EMPLOYMENT AND SERVICES TAX ACT

DETAILED TECHNICAL NOTES

These notes provide a detailed technical analysis on a section-by-section basis of the Employment and Services Tax Act (referred to as the "Act").

1. Short Title

This section provides that the Act may be cited as the Employment and Services Tax Act 2014.

2. Commencement and Application

This section provides for the commencement and application of the Act.

Subsection (1) provides that the Act commences from the date that notice of the Act is published in the Gazette.

Subsection (2) provides that the Act applies to employment income and services fees paid on or after the 1 October 2014. This is the case even if the employment or services were performed wholly or partly before that date. The application of the Act is based on the date of payment not the date of service.

It is intended that the Act will come into force under subsection (1) prior to the application date specified in subsection (2). This is intended to allow the Nauru Customs and Revenue Office ("NCRO") to register employers and payers under section 15 before the application of the tax from October 1, 2014. If the commencement date of the Act were to be October 1, 2014, the NCRO would have no legal authority to register employers and payers before that date.

While it is intended that the Act will come into force prior to October 1, 2014, the operation of subsection (2) means that the Act applies only to employment income and service fees paid on or after that date.

3. Definitions

This section sets out, in alphabetical order, definitions of terms used in the Act. These definitions apply unless it is specified otherwise. The main definitions are discussed below; the other definitions are self-explanatory. Sections 4-9 provide further definitions of terms used in the Act.

Employee

This term is relevant to the section 3 definition of "employer", and section 5 (which defines employment income by reference to an employee), section 11 (which provides for the imposition of employment tax on employees) and section 17 (which provides

for the collection of employment tax by employers withholding the tax from payments of employment income made to employees).

"Employee" is defined to mean an individual engaged in employment. Any individual providing services under a relationship within the definition of "employment" is an employee for the purposes of the Act. Thus, the term "employment" is central to the definition of "employee". As discussed below, "employment" is defined to mean any employee/employer relationship within the ordinary meaning. The definition of "employment" is extended to include the holding of an office, being a contractual relationship that is economically equivalent to an employment relationship. Thus, an individual is an employee for the purposes of the Act if the individual is: (i) an employee within the ordinary meaning of an employment relationship (see below); or (ii) an office holder.

Employer

This term is relevant to section 5 (which defines employment income by reference to an employer) and section 17 (which provides for the collection of employment tax by employers withholding the tax from payments of employment income made to employees).

"Employer" is defined to mean a person who engages or remunerates an employee. Thus, the definition of "employee" is central to the definition of "employer". This means that a person is an employer for the purposes of the Act if the person engages or remunerates an individual who is: (i) an employee within the ordinary meaning of an employment relationship; or (ii) an office holder.

While, ordinarily, the same person will both "engage" and "remunerate" an employee, the definition is broad enough to accommodate the case, particularly in corporate groups, when the hiring and remuneration functions are in separate entities. If this is the case, then both the person who has hired the employee and the person who remunerates the employee are treated as the employer in respect of the employee. This is particularly important for the withholding of employment tax from payments of employment income.

An employer is a "person" is who engages or remunerates an employee. "Person" is defined broadly in section 3 and, includes in particular, the Government of Nauru, a foreign government and an international organisation. The intention is that every entity that may engage or remunerate an individual as an employee is treated as an employer for the purposes of the Act even if that entity is not a separate legal person under general law, such as a partnership, trust, or unincorporated body of persons. This is particularly important for the withholding obligation under section 17. While the definition of "employer" includes entities that are not separate legal persons, section 12 of the Revenue Administration Act provides that the obligations of a person as employer (such as the withholding of tax from employment income) are to be met by the "tax representative" of the employer (such as, in the case of a partnership, a partner in the partnership or, in the case of a trust, a trustee of the trust).

Employment

This term is relevant to the section 3 definition of "employee", and section 5 (which defines "employment income").

"Employment" is defined inclusively so that it otherwise has its general law meaning as determined under case law. An employment relationship as ordinarily understood does not include an individual engaged on his or her own account as an independent contractor. An independent contractor is engaged in a business activity.

The determination, under general principles, as to whether an individual is an employee or independent contractor involves examining a number of factors, including whether the hirer has the legal right to control the manner in which the work is done and the degree of integration of the activities of the contractor in the business of the hirer. In determining the degree of integration, regard is normally had to the following:

* Whether the contractor is engaged on a continuous basis.

* Where the services are performed, in particular whether they are performed at the hirer's place of business.

* Whether the hirer controls the timing and scheduling of the work.

* Whether the hirer provides the working tools, plant and other relevant facilities necessary for the contractor to perform his or her work.

Paragraphs (a)–(c) of the definition treat the holding of various offices as an employment. While, in legal form, an office holder is not an employee, there is little difference in economic substance between the two relationships. In both cases, remuneration is paid essentially for the labour of the person engaged. Consequently, it is appropriate to treat an office holder as an employee for the purposes of the Act.

Paragraph (a) includes a company director. This means that director's fees are treated as employment income under section 5 and are subject to employment tax under section 11. Paragraph (a) also includes any other office in the management of a company or a body of persons. This would cover, for example, the holder of an office in the management of an unincorporated association of persons.

Paragraph (b) includes any position entitling the holder to a fixed or ascertainable remuneration.

Paragraph (c) includes public offices, such as a judicial office.

International agreement

This term is relevant to section 13 (which specifies amounts as exempt income). Amounts that are exempt income are not subject to tax under section 11 or 12.

The definition specifies two classes of international agreement. Paragraph (a) includes an agreement between the Government of Nauru and a foreign government for the prevention of double taxation (i.e. a double tax treaty) as an international agreement.

The parties to a double tax treaty are referred to as "Contracting States". In broad terms, a double tax treaty allocates taxing rights between the Contracting States in relation to income arising from transactions between the states (employment, business and investment). While Nauru does not have any tax treaties at the time of enactment of the Act, it is possible that Nauru may enter into such a treaty at some later point in time and, therefore, paragraph (a) of the definition accommodates that possibility.

Paragraph (b) includes an agreement between the Government of Nauru and a foreign government or international organisation (separately defined in section 3) for the provision of financial, technical, humanitarian, or administrative assistance to the Government as an international agreement.

International organisation

This term is relevant to the section 3 definitions of "person" (which includes an international organisation) and "international agreement" (which includes an agreement between the Government of Nauru and an international organisation for the provision of financial, technical, humanitarian, or administrative assistance to the Government).

"International organisation" is defined to mean an organisation the members of which are sovereign powers or the Governments of sovereign powers. Examples of an international organisation are the Asian Development Bank and the United Nations and its Specialised Agencies (such as the World Bank).

Knowhow

This term is relevant to section 8 definition of "services fee" (which includes consideration for the provision of knowhow).

"Know-how" is any scientific, technical, commercial or industrial information, techniques, knowledge, experience or skill that is likely to assist in the conduct of business activities. The provision of knowhow may involve the supply of information (such as formulas, designs and drawings) or skills and experience, or both. In relation to information, there is usually an element of confidentiality or secrecy attached to the information. In relation to the skills and experience, it may be that the skills and experience can be passed on only by a demonstration.

Management fee

This term is relevant to section 8 definition of "services fee" (which includes a management fee).

A "management fee" is an amount paid as consideration for the rendering of any managerial service, other than an amount that is employment income (defined in section 5). A management fee is commonly charged by a parent company to a subsidiary for centralised management services provided by the parent company to the subsidiary.

Non-resident person

This term is relevant to section 9 (which provides for determining whether income is derived from sources in Nauru) and section 12 (which imposes services tax).

"Non-resident person" is defined to mean a person who is not a resident person. "Person" is defined in section 3 to mean an individual, company, partnership, trust, body of persons, government, political subdivision of a government, or international organisation. "Resident person" is defined in section 3. Taking account of the section 3 definition of "resident person", the following persons are non-resident persons:

(1) A citizen of Nauru that has a permanent home outside Nauru, except employees of the Government of Nauru posted abroad.

(2) A foreign citizen (other than a resettled refuge).

(3) A partnership, trust, company or other body of persons that is incorporated, formed, settled, or otherwise established outside Nauru.

(4) A foreign government.

(5) A political subdivision of a foreign government, such as a state or provincial government.

(6) An international organisation (as defined in section 3).

Pay period

This term is relevant to section 11 (which imposes employment tax by reference to the employee's pay period) and the Schedule (which specifies the rates of tax for employees who are resident individuals by reference to the employee's pay period).

"Pay period" is defined by reference to an employee's basis of payment. When an employee is paid on a monthly basis, the pay period is the calendar month. When an employee is paid on a fortnightly basis, the pay period is the fortnight. When an employee is paid on a weekly basis, the pay period is the week. If an employee is paid on some other basis, the pay period is the period specified by the Secretary in a notice issued under section 17(3).

