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15 May 2014

PwC submission to the Tax Review Committee

Dear Sir / Madam

We write in response to the request for submissions from interested parties to the Tax Review Committee undertaking a comprehensive review of the PNG revenue regime.

PwC has for many years made submissions to the Department of Treasury on tax and revenue matters as part of the annual National Budget consultation process, and it is our pleasure to now make this submission to the Tax Review Committee.

This submission consolidates our various submissions to the Department of Treasury into one document and includes other matters we believe should be addressed as part of the Tax Review. The matters we have considered are:

1. Taxation of foreign dividend income
2. Import GST deferral scheme
3. Grouping and loss transfer
4. GST on the supply of low cost housing
5. Superannuation for self employed persons
6. Dividend withholding tax on domestic dividends
7. Dividend withholding tax on mining companies
8. Allowable capital expenditure for mining projects
9. Abandoned prospecting authorities and abandoned mining licences
10. Management fee definition and technical fees
11. Refund of excise duty
12. Other matters

PwC is keen to work with you throughout the TRC consultation process. Please contact David Caradus, Raj Makan, or me, if there are any matters you would like to discuss in more detail.

Yours sincerely

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1. Foreign dividend income

In recent times, Papua New Guinean companies, particularly those listed on the Port Moresby Stock Exchange ("POMSOX"), have been in a stage of rapid growth and development. This development not only extends to activities in Papua New Guinea ("PNG"), but also includes investment and growth on an international scale.

One of the benefits of being listed on the POMSOX and on stock exchanges outside PNG is that capital can be raised from investors outside PNG. Consequently, companies listed on POMSOX have the potential to have substantial numbers of shareholders which are not resident of PNG for income tax purposes. In addition, a number of companies have made or are looking to make investments outside PNG. When these entities are considering the structure to undertake investment outside PNG, one important factor in that consideration is the taxation implications for both resident and non-resident shareholders.

The current taxation rules in PNG in respect of PNG resident entities which receive foreign dividend income and then pay dividends from the same source to foreign shareholders means investments outside PNG by PNG resident companies incur a PNG tax cost for non-resident shareholders which would not be the case if the foreign shareholder made a direct investment in the overseas investment. It is considered this potential tax cost reduces the attractiveness of PNG companies as an investment and has the potential to increase the cost of capital for PNG companies as well as undervalue PNG companies.

In addition, companies making such investments are likely to take steps to invest outside PNG in such a way that the PNG tax cost is by-passed as a result of the ownership structure (for example this can be achieved through stapled-stock arrangements). While such structures can be used they provide unnecessary complexity to investment decisions, unnecessary administration as well as complexity for investors. Nevertheless the availability of such structures means the potential cost to the revenue of our suggested amendment is likely to be low.

Background

Generally, when a PNG company receives dividends from a foreign subsidiary or foreign investment that dividend is not subject to income tax due to the operation of the inter-company dividend rebate. Technically the dividend received from a foreign investment is subject to dividend (withholding) tax at the rate of 17% of the gross dividend received. However, this technical application of the law has not been applied in practice by the Commissioner General and in any case a taxpayer is entitled to make an election under Section 189E(12) of the Income Tax Act ("the Act") the effect of which is that dividend (withholding) tax does not apply when the dividend is received.

The issue arises when a PNG company makes a distribution of that foreign dividend to shareholders of the PNG company, subject to the operation of a double tax agreement, this dividend is subject to dividend (withholding) tax at the rate of 17% of the gross dividend paid. Consequently, both resident and non-resident shareholders are subject to dividend (withholding) tax on dividends which have been derived from sources outside PNG. However, this dividend (withholding) tax would not apply if the foreign shareholder received the dividend directly from the foreign source.

The taxation consequences for foreign shareholders provide a disincentive for PNG companies to invest outside PNG, to raise capital from outside PNG and for foreign investors to invest in PNG companies which have foreign investment. On the other hand, the taxation consequences for foreign shareholders provide an incentive for PNG companies to move away from PNG (for example by inter-

posing a new holding company in another jurisdiction or reverse takeover by a company in another jurisdiction) or to adopt more complex shareholding structures (such as stapled-stock arrangements). The effect of these and similar structures is that the problem is eliminated from the perspective of foreign shareholders which means of course PNG does not collect taxation on the foreign dividend income. The downside for PNG is that the entity undertaking the overall business and investment may no longer be a PNG company.

Providing tax relief for foreign dividend income paid to foreign shareholders further enhances the ability of PNG companies with foreign investments to compete for foreign capital to expand their operations beyond PNG. The proposed measures outlined below also improve the attractiveness of PNG as a location for regional holding companies.

Position in Australia

On 14 May 2003, the Australian Treasurer announced the government's decision to introduce conduit foreign income rules. In Australia the rules have effect on income years starting on or after 1 July 2005.

The rules provide tax relief for "conduit foreign income". Conduit foreign income is generally foreign income received by a foreign resident via an Australian corporate tax entity. The measure ensures those amounts are not taxed in Australia when distributed by the Australian corporate tax entity to its foreign owners. At the time the objectives of the conduit foreign income regime were stated as:

- The conduit foreign income measure aims to reduce tax impediments for foreign investors who structure their foreign investments through Australian entities. This is intended to provide those investors with a more neutral Australian tax outcome on those investments when compared with foreign investors who have direct holdings in their foreign investments.

