Deloitte Touche Tohmatsu

Tax Review Committee Submission
Issues Paper No. 2:
Corporate & International Taxation

4 September 2014

04 September 2014

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Attention: Sir Nagora Bogan (Chairman)
Mr David Sode (Deputy Chairman)
Sir John Luke Crittin (Member)
Lady Aivu Tauvasa (Member)
Mr John Lohberger (Member)

04 September 2014

Our Ref: TRC Paper No 2\LH:NS

Dear Chairman and Committee Members

Re: Deloitte's Submission in respect of your Issues Paper No.2 – Corporate & International Taxation

We enclose in this report our further submission, as foreshadowed in email correspondence of the other week.

In preparing this submission, we have considered the various options, remarks and considerations posed by your Committee within this particular paper. We have thus below proceeded to comment on those aspects, in particular where we have formed a view either way.

Should you have any queries in respect of our submissions, please do not hesitate to contact either myself or **Noel Smith** on 308 7000.

Yours sincerely

Lutz Heim
Managing Partner
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Chapter 3 – Corporate Tax Rates & Witholding Taxes

Question 3.1

In the medium to long term "yes", we believe there is potential to lower the normal company tax rate from 30%. Generally lower taxes in the private sector lead to economic growth and that greater economic activity generates increased tax revenue. The compelling data earlier in the paper about the number of companies paying tax, as opposed to those companies registered, certainly suggests that a future tax rate decrease could be financed just by broadening the tax base through compliance activities, to include those companies that should be 'in the tax net' at present.

Question 3.2

On balance we favour a reduction in the actual company tax rate as the simplest and most easily sold solution. A dividend imputation system would be too difficult to be effectively administered in PNG. By lowering the base rate, the increased level of retained earnings is likely to stimulate greater re-investment and thus further economic growth.

Questions 3.3 & 3.4

We strongly favour a reduction in the non-resident company tax rate to 42%. The current 48% level is derived from historically irrelevant comparisons and is a 'turn off' to those foreign investors who might otherwise wish to create a formal branch structure in country.

Question 3.5

We agree that aligning the various rates across the heads of withholding tax revenue is more equitable and makes for greater taxpayer compliance and awareness. So for example in the case of overseas investors it might be that a higher DWT rate influences them to consider transfer pricing strategies more so than might otherwise be the case.

Also, for all non-resident withholding taxes, their effective cost is very often just passed onto the PNG customer and increases their cost of doing business. So a lower and more harmonised rate approach, to say a uniform 10% level, is likely to assist economic efficiency in the domestic market.

Questions 3.6 (a) & (b)

Corresponding to our support for the reduced non-resident company tax rate, we consider that on equity grounds a reduction in the FCWT rate to a unilateral 10.5% rate is absolutely warranted. It may however be easier to do away ith the present formulaic approach and just legislate a separate FCWT rate of 10%, in line with our suggestion above at 3.5.

Question 3.7

Yes, definitely a foreign contractor should have the right to elect or otherwise automatically be allowed to lodge annual income tax returns in lieu of suffering FCWT, and without the current administratively burdensome (for both taxpayers & IRC) formal approval process. This is an even more compelling argument from our perspective in the case of those foreign

contractors whose initial contract to operate in PNG exceeds one year and/or those who have a history of ongoing operations in PNG.

Question 3.8

We do believe that the 2005 change to the management fees regime has resulted in the widening of its impact far beyond its original policy intent. In particular that is the case for some specialist offshore third party services providers who have no involvement in the daily affairs of the PNG customer. Thus the regime should ideally be restricted to situations where the services encompass a direct impact on the internal management or administration of the PNG customer.

We further believe the rate of MFWT should be unilaterally reduced to 10%, at the very least for non-resident recipients that are not associates of the PNG paying entity.

Chapter 4 – Assessment & Collection of Corporate Tax Income

Questions 4.1(a) & (b)

We believe that immediate adoption of a self-assessment system for all corporate taxpayers will prove a very positive step overall and is a high priority. The resources thus freed up can be better deployed to beef up audit capacity, especially at a ‘desk audit’ type level. At the same time, the logically occurring increased field audit capability will assist to widen the tax base by bringing errant companies into the tax net.

