PNG PORTS
CORPORATION

PNG Ports Corporation Limited
Stanley Esplanade
P O Box 671
PORT MORESBY
National Capital District
Papua New Guinea
Ph: +675 3084200
Fax: +675 3211546
Email: enquiries@pngports.com.pg

Our Ref: CNB4.4/C&E169.

OFFICE OF THE CHIEF EXECUTIVE OFFICER

14th May 2014

Sir. Nagora Bogan
Chairman
PNG Tax Review Committee

Dear Sir Nagora,

SUBJECT: SUBMISSION TO PNG TAX REVIEW - INFRASTRUCTURE TAX CREDITS

The PNG Ports Corporation Limited ("PNGPCL") is pleased to submit the aforementioned submission to the Papua New Guinea Tax Review (2013 -2015) as part of the public consultation stage of the Review.

PNGPCL's submission specifically targets the current legislative and policy guidelines relating to the Governments Infrastructure Tax Credit Scheme ("ITCS"). The submission specifically aims to propose for a review and ultimately changes to relevant provision of the Income Tax Act (1959), relating to qualification for Infrastructure Tax Credits such that State Owned Enterprises, such as, PNGPCL which directly build and operate infrastructure through their Community Service Obligation can be allowed to apply for tax credits through the scheme. The submission is arranged as follows;

i. Executive Summary
ii. Brife Overview of PNGPCL
iii. Overview of PNGPCLs CSOs
iv. Purpose and Scope of Infrastructure Tax Credit Scheme
v. Proposed Changes to the Tax Credit Scheme
vi. Basis for SoEs eligibility for the Tax Credit Scheme
vii. Taxes and Dividends Paid by PNGPCL todate
viii. Tax Revenue Implications
ix. Concluding Remarks

PNGPCL therefore requests that this submission be considered and evaluated on its merits by the Tax Review Committee with a view to progresses further debate and consultative exchanges on the issue in latter stage of the review.

Should you require further clarification on the contents of this letter of the attached submission, please do not hesitate to contact **my General Manager – Commercial and New Business, Mr. Fego Kiniafa** on 308 4200 or email. cco@pngports.com.pg

Yours sincerely,
PNG PORTS CORPORATION LIMITED

....
STANLEY ALPHONSE
CHIEF EXECUTIVE OFFICER

Cc: *Managing Director, IPBC*

PNG PORTS CORPORATION

PNG PORTS CORPORATION LIMITED

SUBMISSION TO PAPUA NEW GUINEA TAX REVIEW PUBLIC CONSULTATION STAGE

PROPOSAL FOR SOEs TO BE MADE ELIGIBLE FOR INFRASTRUCTURE TAX CREDITS

APPROVED BY

....

STANLEY ALPHONSE
CHIEF EXECUTIVE OFFICER

Contents

1.0 Executive summary

The PNG Ports Corporation Limited ("PNGPCL") submits this paper proposing for;

i. Section 219 (C) of the Income Tax Act (1959) relating to the Infrastructure Tax Credit Scheme should be reviewed with a view to expanding the definition of "*eligible taxpayer*" to include State Owned Enterprises ("SoE").

ii. The Department of National Planning's Tax Credit Scheme Guidelines to be reviewed to include SoEs participation in the scheme;

iii. PNGPCL to work with the DNPM and the IRC in trialling this proposed change for a period of up to two years

iv. Allowable tax credit range of 3-5% of assessable income for CSO projects funded by SoEs..

SoEs should be made eligible for Tax Credits under the scheme on the following basis;

i. CSO projects are essentially no different to projects currently being delivered by private companies through the ITCS as they are undertaken consistent with specific Government policy directives in the Governments priority development sectors.

ii. Investments in CSO ports are not viable from a purely commercial standpoint but generate significant public benefits therefore PNGPCL should be eligible for tax credits on spending on these projects.

iii. For all intents and purposes the rationale behind most of the CSO projects that PNGPCL delivers are essentially consistent with the objectives of the scheme; hence there should be no reason why PNGPCL should be ineligible for the ITCS.

Based on this high level assessment, the overall effect in terms of revenue loss to the Government would be relatively minor. From an overall perspective, the change is essentially revenue neutral when considering that the tax rebates will ultimately be channelled back into socially desirable projects with no loss to the economy.

This submission intends to initiate further debate with a view to progressing further debate and consultative exchanges between PNGPCL and relevant stakeholders on the issue in latter stage of the review.

