or chartered by the person until the tax due has been paid.

**Security** 76. The Chief Commissioner may, for the purposes of securing payment of any tax that is or may become due under this Act, require a person to give security in such amount and in such manner as the Chief Commissioner thinks fit.

#### Division IV – Withholding Tax

**Withholding of tax from employment income** 77. (1) An employer shall withhold tax from a payment of employment income to an employee as prescribed in the Regulations.

(2) The obligation of an employer to withhold tax under subsection (1) –

- (a) shall not be reduced or extinguished because the employer has a right, or is otherwise obliged, to withhold any other amount from a payment of employment income; and
- (b) shall apply notwithstanding any law that provides that the employment income of an employee is not to be reduced or subject to attachment.

**Withholding of tax from interest** 78. A resident company or permanent establishment in Tonga of a non-resident company paying interest to a resident person, other than a financial institution, shall withhold tax from the gross amount of the interest paid at the rate of 10%.

**Withholding of tax from income from land** 79. If rent has been paid to the Minister of Lands in accordance with the Land Act for the lease of land, the Minister shall withhold tax from the gross amount paid at the rate of 3%.

**Withholding of tax from payments to non-resident persons** 80. (1) In this section, “rent” does not include an amount to which section 79 applies.

(2) A person paying a Tongan-source royalty, interest, technical services fee, dividend, natural resource amount, rent, management fee, or insurance premium to a non-resident person shall withhold tax from the gross amount paid at the rate of –

- (a) in the case of an insurance premium, 5%;
- (b) in the case of rent, 7.5%; or
- (c) in any other case, 15%.

(3) A person paying an amount of Tongan-source business income to a non-resident person rendering independent services shall withhold tax from the gross amount paid at the rate of 10%.

**Comment [LC32]:** 79 repeats current law.

<b>No withholding from exempt income</b>	81.	A person shall not withhold tax from an amount that is exempt income of the recipient.
<b>Time of withholding</b>	82.	<p>A person required to withhold tax under this Division from an amount paid by the person shall withhold the tax at the earlier of –</p> <p>(a) the time the amount is credited to the account of the recipient; or</p> <p>(b) the time the amount is actually paid.</p>
<b>Payment of tax withheld</b>	83.	Tax required to be withheld by a person under this Division shall be paid to the Chief Commissioner within 15 days after the end of the month in which the person was required to withhold the tax.
<b>Failure to pay tax withheld</b>	84.	<p>(1) If a person –</p> <p>(a) fails to withhold tax as required under this Division; or</p> <p>(b) having withheld tax fails to pay the tax to the Chief Commissioner as required under section 83,</p> <p>the person shall be personally liable to pay the amount of tax to the Chief Commissioner.</p> <p>(2) A person personally liable for an amount of tax under subsection (1) as a result of failing to withhold the tax shall be entitled to recover the tax from the recipient of the payment.</p>
<b>Recovery of withholding tax</b>	85.	<p>(1) If a person fails to withhold tax as required under this Division, the Chief Commissioner may recover the tax from the recipient of the payment provided the total amount recovered does not exceed the tax that should have been withheld.</p> <p>(2) Notwithstanding the recovery of any tax under subsection (1), the person who failed to withhold the tax shall continue to be liable for –</p> <p>(a) any other legal action in relation to the failure;</p> <p>(b) the imposition of interest and penalty for the failure; and</p> <p>(c) the disallowing of a deduction for the expenditure to which the failure relates under section 26(2).</p>
<b>Tax withholding certificate</b>	86.	<p>(1) A person withholding tax under this Division shall give to the recipient of the payment a tax withholding certificate as prescribed in the Regulations.</p> <p>(2) A person required to lodge an income tax return for a fiscal year shall attach to the return any tax withholding certificate as prescribed in the Regulations.</p>
<b>Withholding tax statements</b>	87.	<p>(1) In this section, “fiscal year” means the period of twelve months ending on 30<sup>th</sup> June.</p> <p>(2) A person withholding tax under this Division shall, within two months after the end of the fiscal year or within such further time as</p>

the Chief Commissioner may allow by notice in writing, lodge with the Chief Commissioner a withholding tax statement as prescribed in the Regulations.