- Reducing tax barriers will enhance Australia as an investment choice for foreign investors. This will improve the attractiveness of Australia as a location for regional holding companies of foreign groups. This measure will also enhance the ability of Australian entities with foreign investments to compete for foreign capital and therefore encourage them to remain Australian residents if their foreign shareholding becomes significant.

- The overall purpose of the conduit foreign income provisions is to build on Australia's position as an attractive place for business and investment.

Prior to the introduction of the conduit foreign income rules, Australia provided relief from Australian dividend withholding tax through its Foreign Dividend Account provisions. These applied where:

- An Australian corporate entity derives certain non-portfolio dividend from a foreign subsidiary. For Australian purposes these are dividends which are not taxable in Australia and do not give rise to franking credits for the Australian company.

- The Australian company then pays an unfranked dividend (essentially passing on the non-portfolio dividend it received from its non-resident subsidiary) to its foreign shareholders.

It can be seen that the Foreign Dividend Account provisions operated to ensure that the unfranked foreign dividend paid was not subject to Australian dividend withholding tax, recognising that the Australian company is essentially acting as a conduit for the distribution of non-Australian sourced

income to non-Australian residents. This type of measure may be appropriate for PNG rather than the more complex conduit foreign income rules which enable both dividend and foreign branch income to flow through from one jurisdiction through another without incurring a withholding tax cost.

Other Jurisdictions

It is also worthwhile considering comparative tax rules in other jurisdictions, particularly where these jurisdictions may be competing with PNG to attract capital regional holding companies. A summary is provided below.

Hong Kong

- Dividends from sources either inside or outside Hong Kong are not taxable in Hong Kong.
- Resident corporations are not taxed on their worldwide income. Foreign-source income, whether or not remitted to Hong Kong, is not taxed.
- There is no withholding tax on dividends, interest or royalties.

Singapore

- Foreign dividends are exempt from tax subject to certain conditions.
- There is no withholding tax on dividends.

Canada

- In some cases, dividends received by Canadian corporations from foreign affiliates are permitted to flow tax-free between corporations.
- Dividend withholding tax is payable on dividends paid to non-resident corporations.

United Kingdom

- A UK resident company is generally taxed on foreign branch income as earned and, generally, on foreign dividends when received.
- There is no withholding tax on dividends paid to non-resident corporations.

Although the above is only a brief summary, it is clear that there are taxation concessions in other jurisdictions which mirror or have the same effect as Australia's conduit foreign income rules or foreign dividend account rules to encourage the retention of national corporations and encourage foreign investment.

Context of Proposed Measure

Under the current law non-residents who invest in PNG companies will be subject to PNG dividend (withholding) tax on the dividend income from those investments either when the income is derived or when it is distributed to the non-residents. This will be the case whether the underlying income is derived in or outside PNG. However, if the non-residents derived the foreign dividend income directly, or through an interposed foreign entity, the dividend income would not be subject to PNG tax because foreign residents are taxed only on their PNG source income.

It is submitted by eliminating this tax disincentive, the proposed measure will improve PNG as an investment location for foreign investors without impacting existing Government revenues. It is

considered the reforms will encourage the use of PNG as regional headquarters as PNG's existing major companies expand their investments beyond PNG and will also improve PNG's attractiveness as a base for our multinational companies. It is considered if these measures are not introduced PNG's multinational companies will look to alternate means of dealing with the issues which could mean the loss of the PNG identity of some multinational groups.

However, this measure does not, nor is it intended to, remove any PNG tax paid by the PNG entity on the income from the foreign investments. Nor does it refund any of that entity-level tax when the income is distributed to foreign investors. To do either of these things would mean giving foreign-owned PNG companies an unfair advantage over PNG-owned companies when it comes to investing offshore.

These measures are aimed entirely at improving the attractiveness of PNG as a location for regional holding companies and particular businesses of foreign groups. However, the main reason for the proposal is that it will enhance the ability of PNG entities with foreign investments to compete for foreign capital and therefore encourage them to remain PNG residents if their foreign shareholding becomes significant.

This measure is intended to ensure foreign dividend income can flow through more than one PNG entity by removing PNG dividend (withholding) tax on this income when it is distributed to non-residents. This ensures that foreign residents get tax relief for foreign dividend income when they invest in a PNG entity which invests in other PNG entities that earn foreign dividend income. This should provide greater flexibility in structuring holding company arrangements in PNG.

We recommend an amendment that:

1. provides an exemption from dividend (withholding) tax to the extent a dividend is paid out of a foreign dividend account; and
2. establishes the mechanism for recording receipts and payments to a foreign dividend account.

Under the proposed measure, a PNG entity can declare all or part of a dividend to be conduit foreign dividend income in a distribution statement. Where that distribution is made to a non-resident, the PNG entity will not be obliged to withhold dividend (withholding) tax to the extent it is declared to be conduit foreign dividend income.

2. GST deferral scheme

The GST Act imposes GST on the importation of goods into PNG (section 6). The GST payable under section 6 is payable by the importer of goods as if it were Customs duty levied under the Customs Act, and therefore the GST must be paid before goods are entered for home consumption in PNG.

Section 30(1) of the GST Act provides that GST paid on importation under section 6 is "input tax" for the purposes of section 31(3) and therefore is deductible from output tax collected by the taxpayer in calculating the GST payable by the taxpayer. Accordingly, GST paid on importation will generally be refundable in full to the taxpayer on lodgement of a GST return by that taxpayer.