2.0 Brief Overview of PNGPCL

The PNG Ports Corporation Limited ("PNGPCL") is a 100% State Owned Enterprise ("SoE") responsible for the construction, maintenance and operations of sixteen (16) declared ports throughout the country's Maritime Provinces. PNG Ports Corporation Ltd (PNGPCL) is the successor company to the PNG Harbours Board. The Company was incorporated under the Companies Act (1997) in 2002 as part of the Government's Corporatisation Program aimed at improving the overall performance of statutory service providers, which for PNGPCL encompasses ports infrastructure services the scope of which includes the following;

- Vessel Berthing services
- Cargo Wharfage
- Port Storage
- Harbour Pilotage and;
- Other related and auxiliary services

PNGPCL is a regulated entity under the Independent Consumer and Competition ("ICCC") Act where the prices it charges for its Essential Port Services i.e. Berthage and Wharfage are regulated by the ICCC.

The company also performs a regulatory function by virtue of delegation from the Department of Transport which entails monitoring, controlling and licensing all activities within the declared Harbour precincts.

The Governments' shares in PNGPCL are vested in trust with the Independent Public Business Corporation ("IPBC") by virtue of the IPBC Act (2002). Consistent with the IPBC's charter under its empowering legislation, the IPBC requires PNGPCL to operate on a fully commercialised basis with a view to maximising the returns on the shareholders capital through commercially viable investments in the ports network and improvements in the overall efficiency of the enterprise.

3.0 Overview of PNGPCL's Community Service Obligation (CSO)

Concurrent with PNGPCL's commercial interests, the company also fulfils a Community Service Obligation ("CSO") which broadly entails maintaining and operating a number of commercially unprofitable ports that are part of the ports network inherited from the PNG Harbours Board.

Currently, of the sixteen (16) ports in PNGPCL's network, only three (3) ports, including Lae, Port Moresby and Kimbe generate sufficient revenue to fully recover both operating and capital costs. The other thirteen (13) ports which include,

- Alotau
- Oro Bay,
- Daru

- Madang,
- Wewak
- Vanimo
- Aitape
- Rabaul,
- Kavieng
- Lorengau
- Buka
- Kieta
- Samarai

are maintained under PNGPCL's CSO. These ports are classified as CSO ports because they are not profitable on a stand-alone basis i.e. they are unable to fully recover one or all of the following costs;

- Operational Costs;
- Depreciation Costs; and
- The Cost of Capital.

The continued operations of these 13 CSO ports effectively subjects PNGPCL to dual and conflicting mandates i.e. a conflict between its principal commercial objective of profitability required under the IPBC Act and its broader role of facilitating the Governments plans for socio economic growth and development within the ports and maritime transport industry. To compound the issue, the CSO ports are in dire need of rehabilitation as a result of many years of underinvestment and neglect and thus require extensive capital outlay to full rehabilitate the facilities.

Currently, CSOs enable the Government to utilise the existing capacity of SoEs to achieve specific development policy objectives in various key economic sectors. In PNGPCLs case, this relates to the Government's objectives for the ports and maritime transport industry and the transport sector in general. These Government objectives are encapsulated in various development plans and policy instruments including the PNG Developments Strategic Plan 2012-2032 ('MTDS"), the Medium Term Development Plan (2010-2015).

Ideally, the Government should fully subsidise CSO's costs through direct budgetary appropriations. However, in reality, direct funding from the Government channelled through the Public Investment Program ("PIP") under successive annual development budget appropriations have been insufficient to fully subsidise the costs that PNGPCL has to bear in running a ports network with inherent CSO commitments. In the current context funding continues to be a major constraint to fully implementing many of the projects that are planned for the CSO ports given the myriad of competing development priorities that the Government has to budget for annually.

Nonetheless, PNGPCL has been committed to its CSO commitments and in addition to ad hoc Government grants has continued to support the operations of its CSO ports through a system of internal cross subsidisation where earnings from the three (3) profitable ports are channelled towards rehabilitating and maintaining the CSO ports. In the absence of a formal and structured Government policy framework for the delivery of CSOs by SoEs, this has been the modus operandi to date, albeit at an obvious cost to PNGPCL's commercial pursuits.

4.0 Purpose and Scope of Infrastructure Tax Credit Scheme

Infrastructure Tax Credits in the PNG context were initially introduced by the Government in the early 1990s and focused primarily on mining and petroleum sectors. The Infrastructure Tax Credit Scheme ("ITCS") allows mining, petroleum and primary industry companies to fund and build public infrastructure projects and claim a prescribed percentage of this expenditure as rebates from the Internal Revenue Commission on corporate taxes paid.