Payer

This term is relevant to those sections in the Act dealing with the withholding of services tax by payers from the payment of a services fee.

"Payer" is defined to mean a person liable to withhold tax under section 18. Thus, a "payer" is a person paying a services fee (defined in section 8) to a non-resident person that is subject to services tax under section 12. "Person" is defined broadly in section 3 and, includes in particular, the Government of Nauru, a foreign government and an international organisation. The intention is that every entity that may pay a services fee to a non-resident person is treated as a payer for the purposes of the Act even if that entity is not a separate legal person under general law, such as a

partnership, trust, or unincorporated body of persons. This is particularly important for the withholding obligation under section 18. While the definition of "payer" includes entities that are not separate legal persons, section 12 of the Revenue Administration Act provides that the obligations of a person as payer (such as the withholding of tax from the payment of a services fee) are to be met by the "tax representative" of the payer (such as, in the case of a partnership, a partner in the partnership or, in the case of a trust, a trustee of the trust). "

Permanent establishment

This term is relevant to section 9 (which provides rules for determining whether income is received from sources in Nauru) and section 12(2)(b) (which provides that a services fee that is attributable to a permanent establishment in Nauru of a non-resident person is not subject to the services tax).

The definition of "permanent establishment" follows closely the definition in tax treaties. It is intended that the existing learning in tax treaties on permanent establishments is relevant to the interpretation of the definition, particularly the Commentary to the OECD Model Tax Convention on Income and Capital.

The basic notion of a permanent establishment is a fixed place of business through which the business of a person is carried on. There are three key requirements, namely there must be: (i) a place of business; (ii) the place of business must be fixed (that is, there is a degree of permanency); and (iii) a business activity must be carried on through the place of business (for example, it cannot be just a vacant office). The definition has five specific inclusions.

Paragraph (a) includes an office, factory, warehouse, or workshop. These are largely illustrative of the types of places that can qualify as a permanent establishment under the general principle stated in the introductory words of the definition. Each inclusion is to be interpreted broadly. For example, "office" includes any office no matter what activity is conducted through the office. However, there is an exception for an office that has representation of a person's business as its sole activity (i.e. a liaison office). To qualify for the exception, the liaison office must not engage in the negotiation of contracts of sale or supply. The negotiation of contracts is more than simply a liaison or representative function and goes to the core of a non-resident person's business.

Paragraph (b) includes a mine site, oil or gas well, quarry, or other place of exploration for, or extraction of, natural resources. Again, these are largely illustrative of the types of places that qualify as a permanent establishment under the general principle as stated in the introductory words of the definition as they would ordinarily constitute a fixed place of business. It is expressly provided that a boat or ship that provides a base for the exploration or extraction of natural resources is a permanent establishment. A specific reference to a "boat" or "ship" is included to avoid any argument that the boat or ship is not a permanent establishment as it is not a "fixed" place.

Paragraph (c) includes a building site, a construction, assembly or installation project, or supervisory activities (such as the services of a consulting engineer) connected

with such site or project, but only if the site, project or activity continues for more than ninety days.

Paragraph (d) includes the furnishing of services through employees or other personnel when the services continue for the same or a connected project for a period or periods aggregating more than ninety days within any twelve-month period. The ninety-day period is tested over any twelve-month period and not by reference to the calendar year. Paragraph (d) can be satisfied by the aggregation two or more periods for a total period of ninety days within any period of twelve months provided the aggregated periods relate to the same or a connected project.

Paragraph (e) specifies two situations when an agent is a permanent establishment of the principal. The first is when the agent has and habitually exercises an authority to conclude contracts on behalf of the principal. The reference to "authority to conclude contracts" is intended to be interpreted broadly and would include a case when the agent negotiates all the essential terms of a contract even though the contract may be formally signed by the principal.

The second is when the agent maintains a stock of goods or merchandise from which the agent regularly delivers goods or merchandise on behalf of the principal. The ability to make timely delivery of goods or merchandise is considered to be a central part of any sales activity.

In both cases, an agent is not a permanent establishment if the agent is of independent status (i.e. its business is to act as agent for a number of customers and to act independently of each principal that it has as a client). An agent of independent status would include, for example, a general import agent.

Person

This term is primarily relevant in the section 3 definitions of "employer" (an employer is a "person" who engages or remunerates an employee) and "payer" (a payer is a person liable to withhold tax under section 18).

"Person" is defined to mean an individual, company, partnership, trust, body of persons, government, political subdivision of a government, or international organisation. The definition is broad and includes some entities (such as a partnership, trust and body of persons) that are not separate legal persons.

Paragraph (a) includes an individual. An individual is a natural person.

Paragraph (b) includes a partnership, trust, company and other bodies of persons. These terms are not separately defined in the Act and, therefore, have their normal meaning. A partnership is the relation that exists when two or more persons carrying on business for joint profit. A trust is any relationship that is recognised under the laws of equity as a trust. The main category of trust is a trust created by a settlement, but the definition would also include a constructive or resulting trust. A company is an incorporated body of persons. The reference to company will also include a statutory corporation (i.e. a company created by statute). The reference to "other

bodies of persons" is a reference to an unincorporated association or body of persons (such as a members club or society).

Paragraph (c) includes the Government of Nauru, a local authority in Nauru, a foreign government, or a political subdivision of a foreign government, such as a state or provincial government of a foreign country.

Paragraph (d) includes an international organisation, which is separately defined in section 3 to mean an organisation the members of which are sovereign powers or the Governments of sovereign powers. Examples include the Asian Development Bank and the United Nations and its specialised agencies (such as the World Bank).

The intention is that the concept of "person" includes every entity that is likely to engage employees or pay amounts subject to services tax. For those persons who are not separate legal persons under Nauru law, the obligations under this Act are to be performed by the tax representative of the person (see section 12 of the Revenue Administration Act).

Received

This term is primarily relevant to section 11 (which imposes employment tax) and section 12 (which imposes services tax). The taxing point for both taxes is when the employee or non-resident person receives the relevant income.

"Received" is defined inclusively so that it otherwise has its ordinary meaning, namely to take into one's possession. The definition expands upon the ordinary meaning to legislatively provide for a principle of constructive receipt.

Paragraph (a) treats an amount as received by a person if it is applied on his or her behalf. This may be at the instruction of the person or under any law. For example, if an employee instructs his employer to pay part of his or her salary direct to a third person (e.g. the employee's spouse), the employee is treated as having received the salary even though it is actually received by the third person. Similarly, if an amount is paid out of an employee's salary to a creditor of the employee under a garnishee order, the employee is treated as having received the garnisheed amount.

Paragraph (b) treats an amount as received by a person if it is credited to an account, or carried to any reserve, for the benefit of the person. This is particularly relevant to related party amounts subject to services tax. For example, a Nauru subsidiary of a foreign parent company may be liable to pay a management fee to the parent company. Instead of the management fee actually being paid, the subsidiary may credit the fee to a loan account for the benefit of the parent company. Paragraph (b) would treat the parent company as having received the amount credited to the loan account.

Paragraph (c) treats an amount as received by a person if it is otherwise made available to the person. For example, an employee cannot delay a receipt of salary by simply delaying the collection of his or her salary; once the salary is available for collection, the employee is treated as having received it.

Relative

This term is relevant to the definition of "associate" in section 4. Under section 4(3), *prima facie*, an individual and a relative of the individual are treated as "associates" of each other for the purposes of the Act. The term of "associate" is primarily relevant to the definition of the definition of employment income in section 5.

"Relative" is defined by reference to an individual. The following are treated as a relative of an individual:

(1) An ancestor of the individual. This includes the parents, grandparents and great-grandparents of the individual (paragraph (a)).

(2) A descendant of any of the grandparents of the individual. This includes the parents, siblings of the parents, siblings, children, grandchildren, great-grandchildren, nephews and nieces of the individual (paragraph (a)).

(3) An adopted child of the individual (paragraph (a)).

(4) An ancestor of the spouse of the individual. This includes the parents, grandparents and great grandparents of the individual's spouse (paragraph (b)). "Spouse" is defined in section 3 and includes a *de facto* spouse.

(5) A descendant of any of the grandparents of the individual's spouse. This includes the parents, siblings of the parents, siblings, children, grandchildren and great-grandchildren (including children from another marriage), nephews and nieces of the individual's spouse (paragraph (b)).

(6) An adopted child of the individual's spouse (paragraphs (b)).

(7) A spouse of the individual (paragraph (c)). "Spouse" is defined in section 3 and includes a *de facto* spouse.

(8) A spouse of any person mentioned in (1)-(6) above (paragraph (c)).

Under the section 4(3) definition of "associate", an individual and a relative of the individual are treated as associates of each other unless the Secretary is satisfied that neither person is reasonably expected to act in accordance with the directions, requests, suggestions, or wishes of the other.

