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TAX CIRCULAR – Application and Treatment of Taxes within the Capitol Complex Tax-Free Zone (TFZ) – Chapter 24 of Title 40 the Palau National Code (PNC)

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Notice: Tax Circulars provide the public with information on the Bureau's interpretation of the tax laws it administers. They are the Director's interpretation of the law and indicate how the law would be applied by the Bureau in similar circumstances. Refer to TC – 2022-1 for details on how taxpayers may rely on advice given in a Tax Circular.

Purpose

This circular offers a guidance on Chapter 24 of Title 40 of the Palau National Code (PNC), specifically focusing on the treatment and application of taxes for a person (individuals and entities) possessing a Certificate of Qualification to conduct business within the National Capitol Complex Tax-Free Zone (TFZ).

Background

Chapter 24 of Title 40 of the PNC provides an incentive to establish new businesses, located within the TFZ. A person who establishes a new business within the boundaries of the TFZ possessing a Certificate of Qualification to operate in the TFZ will not be required to pay tax in respect of the taxes listed below:

1. All gross revenue and net income taxes, as per the Republic's laws, pertaining to income or revenue derived from or generated by businesses conducted within the TFZ,
2. All import taxes imposed by the Republic's laws on building materials imported by TFZ-based businesses, exclusively utilized for the construction or renovation of their structures within the TFZ,
3. All import taxes on capital equipment, fixtures, furnishings, and machinery imported and exclusively deployed within the TFZ by businesses,
4. All export taxes on any product manufactured within the TFZ by businesses operating therein.
5. Business license and additional business license fee may not be payable.

The introduction of RPPL 11-11 has led to significant changes in the application and treatment of taxes for persons possessing a Certificate of Qualification to operate within the TFZ.

Certificate of Qualification Term

A person who established a new business after the effective date of the Act on November 29, 2010, within the boundaries of the Capitol TFZ, shall be granted a Certificate of Qualification for a term of 10 years from the commencement date or dates indicated in the Certificate of Qualification issued to the business.

A person with an existing business in operation within the Capitol TFZ at the time of the Act's effective date on November 29, 2010, may be granted a Certificate of Qualification for a period of 2 years from the commencement date or dates in the Certificate of Qualification for the business operating within the Capitol TFZ.

A person possessing a Certificate of Qualification to operate in the TFZ must renew their Certificate of Qualification annually and pay an annual fee of $100. The commencement and expiration date will remain the same as the original certificate issued.

Business Profits Tax (BPT)

With the implementation of the RPPL 11-11, from January 1, 2023, PGST registered persons and commercial banks are no longer subject to the 4% Gross Revenue Tax or Financial Institutions Tax; instead, they are subject to Business Profits Tax (BPT) at a rate of 12%.

The concession provided under 40 PNC § 2402(1) provides that that a person possessing a Certificate of Qualification for a business within the TFZ will not be required to pay tax on income attributable to the business in the TFZ. The amount of income earned, and expenses incurred in respect of the TFZ business must still be included in your annual BPT return; however, the amount of tax payable in respect of the TFZ business will be extinguished by attaching a copy of your Certificate of Qualification to your return.

A person subject to BPT may apply to the Director of the Bureau of Revenue and Tax to vary their quarterly instalments to reflect the tax that is reasonably expected to be paid by the person after considering the TFZ tax concession for revenue attributable to the TFZ business.

Gross Revenue Tax (GRT)

A person in possession of a Certificate of Qualification is exempt from payment of GRT on gross revenue attributable to the business in the TFZ. The amount of gross revenue earned in respect of the TFZ business must still be included in your GRT returns, however, the amount of tax payable in respect of the TFZ business will be extinguished by attaching a copy of your Certificate of Qualification to your return.

A person will be liable for GRT if they are not registered for PGST and earn more than $50,000 gross revenue per year.

Business License and Additional Business License Fee (ABL)

In addition, payment for the Certificate of Qualification will serve as the National Government business license for the business activity carried out in the TFZ. Accordingly, a person with a valid Certificate of Qualification will not be required to apply for or pay for a business license for activities in the TFZ to which a Certificate of Qualification applies.

A person with a Certificate of Qualification for a business in the TFZ will not be required to pay the ABL if the sole source of gross revenue is from the business in the TFZ and they earn $50,000 or less in the year.

A person with a Certificate of Qualification for a business in the TFZ will be required to pay the ABL if they earn any gross revenue (less than $50,000 in the year) from business activities outside of the TFZ.

Note: Special rules apply to exempt certain makit businesses from payment of the ABL.

Application of Palau Goods & Services Tax (PGST)

Under Chapter 24 of Title 40 PNC, the TFZ concession does not exempt any person from the application of the Palau Goods & Services Tax (PGST). PGST is a consumption-based tax imposed by PGST-registered persons when providing goods and services to a customer and remitted to the Republic.

All PGST Registered Persons must charge PGST at a rate of 10% on all supplies, except for supplies that are zero-rated (0% rate) or are exempt supplies. PGST is paid on the import of goods irrespective of whether the goods will be used or sold within or outside the TFZ.

Import Tax

With effect from January 1, 2023, the rate of import tax was reduced to 0.

Wages and Salary Tax

Wages and salaries earned by employees employed at the businesses operating within the TFZ will be subject to withholding of wages & salary tax as tax exemptions provided under the TFZ do not extend to wages and salaries earned by employees.

Other Taxes and Laws

As specified by 40 PNC § 2408, a person operating a business within the TFZ is liable to pay all other taxes imposed by the laws of the Republic and must comply with all National and State laws generally.

Recordkeeping

The TFZ concession requires a person possessing a Certificate of Qualification to operate in the TFZ, to maintain all normal business records and file all BPT, GRT and other tax forms as a normal taxpayer.

A person subject to BPT must maintain records to clearly identify income and expenses (including depreciation) attributable to the activity carried out in the TFZ. This is essential to ensure you can properly claim the benefits of this concession. Furthermore, when completing your annual tax return you will declare all income and expenses (including the TFZ income); however, you will not be required to pay any BPT in respect of net income attributable to the TFZ. Instead, you must provide a copy of your certificate of qualification in your tax return. This will remove the need for you to pay BPT in respect of income from your operations in the TFZ.

GRT taxpayers must also maintain records to clearly identify gross revenue attributable to the activity carried out in TFZ. This is essential to ensure you can properly claim the benefits of this concession.

Application of this Tax Circular

This Tax Circular shall remain in effect until nullified.

Authorized by:

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