

The National Research Institute

A Symposium Paper



**SCOPING PAPER: MODERN AND RATIONAL TAX
ADMINISTRATION SYSTEM FOR PAPUA NEW GUINEA**

by

Roneil V. Prasad

*Barrister, Solicitor and Tax Consultant
Sydney, Australia*

Paper presented at the PNG Taxation Research and Review Symposium

29-30 May, 2014

Holiday Inn, Port Moresby

This paper was prepared as a basis for discussion at a Symposium organized by the National Research Institute (NRI). (Funding from the National Tax Review Committee/Secretariat for this Symposium is gratefully acknowledged. More information regarding the National Tax Review Committee/Secretariat is at www.taxreview.gov.pg.) It is circulated to inform interested persons with regards to research in progress at the Institute. As work on this manuscript is still in progress, it is not a publication and is subject to revision; comments are invited to improve the final version. The views and opinions expressed, which are exposed in this paper for further public debate, are those of the author and do not necessarily represent the views NRI or its directors.

This paper was prepared as part of a research project of NRI supported by funds provided by the Australian Department for Foreign Affairs and Trade none of these institutions endorses the views presented in this paper. The authors benefitted from numerous comments and suggestions of the participants at the Symposium organised by NRI, and by Ron Duncan, Emeritus Professors at the Australian National University. The authors remain entirely responsible for the contents.

CONTENTS

1. INTRODUCTION	1
2. CORPORATE STRUCTURE AND RESOURCING ISSUES.....	3
2.1 IRC Internal Organisation Design.....	4
3. TAX COMPLIANCE MODELS	6
3.1 Disengagement.....	6
3.2 Resistance	7
3.3 Capture	7
3.4 Accommodation.....	8
3.5 Compliance strategies.....	8
3.6 Criticisms of CTF.....	8
3.7 The Netherlands Approach.....	10
3.8 Lesson for PNG.....	12
3.9 Technology and social media	12
4. TAX ASSESSMENTS AND RETURN FILING: SIGTAS.....	14
4.1 Self-assessment and voluntary disclosure	15
5. TAX INVESTIGATIONS AND COMMISSIONER’S POWERS	16
6. TAX DISPUTES.....	17
6.1 Assessment	18
6.2 Post self-assessment audit and reassessment	19
6.3 Notice of objection.....	19
6.3.1 Objection notice	20
6.3.2 Taxpayer’s right to appeal objection decision.	20
6.4 Contrast with the New Zealand System	20
7. TAX ADMINISTRATION REFORMS CURRENTLY UNDERWAY IN PNG	22
8. CONCLUSION	24
REFERENCES	25

1. INTRODUCTION

Jean-Baptiste Colbert once famously remarked that the art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing. Although made some 350 years ago, the essence of this quote is still relevant. Taxation involves two major stakeholders (the taxpaying community and the taxing authority) with often competing self-interests. This is especially true in a tax administration context. The taxpaying community generally prefers a simple tax compliance model that involves minimum compliance and tax audit costs. Governments and revenue authorities often have limited resources but have a vested interest in ensuring maximum compliance (with minimum tax evasion and avoidance). Hence, the tax administration system will invariably incorporate checks and balances that could be onerous for taxpayers in terms of time expended and cost.

The designers of the best tax systems arguably find a good balance between the two competing interests. Further, there has been a considerable change in focus recently in this area. For example, the OECD's Forum on Tax Administration¹ was set up to encourage tax authorities to move away from a confrontational dialogue to more constructive engagement with taxpayers.

As a practitioner who has worked on both sides of the tax administration fence (in private tax practice and as a revenue official), the writer is just as aware of the challenges facing tax authorities as of the expectations of the taxpaying community. This is the theme of this paper: to recognise that designing an effective tax administration is a finely balanced exercise and to generate discussion in where that balance sits for the tax administration of Papua New Guinea (PNG). The writer suspects that there is no one model that will yield the best results: PNG has its own dynamics (such as level of economic participation) that will dictate the effective design of its tax administration system. Yet there is much to learn from the somewhat revolutionary changes taking place in the tax administration sphere in countries such as the Netherlands² and from the ever increasing role of technology in tax administration.