Resident person

This term is relevant to the source rules in section 9. Employment income or a services fee is received from sources in Nauru if, *inter alia*, the income or amount is paid by a resident person.

There are three inclusions in the definition of resident person.

Paragraph (a) treats a resident individual as a resident person. "Resident individual is defined in section 7.

Paragraph (b) treats a partnership, trust, company or other body of persons that is incorporated, formed, settled, or otherwise established in Nauru as a resident person. "Incorporated" and "settled" are terms of legal art. "Incorporated" relates to a company and "settled" relates to a trust. Thus, a company that is incorporated in Nauru and a trust established by a deed of settlement executed in Nauru are resident persons. A statutory corporation is created by statute and, therefore, a statutory corporation created by statute enacted in Nauru will be a resident person on the basis that the corporation is "created" in Nauru. Partnerships and bodies of persons are created by agreement and, therefore, will be resident persons if the agreement is executed in Nauru as the partnership or body of persons is formed or created in Nauru.

Paragraph (c) treats the Government of Nauru or any local authority in Nauru as a resident person.

Spouse

This term is relevant to the section 3 definition of "relative". Under paragraph (c) of the definition of "relative", an individual and a spouse of the individual are treated as relatives. Paragraph (c) of the definition of "relative" also treats an individual and a spouse of a person referred to paragraphs (a) and (b) of the definition of "relative" as relatives. Thus, for example, an individual and the spouse of the sister of the individual are relatives. Further, under paragraph (b) of the definition of "relative", an individual and a relative of the spouse of the individual are treated as relatives. Thus, for example, an individual and the sister of the individual's spouse are treated as relatives.

"Spouse" is defined to mean the husband or wife of an individual. The definition expressly includes individuals who are in a genuine *de facto* relationship as spouses of each other.

Tax

This term is primarily relevant to section 28 (which provides for a general anti-avoidance rule).

"Tax" is defined to mean a tax imposed under the Act, namely the employment tax imposed under section 11 and services tax imposed under section 12.

Third party arranger

This term is relevant to the section 5 definition of "employment income". Section 5(3) and (4) make it clear than an amount is employment income of an employee even though a third party arranger pays the amount to the employee or to an associate of the employee.

"Third party arranger" is a person who is a third party to an employment relationship and who has entered into an arrangement with an employer or an associate of an employer to pay or provide employment income to an employee of the employer.

Thus, an amount may be employment income even though it is provided to an employee or an associate of an employee by a third party to the employment relationship under an agreement with the employer or an associate of the employer.

Withholding tax

This term is relevant to section 21 (which provides for the filing of withholding tax returns) and section 22 (which provides for the payment of withholding tax).

"Withholding tax" is defined to mean the tax that an employer or payer withholds, or is required to withhold, under section 17 or 18. Thus, the amount of employment tax that an employer withholds and the amount services tax that a payer withholds are referred to as withholding tax.

4. Associate

This section defines "associate" for the purposes of the Act. The definition is relevant to section 5 (which defines employment income). Section 5(3) makes it clear than an amount is employment income of an employee even though an associate of the employee's employer pays the amount to the employee and section 5(4) makes it clear that an amount is employment income of an employee even if it is paid to an associate of the employee.

The basic rule is set out in subsection (1), which provides that two persons are associates when the relationship that exists between them is such that one person may reasonably be expected to act in accordance with the directions, requests, suggestions, or wishes of the other, or both persons may reasonably be expected to act in accordance with the directions, requests, suggestions, or wishes of a third person. Whether a person may reasonably be expected to act in accordance with the directions, requests, suggestions, or wishes of another is determined objectively having regard to all the facts and circumstances.

The reference to both persons being reasonably be expected to act in accordance with the directions, requests, suggestions, or wishes of a third person would cover, for example, "sister" companies that are under common control.

Subsection (2) states an exception, namely that two persons are not associates solely by reason of an employment or client relationship. In the absence of subsection (2), subsection (1) may treat an employer and employee as associates as the employee would ordinarily be expected to act in accordance with the directions, requests, suggestions, or wishes of his or her employer. Similarly, in the absence of subsection (2), subsection (1) may treat, for example, a lawyer and their client as associates as the lawyer would ordinarily be expected to act in accordance with the directions of its client.

The exception in subsection (2) applies only when the employment or client relationship is the sole reason why one person may act in accordance with the directions, requests, suggestions, or wishes of the other. If there is another reason why this may occur (e.g. the employee and employer are relatives), the two persons may still be associates.

Subsection (3) makes it clear that an individual and a relative of the individual are associates. "Relative" is defined in section 3 (see explanation above). There is an exception if the Secretary is satisfied that neither person is reasonably expected to act in accordance with the directions, requests, suggestions, or wishes of the other, such as when an individual and a relative are estranged.

The following are examples of persons who would ordinarily be regarded as associates: husband and wife, siblings, parent and child, partners in a partnership, beneficiary and trustee, and controlling shareholders and the company they control.

5. Employment Income

This section defines "employment income" for the purposes of the Act. It is mainly relevant to section 11 (which imposes employment tax on employment income) and section 17 (which provides for the withholding of employment tax from employment income).

Subsection (1) lists the amounts that are included in employment income. Paragraph (a) includes salary, wages, an allowance, leave pay, payment in lieu of leave, overtime pay, bonus, commission, fees, gratuities, salary or wage supplements, and other similar amounts received by an employee in respect of employment. The amounts referred to in paragraph (a) will have their ordinary meaning. Each amount referred to in paragraph (a) is a standard cash amount paid to employees for work done. The reference to "other similar amount" is a reference to amounts that are similar in nature to those listed in paragraph (a) whatever they may be called. Essentially, paragraph (a) includes in employment income the usual cash amounts paid to employees as remuneration for work done.

There is a requirement that an employee receives each of the listed amounts in respect of employment. "Employment" is defined in section 3 to mean employment within the ordinary meaning and includes the holding of an office (such as a company directorship or a public office). The words "in respect of employment" require that there is a sufficient nexus between the amount received and the employee's employment. In broad terms, an amount received by an employee is in respect of employment if it is a reward for work undertaken by the employee. It is intended that the nexus to employment should be interpreted broadly. However, any amount that is a pure gift would not be employment income because the employee receives the amount in his or her personal capacity rather than as a reward for work undertaken.

Paragraph (a) includes an allowance as employment income. An allowance is an amount paid to an employee for use by the employee in meeting particular expenses but with no requirement for the employee to vouch that the amount has been expended or fully expended for the stated purpose. Subsection (2) provides that an allowance that the Secretary regards as reasonably likely to be expended by an employee in the performance of the employee's duties of employment is not employment income. This would include, for example, a work travel allowance.

Paragraph (b) includes in employment income any amount received by an employee on termination of employment. An amount is included under this paragraph regardless

of whether it is paid voluntarily by the employer, under the terms of the employee's employment contract, or as a result of legal action. The paragraph expressly includes a redundancy payment and any other amount received as compensation for loss of employment, such as a severance or golden handshake payment. A "golden handshake payment" is an amount that an employer is obliged to pay under an employment contract usually with a senior employee in the event that the employee's employment is terminated. These amounts are included in employment income because they are usually an additional amount paid for work done.

Subsection (3) provides that an amount is treated as received by an employee in respect of employment regardless of whether it is paid or provided by the employee's employer, an associate of the employee's employer or by a third party arranger. "Associate" is defined in section 4 and "third party arranger" is defined in section 3. In broad terms, an "associate" of an employer is a person related to the employer and includes a relative if the employer is an individual. A "third party arranger" is a non-associated person who provides the amount under an arrangement with the employee's employer or an associate of the employer. If an amount is paid or provided to an employee by an associate of the employee's employer or under a third party arrangement, subsection (3) avoids any argument that the amount is not included in the employee's employment income on the ground that no employment services have been rendered by the employee to the actual person paying the employment income. This reinforces the constructive receipt rule in the section 3 definition of "received".

Subsection (3) also provides that an amount is treated as received by an employee in respect of employment regardless of whether it is paid or provided by a past or prospective employer of the employee. This ensures that an amount is employment income despite the fact that the employment has ceased or is yet to commence.

Subsection (4) provides that an employee is treated as receiving an amount even though it is paid or provided to an associate of the employee. "Associate" is defined in section 3 and, in this context, the main example of an associate of an employee is a relative of the employee. This also reinforces the constructive receipt rule in the section 3 definition of "received" and avoids any argument that the associate is the person who received the amount and that it is not employment income because the associate has not rendered any services to the payer.

6. Non-profit Organisation

This section defines "non-profit organisation" for the purposes of the Act. The definition is relevant to section 13(1)(c) (which treats an amount received by a non-profit organisation as exempt income).