- (3) In addition to the annual withholding tax statement required to be lodged under subsection (1), a person withholding tax may be required to furnish statements on a monthly, quarterly, or six monthly basis as may be prescribed in the Regulations.
- Priority of tax withheld** 88. (1) Tax withheld from a payment under this Division –
- (a) shall be held by the person in trust for the Government; and
- (b) shall not be subject to attachment in respect of any debt or liability of the person.
- (2) In the event of the liquidation or bankruptcy of a person who has withheld tax under this Division, any amount withheld shall not form part of the estate of the person in liquidation or bankruptcy and the Chief Commissioner has first claim for that amount before any distribution of property is made.
- (3) An amount that a person is required to withhold from a payment under this Division shall be –
- (a) a first charge on the payment; and
- (b) deducted prior to any other amount that the person may be required to deduct from the payment by virtue of an order of any Court or under any other law.
- Indemnity** 89. A person who has withheld tax from a payment under this Division and remitted the tax to the Chief Commissioner shall be indemnified against any claim by the recipient for payment of the withheld amount.
- Credit for tax withheld** 90. (1) For the purposes of this Act, if tax has been withheld under this Division from income derived by a person, the amount of income included in the gross income of that person shall be the amount derived before the withholding of the tax.
- (2) Subject to subsections (3) and (4), if tax has been withheld under this Division from income derived by a person, the person shall be allowed a tax credit for that tax against the tax due by the person on the chargeable income of the person for the fiscal year in which the tax was withheld.
- (3) No tax credit shall be allowed if the tax withheld is a final tax on the income under section 9 or 91.
- (4) A tax credit allowed under this section shall be applied in accordance with section 5(3).
- (5) A tax credit or part of a tax credit allowed under this section for a fiscal year that is not credited under section 5(3) for the year shall be treated as overpaid tax and dealt with in accordance with section 96.
- Withholding tax as a final tax** 91. (1) This section applies to tax withheld under –
- (a) section 77 if section 70 applies;

- (b) section 78 if the interest is paid by a financial institution and is derived by an individual; or
  - (c) section 79 if the amount is derived by a non-resident.
- (2) If this section applies, the tax withheld shall be a final tax on the income in respect of which the tax has been withheld and-
- (a) the income shall not be included in –
    - (i) gross income in computing the chargeable income of the person who derives it for any fiscal year; or
    - (ii) turnover in computing the minimum income tax liability of the person who derived it for any fiscal year;
  - (b) no deduction shall be allowable under this Act for any expenditure incurred in deriving the income;
  - (c) the income shall not be reduced by any loss;
  - (d) the tax withheld shall not be reduced by any tax credits allowed under this Act; and
  - (e) there shall be no refund of the tax withheld.

#### **Division V – Instalments of Income Tax**

- |                                  |     |  |
|----------------------------------|-----|--|
| <b>Instalments of income tax</b> | 92. | <ul style="list-style-type: none"> <li>(1) In this section, “turnover” does not include any amount subject to withholding tax under Division IV of this Part.</li> <li>(2) A taxpayer shall pay instalments of income tax for a fiscal year.</li> <li>(3) Instalments shall be payable for the period of three calendar months ending on last day of the third, sixth, ninth and twelfth months of the fiscal year of a taxpayer.</li> <li>(4) The amount of each instalment shall be 1% of the turnover of the taxpayer for the period.</li> <li>(5) Instalments of income tax shall be due on the 15<sup>th</sup> day after the end of the period to which they relate.</li> <li>(6) Instalments of income tax paid by a taxpayer in a fiscal year shall be –           <ul style="list-style-type: none"> <li>(a) credited against the taxpayer’s income tax liability on chargeable income for that year in accordance with section 5(3);</li> <li>(b) any excess shall be credited against the taxpayer’s minimum income tax liability for that year; and</li> <li>(c) any further excess shall be treated as overpaid tax and dealt with in accordance with section 96.</li> </ul> </li> </ul> |
|----------------------------------|-----|--|

#### **PART X – PRESUMPTIVE INCOME TAX PROCEDURE**

- |                    |     |  |
|--------------------|-----|--|
| <b>Presumptive</b> | 93. | (1) A presumptive income taxpayer shall lodge a presumptive income |
|--------------------|-----|--|

**income tax returns**

tax return for each quarter within 15 days after the end of the quarter.