The requirement for taxpayers (importers) to pay GST on importation and subsequently seek to have the same GST refunded by the Internal Revenue Commission (IRC) presents a number of practical issues for taxpayers and the IRC, including:

- The need for taxpayers to fund the additional cost of GST advanced to the IRC on importation – even if only until lodgement of a GST return– is an additional cost of carrying on business in PNG, and decreases the attractiveness of PNG for international investment. This cost can be potentially significant if the goods imported are of high value.

- The IRC and Customs are required to manage the administration and collection of GST, only to refund the same GST to the taxpayer. Accordingly, a considerable amount of IRC and Customs resources are being directed toward management of a tax that results in no revenue being collected by the IRC.

- The administration required from the IRC often results in considerable delays in refunding GST owing to taxpayers – sometimes over many months or years – and therefore the cost of funding this GST for taxpayers is increased.

- One of the fundamental characteristics of a GST is that the tax should not be a cost to business. However, the cost of funding import GST is a significant cost to taxpayers that comply with the law.

With the continued increase in economic activity and foreign investment in PNG we are frequently seeing that funding GST on importation is not only a project cost, but a potential barrier to entry into PNG. Given that GST collected on importation is refundable, and therefore results in no net revenue to the IRC, this seems to be an undesirable outcome.

Recommendation

Australia operates a GST deferral scheme whereby the liability to pay GST on importation of goods is deferred until the due date for lodgement of the GST return for the month of importation. The input tax credit for the GST paid on the importation arises on lodgement of the same return, so there is no net GST cash cost to the importer. GST is still paid on import, but is collected at the same time as the input tax credit is allowed for the payment.

We recommend a similar scheme be introduced in PNG.

Participation in the scheme in Australia is subject to an application and approval process conducted by the Australian Taxation Office (ATO). The approval can be refused or revoked at any time by the ATO due to poor tax compliance by the taxpayer with other tax obligations.

We suggest a GST deferral scheme in PNG should also be limited to taxpayers approved by the IRC. In this way the IRC will retain control over who can participate in the scheme, and they can revoke approval where, for instance, a taxpayer fails to adequately comply with the requirements of any other tax law.

In our view the introduction of a GST deferral scheme is a revenue neutral amendment to the GST Act, will facilitate investment in PNG, and will relieve the IRC of a significant administrative burden that currently generates no net revenue.

3. Tax loss transfers

There is currently no tax grouping allowed in PNG. PwC believes that even if comprehensive grouping

rules are not possible at this stage, it would nevertheless be desirable to allow transfer of tax losses between wholly owned companies. The current prohibition on grouping of losses means that:

- Organisations set up their affairs in single companies – even where different and distinct business are operated – so that losses from (for example) start-up businesses are able to be utilised by profitable businesses. Ordinarily, different businesses should be operated by different companies (for compliance, governance, liability limitation) and the current tax law distorts ordinary commercial decision making.

- In some cases new businesses may not be established because the inability to utilise tax losses in start-up phase, against the income of mature businesses in the same group, means the return on the new business is not sufficient for a positive investment decision.

- Where losses are incurred by an entity in a group the inability to transfer the loss leads taxpayers to create artificial means of transferring the loss through other intra-group transactions.

Tax grouping is a feature of most developed tax regimes. PwC believes that the inability to transfer tax losses distorts economic decision making and potentially stifles new investment in PNG. Allowing tax loss transfer should not be a cost to the State – it is a timing matter only, and in many cases taxpayers are employing tax planning measures to effectively transfer losses anyway.

4. GST on the supply of low cost housing

The current income tax and stamp duty law provide concessions which assist citizens acquire residential property. However, there is no similar concession for Goods and Services Tax (“GST) where a citizen acquires a home from a person who is registered for the purposes of the Goods and Services Tax Act (“the GST Act”). It is considered this represents a disincentive to the development of low cost housing for citizens and a change to the GST Act is necessary to encourage the development of low cost housing to address the current chronic shortage of this type of accommodation.

There is clearly an existing policy to provide tax concessions for the acquisition of residential property by citizens and it is submitted this needs to be extended. For example in the 2011 National Budget changes were made in respect of these concessions to reflect the significant increases in the cost of housing in the country. In summary these amendments were:

- From 1 January 2011, the Low Cost Housing Scheme was replaced by a program referred to as the “Citizen Employee First Time Home Buyer Scheme”. Under the prior low costing housing scheme arrangements, a low cost house was one with a value of K75,000 or less. This was replaced with a new maximum value of K400,000.

- An increase was also made to the stamp duty concession that is available to citizen first time home buyers. Under the revised concession, a first time citizen home buyer is now only subject to stamp duty on the portion of the purchase price that exceeds K500,000. This was a significant increase from the prior concession which imposes a reduced rate of 2% where the value of the property purchased by a first time citizen was greater than K210,000 and less than K280,000, and 5% for amounts in excess of K280,000.

These concessions do provide some assistance to first time home owners and those who are acquiring low cost housing. However, as noted above there are no such concessions in respect of GST which at the current rate of 10% adds a significant amount to the purchase price of a new home and which may

also push the cost above the maximum limits for accessing the current concessions for income tax or stamp duty.