Subsection (1) provides that a "non-profit organisation" is an organisation that satisfies the following conditions:

(1) The organisation is established solely to provide relief to those suffering from poverty or distress, or for the advancement of education or religion (i.e. in broad terms, the organisation is established for charitable purposes). An organisation that is established to provide relief to those suffering from

poverty or distress, or for the advancement of education or religion, and for some other purpose or purposes is not a non-profit organisation.

(2) No part of the income or other funds of the organisation is used, or is available for use for the profit of a proprietor or member of the organisation. In other words, it must not be possible for an owner or member of the organisation to obtain a private benefit through the activities of the organisation.

(3) The Secretary has certified, by notice in writing, that the organisation is a non-profit organisation. Thus, the exemption is available only if the Secretary has certified the organisation as a non-profit organisation. This is the case even if, as a matter of fact, the organisation satisfies conditions (1) and (2).

The word "organisation" is intended to have a broad meaning, including all forms of entity that may be engaged in charitable activities (such as company, trust, or an unincorporated body of persons).

Subsections (2) and (3) provide for applications to the Secretary by an organisation seeking certification as a non-profit organisation.

Subsection (4) obliges an organisation to notify the Secretary immediately, in writing, if the organisation no longer satisfies the conditions to be a non-profit organisation. This applies to an organisation that ceases to satisfy conditions (1) and (2) above. An organisation that fails to notify the Secretary as required under subsection (4) may be liable for a late filing penalty under section 62 of the Revenue Administration Act or prosecuted for an offence under section 72 of the Revenue Administration Act.

Subsection (5) provides that a certificate of exemption remains in force until withdrawn by the Secretary by notice in writing to the organisation. The withdrawal of a certificate of exemption may be on application by the organisation under subsection (4) or on the Secretary's own motion.

7. Resident and Non-resident Individuals

This section defines "resident individual" and "non-resident individual" for the purposes of the Act. The definition of "resident individual" is relevant to the section 3 definition of "resident person (which includes a resident individual) and the rates of employment tax specified in the Schedule for resident individuals. The definition of "non-resident individual" is relevant to the rate of employment tax specified in the Schedule for non-resident individuals.

Subsection (1) defines "resident individual". Subsection (1)(a) includes a citizen of Nauru as a resident individual. An individual may be a citizen of Nauru under Part VIII of the Constitution or section 4 of the Naoero Citizenship Act, 2005.

There is an exception when a citizen has a permanent home outside Nauru. This means that an individual who is a citizen of Nauru but who has made their permanent home outside Nauru is not a resident individual and, therefore, is a non-resident individual (as defined in subsection (3)). Whether a citizen of Nauru has a permanent home outside Nauru will depend on all the facts and circumstances. The following

factors will be important in the analysis: (i) whether the individual has formed an intention to live outside Nauru; (ii) the intended period of absence from Nauru (as a rule of thumb, an individual is likely to have a permanent home outside Nauru if the intended period of absence is three years or more); and (iii) the "durability" (or strength) of the individual's association with the foreign jurisdiction.

Subsection (2) provides that a citizen of Nauru who is an employee of the Government of Nauru posted abroad is a resident individual during the period of the posting. This is the case even if they have a permanent home outside Nauru. This will apply to Nauruan diplomats, consular and trade officials, and the like. Section 9(1)(b) treats the employment income of Nauruan Government officials posted abroad as received from sources in Nauru and, therefore, the effect of subsection (2) is that the rates of employment tax applicable to resident individuals apply to such income.

Subsection (1)(b) includes an individual who lives in Nauru as a resettled refuge as a resident individual.

Subsection (3) provides that an individual who is not a resident individual is a non-resident individual. The following are non-resident individuals for the purposes of the Act:

(1) Citizens of Nauru that have a permanent home outside Nauru, except employees of the Government of Nauru posted abroad.

(2) Foreign citizens (other than a resettled refugee).

8. Services Fee

This section defines "services fee" for the purposes of the Act. It is relevant to section 12 (which imposes services tax on a services fee received by a non-resident person) and section 18 (which provides for the withholding of services tax from a services fee).

Subsection (1) defines "services fee" to mean a fee as consideration for the provision of independent services. Thus, the basic notion of a services fee is that it is a payment received in return for providing services as an independent contractor. The distinction between employment and independent contractor relationships under general principles is discussed above in the context of the definition of "employment".

Ordinarily, the concept of employment would not include an independent contractor relationship so that the concepts of employment income and services fee are mutually exclusive concepts. However, the section 3 definition of "employment" does extend to some independent contractor relationships, particularly, relating to the holding of an offence. For this reason, subsection (2) provides that an amount that is employment income is not a services fee. Thus, an amount that may be both employment income and a services fee is treated as employment income and, therefore, subject to employment tax.

Subsections (1)(a)-(d) list out amounts that are expressly treated as a services fee. Generally, these amounts should come within the basic principle expressed in the

introductory words of subsection (1). These amounts have been included as indicative of amounts that are treated as a services fee. It is expressly provided that the inclusion of the amounts in subsection (1)(a)-(d) as a service fee does not, in any way, limit the generality of the basic principle that a services fee is a fee as consideration for the provision of independent services. This is intended to avoid any argument that a services fee is limited to the classes of fee specified in subsection (1)(a)-(d).

Paragraph (a) includes a fee for professional services as a services fee. "Professional services" is not defined and, therefore, has its ordinary meaning, namely occupations requiring special training or skills usually acquired through tertiary education. Common examples of professional services are the services provided by doctors, lawyers, engineers, architects, dentists, financial analysts and accountants. By virtue of subsection (2), a fee for professional services is a services fee only when the fee is not employment income. Thus, the reward for professional services provided as an employee (such as an in-house legal counsel) is treated as employment income for the purposes of the Act.

Paragraph (b) includes a fee for the provision of building or construction services, including a fee for supervisory activities related to such services, as a services fee. By virtue of subsection (2), a fee for building or construction services, or supervisory activities relating thereto, is a services fee only when the fee is not employment income. Thus, the reward for building, construction or supervisory services provided as an employee is treated as employment income for the purposes of the Act.

Paragraph (c) includes an amount as consideration for the provision of knowhow as a services fee. "Know-how" is defined in section 3 to mean any scientific, technical, commercial or industrial information, techniques, knowledge, experience or skill that is likely to assist in the conduct of business activities.

Paragraph (d) includes a management fee as a services fee. "Management fee" is defined in section 3 to mean the remuneration for the provision of any managerial service other than as an employee.

9. Source of Income

This section provides for the determination of the geographic source of income subject to tax under the Act. It is relevant to section 11, which imposes employment tax only on employment income received from sources in Nauru, and to section 12, which imposes services tax only on amounts received from sources in Nauru.

Subsection (1) applies to both employment income and a services fee. There are two bases on which employment income or a services fee is received from sources in Nauru.

Subsection (1)(a) provides that employment income or a services fee is received from sources in Nauru when the employment income or fee is received in respect of an employment or services exercised or performed in Nauru, regardless of where the employment income is paid. This means that, consistent with international norms, the place of performance is the basic rule for determining the source of employment income or a service fee. An amount of employment income or a services fee in

respect of employment or services exercised or performed in Nauru is received from sources in Nauru even if the income is paid to the employee or non-resident contractor outside Nauru. Thus, for example, the remuneration of an employee for work performed in Nauru is derived from sources in Nauru even if the remuneration is paid directly into the employee's Australian bank account.

Subsection (2) provides that, for the purposes of subsection (1)(a), employment income paid in respect of any period of leave taken outside Nauru that is related to employment exercised in Nauru is treated as received in respect of employment exercised in Nauru. This is relevant, for example, when an individual's contract of employment provides that, for each month, the employee works for three weeks in Nauru and then has one week's leave in their home country. Subsection (2) prevents any argument that the employee's monthly salary is apportioned so that only three-quarters of the monthly salary is treated as received from sources in Nauru.

Subsection (1)(b) provides that employment income or a services fee is received from sources in Nauru when the employment income or fee is paid or provided by, or on behalf, of a resident person (such as the Government of Nauru) or a permanent establishment in Nauru of a non-resident person, wherever the employment is exercised. The fact that the employment income or services fee is paid by a resident person or Nauru permanent establishment of a non-resident person means that the benefit of the work is obtained in Nauru and this supports Nauru's right to tax the income as Nauru source income. "Resident person", "non-resident person" and "permanent establishment" are defined in section 3.

Subsection (1)(b) is particularly relevant to Nauruan Government officials working abroad as, generally, their employment income will be exempt from tax in the country of service, particularly under international agreements (such as the Vienna Convention on Diplomatic Relations). The exemption applies in the country of service on the assumption that a foreign government official will be taxed in their home country (hence the inclusion of subsection (1)(b)).