- (2) A presumptive income tax return shall be lodged in the form and manner prescribed in the Regulations.

**Payment of presumptive income tax**

94. (1) The presumptive income tax payable by a presumptive income taxpayer for a quarter shall be due by the due date for lodging the presumptive income tax return for the quarter.

- (2) The liability for presumptive income tax shall arise by operation of this section and shall not be dependent on the Chief Commissioner making an assessment of presumptive income tax due.

**Presumptive income tax assessment**

95. (1) The Chief Commissioner may make an assessment of presumptive income tax payable by a presumptive income taxpayer if –
- (a) the taxpayer fails to lodge a presumptive income tax return for a quarter; or
  - (b) the Chief Commissioner is not satisfied with a presumptive income tax return lodged by the taxpayer.
- (2) The Chief Commissioner may make an assessment –
- (a) under subsection (1)(a), at any time; or
  - (b) under subsection (1)(b) –
    - (i) if the default was due to fraud or wilful neglect, at any time; or
    - (ii) in any other case, within two years of the due date for payment of the presumptive income tax to which the assessment relates.
- (3) The Chief Commissioner may, based on any available information and to the best of his judgment, estimate the presumptive income tax payable by a presumptive income taxpayer for the purposes of making an assessment under subsection (1).
- (4) The Chief Commissioner shall serve a notice of the assessment made under subsection (1) on the presumptive income taxpayer stating –
- (a) the reason for the assessment as provided for in subsection (1);
  - (b) the presumptive income tax payable under the assessment;
  - (c) the original due date for payment as determined under section 94;
  - (d) the amount of any penalty or interest payable in respect of the presumptive income tax due; and
  - (d) the time, place, and manner of objecting to the assessment.
- (5) The Chief Commissioner may, within 2 years after serving a notice of assessment under subsection (4) on a presumptive income

taxpayer, amend the assessment by making such alterations and additions as he considers necessary, and a notice of the amended assessment shall be served on the taxpayer.

- (6) Nothing in this section prevents penalty and interest in respect of presumptive income tax assessed under this section from being computed from the original due date for payment of the tax as determined under section 94.

#### **PART XI – REFUNDS**

- Refunds** 96. (1) Subject to this Act, a taxpayer who has paid tax in excess of the amount for which the taxpayer is properly chargeable under this Act may apply to the Chief Commissioner for a refund of the excess.
- (2) An application for a refund under subsection (1) shall be lodged in the form and manner prescribed in the Regulations within 5 years of the date on which the tax was paid.
- (3) If the Chief Commissioner is satisfied that tax has been overpaid, the Chief Commissioner shall -
- (a) apply the amount overpaid in reduction of any other tax due, including an instalment of tax due, by the taxpayer under this Act; and
- (b) refund the remainder, if any, to the taxpayer.
- (4) The Chief Commissioner shall serve the taxpayer with notice, in writing, of the decision on the application for a refund within 45 days of the application being lodged with the Chief Commissioner.

#### **PART XII - MISCELLANEOUS**

- Regulations** 97. (1) The Chief Commissioner may, with the consent of Cabinet, make regulations for –
- (a) matters prescribed to be made by regulation under this Act; or
- (b) the application and administration of this Act.
- (2) Without limiting the general effect of subsection (1), regulations made under that subsection may –
- (a) contain provisions of a saving or transitional nature consequent upon the making of this Act; or
- (b) prescribe penalties for the contravention of the regulations.
- (3) Transitional regulations made within 6 months after the commencement of this Act may provide that they take effect from the date on which the Act comes into force but only if this is to the benefit of taxpayers.

- Repeal and Transitional** 98. (1) The Income Tax Act (Cap. 68) is hereby repealed.
- (2) Notwithstanding subsection (1) and subject to the Revenue Services Administration Act 2002, the Income Tax Act (Cap. 68) shall continue to apply to any fiscal year of a taxpayer ending before the

commencement of the taxpayer's first fiscal year under this Act.