It is submitted that the supply of improvements and structures on land to a citizen should be zero-rated for GST purposes provided the citizen purchaser is not registered for GST purposes and provided the value of the supply and related supplies does not exceed K500,000 (this is the same as the threshold for stamp duty relief). It can be seen the intention of this proposal is that the zero-rating should only apply to the improvements and fixtures being sold as a house and land package by the original developer of the property. Consequently, if the developed property included household items such as washers and dryers these elements would be sold separately and would be subject to GST on sale.

We also recommend the Committee considers increasing the threshold for eligibility for the limit for the Citizen Employee First Time Home Buyer Scheme to K500,000 to reflect the high cost of property in PNG and to align with the stamp duty concession.

5. Superannuation for self employed persons

In our letter dated 20 October 2005 to the Superannuation Task Force we noted that the existing superannuation provisions of the Income Tax Act do not allow deductions for superannuation contributions for self-employed persons, partners in professional firms and others who derive income other than in the form of salary and wages as there is no employer to make the contribution. This appeared to us to be an unintended consequence of the Income Tax Act and the Superannuation (General Provisions) Act 2000. The Superannuation Task Force supported our suggestion that the law be amended and took up our offer to provide suggested amendments to the law.

These issues were also addressed in our submission in respect of the 2006 National Budget dated 21 August 2006 where we stated that:

> "One area of the provision for retirement which has not yet been fully addressed is access to superannuation savings for the self-employed, partners in professional firms and others who derive income other than in the form of salary and wages. In 2005 we made a submission to the Superannuation Task Force that pointed out that both the Superannuation Act and the Income Tax Act only cater for the provision of superannuation for employees.

The Superannuation Task Force agreed with the points made in our submission and by letter dated 20 October 2005 requested our assistance to draft suggested amendments to the Superannuation (General Provisions) Act 2000 ("the Superannuation Act") to include self-employed persons to become eligible for participation in superannuation funds and at the same time to obtain an income tax deduction under the Income Tax Act, 1959 as amended ("the Income Tax Act"). We understand the Superannuation Task Force supported the proposal.

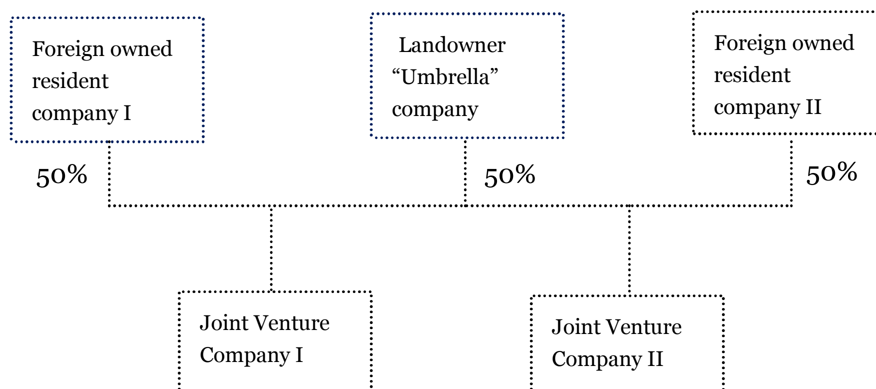
Section 88 of the Income Tax Act limits the deduction for contributions to an authorised superannuation fund to an amount which does not exceed 15% of an employee's fully taxed salary and wages. In order to enable self-employed persons to obtain an income tax deduction for superannuation contributions Section 88 of the Income Tax Act needs to be amended. It is proposed that this would be done in a way which enables a self employed person a standard income tax deduction for superannuation contributions of an amount up to 13.04% of their taxable income prior to the deduction for superannuation. Thus if a person's income before a superannuation deduction was K115,000 a deduction would be allowed for K15,000.

6. Dividend withholding tax on domestic dividends

Section 189B of the Act imposes dividend withholding tax on dividends paid by a resident company. Where the net dividend is paid to a resident company, that company is required to record the gross amount of the dividend in an account entitled "undistributed dividend account" and is required to record the amount of dividend withholding tax in an account entitled "Refundable Dividend (Withholding) Tax Account".

Section 216 of the Act provides that a resident company is entitled to a rebate in its assessment of the amount obtained by applying to that part of its taxable income that represents dividends the average rate of tax payable by the company. The consequence of the Section 216 dividend rebate is that dividends are effectively received tax free by a resident company.

In the context of dividends received by resident companies, the combined effect of the obligation to withhold tax on dividends paid to resident companies and the dividend rebate is that dividend withholding tax represents the payment of the tax of the ultimate shareholder and is not a tax liability of the resident company shareholder. This means the imposition of dividend withholding tax on dividends paid to resident companies is an impediment to the operation of company groups and has the potential to reduce the amount which would otherwise be available for future investment or available for repayment of debt. The issue can be illustrated in the typical structure for businesses supporting the PNG LNG Project:



In this example the after corporate tax profits of the joint venture companies will be returned to the shareholder companies by way of dividend. Under the current law these dividends will be subject to dividend withholding tax but not subject to tax in the hands of the holding companies. The requirement to pay dividend withholding tax in these circumstances reduces the ability of the holding companies to reduce debt or reinvest profits. In other words, the payment of dividend withholding tax on dividends paid between resident companies is an impediment to business. It is considered this impediment should be removed by exempting from dividend withholding tax dividends paid to resident companies.