10. Act Binds the Republic

This section provides that the Act binds the Republic.

This is particularly important, for example, when the Government of Nauru is an employer or a payer. The effect of the section is that, when required to do so under section 17 or 18, the Government must withhold tax from payments of employment income or services fees paid to employees or non-resident payees.

11. Imposition of Employment Tax

This section provides for the imposition of employment tax on an employee who has received employment income. The tax is imposed by reference to the employee's pay period (monthly, fortnightly, weekly or other basis under a section 17(3) notice) and is imposed on the employee's total employment income for the pay period. The employee's employer collects the tax by withholding the tax from each payment of employment income (see section 17). No deductions are allowed for work expenditures (see section 14).

Subsection (1) provides for the imposition of employment tax. Employment tax is imposed for each pay period, at the rates specified in the Schedule, on every employee who has employment income for the pay period. Subsection (1) specifies the key concepts underlying the imposition of employment tax.

First, subsection (1) identifies the persons who are liable for employment tax. It is provided that employment tax is imposed on an "employee", which is defined in section 3 to mean an individual engaged in employment. "Employment" is also defined in section 3 and includes an employment relationship within the ordinary meaning and the holding of an office (such as the directorship of a company or a public office). Apart from an office holder, an independent contractor is not an employee for the purposes of the employment tax.

Secondly, subsection (1) identifies the employment tax base by reference to the concept of "employment income", which is defined in section 5. In broad terms, "employment income" is the salary, wages and other similar cash-based remuneration received from employment and fees received by office holders.

Thirdly, subsection (1) specifies the jurisdictional limits on the imposition of employment tax. The tax is imposed only on employment income received by an employee from sources in Nauru. Section 9(1) sets out rules for determining when employment income is received from sources in Nauru. There are two alternative bases upon which employment income is treated as received from sources in Nauru: (i) the employment is exercised in Nauru; or (ii) a resident person or Nauru permanent establishment of a non-resident person pays the employment income (i.e. the benefit of the employment is utilised in Nauru). "Resident person", "non-resident person" and "permanent establishment" are defined in section 3.

Fourthly, subsection (1) provides that the tax period for the purposes of the employment tax is the employee's pay period. This is defined in section 3 to mean the period that is the basis of payment of employment income, namely monthly, fortnightly, weekly, or some other basis under a section 17(3) notice.

Fifthly, subsection (1) provides that employment income is subject to tax in the pay period in which it is "received" by the employee. "Received" is defined in section 3 and is further expanded by section 5(3) and (4). In broad terms, an employee receives employment income when the employee actually receives the income or is treated as having "constructively" received the income.

Finally, employment tax is imposed at the rate or rates specified in the Schedule. The rate or rates of employment tax differ depending on whether the employee is a resident or non-resident individual. "Resident individual" and "non-resident individual" are defined in section 7.

Subsection (2) provides that employment income that is exempt income is not subject to employment tax. Amounts that are treated as exempt income for the purposes of the Act are specified in section 13.

Subsection (3) provides for the computation of the amount of employment tax payable by an employee for a pay period. The tax is computed by applying the rate or rates of tax specified in the Schedule to the total employment income of the employee for the pay period. Section 14(b) provides that no deductions are allowed for expenses incurred in earning employment income. Thus, employment tax is imposed on the gross amount of employment income. Separate rates are provided for resident and non-resident individuals. The difference between the two is that a tax-free threshold applies to resident individuals. As stated above, "resident individual" and "non-resident individual" are defined in section 7.

While employment tax is formally imposed on the employee, the employee's employer collects the tax by withholding the tax from each payment of employment income at the time of payment under section 17. Subsection (4) provides that the liability of an employee for employment tax is satisfied if the employer has correctly withheld tax from the employment income under section 17. An employer who fails to withhold tax as required under section 17 is personally liable for the tax (section 22(3)). The tax that an employer is required to withhold from a payment of employment income is referred to as "withholding tax" (see section 3 definition) and is treated as "tax" for the purposes of the Revenue Administration Act and, as such, may be recovered from the employer under the collection and recovery provisions in Part 7 of the Revenue Administration Act.

12. Imposition of Services Tax

This section provides for the imposition of services tax on a non-resident person who receives a services fee from sources in Nauru. The tax is a final tax on the fee (section 14(a)) and the payer of a services fee collects the tax by withholding the tax from each payment of a services fee (section 18). The tax is imposed on the gross amount of the fee received by the non-resident person with no deduction is allowed for expenditures or losses incurred in deriving the fee (section 14(b)).

Subsection (1) specifies the key concepts underlying the imposition of services tax.

First, subsection (1) identifies the person who is liable for services tax. It is provided that services tax is imposed on a "non-resident person", which is defined in section 3 to mean a person who is not a resident person. Taking account of the section 3 definitions of "person" and "resident person", the following persons are non-resident persons for the purposes of the Act:

(1) Citizens of Nauru that have a permanent home outside Nauru, except employees of the Government of Nauru posted abroad.

(2) A foreign citizen (other than a resettled refugee).

(3) A partnership, trust, company or other body of persons that is incorporated, formed, settled, or otherwise established outside Nauru.

(4) A foreign government.

(5) A political subdivision of a foreign government, such as a state or provincial government.

(6) An international organisation (as defined in section 3).

Subsection (2)(b) provides that a non-resident person is not liable for services tax if the services fee is paid to a Nauru permanent establishment of the non-resident person.

Secondly, subsection (1) identifies the services tax base by reference to the concept of a "services fee", which is defined in section 8. In broad terms, a services fee is a fee as consideration for the provision of independent services, including professional, building, construction and managerial services. The definition of services fee includes also an amount as consideration for the provision of knowhow. It is expressly provided in section 8(2) that employment income (as defined in section 5) is not a services fee.

Thirdly, subsection (1) specifies the jurisdictional limits on the imposition of services tax. The tax is imposed only on a services fee received by a non-resident person from sources in Nauru. Section 8(1) sets out the rules for determining when a service fee is received from sources in Nauru. There are two alternative bases upon which a services fee is treated as received from sources in Nauru: (i) the services are exercised or performed in Nauru; or (ii) a resident person or Nauru permanent establishment of a non-resident person pays the services fee (i.e. the benefit of the services is utilised in Nauru).

Fourthly, subsection (1) provides that a services fee is subject to services tax when the non-resident person receives the fee. "Received" is defined in section 3. In broad terms, a non-resident person receives a services fee when the person actually receives the fee or is treated as having "constructively" received the fee. For example, if a foreign parent company provides managerial services to its Nauru subsidiary and the management fee payable is credited to the parent company in an inter-company loan account, the parent company will be treated as having received the fee at the time the amount is so credited (see paragraph (b) of the definition of "received" in section 3).

Subsection (2) specifies two cases when the services tax does not apply. Subsection (2)(a) provides that a services fee that is exempt income is not subject to services tax. Amounts that are treated as exempt income for the purposes of the Act are specified in section 13. The main example of a services fee being exempt income is when the fee is exempt from tax under an international agreement.

Subsection (2)(b) provides that a services fee that is effectively connected to a Nauru permanent establishment of a non-resident person is not subject to the services tax. "Permanent establishment" is defined in section 3. In broad terms, a permanent establishment of a non-resident person in Nauru is a fixed place of business through which the business of the person is carried on in Nauru. For subsection (2)(b) to apply, there must be a sufficient connection between the provision of the services and the activities conducted by the non-resident person through the permanent establishment. This connection is stated by the concept of "effectively connected". This concept is used in tax treaties for a similar purpose and it is intended to have the

same meaning when used in subsections (2)(b). Whether the effectively connected test is satisfied will depend on the facts. In the ordinary case, an "effective connection" would be established when the services are provided by staff engaged by the permanent establishment.

Consistent with international norms, subsection (2)(b) ensures that a Nauru permanent establishment of a non-resident person is given equivalent treatment to a resident person operating a business in Nauru. The intention is that a services fee paid to a Nauru permanent establishment will be subject to the net profits tax imposed from 1 July 2015.

Subsection (3) provides for the computation of the amount of services tax payable by a non-resident person. The tax is computed by applying the rate of tax specified in the Schedule to the total amount of the services fee received. Section 14 provides that no deductions are allowed for expenses incurred in earning a services fee. Thus, services tax is imposed on the gross amount of the services fee.

While the services tax is formally imposed on the non-resident recipient of the services fee, the payer of a services fee collects the tax by withholding the tax from each payment of a services fee at the time of payment under section 18. Subsection (4) provides that the liability of a non-resident person for services tax is satisfied if the payer of the fee has correctly withheld tax from the fee under section 18. A payer who fails to withhold tax as required under section 18 is personally liable for the tax (section 22(3)). The tax that a payer is required to withhold from the payment of a services fee is referred to as “withholding tax” (see section 3 definition) and is treated as “tax” for the purposes of the Revenue Administration Act and, as such, the tax may be recovered from the payer under the collection and recovery provisions in Part 7 of the Revenue Administration Act.

