Head of Secretariat
PNG Tax Review Secretariat
Department of Treasury
P O Box 1598
Boroko
National Capital District

30 April 2014

To the Review Committee

Review of Papua New Guinea's Tax Regime

JAJ and Associates a small but growing national accounting firm provide this submission to the Taxation Review Committee of Papua New Guinea's Tax System ('this Review') to address some of the issues for PNG's taxation system, its problems and the relevant actions which should be identified, investigated and necessary amendments are made to provide a tax friendly environment to conduct business, encourage international investment and growth of the Papua New Guinea economy.

We welcome this Review and the committee's willingness to seek input from various interested stakeholders. To assist this Review we set tax issues we think should be covered in this review and suggested actions.

PNG's tax system needs to support PNG's economic growth and productivity in various business sectors. This requires reform to the system which in some areas, are out of date and touch with the changing and rapidly growing economy.

If you would like to discuss this submission please contact Jacob Kiak or Arthur Sam on telephone 3251962 or 3238379.

Yours faithfully,

Jacob Kiak
Partner – Taxation Services

JAJ & ASSOCIATES

Registered Public Accountants, Auditors, Tax Agents and Business Consultants

TAXATION REVIEW SUBMISSION

(2013 – 2015)

Table of Contents

1. Increase of Tax Revenue Base

The objective here is for PNG to broaden it tax base and provide relief for some income areas that are heavily taxed. This Review should consider bringing some income areas into the tax net so that it is equitable for all taxpayers.

Comments

Papua New Guinea's tax system is not overly complicated but the polishing it by enforcing compliance and collection of appropriate taxes is significantly lacking from the implementing agent IRC. Because of its lack of qualified, experience and knowledgeable work force it currently does not implement the Tax Law properly resulting in inadequate tax revenue collection. For instance, the Rental Industry have grown in last twelve (12) years (i.e.2002 to 2014) but the taxation of is lacking and as such a lot of individual property owners and companies are not brought into the tax net and the rental income taxed accordingly.

Suggested action

We suggest that the Committee review and broaden the tax base. These should include areas like:

- Rental Properties
- Taxis and Buses income to be taxed at certain threshold
- Introduce Capital Gains Tax (This is the biggest leakage in the tax revenue collection)
- Taxation of individual consultants
- Small Contractors

The inclusion of the above should be enabled by proper and workable legal mechanism.

2. A competitive, lower, corporate tax

With the global mobility of people, capital and business investment, Papua New Guinea's business tax environment must be internationally competitive to encourage businesses to invest in Papua New Guinea to develop the economy and increase opportunities for Papua New Guineans.

.

Comments

Papua New Guinea's company tax rate is quite high in both effective tax rate terms and nominal tax rate terms. Papua New Guinea's corporate tax rate of 30% is significantly higher than that of Fiji which is 20% and Indonesia of 25%. This impairs Papua New Guinea's competitiveness in attracting and retaining businesses.

Suggested action

Papua New Guinea's corporate tax rate needs to be reduced. The rate should be competitive with relevant countries including developing counties and the more developed Asian economies.

The government should task the IRC and Treasury to main data on comparative company tax rates should be updated to include forward-looking company tax rates announced and planned by other developing countries.

3. Dividend Withholding Tax

Dividend withholding tax can create uncompetitive and unattractive to international companies when considering investment in Papua New Guinea.

Comments

At a time of global capital mobility, the high dividend withholding tax rate should not create unattractiveness and uncompetitive environment. Such barriers are potentially dangerous for a growing and developing economy trying to bring in much needed foreign investments.

Suggested action

The withholding tax is needed to be reviewed and have the rate reduced to 10% to protect Papua New Guinea's competitiveness and attractiveness to foreign investment. The reduction of the rate would be comparable to Australia dividend withholding tax rate. This tax should apply to for both to national and multinational companies.

4. Reducing Interest Withholding taxes

Interest withholding tax (IWT) is an impediment to legitimate foreign borrowing and the investment of capital in Papua New Guinea. Consideration should be given for use of foreign borrowings in Papua New Guinea given the cost and competitiveness issues.