Another advantage we see of adoption of self-assessment is the earlier collection of due taxes by the IRC. We have encountered numerous situations of taxable returns being lodged for income years where no provision tax had been levied and yet the relevant assessment(s) can take anything from 4 months to over a year to issue. A standard & automated self-assessment system will remove that possibility and make revenue collections more immediate.

Chapter 5 – Integrity Frameworks

Question 5.1

We do not believe that there is any real reason to consider updating or changing the existing Division 15 arrangements in the PNG tax laws, especially as there are far higher priorities in terms of tax reform. To dedicate scarce resources to this task would be in the least premature in our view, and we think also the supposed concerns raised in the issues paper are not of such relevance to PNG. It is our experience that the focus on transfer pricing arrangements by taxpayers in PNG is far less aggressive and/or sophisticated than the type of situations you have noted from for example the Australian context.

Question 5.2

We see no reason at all for the present thin capitalisation provisions to be extended to the finance sector, regardless of any increased ratio being considered.

The PNG finance sector is heavily regulated by the central bank, whose oversight in this regard is well recognised. Moreover, it is fairly well established that the PNG banks do not undertake much in the way of foreign debt raising, so there seems even no practical need to currently consider such further options.

Question 5.3

As tax professionals we have not really encountered practical issues from our clients with the present definitions in this area. Most of our larger clients and certainly all multi-national clients are driven by the efforts of their independent auditors to adopt correct definitions of “debt” versus “equity” for IFRS purposes. At the smaller corporate or SME level we would not see this being an issue of much practical importance. If for some other specific reason it was felt the definitions had to change, is it possible to just adopt those from IFRS?

Question 5.4

We see no need at present for additional integrity frameworks in the PNG context.

To consider any type of CFC measures is premature and in fact from what we see PNG is not really a strong outward bound investment location. A number of the other “integrity” issues mentioned may well be an issue in developed economies, but that does not mean that adoption of regimes to address these issues is suitable for PNG. One of the positive aspects of the overall PNG income tax framework is that it remains relatively uncomplicated, thus easier to both administer (for the IRC) and understand (for taxpayers). In the absence of definitive evidence that material avoidance of the type described occurs here, we think there are far higher reform priorities.

The kind of alternative minimum taxation arrangements suggested are most likely to disadvantage SMEs, at a time when there is a concerted effort by Government to promote the viability of same in PNG.

There is no doubt some value for PNG to be part of or at least aware of developments in the BEPS space. However, care needs to be taken that forcefully moving PNG taxpayers to consider adopting such transfer pricing principles or approaches does not actually lead to greater tax collections offshore and less in PNG as a result.

Chapter 6 – International Tax Agreements

Questions 6.1 & 6.2

We consider that consideration of negotiations with both the US and Japan should be looked upon with some level of priority, given the relative importance of these two countries as sources of both investment and aid funding to PNG. With those two added to the 4 others ‘in the pipeline’ awaiting ratification, we consider the priority accorded any other country new DTAs would be low in the current environment.

As to reviewing and/or renegotiating existing treaties, there is value in trying to ensure that treaty provisions on a partner country basis are as consistent as possible. That said, even very developed tax jurisdictions have a range of treatments within comparable Article terms across the range of their operational treaties, because of the differing needs of each treaty partner.

From the PNG perspective we also consider that inclusion of a Non Discrimination Article in all new treaties will in fact benefit the domestic revenue of PNG. That is due to the increased

volume of business that is likely to result from genuine residents of the relevant treaty partner country, plus the fact that such countries in both the PNG new & proposed treaty context generally have robust tax administrations of their own.

Questions 6.3 & 6.4

There is no doubt some long term benefit in the prospect of both entering into multilateral agreements and in PNG becoming a member of relevant international tax forums, as opposed to having merely observer status in which we see little value.