13. Exempt Income

This section specifies amounts that are exempt income for the purposes of the Act. Section 11(2) provides that employment tax is not payable in respect of employment income that is exempt income and section 12(2) provides that services tax is not payable in respect of a services fee that is exempt income.

Subsection (1)(a) provides that an amount is exempt income to the extent that it is exempt from tax under an international agreement. “International agreement” is defined in section 3. The definition has two inclusions. Paragraph (a) of the definition of “international agreement”) includes an agreement between the Government of Nauru and a foreign government for the prevention of double taxation (i.e. a tax treaty) as an international agreement. Articles 7 and 19 of a standard double tax treaty are of particular relevance to taxes imposed under the Act.

Under Article 7 of a tax treaty, Nauru can tax the business income of a resident of the other Contracting State only when: (i) that person has a permanent establishment in Nauru; and (ii) the income is attributable to activities conducted through the permanent establishment. If the business income of a resident of a Contracting State is not connected to a permanent establishment in the other Contracting State, then only

the Contracting State of residence can tax the business income. This largely aligns with the effect of section 12(2)(b)

Under Article 19 of a tax treaty, Nauru is not permitted to tax certain employment income paid by the Government of the other Contracting State to a resident of that State for services performed in Nauru. Only the Contracting State of residence can tax such income.

Paragraph (b) of the definition of "international agreement" includes an agreement between the Government of Nauru and a foreign government or international organisation for the provision of financial, technical, humanitarian, or administrative assistance to the Government as an international agreement. If such an agreement provides for an exemption from tax for employment income or a services fee, then the employment income or services fee is treated as exempt income. Importantly, the employment income or services fee is exempt only to the extent provided for under the agreement. In this regard, the scope of tax exemptions provided for in international agreements can differ from agreement to agreement.

Subsection (1)(b) provides that an amount is exempt income to the extent that it is exempt from tax under the Diplomatic Privileges and Immunities Act 1976, the Consular Privileges and Immunities Act 1976, or the Special Missions Privileges and Immunities Act 1976.

The Diplomatic Privileges and Immunities Act gives effect to the Vienna Convention on Diplomatic Relations 1961 ("Vienna Convention"). Under Article 34 of the Vienna Convention, a diplomatic agent is exempt from, among other things, tax on emoluments (i.e. employment income). "Diplomatic agent" is defined in Article 1 of the Vienna Convention to mean the head of a diplomatic mission (such as an Ambassador or High Commissioner) and the members of the diplomatic staff of the mission. Article 37 extends the exemption to: (i) members of the family of the diplomatic agent; (ii) members of the administrative and technical staff of the diplomatic mission; (iii) members of the service staff of the mission; and (iv) the private servants of members of the diplomatic mission. In each case specified in Article 37, the exemption does not apply to Nauruan citizens or permanent residents. Section 4(1) of the Diplomatic Privileges and Immunities Act gives effect to the exemptions in Articles 34 and 37 in Nauru. Further, section 4(2) of the Diplomatic Privileges and Immunities Act provides that the Minister responsible for foreign affairs, with the concurrence of the Minister responsible for finance, may grant more favourable fiscal privileges than that provided for in the Vienna Convention.

The Consular Privileges and Immunities Act 1976 operates in a similar way in relation to the Vienna Convention on Consular Relations and the Special Missions Privileges and Immunities Act 1976 operates in a similar way in relation to the Convention on Special Missions 1969.

Subsection (1)(c) provides that an amount derived by a non-profit organisation is exempt income. "Non-profit organisation" is defined in section 6. In broad terms, a "non-profit organisation" is an organisation that the Secretary has certified as genuinely conducting charitable activities. Subsection (1)(c) applies to a Nauru-source service fee paid to a non-resident non-profit organisation.

Subsection (1)(d) provides that an amount is exempt income to the extent that it is exempt from tax under an exemption provision in an agreement entered into by the Government when the following conditions are satisfied:

(1) The agreement is for the provision of financial, technical, humanitarian, or administrative assistance to the Government of Nauru. It is contemplated that the agreement to which subsection (1)(b) applies is not an international agreement (i.e. the other party to the agreement is not a foreign government or an international organisation). The other party to the agreement may be a private party. The agreement must be for the provision of financial, technical, humanitarian, or administrative assistance to the Government of Nauru. Exemptions in other agreements (such as a normal commercial agreement for the supply of goods to the Government) will not have legal effect (i.e. the Act will override the exemption).

(2) The Cabinet has concurred, in writing, with the exemption provision. Because of the impact of exemptions on the budgetary situation of the Government, it is important that Cabinet agrees to the exemption. An exemption provision for which Cabinet has not provided written concurrence with will have no legal effect.

(3) The name of the person benefitting from the exemption provision must be included in a notice published in the Gazette within thirty days after the agreement comes into effect. This ensures that there is transparency in the granting of exemptions.

Subsection (2) specifies that a provision in another law providing that an amount is exempt from tax does not have legal effect unless also provided for in the Act. This is consistent with modern drafting practice that all tax exemptions should be provided in the tax law for transparency reasons.

The section applies to exemptions provided in laws enacted before the Act is enacted. It applies also to laws enacted after the Act is enacted except when the later law expressly provides that it overrides this section.

14. General Provisions Relating to Taxes Imposed under this Act

This section specifies general provisions relating to the taxes imposed under sections 11 and 12.

Paragraph (a) provides that the sections 11 and 12 taxes are final taxes on the income or fee in respect of which they are imposed. This will be particularly relevant when the net profits tax comes into operation and ensures that income subject to tax under the Act is not included in the computation of the net profit of the person receiving the income.

Paragraph (b) provides that, in computing the taxable amount under sections 11 and 12, no deduction is allowed for any expenditure or loss incurred by the person in earning the income or fee. This reinforces sections 11(3) and 12(3) and makes it clear

that the section 11 and 12 taxes are imposed on the gross amount of the employment income or service fee.

15. Registration of Employers and Payers

This section provides for the registration of employers and payers for the purposes of the Act.

Subsection (1) obliges a person who has become an employer to apply to the Secretary for registration as an employer within seven days of becoming an employer. The short time period for employer registration applications is necessary to ensure that a person is registered as an employer by the end of the first pay period after becoming an employer (particularly when the pay period is weekly or fortnightly).

Subsection (2) obliges a person who has become a payer to apply to the Secretary for registration as a payer within fourteen days of becoming a payer.

It is provided in subsections (1) and (2) that the Secretary may allow a person an extension of time to lodge a registration application.

Subsection (3) obliges the Secretary to register an applicant for registration when satisfied that the applicant is, or will be, an employer or payer, as the case may be. "Employer" and "payer" are defined in section 3.

Subsection (4) obliges a person to apply to the Secretary for cancellation of their registration when the person ceases to be an employer or payer. For example, an employer may have shut down their business. The application must be made within fourteen days of ceasing to be an employer or payer.

Subsection (5) obliges the Secretary to cancel the registration of a person who ceases to be an employer or payer, except when the cessation is only temporary. An example of a temporary cessation is when an employer suspends their business operations, but with the intention to restart the business at a later date. The cancellation of registration under subsection (5) may be as a result of an application under subsection (4) or on the Secretary's own motion.

Subsection (6) requires that an application under subsection (1) or (2), or a notification under subsection (4), must be in the approved form. This is the form approved by the Secretary for such applications or notifications in accordance with section 52 of the Revenue Administration Act. Further, the application or notification must be lodged in the manner specified in the Revenue Administration Act for the lodgement of documents with the Secretary (see section 53 of the Revenue Administration Act).

A person who fails to lodge a registration application within the time specified in subsection (1) or (2) (or within such further time as the Secretary may allow) or a cancellation application within the time specified in subsection (4) is liable for an administrative penalty under section 60 of the Revenue Administration Act. Alternatively, the person may be prosecuted for an offence under section 68 of the Revenue Administration Act.

16. Application of Revenue Administration Act

This section provides for the application of the Revenue Administration Act for the purposes of administering the employment and services taxes.

It is provided that the Revenue Administration Act applies for the purposes of the administration of the Act but subject the application of Part 4 of the Act. The Revenue Administration Act provides for harmonised procedural and administrative rules applicable to taxes imposed in Nauru. For this reason, the Act is a "tax law" for the purposes of the Revenue Administration Act. However, the application of the Revenue Administration Act for the purposes of the Act is subject to Part 4 of the Act. Part 4 provides for procedural and administrative rules that are specific to the taxes imposed under the Act. Thus, the legislative structure is that any procedural or administrative rules that are specific to the taxes imposed under the Act are provided for in the Act, while any generic procedural or administrative rules are provided for in the Revenue Administration Act. For example, the obligation to file a return is in the relevant Act requiring the return as the due date for filing returns can differ from tax to tax (see section 21 of the Act). However, general rules relating to returns, such as extensions of time of file returns, are provided for in the Revenue Administration Act.