Comments

Papua New Guinea's IWT means that funds which are sourced globally, to be used in Papua New Guinea, bear a tax penalty of an additional 15% IWT. As a result Papua New Guinean borrowers are facing deadweight costs.

IWT on arm's length outbound interest payments to unrelated residents of all countries should not apply but while those with associates and related parties continue to apply but a reduce rate. Fiji and Australia are applying a rate of 10% and to be competitive, PNG must consider reducing its rate.

Suggested action

First, Papua New Guinea should consider abolition of IWT from arms length borrowings. The suggested amendment needs urgent consideration as it will prompt foreign capital investment into the country. Secondly we suggest that IWT should not be abolished for interest paid to associates but should consider reducing the current interest rate of 15% to 10% to be comparable to Fiji and Australia.

5. Capital Gains Tax

Papua New Guinea's does not have capital gains tax provision in place. This is one income source that can be included to broaden the tax base for the country.

Suggested action

We suggest the following:

- An explicit definition is provided to ascertain what should be considered as capital gain
- Any gain above the original cost especially on property (whether personally or business) should be considered for capital gains tax?
- The gain should form part of a company or individual assessable income and tax on the corporate or individual marginal tax rate.

6. Black holes expenses definition and treatment

The PNG Income Tax Act does not have an existing definition and rules on black hole capital expenses rules. In the absence of such tax rule providing clear guide and proper tax treatment, tax administrators - IRC and tax practitioners' tend to use Australia Tax Office Rulings.

Suggested action

We suggest the following:

- A clear definition of the black hole expense is provided and done as amendment to the Income Tax Act
- Rules on the eligibility and deductibility of the expense is set out as a guide for recognition and deductibility
- The black hole expenses should be considered for immediate write off or amortised over several year but not greater than five years.

7. Fixed Assets valuation

In complying with International Accounting Standards, many companies in Papua New Guinea are doing Revaluation of the major Income generating assets such as land and building, wharves etc. Currently the PNG Tax regime restricts depreciation to the original cost of the asset and does create tax disadvantage.

Comments

The tax rules restrict the taxpayer to be able to consider the revaluation increment to add to the original cost of the fixed asset and claim depreciation accordingly. The revaluation of fixed assets value for accounting purposes does increase the life of the asset, thus tax rules should be reviewed to accommodate such changes.

Suggested action

Our recommendations for attention are:

- The Review Committee should discuss and consider whether revaluation done for accounting purposes should be added onto the original cost of the fixed asset for tax depreciation purpose.
- If so how frequent or what time period should be considered for the asset to be subject for valuation.
- All revaluation outcome should be provided to the IRC for approval prior to claiming depreciation

8. Reduction of Personal Tax Rate

Papua New Guinea needs to review, reduce it personal tax rates to be comparable and competitive against developing countries in the Pacific and Asia countries. This includes the need to lower effective marginal tax rates and lower personal tax rates to cater for increasing labour mobility.

Comments

This action is strategically important to attract talented, skilled and very experiences expatriates. This should stimulate growth in the public and private sector.

Papua New Guinea's personal taxes need further attention by this Review. A planned reduction in personal tax rates should be done on a stage basis to negate the negative impact it will have on the national budget.

Suggested action

We suggest that more analysis is done to establish whether Papua New Guinea's personal tax rates are internationally competitive amongst the developing countries in the Pacific and Asia.

We believe that this would attract skilled and experienced expatriates to come and work in Papua New Guinea.

9. Dead Person Tax

In the current legislation, there is no provision provided on taxation on final entitlements for dead persons. In the absence of such provision it is defaulted to using the normal salary and wages tax. And as such, it considered harsh on taxing the deaths final entitlements or payouts even to the grave. New rules should be introduced to show some dignity to the dead.

Suggested Action

We suggest that the dead person's final entitlements in terms of annual leave, long service leave, employee retention payout and superannuation (employer contribution) should be taxed at a rate of 2% as oppose to taxing at marginal tax rate.

10. Early Retirement on medical grounds

A lot of working class people are continue to work with life threatening illnesses. Legislation should be considered and introduced in relation to early force upon retirement based on medical grounds. Final entitlements due to them should be paid to them without it being subject to tax.

