Papua New Guinea

The Minister for Treasury and Finance, the Honourable Patrick Pruaitch, MP handed down the 2015 National Budget on 18 November 2014. This article summarises the taxation changes announced in the budget.

**Taxation reform**

The 2015 Budget included five major taxation policy measures, as well as a number of minor taxation policy measures including technical amendments, as part of the government’s ongoing effort to enhance compliance and strengthen the revenue base. These include:

- liabilities on directors in relation to goods and services tax (GST)
- a major compliance measure in relation to rental income
- changes to the excise on tobacco
- an update on non-tax fees and charges, and
- measures to enhance compliance for legally issued court orders.

In September 2013, the government established a Tax Review Committee (TRC) to undertake a national tax review. The TRC is made up primarily of former commissioner generals and it is expected the TRC will hand down its report in 2015 in time for changes to be implemented in the 2016 National Budget.

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**Corporate and personal tax rates**

There was no change to the general corporate income tax rates of 30% for residents and 48% for non-residents. There was also no change to the personal income tax rates which have been applied since 1 July 2012.

From 1 January 2015, the personal income tax rates for resident individuals will continue to be as follows:

<table>
<thead>
<tr>
<th>Taxable income (PGK)</th>
<th>Tax thereon (PGK)</th>
<th>Rates on tax on excess (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000</td>
<td>Nil</td>
<td>22</td>
</tr>
<tr>
<td>18,000</td>
<td>1,760</td>
<td>30</td>
</tr>
<tr>
<td>33,000</td>
<td>6,260</td>
<td>35</td>
</tr>
<tr>
<td>70,000</td>
<td>19,210</td>
<td>40</td>
</tr>
<tr>
<td>250,000</td>
<td>91,210</td>
<td>42</td>
</tr>
</tbody>
</table>

From 1 January 2015, the personal income tax rates for non-resident individuals will continue to be as follows:

<table>
<thead>
<tr>
<th>Taxable income (PGK)</th>
<th>Tax thereon (PGK)</th>
<th>Rates on tax on excess (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nil</td>
<td>Nil</td>
<td>22</td>
</tr>
<tr>
<td>18,000</td>
<td>3,960</td>
<td>30</td>
</tr>
<tr>
<td>33,000</td>
<td>8,460</td>
<td>35</td>
</tr>
<tr>
<td>70,000</td>
<td>21,410</td>
<td>40</td>
</tr>
<tr>
<td>250,000</td>
<td>93,410</td>
<td>42</td>
</tr>
</tbody>
</table>
**Other tax developments**

**Thin capitalisation**

In the 2013 Budget, the government introduced thin capitalisation rules into the income tax law which are only applicable to non-resource companies. These rules introduced the definitions of 'debt', 'equity' and 'interest' to remove uncertainty to the definition of these terms for the purpose of calculating a debt to equity ratio for the thin capitalisation rules.

As the definitions were inserted into the general definition section, they apply to all purposes of the Income Tax Act (the Act). One of the consequences of the new definitions was that a transaction could be characterised as both interest and dividend for income tax purposes.

To limit the unintended consequences of the definition of debt, the 2015 Budget repealed the definition of interest and the definitions of 'debt' and 'equity' were included for the purposes of the thin capitalisation rules. The amendment is consistent with the original intent of the introduction of these definitions in the 2013 Budget.

**Research and development**

A significant tax change in the 2014 Budget was the phasing out of the additional 50% deduction for expenditure incurred on approved research and development projects from 1 January 2014. The government acknowledges there remains a need to address research and development claims made prior to the repeal of this concession. Treasury and Internal Revenue Commission (IRC) have progressed the establishment of a working group to evaluate the legislation governing this incentive and to form the R&D Committee to evaluate outstanding claims. Part of this ongoing work is in conjunction with the national tax review.

**Goods and services tax – director’s liability**

Before 1 January 2015, the GST Act did not contain provisions which held company directors liable for failing to ensure their company complied with the GST obligations. The GST Act has been amended to extend the director penalty regime for salaries and wages tax obligations of a company to the GST obligations of the company.

The director penalty regime makes directors of companies, which fail to comply with GST obligations, personally liable for a penalty equal to the amount that the companies ought to have remitted to the IRC.

**Salary or wages tax – director’s liability**

The provisions of the income tax law which held company directors personally liable for failing to ensure their company complied with its obligations under the salary or wages tax (SWT) provisions have been amended to enhance the implementation of the current director penalty regime. Under the amendment, company directors are required to be proactive in ensuring that amounts due by their company are reported by the due date. Directors who fail to ensure their company complies with its SWT reporting obligations are, after three months, unable to obtain a remission of their director penalty by winding up the company except by causing the company to pay the amount due to the IRC.