17. Withholding of Tax from Employment Income

This section obliges employers to withhold tax from payments of employment income.

The obligation to withhold is specified in subsection (1). An employer paying employment income) to an employee that is subject to tax under section 11 must withhold tax from the gross amount of employment income paid to the employee at the employee tax rate or rates applicable to the employee as specified in the Schedule. "Employee" and "employer" are defined in section 3 and "employment income" is defined in section 5. The tax withheld is referred to as "withholding tax" (see section 3 definition of "withholding tax").

The obligation to withhold arises only when the employment income is subject to employment tax under section 11. Consequently, there is no obligation to withhold from: (i) employment income that is not received from sources in Nauru (see section 9); or (ii) employment income that is exempt income (see section 13).

Subsections (2) and (3) apply when an employer pays an employee who is a resident individual on some basis other than monthly, fortnightly or weekly (such as daily). In this case, the employer must notify the Secretary, of the basis of payment. The intention is that this will allow the Secretary to compute the basis of withholding to apply to the employee taking account of the tax-free threshold. The Secretary must notify the employer, in writing, of the amount of tax to be withheld by the employer from the employment income paid to the employee. It is intended that the notice will specify the pay period relevant to the employment income. The employer is then obliged to withhold tax as notified by the Secretary.

Subsection (4) provides that the Secretary may prepare tax tables to assist employers with the withholding of tax.

Subsection (5)(a) maintains an employer's obligation to withhold tax under the section even though the employer may be obliged to withhold other amounts from the employment income payable to an employee. For example, a creditor of an employee may have obtained a garnishee order requiring the employer to withhold regularly an amount from the employee's salary and forward it to the creditor to be credited against the amount owed to the creditor. The effect of subsection (5)(a) is to require the employer to withhold tax based on the entire employment income, including the part that is withheld for the benefit of the creditor.

Subsection (5)(b) provides that any laws that may prevent attachment of, or withholding of amounts from, employment income do not apply to the obligation to withhold tax.

Section 24 of the Revenue Administration Act provides for the following priorities in relation to the withholding of tax from employment income:

(1) An employer holds the tax withheld in trust for the Government. Thus, withholding tax does not form part of the income or assets of the employer.

(2) In the event of the liquidation or bankruptcy of an employer, withholding tax does not form part of the estate in liquidation or bankruptcy and must be paid to the Secretary before any distribution of property is made.

(3) Withholding tax is not subject to attachment in respect of any debt or liability of the employer.

(4) Withholding tax is a first charge on the employment income from which the tax is withheld.

(5) Withholding tax is withheld prior to any other deduction that the employer may be required to make from employment income under an order of any court or other law.

18. Withholding of Tax from Services Fees

This section obliges payers to withhold tax from the payment of a services fee.

The section provides that a person (referred to as the "payer") paying a services fee to a non-resident person that is subject to tax under section 12 must withhold tax from the gross amount of the services fee paid at the services tax rate specified in the Schedule. "Services fee" is defined in section 8 and "non-resident person" is defined in section 3. The tax withheld is referred to as "withholding tax" (see section 3 definition of "withholding tax").

The obligation to withhold arises only when the services fee is subject to tax under section 11. Consequently, there is no obligation to withhold from: (i) a services fee

that is not received from sources in Nauru (see section 9); or (ii) a services fee that is exempt income (see section 13).

Section 24 of the Revenue Administration Act provides for the following priorities in relation to the withholding of tax from a services fee:

(1) A payer holds the tax withheld in trust for the Government. Thus, withholding tax does not form part of the income or assets of the payer

(2) In the event of the liquidation or bankruptcy of a payer, withholding tax does not form part of the estate in liquidation or bankruptcy and must be paid to the Secretary before any distribution of property is made.

(3) Withholding tax is not subject to attachment in respect of any debt or liability of the employer.

(4) Withholding tax is a first charge on the services fee from which the tax is withheld.

(5) Withholding tax is withheld prior to any other deduction that the payer may be required to make from a services fee under an order of any court or other law.

19. Time of Withholding

This section states the time at which an employer or payer must withhold tax from a payment of employment income or a services fee, as the case may be.

Consistent with the imposition of the employment and services taxes on a receipts basis, the obligation to withhold tax is on a payments basis. The obligation to withhold is imposed at the earlier of: (i) the time the amount is actually paid; or (ii) credited to the account of the recipient. For example, the obligation to withhold tax arises on the crediting of a services fee to an inter-company loan account. The reference to the crediting of accounts means that a "constructive" payment rule applies and this aligns with the constructive receipt rule in the section 3 definition of "received".

20. Notification of tax withheld

This section provides for notification of the amount of tax withheld from each payment of employment income or a services fee.

The section obliges an employer or payer who withholds tax under section 17 or 18 to provide the recipient of the employment income or services fee with written notice of the amount of tax withheld from the payment of employment income or a services fee. The notice must be provided at the time of the payment. No particular format is specified for the notice. In case of employment income, for example, the employee may be notified by including the amount of withholding tax on the employee's payslip.

21. Withholding Tax Return

This section provides for the filing of monthly withholding tax returns.

Subsection (1) obliges an employer or payer required to withhold tax under section 17 or 18 to file monthly withholding tax returns. The return must be filed within 15 days after the end of the month. Subsection (2) requires that a withholding tax return must be in the form approved by the Secretary for such returns (see section 52 of the Revenue Administration Act) and filed with the Secretary in the manner specified in section 53 of the Revenue Administration Act.

A withholding tax return is a "tax return" for the purposes of the Revenue Administration Act (see definition of "tax return" in section 3 of the Revenue Administration Act). This means that the generic rules applicable to tax returns in that Act apply to a withholding tax return. Thus, for example, that the Secretary may grant an extension of time to file the return under section 15 of the Revenue Administration Act if the employer or payer demonstrates reasonable cause for the grant of the extension. It also means that an employer or payer may be liable for an administrative penalty for the late filing of a withholding tax return under section 62 of the Revenue Administration Act or, alternatively, prosecuted for an offence under section 72 of the Revenue Administration Act.

22. Payment of Withholding Tax

This section provides for the payment of tax withheld under sections 17 and 18.

Subsection (1) provides that tax that an employer or payer is required to withhold under section 17 or 18 during a calendar month must be paid to the Secretary within 15 days after the end of the month. Thus, withholding tax is payable to the Secretary on a monthly basis. This is the case even if the payment period is fortnightly or weekly. The due date for paying tax withheld or that should have been withheld during a month is the same as the due date for filing the withholding tax return for the month. The intention, therefore, is that the withholding tax payable for a month is paid to the Secretary with the filing of the withholding tax return for the month.

The Secretary may grant an extension of time under section 23 of the Revenue Administration Act for the employer or payer to pay withholding tax if the employer or payer demonstrates reasonable cause for the grant of the extension.

Subsection (2) provides that a liability to withhold tax under section 17 or 18 arises by operation of the section and is not dependent on the Secretary making an assessment of the tax due. This means that the Secretary can seek to recover withholding tax that is not paid by the due date by notice of claim.

Subsection (3) imposes a personal liability on an employer or payer who either: (i) fails to withhold tax as required under section 17 or 18; or (ii) withholds tax but fails to remit the tax to the Secretary as required under subsection (1).

Subsection (4) provides that an employer or payer personally liable for tax under subsection (3) that has not been withheld from a payment has a legal entitlement (a "cause of action") to recover the tax from the employee or non-resident recipient of the services fee. This applies only when the personal liability under subsection (3) arises because the employer or payer has failed to withhold the tax. It does not apply when the tax has been withheld but not remitted to the Secretary. The withholding of the tax discharges the employee's or payer's tax liability (see sections 11(4) (employment tax) and 12(4) (services tax).

Withholding tax is treated as a "tax" for the purposes of the Revenue Administration Act and, therefore, the Secretary can rely on the recovery provisions in that Act to collect unpaid withholding tax from an employer or payer.

An employer or payer who fails to pay withholding tax to the Secretary by the due date for payment is liable for late payment interest under section 28 of the Revenue Administration Act. Further, the person may be liable also for a late payment penalty under section 62 of the Revenue Administration Act or prosecuted for an offence under section 71 of the Revenue Administration Act.

Section 27 of the Revenue Administration Act provides a person withholding tax with an indemnity. The indemnity applies when a person has withheld tax and remitted the withheld tax to the Secretary as required under Part 4 of the Act. In this case, the person withholding the tax is indemnified against any claim brought by the recipient of the payment for the withheld amount. In effect, section 27 of the Revenue Administration Act treats a person withholding tax as if they had provided the gross amount (i.e. including tax) to the recipient and, therefore, the recipient has no right to recover the withholding tax from the employer or payer.