However, in the current environment where for example we see months long delays in the processing of GST credit offset requests, even after those credits are confirmed by GST Audit section, we do not see either as a high priority at this stage.

Chapter 7 – Depreciation

Questions 7.1(a), (b) & (c)

Indeed we see a very high priority in updating the current outdated depreciation rates tables, for all the obvious reasons mentioned in the issues paper.

However, in our view the IFRS regime doesn't actually provide specific rates on an item by item basis, so it may not be such an easily adaptable option. Other options could be to:

i) Simply adopt effective life rates as published annually by other reliable tax jurisdictions, as for example the ATO in Australia, or
ii) Adopt just say 4 standard rate bands for depreciation at the 5%, 10%, 15% & 20% prime cost (straight line) level, based on effective life of asset estimates[1]. This to some degree is similar to the 'short-life' and 'long-life' approach currently available in the resource sector.

If you adopt the type of 4 rate banding approach noted above, then to you would be permitting a degree of self-assessment, as taxpayers will be responsible for coming to a view on the relevant effective life for each asset.

That is of course unless you used a combination of options i) and ii) above, such that IRC annually published approved effective life tables and these then determined which of the 4 standard rate bands the asset or equipment was treated under.

To otherwise allow a total self-assessment system for depreciation we believe has the potential to create too much in the way of likely future disputes or queries between the IRC and the taxpayer. A simple self-evident regime is thus far preferable.

Question 7.2

We very much agree that a small value items 100% depreciation regime should be introduced for all non-resource sector taxpayers, to give greater equity of treatment & transparency in this regard. A starting threshold amount of K2,500 should at least be contemplated there in our view.

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[1] - for example 5% for >15yrs effective life; 10% for those 10yrs to 15yrs; 15% for those 5yrs to 10yrs & 20% for those <5yrs.

Question 7.3

Whilst simplifying the tax system generally is of course of benefit to small business, as they generally have more limited accounting skills or affordable access to same, we don't believe there needs to be a 'two-tier' approach to depreciation on that basis. That is not least because of the ongoing difficulties and/or argument in setting turnover threshold levels to distinguish SMEs from other businesses. Overall simplification and small value items immediate expensing should achieve sufficient to be of benefit for all in the current PNG environment.

Question 7.4

We believe that such rules would add to the certainty of the tax regime by fairly allowing a depreciation style deduction for all capital expenditure.

Questions 7.5 & 7.6

Whilst there are obvious advantages in simplifying the depreciation system, some of the more notable current concessions are designed to provide support to certain sectors of the economy. Examples there are the 100% (with some limits) concession for manufacturing plant and the 100% for agricultural plant[2]. So the Committee would need to consider relevant current Government priorities in those sectors before consideration repeal of such concessions.

Apart from our simplification suggestions above at Question 7.1, further options overall that might be considered are:

i) Allowing full year depreciation for al assets, regardless of the stage during the year at which they were purchased, and/or
ii) Removing the diminishing value option and just allowing straight line depreciation.

Chapter 8 – Incentives to encourage training

Question 8.1

As we have previously submitted, we see the training levy tax regime as an unnecessary cost to compliant businesses and one that does nothing in practice to actually encourage more training than the economic reality of PNG business already dictates. This tax has presently only generated between around K 3 million & K 6 million in revenue over the past few income years. Thus the taxpayer and IRC resources involved in its administration are far better employed elsewhere. We very strongly support entire repeal of the training levy regime.

As to the separate double deduction for certain citizen apprentice, employee coursework and full time trainers, we do see value in these being retained, essentially for the bias it creates towards citizen engagement in the workforce (as noted in the issues paper). However, if this concession was thought necessary to be repealed in conjunction with repeal of the training levy then we could understand such an approach.

[2] - subsections 73(7) & 73(9) respectively

Chapter 9 – Sector Specific Tax Issues

Question 9.1

We do see that targeted use of export taxes may have a part to play in generating some level of tax revenue from within sectors that are notoriously non-compliant and/or difficult to monitor. The logging and timber export industry would this be an ideal candidate for further consideration, noting that a log export tax may already be in place but may not be of sufficient probity or rigour.