Tax administration is a very wide topic, incorporating issues such as:

1. The structure and constitutional nature of the revenue authority.
2. Taxpayer compliance: tax returns and assessments and the growing trend to do away with tax returns for individuals.
3. Commissioner's powers to withhold refunds.
4. Use of compliance models as a resource allocation tool.
5. Commissioner's powers to audit/investigate tax positions taken by taxpayers; amendments to assessments.
6. Commissioner's information gathering powers.

¹ See Background to the Forum at < <http://www.oecd.org/site/ctpfta/abouttheforum.htm>>

² As discussed later in this paper.

2 *A Modern and Rational Tax Administration System for Papua New Guinea*

7. Use of electronics services in tax administration.
8. The international dimension of taxing multi-jurisdiction entities.

A detailed study on every topic that falls under the tax administration umbrella is beyond the scope of this paper. Moreover, it is unnecessary. The purpose of this paper is to highlight:

1. Lessons learnt from international practice and trends that can be adapted to PNG.
2. Aspects of the current PNG tax administration system that is undergoing reform.
3. Areas for possible reform.

The writer considers that a tax regime that is low-rate, comprehensive, and with minimum incentives and structural inequities will lead to a tax system that is easier to administer.

This paradigm follows the trend in most Organisation for Economic Co-operation and Development (OECD) countries and PNG's main trading partners such as Australia to move towards the Haig-Simons comprehensive tax base that includes realised capital gains and even rates across all entities. Incentives and all personal deductions are removed. Professor Chris Ohmsø chapters in this publication deal with a conceptual framework for this overall reform within the context of an economic model that promotes a competitive market supported by a Government structure to provide public goods and assistance when necessary such as social welfare.

This paper may be read as part of an overall package and with papers relating to the tax base and tax rates and tax incentives which are also part of the research of the National Research Institute of Papua New Guinea. No analysis on these topics is undertaken in this paper. Hence, the analysis of tax administration issues specific to PNG are based on core tax laws as they stand.

The paper follows the expected flow of activity in any tax authority: from the setup of the revenue authority to tax assessments, Commissioner's investigation powers, and solving tax disputes.

2. CORPORATE STRUCTURE AND RESOURCING ISSUES

The most fundamental aspect of tax administration is arguably in relation to the corporate structure and resourcing of a tax authority. It is trite to say that the better resourced a tax authority is, the more it is able to do in terms of tax administration.

This scoping paper does not include a full examination of the appropriateness of the resources available to the PNG Internal Revenue Commission (IRC). However, any analysis of the effectiveness of IRC's tax administration capabilities will not be complete without an examination of the funding structures and these should be considered in due course.

Some indications of the IRC's structure and funding is contained in a paper entitled *A Comparative Analysis of Tax Administration in Asia and the Pacific* by Araki & Claus (2014). The authors note that the IRC is not affiliated to the PNG Ministry of Finance and as such has considerable autonomy. An autonomous structure is arguably the best structure for creating an atmosphere where the IRC is able to carry out its statutory functions without undue influence from other sources. The authors note the following benefits from having an autonomous structure:³

- i. A semiautonomous body can be free from political interference in day-to-day operations.
- ii. It can implement human resources policies differently from the Ministry of Finance to recruit and retain motivated and skilled staff members.
- iii. It can implement organisational reforms such as establishing specialised audit functions.
- iv. Its budget arrangements offer more flexibility to invest in information and communication technology (ICT).

A review of IRC's Corporate Plan for 2013 to 2017⁴ shows that as an organisation it is fully cognisant of the important role it plays in enabling social development. It also has a number of exciting initiatives in organisation building. Two key initiatives stand out:

Firstly, IRC aims to have an ICT capability that fully supports IRC's business activities. Specifically, it aims to have appropriate and effective information technology and communication systems.