**Royalty withholding tax**

Before 1 January 2015, individual recipients of prescribed royalty payments were required to lodge tax returns declaring income in the nature of the royalty and any other income they would derive in a tax year. The individual taxpayer would be assessed on that income and the royalty withholding tax (RWT) withheld would be allowed as a credit against the tax liability established.

The budget papers reckoned it was not easy to identify all the recipients of royalty payments and to break down the RWT to allow a credit to the individual recipients. The IRC did not have the capacity to require royalty recipients to lodge tax returns, and be assessed on that income to be eligible for a credit or refund on the RWT withheld. Administration cost was another consideration, as it outweighed the benefits. Most individual recipients of prescribed royalty payments required assistance to lodge their tax returns, adding extra cost of administration.

From 1 January 2015, the RWT has become the final tax and recipients of prescribed royalty income no longer need to lodge income tax returns. This has reduced the administrative burden on the IRC and freed up resources for other critical revenue raising activities.
Stamp duty – increased compliance for reporting rental income

The Stamp Duties Act was amended to implement a rental income compliance system. The amendment effectively makes it compulsory for landlords to provide their taxation identification number (TIN) on lease documents which will not be stamped otherwise.

This amendment is intended to capture landlords who are currently leasing out their commercial and residential properties but are not declaring rental income derived to the IRC.

Excise duties

The government has increased excise indexation by a fixed rate of 5% biannually (10% annually) since 1 December 2014.

Under the previous excise regime on tobacco, the excise was adjusted in line with the consumer price index (CPI) every six months, capped at 2.5% at the maximum. This meant that if the CPI was above 2.5%, the excise would be increased by a maximum of 2.5%. However, if the CPI was less than 2.5%, the excise would be adjusted to the CPI inflation rate.

The government believes the increase in tobacco excise by 10% annually is necessary given the high health risks tobacco poses on people and the high cost of treating tobacco related diseases amounting to around PGK9 million per year.

By increasing the excise duty at a fixed rate of 5% biannually, the government will be able to recover part of the health cost. It is expected to raise about PGK6.8 million in 2015 and PGK145 million over the next five years after accounting for the behavioural effects related to a reduction in the smoking population and substitution to illicit tobacco usage driven by this tax increase.

New tariff items

Effective from 1 January 2015, new tariff items for other meats and edible offal that do not fall in the mechanically deboned meat (MDM) description were introduced. This amendment is to avoid potential confusion in the identification of appropriate items and rates. The import duty rate of this tariff item is now consistent with other tariff items under heading 0207 except for MDM.

The government also introduced a new tariff item for misclassified cigarettes effective from 1 January 2015. Previously, there were no descriptions in the Papua New Guinea (PNG) customs harmonised system to cater for cigarettes with a filter containing tobacco other than dark fired tobacco, cigarettes without filter containing tobacco, or other tobacco substitutes containing dark fired tobacco.

Under the previous legislation, these cigarettes were classified under tariff item 2402.20.10, attracting an excise duty of PGK249.06 per 1,000 sticks (excise rate as at 1 June 2014). The item code 2402.20.10 catered for cigarettes of dark fired tobacco without filter such as ‘spear or mutrus’.

The amendment ensured that cigarettes are correctly classified under the new tariff item 2402.20.40 and 2402.20.50 reflecting their descriptions. The excise rate of these tariff items is now consistent with the current practice. From 1 January 2015, the excise rate of cigarettes is PGK249.06 per 1,000 sticks indexed to change in CPI over the previous six months between March 2014 and September 2014, and further indexed to the newly introduced 5% nominal biannual increase for tobacco.
Enhancement of compliance measures for convicted taxpayers

The government introduced tougher measures effective from 1 January 2015 to deal with convicted tax offenders who fail to comply with legally issued court orders. Under the previous regime, the penalty for non-compliance with a court order ranged from PGK500 to PGK5,000, which was the same as the penalty applied to the tax offence committed at the time of offence.

The government was of the view that the previous regime did not provide the IRC with a strong enough enforcement action if taxpayers refuse to comply with the court orders served on them and pay the court fines levied.

The amendment introduced a jail term penalty to convicted tax offenders who fail to comply with court order and increased the monetary fines to provide different levels of fines for individual and corporate taxpayers.