However, for mature and transparent industries such as for example that of oil palm, consideration of an export tax introduction would be disastrous for PNG. It would decrease returns to landholders & growers which provide a substantial part of the production of these oil palm projects. It might also quite possibly deny PNG product entry to some developed markets. So it should not be considered in such a context.

Question 9.2

We do consider the suggestion for an export tax on unprocessed tuna to be a sensible one. Given the quality of tuna in PNG waters and the growing scarcity of such product it is likely genuine fishing companies will still seek to operate here even with such a tax.

Another more radical idea might be to grant licences on a preferential basis to companies resident in countries where the tax authorities there agree to give PNG a share of the revenue they derive from those entities. This is because unfortunately it would appear that the majority of present fishing companies operative in PNG waters are from non-tax treaty partner countries, so exchange of information procedures are not available to IRC.

Question 9.3

One sector that we might be considered for adoption of a withholding tax type regime is the property rental sector. There would seem to be a number of individual and mid-level participants in this market who operate outside the tax net. Such a move could perhaps be accomplished by including rental payments within the business payments tax regime, where bigger more compliant participants would presumably have a COC. Alternatively and/or in conjunction with this move, employers could be denied a deduction in their tax returns for staff rental payments unless they could sight and retain verification of a current COC for the landlord in question.

Chapter 10 – Other Issues

Questions 10.1 & 10.2

We note the commentary about the potential for a foreign dividend account regime to potentially benefit investment in PNG. We consider that such a regime would advantage PNG companies with global ambitions, such that they can be seen as an exporter of investment. In the Pacific regional context the insurance and hospitality industries could perhaps be seen as examples of sectors in PNG where this initiative could stimulate further economic growth. In the short term however there are probably other issues raised in this paper that are more pressing.

If such a regime were to be introduced, we do not see any need for a specific integrity regime to be also introduced, apart perhaps from the ‘subject to tax’ requirement mentioned in relation to the foreign dividend treatment at source.

Question 10.3

If introduced, an EITI equivalent type transparency regime would no doubt produce very interesting results in some industry sectors, such as the timber industry. In other sectors we believe there will be more than sufficient compliance already so that this type of change would not be an efficient use of resources. In general terms, we do not see this idea as one of great priority in the current PNG environment.

Question 10.4 & 10.5

We very strongly support the introduction of a simple loss transfer system within wholly owned company groups. The only current practical alternative of amalgamation, which we note is not restricted in the tax law to wholly owned groups, is a cumbersome, expensive and time consuming process. From an equity perspective we believe this should apply to all PNG resident companies and if done so we do see greater investor confidence resulting, both from within and outside PNG.

We further agree that the introduction of such a loss transfer regime needs to be revenue neutral. Accordingly we would support the simple solution you note of restricting transferrable losses to only those incurred after the date of implementation. This also removes any perceived distortion of benefits between existing and new businesses.

Question 10.6

On our view of the current operation of the tax laws there is no major income tax impediment to the conduct of a share buy-back or equivalent arrangement. That is said of course is in an environment where there is presently no capital gains tax and excludes reference to the obvious stamp duty considerations.

In the short term we see such considerations as having a low priority.

Question 10.7

As a firm, we agree with the policy intent of the current tax law to effectively discourage the general or widespread use of trusts. However, we also strongly agree that if the present income tax definitions for public and property unit trusts were expanded to enable more diversified investments, along the lines of managed investment funds elsewhere in the world, we see more opportunity for individual PNG investors to do so meaningfully onshore.

If successful, such a move might also introduce opportunities for greater private sector investment, through aggregated pools of funds being available, into large scale infrastructure projects in PNG.

In keeping with previous submissions on this topic, we further recommend that full stamp duty exemptions be considered for purchase or transfer of underlying assets such as real property, where these are owned by such widely held collective investment vehicles as the measure contemplates.

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