7. Dividend withholding tax – mining companies

In addition to the concern raised above in relation to dividend withholding tax generally, there is also an anomaly in the law in respect of the treatment of dividends paid by mining companies.

The Bogan Review recommended uniformity in relation to the taxation of resource projects. However, there is under the current law a difference between the general principles for taxation of dividends paid from petroleum and gas projects compared with the general principles applicable to dividends paid from mining projects. Under the current law the rate of withholding tax in respect of dividends paid from mining profits is determined as follows:

"*dividends paid by a company carrying out mining operations is 10%"*

The exemption for dividends paid by petroleum or gas companies is contained in Section 42(3) of the Act which provides as follows:

"The assessable income of a shareholder does not include the amount of any dividends paid directly or indirectly out of income that was assessable income from petroleum operations or assessable income from gas operations, but only to the extent that the Commissioner General is satisfied that they were so paid."

As it is the source of the income which is exempt, this provision enables dividends paid from petroleum or gas companies to retain their character when paid through a chain of companies. It is submitted the same character retention should apply to dividends paid from mining income. Consequently, it is submitted the Income Tax and Dividend Withholding Tax Rates Act should be amended to retain the existing law and add the same concept that exists for petroleum and gas companies:

"dividends paid by a company carrying out mining operations and dividends paid directly or indirectly out of income that was assessable income from mining operations, but only to the extent that the Commissioner General is satisfied that they were so paid is 10%"

This enables PNG companies to hold investments in PNG mining companies and to pass on dividends from mining companies at the 10% dividend withholding tax rate (which presumably reflects the original intention of the reduction in the rate).

8. Allowable capital expenditure – mining projects

Section 156F of the Income Tax Act 1959 (the Act) provides that the rate of deduction for allowable exploration expenditure to taxpayers carrying on mining operations pursuant to a mining lease or special mining lease issued under the Mining Act 1992, on or after 1 January 2003 is 25% of the unclaimed balance of the allowable capital expenditure. However, under the general provisions of Subdivision A of Division 10 of the Act the deduction for both long-life allowable capital expenditure and short-life allowable capital expenditure effectively switches to a straight line or prime cost basis where the remaining life of a project falls below 10 in the case of long-life allowable capital expenditure and 4 in the case of short-life allowable capital expenditure. As the current rate of deduction under Section 156F is not consistent with the standard provisions and as this may be an issue at the end of the life of the project or for projects which have a life of less than five years it is submitted Section 156F should be amended to include a similar switch to a straight line calculation once the remaining life of the project is four years or less.

9. Abandoned prospecting authorities and abandoned mining licences

Recommendation 46 of the Bogan review concluded that depreciation rules for resource projects should be uniform. To a large extent this uniformity has been achieved through the introduction of Subdivision A of Division 10 which provides rules which are common for mining, petroleum and gas

projects. However, at the time that the law was amended by Act No 67 of 2000, Section 154EA was repealed. Section 154EA dealt with the treatment of unclaimed exploration or allowable capital expenditure in respect of resource licences which are cancelled, surrendered or expired.

The current law does not deal with exploration expenditure in respect of prospecting authorities or mining leases which have been surrendered cancelled or expired or allowable capital expenditure incurred on mining leases or special mining leases which have been surrendered cancelled or expired. However, specific provisions exist under Subdivision C and Subdivision D which apply to petroleum projects and designated gas projects, respectively. For ease of reference the provisions dealing with petroleum projects are detailed in the following paragraphs.

Section 157B (5) of the Act deals with exploration costs in relation to a petroleum prospecting licence or retention licence and provides:

"Where, at a particular time—

- *(a) a taxpayer or a related corporation has allowable exploration expenditure in relation to the area of a petroleum prospecting licence or a retention licence; and*
- *(b) the petroleum prospecting licence or retention licence is surrendered or cancelled or expires, the Commissioner General may at any time, in his discretion, allocate so much of that allowable exploration expenditure as was incurred within 20 years before the time of allocation (including, for the avoidance of doubt, expenditure incurred before the commencement of this section) as the Commissioner General considers is reasonable to any petroleum project in which the taxpayer has a beneficial interest at the time of allocation, and upon such allocation that allowable exploration expenditure shall become allowable exploration expenditure of the taxpayer (other than for the purposes of Subdivision E) in relation to that petroleum project."*

Section 157B (6) deals with exploration expenditure in relation to a petroleum development licence and provides:

"Where at a particular time a taxpayer ceases to have an interest in a petroleum project consequent upon—

- *(a) the surrender, cancellation or expiry of a development licence or a pipeline licence; or*
- *(b) the disposal by the taxpayer of the whole of its interest in the petroleum project,*

and immediately before such cessation, disposal or abandonment a taxpayer had residual exploration expenditure in relation to that petroleum project, the Commissioner General may at any time, in his absolute discretion, allocate that residual exploration expenditure (other than any amount transferred by the taxpayer to another person pursuant to Section 155L)—

- *(c) if the taxpayer or a related corporation has a beneficial interest in any other petroleum project or designated gas project from which the taxpayer or the related corporation is deriving assessable income from petroleum operations or assessable income from gas operations, to that petroleum project or designated gas project or those petroleum projects or designated gas projects, as the case may be, in such proportions as the Commissioner*

General considers reasonable,

and following the allocation that amount of residual exploration expenditure shall become allowable exploration expenditure of the taxpayer or the related corporation, as the case may be, in relation to the petroleum project or projects or designated gas project or projects to which they were allocated (other than for the purposes of Subdivision E), with effect from the date of allocation."