The increase in the amount of court order fines and the different levels of fines for natural and corporate persons range from PGK1,000-PGK10,000 for a natural person and PGK5,000-PGK50,000 for a company.

Global Forum on Transparency and Exchange of Information on Tax Matters

The government has announced its support for PNG’s membership to the Global Forum on Transparency and Exchange of Information on Tax Matters.

The Global Forum on Transparency and Exchange of Information on Tax Matters is the largest of such organisation with over 121 member countries, including a number of developing countries. This global forum provides support to countries with limited administrative capacity, particularly in building their capacity to engage in exchange of information with other jurisdictions.

Membership to the forum could be a precursor to signing up to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters which would provide the legal basis for PNG to exchange tax information with much broader range of jurisdictions and allow PNG to ask other jurisdictions to collect taxation debts on its behalf.

There will be no significant revenue implications as membership to the global forum only requires a nominal annual fee. Also, no legislative amendments would be required for the membership for the forum.

Revenue compliance measures

In the 2014 Budget, the government announced that the Treasury and IRC had developed a strategy to improve compliance and collections based on the existing tax system. The main focus areas of additional revenue from improvements in compliance and IRC efficiencies in 2015 and 2016 are listed below. To a large extent the themes remain similar to those of 2014.

Taxpayer registration compliance

This involves the IRC new registrations with the concurrent IRC and Investment Promotion Authority registrations and extra contemporary registrations. Part of this also involves Anti-Money Laundering (AML) Prudential Standard impacts and follow up for current non-compliant taxpayers.

Taxpayer lodgement compliance

This measure sees firmer action on late lodgement with assigned penalties plus identification and enforcement of currently registered taxpayers who fail to submit lodgements.

Taxpayer reporting compliance

The IRC will undertake substantially more verification and audit activities, particularly for GST debit, large and SME business income tax, foreign contractor withholding tax and employee/contractor issues, data matching (including, provisional tax underestimation), TIN and rental contracts and GST credit verification.
Taxpayer payment compliance

Work to be undertaken within this measure will see IRC introducing approaches to deal with additional early collection and firmer action on debt and late payment penalties, GST Director Penalty Notices (new legislation to be enforced) and finalising objections and requests for amendment.

Efficiencies

This involves other revenue improvement measures, including thorough improvements in case selection, improved data quality allowing earlier enforcement action, improved taxpayer awareness and knowledge/clarification of obligations etc.

The IRC strategy remains fairly constant and consistent with its 2013-2017 corporate plan strategy and involves:

• the need to get its basic tax administration operations running smoothly and sustainably. An important part of this is to have sufficient staff in place to manage all core aspects of standard taxation administration;

• attraction and retention of the right calibre of staff required for the more classified professional and knowledge work roles and have the ability to deploy them to areas of the greatest risk to revenue; and

• the need to modernise its obsolete core processing capability. IRC has taken the first steps towards this with the ongoing phased implementation of its new revenue accounting system (RASII) and other revenue raising initiative capital expenditures.

Future development of taxation policy

The TRC was formally established in September 2013 and the government is pleased with the progress of the work undertaken. Some of the major work undertaken since the tax review was launched includes:

Blue sky consultation

Over 45 submissions were received in response to the committee’s general call for submissions in December 2013. This provided stakeholders with an opportunity to raise any issue of interest to be considered as part of the review.

Diagnostic reviews

The tax review has commissioned a number of diagnostic reviews. This has included a diagnostic review of PNG’s direct taxation system, as well diagnostic reviews of PNG’s two revenue collection agencies. These two tax administration reviews are expected to be concluded shortly.

Regional consultations

The TRC has to date held open forums in Lae, Kokopo and Madang. These forums were well attended by over 100 people in each event. Further regional consultations will follow.

Tax symposium

In collaboration with the National Research Institute (NRI), a tax symposium was staged in Port Moresby in May 2014. The symposium provided an opportunity for local and international academics to present and seek feedback on draft papers on various tax issues. The NRI’s engagement in the tax review process has been ongoing.

Release of issues papers

To date five issues papers have been released by the TRC for public consultation – these are on mining and petroleum taxation, corporate and international taxation, broad directions issues paper, capital gains tax and tax incentives.

The tax review continues to consult and engage widely with stakeholders. It is anticipated that the review will continue to release issues papers on various areas of taxation until the second quarter of 2015.

This will be followed by further consultation upon release of a single final draft report, which will put forward the committee’s proposed recommendations.

In recognition of the level of interest in the tax review and the value of the consultation processes to date, the government has agreed to extend the timeline for the review by three months, until 31 July 2015.