- (3) Subject to subsection (4), sections 27-29, 31 and 32 shall apply to a depreciable asset acquired by a taxpayer before commencement of the taxpayer's first fiscal year under the Act on the basis that the written down value of the asset at the beginning of that year shall be the cost of the asset less the total deductions allowed under section 6(2)(a) of the Income Tax Act (Cap. 68).
- (4) If section 27(7) applies to a depreciable asset referred to in subsection (3), the written down value of the asset at the commencement of the taxpayer's first fiscal year under the Act shall be computed on the basis that the asset was used solely to derive income subject to tax under section 4(a) of the Income Tax Act (Cap. 68).
- (5) Section 30 shall not apply to an intangible acquired by a taxpayer before the commencement of the taxpayer's first fiscal year under the Act.
- (6) Section 33 shall not apply to preliminary expenditure incurred by a taxpayer before the commencement of the taxpayer's first fiscal year under the Act.
- (7) Section 34 shall apply in respect of a debt or other instrument or agreement giving rise to interest whenever incurred by a taxpayer.
- (8) Where a debt—
  - (a) is written off by a taxpayer as a bad debt in a fiscal year; and
  - (b) the debt arose before the commencement of the taxpayer's first fiscal year under the Act,

the reference in section 36(1)(a) to the amount of the debt being previously included in the gross income of a taxpayer shall include an amount included in assessable income under section 4 of the Income Tax Act (Cap. 68).
- (9) If, at the commencement of a taxpayer's first fiscal year under the Act, the taxpayer has a business loss carried forward under section 41(3) of the Income Tax Act (Cap. 68) the amount of the loss shall be allowed as a deduction under section 37.
- (10) Section 43 shall not apply to a financial lease entered into before the commencement of this Act.
- (11) A reference in section 52 to a deduction allowed for any expenditure or loss incurred, or bad debt written off in a fiscal year shall include any expenditure, loss, or bad debt deducted under the Income Tax Act (Cap. 68).
- (12) Income that would be exempt income under section 11(p) of the Income Tax Act (Cap. 68) shall continue to be exempt if it is derived before 1 July 2006.
- (13) Self-assessment under section 71 shall not apply to a taxpayer whose annual turnover is less than \$100,000, unless the Chief Commissioner has specified by notice in the Gazette that the section

shall apply to such taxpayer.

- (14) Where self-assessment does not apply to a taxpayer by virtue of subsection (13), the Chief Commissioner shall, based on the taxpayer's income tax return for a fiscal year and on any other information available, make an assessment of the chargeable income or the business loss of a taxpayer and any tax payable thereon for the year.

Passed in the Legislative Assembly this                      day of                      2004.

**SCHEDULES****FIRST SCHEDULE**

(Section 5)

**RATES OF INCOME TAX**

1. The rates of income tax imposed on the chargeable income of an individual shall be –

<b>Chargeable Income</b>	<b>Income Tax Rate</b>
\$0-\$5,000	0%
exceeding \$5,000-20,000	10%
exceeding \$20,000	20%

2. The rate of income tax imposed on the chargeable income of a company shall be twenty percent (20%).
3. The rate of income tax payable by a trustee shall be –
- (a) in the case of beneficiary under a legal disability or the first two years of administration of a deceased estate, the rates of tax applicable under paragraph 1; or
  - (b) in any other case, twenty percent (20%).

**SECOND SCHEDULE**

(Section 13)

**VALUATION OF EMPLOYMENT BENEFITS**

1. In this Schedule -

“benchmark rate” means the National Reserve Bank of Tonga rediscount rate at the commencement of the fiscal year; and

“services” includes the making available of any facility.

2. The value of any benefit-in-kind included in the employment income of an employee under section 13(1)(b) shall be determined in accordance with this Schedule.