Section 157C (3) deals with allowable capital expenditure in relation to a petroleum development licence and provides:

"Where, at a particular time—

(a) a taxpayer ceases to have an interest in a petroleum project consequent upon—

i. the surrender, cancellation or expiry of a petroleum development licence; or
ii. the disposal by the taxpayer of the whole of its interest in the petroleum project; or

(b) abandonment of a petroleum project occurs,

and immediately before such cessation, disposal or abandonment a taxpayer was entitled to the benefit of allowable capital expenditure in relation to that petroleum project, the Commissioner General may at any time allocate that allowable capital expenditure (other than any amount transferred by the taxpayer to another person pursuant to Section 155L)—

(c) if the taxpayer or a related corporation has a beneficial interest in any other petroleum project from which the taxpayer is deriving assessable income from petroleum operations, to that petroleum project or those petroleum projects, as the case may be, in such proportions as the Commissioner General considers reasonable; or

(d) if the taxpayer or a related corporation has no beneficial interest in another petroleum project but has a beneficial interest in any other designated gas project from which the taxpayer or the related corporation, as the case may be, is deriving assessable income from gas operations, to that designated gas project or those designated gas projects, as the case may be, in such proportions as the Commissioner General considers reasonable; or

(e) in any other case, to any petroleum project or if no petroleum project becomes available to any designated gas project carried on by the taxpayer or by a related corporation pursuant to any development licence issued within 20 years from the date of such cessation or abandonment,

and following the allocation that allowable capital expenditure shall become allowable capital expenditure of the taxpayer or of the related corporation, as the case may be, in relation to the petroleum project or projects or designated gas project or projects to which it was allocated (other than for the purposes of Subdivision E), with effect from the date of allocation."

Identical provisions exist in relation to designated gas projects. However, the law is only repeated for mining projects in Section 156C in respect of allowable exploration expenditure in respect of the surrender, cancellation or expiry of a mining development licence.

It is submitted that the repeal of Section 154EA was an unintended consequence of the repeal of the former Division 10 and the introduction of the general rules for resource projects for the following reasons:

- There was no specific recommendation to repeal the concepts contained in Section 154EA in the "Report of the Taxation Review: Refining the Tax System" presented to the National Parliament in October 2000.
- There was no specific recommendation to repeal the concepts contained in Section 154EA in the "Review of the Fiscal Regimes for Mining and Hydrocarbons" released in October 2000 as part of the Bogan Review.
- There was a specific recommendation in the Bogan Review and the Review of the Fiscal Regimes for Mining and Hydrocarbons that depreciation rules should be uniform for resource projects.
- The existing law is not uniform as it contains provisions (Section 157B, Section 157C, Section 158C and Section 158D) which enable the Commissioner General to allocate to another petroleum project of the taxpayer or a related corporation the balance of unclaimed exploration expenditure and the balance of unclaimed allowable capital expenditure upon the surrender, cancellation or expiry of a petroleum prospecting licence, petroleum retention licence, petroleum development licence or petroleum pipeline licence.

In order to reinstate the uniformity of the taxation treatment of expenditure in relation to resource projects it is submitted the Act should be amended to introduce identical provisions for mining projects to those which currently exist for petroleum and gas projects with effect from 1 January 2012.

10. Management fee definition- technical fees

In the 2005 National Budget a new definition of management fees was inserted into Section 4 to include "technical fees". The definition of management fees for all purposes of the Act is currently:

"Management fee" *means a payment of any kind to any person, other than to an employee of the person making the payment and other than in the way of royalty, in consideration for any services of a technical or managerial nature and includes payments for consultancy services, to the extent the Commissioner is satisfied those consultancy services are of a managerial nature.*

The consequences of the change to the definition of management fees are that from 11 February 2005 fees paid for technical services:

a) rendered outside PNG by a resident of a country with which PNG does not have a double tax agreement will be subject to management fee withholding tax. Prior to the change in the law amounts paid for such services were not subject to tax in PNG. This is consistent with the general basis of taxation in PNG which provides that only PNG sourced income of a non-resident is subject to tax in PNG.

b) rendered in PNG by a resident of a country with which PNG does have a double tax agreement (other than Australia, Canada, China, Korea and Singapore) and where the non-resident does not have a permanent establishment in PNG, will be subject either to foreign contractor (withholding) tax or to management fee (withholding) tax.

When delivering the 2005 Budget the Treasurer noted that there were no new taxes introduced in the 2005 Budget. However, following the 2005 Budget income which had not previously been subject to tax became subject to tax. Given this and the statement by the Treasurer it is possible the application of management fee (withholding) tax to technical fees was an unintended consequence of the change in the definition of management fee.

Division 14C of the Act deals with Management Fee (Withholding) Tax. It seems this division was originally introduced to deal with the fact that as a general proposition management fees paid to a non-resident in respect of services rendered outside PNG were not subject to tax in PNG as the income was not sourced in PNG. If as a general proposition management fees for services performed outside PNG were sourced in PNG there would have been no need to introduce Division 14C. On the other hand where services are rendered in PNG, fees for such services would generally be subject to tax under the foreign contractor provisions of the Act. We believe the Act should be amended to make this distinction clear.