Suggested Action

We suggest that the payment should subject to no tax or be capped at 2%.

11. Salary Packaging Practise

Salary packaging is practised widely in the statutory organisation and private sector for school fees, airfares and rental accommodation. It proves to be a win-win situation for both the employer and employee. However, there is certain abuse of the practise by some employees. The abused areas are especially in the airfares and rental accommodation. Airfares are paid to the travel agents and used for international travel and funding air travel for other extended family members.

Tax avoidance scheme is ripe where employee incorporates a conduit via a K1.00 company to have the rental paid under it. The shareholder and director of the company is the employee. The title of the residential property is in the hand of the employee.

Comments

The above are some example of abuse of practise but technically it does amounts to tax avoidance. Airfares are provided for travel to place of recruitment or place of origin especially to citizen employees but not overseas. Rental accommodation is to be paid to a third party to ensure that there is a clear arms length transaction. Current process at the IRC does not detect such tax evasion activities and does contribute to the leakage on the tax income.

Suggested Action

We suggest the following:

- We suggest proper procedure is put in place to tax citizen employees travelling overseas using airfares year marked for domestic travel
- Restrict rental paid to employee own companies or spouses owned properties.
- The IRC should set up audit team to carry out specific audit investigation into such arrangement within the arm bit of anti avoidance section.

12. Small Business Tax Incentives

There has been much said above growing the Small Business Sector to drive the economy. In order for the sector to grow and develop it must be given the right business environment to grow. One of the things the government should consider is providing tax incentives to grow the sector.

Comments

Taxes are some of the many hurdles a starting small business must overcome in its inception. For most small businesses it is an unwelcoming mosquito bit in the initial year. It takes away a much need fund, it could have used to buy an essential equipment, hired a new employee, increased the working capital, increase inventory or expand the business. This is one of the major barriers to the small business sector.

Suggested Action

We suggest the following tax incentives to be considered for the SME sector to encourage greater participation by the citizens and growth of the sector:

- Provide tax breaks for the first five years of operation. This can come with conditions such as must employee or provide employment for up to 10 to 15 peoples within the five years. Tax losses incurred within the exemption period is not be carried forward
- Micro and small business that generate certain revenue threshold should be exempt from income tax. (Fiji has existing tax legislation where a small and micro enterprise that has turnover less than Fiji$300,000 is exempt from income tax).
- Reduce salary and wages tax rates for the first year

13. Charity Organisations

Charity originations in PNG are doing an excellent work for the unfortunate citizens of this country. The government has provided tax relief for the organisations by way of income tax exemptions.

Comments

The tax exemption is the only relief provided to the Charity organisations and is considered not sufficient for their operations. One of the taxes that hinders their administration and provision of core services is salary and wages tax.

Suggested Action

We suggest that a separate salary and wages tax rates are determine for the employees employed within the charity organisations (e.g. Cheshire disabilities Services, Sheltered Workshop, Red Cross etc).

14. Tax administration

Improved processes and administration of taxpayer matters/issues requires a significant change in service delivery from the IRC. The unnecessary cost incurred by the taxpayer to get its Tax Agent to resolve issues is becoming too expensive and is becoming uncompetitive.

Comments

IRC tax administration, and the experience which business taxpayers have with the administrators, have become a competitiveness issue, as well as adding risks and inefficiencies for purely domestic business.

Some of the tax issues before the IRC have taken years and some still remain unresolved. The time it has taken, highlights the issue on its capability to administer and resolve issues within the required time is a serious cause for concern. Review Tribunal is non-existent and so many cases are outstanding.

National and Multi-national companies are nervous what the outcome would be like. Thus either providing provisions or carrying unresolved liabilities in their books.

.

Suggested actions

We welcome the recent move by the National Government to have IRC to be a statutory body. In providing our support we suggest it should set up in the same way as business has governance arrangements over its executives by virtue of its board of directors, consideration could be given to the IRC having a governance mechanism involving a Board, which can provide significant counsel and oversight to the IRC in its activities. Other countries such as US, Canada and the UK are using this approach.