3. This Schedule shall not apply to any allowance or reimbursement referred to in section 13(1)(c) or (d).

4. If, in a fiscal year, a motor vehicle is provided by an employer to an employee wholly for the private use of the employee, the value of the benefit for the year shall be the amount computed in accordance with the following formula –

$$(20\% \text{ of } A) - B$$

where -

**A** is the cost to the employer of acquiring the motor vehicle or, if the vehicle is leased by the employer, the fair market value of the vehicle at the commencement of the lease; and

**B** is any payment made by the employee for the use of the motor vehicle or for its running costs.

5. If, in a fiscal year, a motor vehicle is provided to an employee partly for private use and partly for use in employment, the value of the benefit for the year shall be the amount computed in accordance with the formula in paragraph (4) reduced by the proportion of that amount representing use in employment.

6. If a motor vehicle referred to in paragraph 4 or 5 is not provided for the whole of the year, the value of the benefit computed under those paragraphs, as the case may be, shall be based on the proportion of the year that the vehicle was provided.

7. If, in a fiscal year, the services of a housekeeper, driver, gardener or other domestic assistant is provided by an employer to an employee, the value of the benefit for the year shall be the total employment income paid to the domestic assistant in that year for services rendered to the employee, as reduced by any payment made by the employee for such services.

8. If, in a fiscal year, a loan is made by an employer to an employee, the value of the benefit for the year shall be the difference between the interest paid by the employee on the loan for the year, if any, and the interest which would have been paid by the employee on the loan for the year if the loan had been made at the benchmark rate for that year.

9. For the purposes of this Act other than paragraph 8, if the employee uses a loan referred to in paragraph 8 wholly or partly for the acquisition of property producing amounts included in

**Comment [LC33]:** 20% reflects the depreciation and is covered in the cost all the expenditure and is apportioned to private and business use. Make formula clear. A/5. If cars have longer life here than have longer life than 5%. Is the value of the benefit, here saying that the value to you each year is the dep cost.

gross income, the employee shall be treated as having paid an amount as interest equal to the benchmark rate on the loan or that part of the loan used to acquire the property.

10. If, in a fiscal year, an obligation of an employee to pay or repay an amount owing by the employee to the employer is waived by the employer, the value of the benefit shall be the amount so waived.
11. If, in a fiscal year, an obligation of an employee to repay an amount owed by the employee to another person is paid by the employer, the value of the benefit shall be the amount so paid.
12. If, in a fiscal year, property is transferred or services are provided by an employer to an employee, the value of the benefit shall be the fair market value of the property or services determined at the time the property is transferred or the services are provided, as reduced by any payment made by the employee for the property or services.
13. If, in a fiscal year, accommodation or housing is provided by an employer to an employee, the value of the benefit shall be –
  - (a) when the employer or an associate owns the accommodation or housing, the fair market rent of the accommodation or housing; or
  - (b) in any other case, the rent paid by the employer for the accommodation or housing,

as reduced by any payment made by the employee for the accommodation or housing.

14. If, in a fiscal year, an employer has provided an employee with a benefit not covered by paragraphs (4) to (13), the value of the benefit shall be the fair market value of the benefit determined at the time it is provided, as reduced by any payment made by the employee for the benefit.

**Comment [LC34]:** 13. the govt houses must be valued, normal admin practice, is that admin in consultation, would prepare what value of house in arrears. Reduced rent, so market rent less than what paid. Who will value? Only if sig diff.

**THIRD SCHEDULE**

(section 28, and 29)

**DEPRECIATION RATES**

The depreciation rates specified for the purposes of section 28 and 29 shall be –

Asset	Depreciation Rate	
	Diminishing value	Straight-line
Motor vehicles; buses and minibuses with a seating capacity of less than 30 passengers; goods vehicles with a load capacity of less than 7 tonnes; computers and data handling equipment; and construction equipment and earthmoving equipment	40%	25%
Buses with a seating capacity of 30 or more passengers; goods vehicles designed to carry or pull loads of more than 7 or more tonnes; specialised trucks; tractors; trailers and trailer-mounted containers; and plant and machinery used in manufacturing, mining, or farming operations	30%	20%
Vessels, barges, tugs, and similar water transportation equipment; aircraft; specialised public utility plant, equipment, and machinery; office furniture, fixtures, and equipment; and any depreciable asset not included in another category	20%	12.5%
Buildings		5%