It is also noted that Division 14C of the Act applies to a taxable management fee which means:
" that part of a management fee that is an allowable deduction after the application of Section 68AD or Section 155M, as the case may be."

Section 68AD and 155M are anti-avoidance provisions which limit the deduction of management fees paid to an associate. Under the current law there would be no limit on the deductibility of technical fees paid to an unrelated party for services rendered outside PNG. Thus the whole amount of such fees would be subject to management fee (withholding) tax. On the other hand the use of a tax rate of 17% suggests the anti-avoidance measure was to attack payments which were disguised dividends. Assuming this was the case this suggests the management fee (withholding) tax should be applied to that portion of the management fees which are not tax deductible rather than that which is deductible. It is submitted it is the excess management fee which is the equivalent of a dividend and not the other way around.

In our experience the domestic laws of most jurisdictions operate in the same way as PNG in respect of the allowance of a foreign tax credit. The basic requirement is that the income against which the foreign tax credit can be claimed must be derived from a foreign source. Technical service fees paid from PNG in respect of services rendered outside PNG would not be derived from a foreign source. This means in the absence of a double tax agreement the recipient of the fees is unlikely to be entitled to claim a foreign tax credit. The effect of this is that the provider of the service will require the fee to be paid without deduction of tax. This will either increase the cost of the purchase of such services to PNG companies or result in PNG companies only using service providers from countries such as Australia, Canada, Singapore, Korea or China where the double tax agreements prevent PNG from imposing management fee (withholding) tax on the technical fees.

Against this background, it is submitted that Division 14C of the Act should be amended to ensure it has application only to management fees paid for services rendered outside PNG to associates in PNG and to reflect the original anti-avoidance intent regarding management fees which are in excess of the deduction limits as it is these charges which represent a disguised dividend.

11. Refund of excise

Excise duty applies to certain products manufactured in PNG and in particular petroleum products, alcoholic beverages and tobacco products. Section 52 of the Excise Regulation provides a mechanism for refunds of excise duty in certain circumstances and these include where goods which have been

subject to excise become unfit for human consumption. In particular, Subsection (1) of Section 52 provides:

(1) Where—
(a) excisable goods have, while subject to the control of the Customs, been damaged, pillaged, lost or destroyed; or
(b) excisable goods—
(i) have become unfit for human consumption; or
(ii) are, for some other reason, not worth the amount of excise duty payable on them, and have been destroyed under supervision—
(iii) as prescribed; or
(iv) in such manner as the Commissioner General of Internal Revenue directs; or
(c) excise duty has been paid through manifest error of fact or patent misconception of the law, a refund or remission, as the case requires, of the excise duty payable on them shall, subject to this Regulation, be made."

Subsection 2 of Section 52 prescribes the procedure for making the claim for a refund of excise duty and provides as follows:

"(2) An application for refund or remission of excise duty shall—
(a) be in Form 20; and
(b) state clearly and as far as practicable full particulars of the claim; and
(c) subject to Subsection (3), in the case of an application for refund of excise duty—be made not later than 14 days after the date on which duty was paid; and
(d) in the case of an application for remission of excise duty—be made while the goods are under control of the Customs"

The effect of Section 52 in the context of goods which have become unfit for human consumption is that the claim for the refund of excise must be made within fourteen days of the excise being paid. The only extension of this fourteen day period arises under Subsection 3 of Section 52 which extends the time limit to twenty eight days when *"the Collector is satisfied that the information necessary to verify the application was ascertained by the Customs while the goods, or the packages in which the goods were originally packed or were assumed to have been packed, were under the control of the Customs"*.

In the context of manufactured goods an issue arising from the manufacturing process which leads to the goods becoming unfit for human consumption may not manifest itself within fourteen days of excise being paid. In addition, the manufacturer's efforts will initially be focused on recalling the product and thus in practice it would be difficult to make the claim in the prescribed form within the specified period and to provide the necessary supporting documentation. Accordingly it is submitted the number of days in which the claim for refund be made should be extended to a more realistic period of eight weeks (56 days) or at least extended to 28 days to enable manufacturers to have a realistic time frame to make the necessary application.

12. Other matters

In addition to the matters discussed above, there are a number of minor issues and technical amendments we would like to bring to bring to your attention.

Training Levy

Given the limited resources of the IRC, the administrative burden on taxpayers and the relatively small amount collected from training levy consideration should be given to the repeal of training levy. Alternatively if training levy is to continue qualifying training expenses should extend to training citizens and not just citizen employees. This was an issue for some contractors to the PNG LNG Project which were prevented from employing citizen employees as they were required to hire citizen labour through landowner controlled labour hire companies. However, considerable time and costs were incurred in training the citizen employees of the labour hire companies.

Leave fares

To obtain the exemption for additional leave fares for employees working at remote locations requires the employee to make an application for a determination by the Commissioner General. Such applications are only made where the facts support the additional fares being exempt and the Commissioner General always exercises his discretion to exempt the additional leave fares. Given this involves unnecessary administration to employers and the Commissioner General it is considered the law should be amended to provide an automatic exemption for additional leave fares for employees working in remote locations (which could be defined as anywhere outside Area 1 in Regulation 9 of the Income Tax Regulations).