Importantly, the indemnity applies only when the tax has been both: (i) withheld; and (ii) remitted to the Secretary. There is no indemnity in relation to tax withheld but not remitted to the Secretary.

23. Recovery of Unpaid Withholding Tax from Recipient of Payment

This section provides for the recovery of unpaid withholding tax from the recipient of the payment of the employment income or services fee when the tax has not been withheld from the payment of employment income or a services fee.

Subsection (1) empowers the Secretary to collect employment or services tax from the recipient of a payment of employment income or services fee when the person who was required to withhold the tax from the payment failed to do so. The power to collect the tax from the recipient of a payment of employment income or services fee arises only when the employer or payer fails to withhold the tax. The withholding of the tax discharges the employee's or payer's tax liability (see sections 11(4) (employment tax) and 12(4) (services tax).

Subsection (2) makes it clear that if, the Secretary recovers the tax from the recipient of the payment, the employer or payer is still liable in respect of the failure. For example, the employer or payer may be prosecuted for an offence in respect of the failure to withhold tax (section 71 of the Revenue Administration Act).

24. Withholding Tax Records

This section sets out the records that an employer or payer must keep for the purposes of withholding tax.

Subsection (1) sets out the records that an employer must keep, namely records of the following:

(1) The gross amount of employment income paid to each employee for each pay period.

(2) The amount of withholding tax withheld from each payment of employment income.

Subsection (2) sets out the records that a payer must keep, namely records of the following:

(1) The services fees paid to non-resident persons.

(2) The amount of withholding tax withheld from each payment of a services fee.

Generic rules relating to records are provided for in section 14 of the Revenue Administration Act. In particular, records must be kept in English language and must be kept for five years from the end of the calendar month to which they relate.

A person who fails to keep records as required under this section may be liable for an administrative penalty under section 61 of the Revenue Administration Act or prosecuted for an offence under section 70 of the Revenue Administration Act.

25. Annual Withholding Tax Summary

This section provides for the filing of annual withholding tax summaries.

Subsection (1) obliges a person withholding tax under Part 4 to file with the Secretary an annual withholding tax summary in the form approved by the Secretary for such summaries (see section 52 of the Revenue Administration Act). The annual withholding tax summary must be filed within two months after the end of the tax year to which it relates or within such further time as the Secretary may allow. For the purposes of this section, subsection (2) provides that the tax year is the period 1 July – 30 June (i.e. the Government's budget year). Thus, the summary must be lodged by the end of August each year.

An annual withholding tax summary is treated as a "tax return" for the purposes of the Revenue Administration Act (see the definition of "tax return" in section 3 of the Revenue Administration Act). This means that the generic rules applicable to tax returns in that Act apply to an annual withholding tax summary. Thus, for example, the Secretary may grant an extension of time to file the summary under section 15 of the Revenue Administration Act if the employer or payer demonstrates reasonable cause for the grant of the extension. It also means that an employer or payer may be

liable for an administrative penalty for the late filing of an annual withholding tax summary under section 62 of the Revenue Administration Act or, alternatively, prosecuted for an offence under section 72 of the Revenue Administration Act.

26. Annual Tax Statement

The section provides for the giving of annual tax statements to non-resident employees and payees.

The section is relevant to those employees and payees who are resident in a foreign country that taxes residents on worldwide income (i.e. both domestic and foreign income). Thus, employment income or services fees received by an employee or payee from sources in Nauru may be taxed in Nauru on the basis of source and taxed in again in the home country of the employee or payee on the basis of residence. Consequently, there is the potential for double taxation of the employment income or services fee. The country of residence of the employee or payee will provide relief from double taxation usually by crediting the Nauru tax against the residence country tax (referred to as a "foreign tax credit").

To claim a foreign tax credit in their home country, an employee or payee is usually required to provide their home country tax authority with proof of the payment of foreign tax. The purpose of the section is to allow an employee or payee to obtain an annual tax statement from the Secretary as proof of the payment of Nauru tax to support the claim for a foreign tax credit in their country of residence.

Subsection (1) provides that the Secretary must provide an employee with an annual tax statement setting out the amount of employment income received by the employee for the period of twelve months stated in the application and the employment tax paid by the employee in respect of that income. The obligation to provide an annual tax statement arises only on application by an employee or payee. An application for an annual tax statement must be in the form approved by the Secretary for such applications (see section 52 of the Revenue Administration Act).

An applicant under subsection (1) can request an annual tax statement for any period of twelve months. This flexibility is necessary because tax years differ from country-to-country. For example, in some countries, the tax year maybe the calendar year, while in other countries it maybe the period July 1 to June 30.

Subsection (2) sets out a similar obligation of the Secretary in relation to applications by non-residents subject to services tax in respect of services fees received from sources in Nauru.

Subsection (3) sets out a rule of convenience whereby an employer or payer can make an application under subsection (1) or (2) on behalf of an employee or payee.

27. Currency Translation

This section provides for the currency of account for the purposes of the Act.

Subsection (1) provides that all amounts (employment income and services fees) taken into account under the Act must be expressed in Australian dollars.

Subsection (2) provides for the translation of foreign currencies to Australian dollars. A foreign currency amount is to be translated to Australian dollars at the Reserve Bank of Australia exchange rate on the date the amount is taken into account for the purposes of the Act. This will be relevant, for example, when employment income or a services fee is paid in a currency other than Australian dollars, such as in US dollars.

28. Tax Avoidance Schemes

This section provides for a general anti-avoidance rule applicable to taxes imposed under the Act.

Subsection (1) provides that the section applies when the Secretary is satisfied of the following:

(1) A scheme has been entered into or carried out. The concept of a "scheme" is defined broadly subsection (5) and is not limited to express, legally enforceable agreements, and can include a unilateral course of action.

(2) A person has obtained a tax benefit in connection with the scheme. The concept of a "tax benefit" is explained in subsection (5). The following are a "tax benefit" for the purposes of the section: (i) a reduction in a liability for tax; (ii) a delay in the arising of a liability for tax; (iii) any other advantage obtained from a delay in the payment of tax; (iv) anything that causes an amount of employment income or a services fee to be exempt income (i.e. not taxed); (v) anything that causes an amount of employment income or a services fee to otherwise not be subject to tax (such as an arrangement to convert Nauru-source employment income or services fee into foreign-source income); or (vi) anything that causes an amount that would otherwise be employment income or a services fee to not be employment income or a services fee (such as an arrangement to convert cash salary (employment income) into a non-cash benefit (not employment income)).

(3) Having regard to the substance of the scheme, it would be concluded that a person, or one of the persons, who entered into or carried out the scheme did so for the sole or dominant purpose of enabling the person referred to in (2) to obtain the tax benefit. Importantly, the person who has the requisite purpose and the person who obtained the tax benefit need not be the same person. In other words, the section can apply when a person enters into a scheme with the sole or dominant purpose that another person obtains a tax benefit under the scheme.

When the requirements in subsection (1) are satisfied, subsection (2) empowers the Secretary to determine the liability of the person as if the scheme had not been entered into or carried out. In determining a person's tax liability as if the scheme had not been entered into or carried out, subsection (2) enables the Secretary to "rewrite" a transaction by treating particular events as if they did or did not happen and at

particular times or involving particular third party actions. Subsection (2) also empowers the Secretary to make compensating adjustments to the tax liability of any other person affected by the scheme. For a compensating adjustment to be made in relation to a person, the person need not be a party to the scheme, it is required only that they are affected by the scheme.

Subsection (3) obliges the Secretary to notify the person whose liability has been determined or adjusted under the section by serving a notice of assessment on the person to give effect to the determination or adjustment. An assessment made under this section is a "tax assessment" for the purposes of the Revenue Administration Act (see the definition of "tax assessment" in section 3 of the Revenue Administration Act). This means, for example, that the assessment can be amended under section 21 of the Revenue Administration Act and can be the subject of an objection under section 41 of the Revenue Administration Act.

Subsection (4) provides for a time limit on the making of a determination under this section. The Secretary must make the determination within five years from the last day of the month to which the determination relates. This aligns with the time limit for amending assessments in section 21(4) of the Revenue Administration Act.

29. Regulations

This section enables Cabinet to make regulations under the Act, including for the amendment of the Schedule. This means that the rates of tax can be amended by regulation rather than through a legislative amendment to the Act.

30. Transitional Provision

This section provides for a transitional rule that gives effect to exemption provisions in agreements entered into by the Government before October 1, 2014. The rule is not limited to international agreements but applies to any agreement entered into by the Government before October 1, 2014.