The Income Tax Act (1959) was amended to incorporate the laws in respect of Infrastructure Tax Credits and the scheme is currently administered by the Department of National Planning and Monitoring ("DNPM") which includes screening and approving of projects eligible for tax credits based on the ITCS Guidelines ("Guidelines") developed by the Department. The maximum allowable percentage of assessable income that can be claimed as a rebate for projects approved under the ITCS is currently set at 0.75% of assessable income for the financial year.

The objectives of the scheme as defined in the DNPMs ITCS Guidelines are;

i. To extend by way of capital works and maintenance of Governments infrastructure on the national development priority sectors, the beneficial impacts of mining, petroleum and primary industry developments to the population of the host province and other parts of PNG.

ii. To assist where possible in developing a planning and implementation capacity at the Provincial, Local Government or Ward Levels.

Currently, the definition of an "eligible tax payer" for the purposes of qualifying for infrastructure tax credits under Section 219(C) of the income Tax Act (1959) states that;

(1) In this Section "eligible tax payer" means

(a) A taxpayer engaged in mining, petroleum or gas operations; or
(b) A taxpayer engaged in primary production;"

Income Tax Act (1959) s.21 (C). Credits in Respect of Prescribed Infrastructure Developments

It is acknowledged that the application of ITCS has greatly assisted the Government to deliver much needed services to affected communities in resource affected areas without the need for any direct budgetary appropriation from Treasury for these projects. Moreover, the scheme has enabled the Government to leverage the productive capacity and expertise of the private sector to cost-effectively deliver public infrastructure projects in remote areas which would normally be too costly for the Government to fund directly given domestic capacity constraints and logistical bottlenecks characteristic of remote areas of PNG.

It is therefore acknowledged that the Scheme has been to a great extent effective in so far as achieving the desired outcomes with respect to the Government's socio-economic development objectives within the mining, petroleum and primary industry sectors.

5.0 Proposed Changes to the Tax Credit Scheme

Notwithstanding the positive impacts that the ITCS has had in the sectors currently covered by the scheme, PNGPCL is of the view that there is scope for further extending the scheme to include SoEs that provide vital economic infrastructure projects as part of their CSO commitments. As was noted in the preceding section, the definition of *"eligible tax"* payer currently stipulated in the Income Tax Act (1959) explicitly precludes SoEs from applying to DNPM for tax credits.

It is therefore the intent of this submission to bring the case forward for the inclusion of SoEs as eligible tax payers for the purposes of qualifying for tax credits through the ITCS.

Accordingly, PNGPCL proposes the following;

v. PNGPCL proposes that section 219 (C) of the Income Tax Act (1959) should be reviewed with a view to expending the definition of eligible taxpayer to include corporatised SoEs.

vi. Consistent with point (i) provisions in the DNPM Tax Credit Scheme Guidelines specifically those relating to the Scope and Objectives of the Scheme to be reviewed and amended consistent with the changes to the eligibility requirements in the Income Tax Act (1959).

vii. AS part of the review process, PNGPCL should be allowed to work with the DNPM and the IRC in trialling this proposed change for a period of up to two years in order for the Government to fully assess the impacts prior to proceeding with the necessary legislative and administrative changes. Compared to other SoEs, PNGPCL is better placed internally to effectively implement this proposed policy change. The company has a strong financial position and has in place an effective accounting and financial reporting system which includes an updated Fixed Assets Register, General Ledger accounts and updated financial audits up to 2011.

viii. PNGPCL proposes for a tax credit range of **3-5% of assessable income** for SoEs. This range exceeds what is currently available to Resource and

Primary Industry developers nonetheless it is appropriate given the infrastructure intensive nature of the ports business as well as the significant funding required to rehabilitate and maintain the CSO ports.

ix. CSO projects considered for Tax Credits should be strictly capital projects tied to CSO ports where PNGPCL can demonstrate that the project that the social benefits of the project far exceeds any expected commercial returns to the business and further that the project is consistent with key developments priorities of the Government encapsulated in various Government plans and policies, including but not limited to the PNGSDP, PNG MTDP, National Transport Development Plan and the PNG Vision 2050.

x. In applying for Tax Credits, SoEs will be subject to all relevant provisions of the ITCS Guidelines and other specific requirements of the DNPM when applying for Tax Credits under the ITCS.