Non-resident tax rates and foreign contractor tax rate

The rate of tax applicable to the taxable income of non-resident companies and foreign contractors is 48%. While this seems high considering tax rates in the region it is also high when compared to the effective rate on distributed profits of a resident company. The effective rate on distributed profits of a resident company is 41.9% (being 30% plus 17% of 70%). In fact it seems that the non-resident rate was derived from a time when the resident rate was 35% and the dividend withholding tax rate was 17% which resulted in an effective rate of 46.05% (35% plus 17% of 65%). In the context of adopting a regionally competitive tax regime, there is no basis to discriminate between the rate of tax applicable to a non-resident company and the rate of tax applicable to a resident company. Accordingly, consideration should be given to reducing the tax rate on non-resident companies and foreign contractors to 42% (or lower if a reduction in the DWT rate occurs as part of the tax reform process). In the context of foreign contractors this would reduce the rate of foreign contractor (withholding) tax to 10.5%.

Foreign contractors assessment basis

Under the current law the Commissioner General has a discretion to allow a foreign contractor to be assessed on an actual taxable income basis rather than on a deemed profits basis. While the Commissioner General has recently indicated in a Taxation Circular this discretion will be exercised in favour of the taxpayer, it is suggested the discretion should be removed. For example where an application is made before the end of the year of income in which the contract commenced the law could be amended to provide the Commissioner General shall allow the taxpayer to be assessed on an actual profits basis.

Cash management trust

A cash management trust is a unit trust established only to accept funds from unit holders and to invest those funds in interest bearing securities. The pooling of funds is intended to enable unit holders to access a higher interest rate than would be available on standard deposits. Under the

current law the potentially combined tax rate on the trustee and beneficiaries means it is unlikely a cash management trust would be established in PNG. It is suggested the law be amended to allow interest to flow through a cash management trust such that the trustee does not pay tax on the net income provided the net income is distributed to unit holders and the distribution of income by a cash management trust would be deemed to be interest for interest withholding tax purposes. In this way the outcome from a taxation perspective would be the same as if the unit holders held the interest bearing investments directly.

Share buy-back

The Companies Act 1998 allows a company to reduce capital and to buy-back shares. When similar rules were introduced in Australia the income tax law was amended to make it clear what were the income tax consequences of share buybacks and distributions of capital. This is particularly relevant in the context of distinguishing between transactions by publicly listed companies (on market share buybacks) and unlisted companies (off market buybacks)

Interest on overpaid tax

The introduction of SIGTAS will result in the automatic imposition of penalties on taxpayers which lodge late or make payments after the due date. Given our experience with response times from the IRC it would seem reasonable if the Commissioner General is to automatically impose penalties on taxpayers that the Commissioner General be required to compensate taxpayers where the Commissioner General has not refunded tax within a reasonable time.

Long term bonds

Some years ago the tax exemption on interest paid on long term bonds approved by the Bank of PNG was phased out such that the exemption ceased to be available for new bonds. Given the need for further development of infrastructure throughout PNG the reintroduction of this exemption may provide opportunities for public/private partnerships for the development of infrastructure projects in PNG.

Depreciation rates

It has been a long time since a review or update of the published rates of tax depreciation was undertaken. The Review Committee may wish to consider whether the current law in respect of depreciation should be changed to a uniform capital allowance approach or at least consider what options exist for updating the published useful life of assets in the context of changing technology. For example internet service providers and mobile communications did not exist when the current rates were published.

Write off of minor assets

Section 155I allows resource projects an immediate deduction for minor capital items with a cost not exceeding K1,000. It is suggested this provision should be extended to all taxpayers and the amount increased to K5,000 or some higher amount to reflect the likely useful life of assets with a relatively low capital cost.

Substituted accounting periods

The introduction of a new revenue accoutring system should allow faster processing of income tax

returns. However, the fact that most taxpayers balance for income tax purposes on 31 December is likely to result in the Commissioner General being faced with processing issues. One way of dealing with this is to make it easier to adopt a balance date other than 31 December. In the past the Commissioner General appears to have considered there was some tax advantage in adopting a balance date other than 31 December. However, if tax payment dates and tax return lodgement dates are determined by reference to a taxpayer's balance date there would be no advantage to adopting a balance date other than 31 December other than tax and accounting balance dates being the same. In many instances taxpayers have not changed their balance date because of concerns with a potential adjustment under Section 12 and consequently it is suggested Section 12 be amended to remove the potential for an adjustment where a taxpayer is granted a substituted accounting period.

Landowner Resources Trusts

These provisions do not appear to have been used in practice although we are aware that an application was recently made for a declaration by the Minister for a trust established to receive royalties from a mining project. We are also aware of the proposed establishment of another trust which will also qualify subject to the required declaration from the Minister. It is suggested that the need for a regulation declaring a landowner resources trust is not necessary as the determination of whether a trust qualifies is a simple question of fact. Consequently, the power to determine whether taxation under Division 6A could be dealt with by the Commissioner General.

It appears the intention of Section 139(5) is that royalties derived by a landowner resources trust are only subject to prescribed royalty payments withholding tax under Subdivision VI.2, In other words this tax is a final tax. However, it is arguable the exemption of the net royalty under Section 139(5) does not achieve this intention. It is suggested the law be amended to ensure the 5% royalty withholding tax is a final tax. For example by saying where a royalty has been subject to prescribed royalty payments withholding tax under Subdivision VI.2, the royalty shall not be included in the assessable income of a landowner resources trust.