6.0 Basis for SoE Eligibility for the Tax Credits Scheme

The proposed changes are based on the following key principles and premises;

iv. The delivery of CSO projects is in essence no different to projects delivered by private companies through the ITCS in the sense that both are essentially non fiscal mechanisms through which the Government delivers essential services in priority sectors in rural underdeveloped areas of the country. Both mechanisms ultimately serve the Governments socio-economic development objectives. However, unlike the resource and primary industry companies, SoEs are unable to access tax credits to recover their investments on CSOs which affects their principle commercial objective.

v. Investment in CSO ports directly conflict with the company's principle commercial objectives as these investments are not viable from a purely commercial standpoint but generate significant public benefits.

vi. In addition, port infrastructure projects are listed in the DNPMs Guidelines as eligible projects under the Transport sector that can qualify for tax credits. The transport sector is one of the National Governments priority sector under the PNGSDP and PNG MTDP. This means that for all intents and purposes the rationale behind most of the CSO projects that PNGPCL delivers are consistent with the objectives of the scheme; hence there should be no reason why PNGPCL should be ineligible for the ITCS.

7.0 Taxes & Dividends Paid by PNGPCL to date

8.1 Taxes Paid to Government

It is appropriate within the context of this submission to provide data on the amount of taxes that PNGPCL has paid to date in order to provide better indication of the taxes that are under consideration. PNGPCL pays Corporate Income Tax annually on its net taxable earnings at the prevailing rate of 30% as required under the Income Tax Act (1959). In addition, the company's operations generate a substantial amount of indirect taxes for the Government including Goods and Services Tax on its sales receipts, Payroll taxes from its workforce and various withholding taxes.

Table 1 provides a summary of the total amount of taxes paid by PNGPCL since the company's incorporation.

Table 1: Total taxes paid to Government 2002-2013

PNGPCL	TOTAL (K'million)
Payroll Tax	**66.8**
Corporate Tax	**90.1**
GST	**67.2**
Foreign Contract W/holding Tax	**12.6**
Local Withholding Tax	**1.6**
Total Taxes Paid	**238.4**

PNGPCL has generated a total of **K238.4 million** in direct tax revenue to the Government in its only twelve years of operations as a corporate entity. The company's first remittance of corporate taxes to the Government was made in 2006 which was on the back of the company's' first ever net profits declaration. The company has since paid a total **K90.1 million** in corporate taxes from consecutive profits since 2006. As table 1 indicates Corporate Taxes make up around 38% of total taxes generated by PNGPCL's operations since 2002.

8.2 Dividends to Government

In addition to taxes, PNGPCL is also required to around 15-20% of its after tax profits as dividends to the Government through the IPBC. Since incorporation, PNGPCL has declared and paid out annual dividends to the IPBC twice including a dividend of **K15 million** from 2011 and **K8.5 million** in 2012.

Table 2: Total dividends paid to Government

Year	Amount
2011	**15**
2012	**8.5**

8.0 Tax Revenue Implications

It is envisaged that the proposed changes would have a reasonably minor impact in terms of tax loss on the amount of taxes paid by PNGPCL in total which is due largely to the fact that Corporate Tax account for only 38% of the total amount of taxes PNGPCL generate (see Table 1) over the twelve years of operations as a corporate entity.

PNGPCL's average Gross Income (assessable income for tax purposes) for the last five (5) years was around **K200 million**. Assuming income is generally maintained at this level going forward, PNGPCL would qualify for tax credits in the range of **K6 – K10** million per year based on PNGPCL's proposed Credit range of 3-6% of Assessable Income. Further high level analysis, based on the historical data on taxes paid by PNGPCL (Table 1), indicates that this range represents around 3 – 4. % of the total amount of all taxes inclusive of Corporate Taxes that PNGPCL directly paid to the Government. Thus based on this high level assessment, the overall effect in terms of revenue loss to the Government would be relatively minor; however, the impact this tax savings would have on PNGPCL's ability to deliver tangible infrastructure to its CSO ports would be significant.

Furthermore, this change is considered to be revenue neutral when considering that whatever the amount of income tax revenue foregone as a result of rebates under the ITCS is channelled back into infrastructure investments that benefits the public. Therefore, in any case, corporate profits are being redistributed to public expenditure which is ultimately, where the Government taxes are spent one way or the other.

9.0 Concluding Remarks

- PNGPCL therefore requests that this submission be considered and evaluated on its merits by the Tax Review Committee and incorporated into the Draft Report of issues.

- At this juncture of the PNG Tax Review, it is envisaged that this submission can initiate some form of debate with a view to progresses further debate and consultative exchanges between PNGPCL and relevant stakeholders on the issue in latter stage of the review.

- PNGPCL intends to provide further details and clarity on the matters raised in this submission at an appropriate stage in the current Tax Review process.