Tax technological tools are already revolutionising tax administration in developed countries and it is likely that they will play a crucial role in developing countries as well. The writer suggests that a detailed plan should be drawn up as to how tax

³ Ibid, n1, at 7.

⁴ Papua New Guinea Internal Revenue Commission, *Corporate Plan 2013 – 2017* <at http://irc.gov.pg/PDF_files/IRC_CorpPLan2013.pdf>

technology can help overcome barriers that have faced PNG tax administration in the past (such as geographical challenges).

The authors of the ADB report note that IRC spent 23.4% of its total expenditure on ICT activities, which is broadly comparable to the percentages of developed countries in the region. At present a significant proportion of the IRC's ICT budget relates to the introduction of Standard Integrated Government Tax Administration System or SIGTAS. SITGAS runs a range of functions including: taxpayer registration; account management; electronic filing (e-Filing); electronic payments and refunds; case tracking for audit purposes; reporting and so forth.

While significant progress has been made in allowing PNG taxpayers to make tax payments electronically, taxpayers at present cannot electronically file returns. The overall tax compliance benefits from e-filing capabilities have been immense wherever they have been introduced. The Corporate Plan notes that IRC anticipates that this facility will be in place in the near future with the introduction of its new accounting system⁵.

The Corporate Plan also highlights the need to build human resource capabilities and lists a number of credible plans to achieve this. The writer suggests that concurrently another exercise should be undertaken to ascertain whether there is further scope for staff to specialise across different tax types and taxpayer types (such as large enterprises).

The Corporate Plan also states that the IRC uses external benchmarks such as the Pacific Islands Tax Administration Base Line Assessment Framework. The writer understands that this is an initiative run by the International Monetary Fund⁶ that provides a yard stick against which Pacific Island tax administrations can measure their performance and progress. This is an excellent initiative as it provides scope for continual feedback on the performance of IRC.

2.1 IRC Internal Organisation Design

The authors of the ADB report note that the internal design of a tax administration can be modelled broadly on three bases: (i) tax item-based, (ii) function-based, and (iii) taxpayer segment-based. These are explained by the authors in the following terms:⁷

The tax item-based model is the traditional organization design and has an internal organization that is structured along with tax laws to administer. For instance, revenue bodies have a personal income tax division, a corporate income tax division, and a VAT division. The function-based model is where departments and divisions

⁵ Ibid n5, p2

⁶ < <http://www.pftac.org/page/tasectors/revenue/> >

⁷ Ibid, n1, at 14

are structured according to business functions, such as audits, taxpayers' account management, arrears collection, and taxpayer consultation.

The third model, the taxpayer segment-based model, provides a setup where organization units are structured based on taxpayer segments, for example, individual taxpayers, small and medium-sized businesses, and large companies.

The IRC currently is organised solely on a functional basis. This is consistent with international practice as all the countries surveyed used function-based modelling at least. However, IRC does not use tax-item based or taxpayer-segment bases to structure its operations. It is suggested that IRC will not be able to achieve its stated aim of being a modern and rationalised tax administration system without introducing some level of tax-item based and taxpayer-segment based system of organising its activities.

However, some progress appears to be on the horizon. The authors of the ADB report note that IRC has mooted the introduction of a Large Taxpayers office⁸. Taxes from the mining and petroleum sectors are likely to contribute the most to any significant growth in revenue for PNG and the taxpayers involved are relatively large, with complex tax issues. The introduction of a well-resourced and trained Large Taxpayers group will be crucial in ensuring that the appropriate level of taxes is obtained from mining and petroleum activities.

⁸ Ibid, n1, at 16

3. TAX COMPLIANCE MODELS

In an ideal world all taxpayers will be fully tax compliant. In other words, the following aspects would be present:

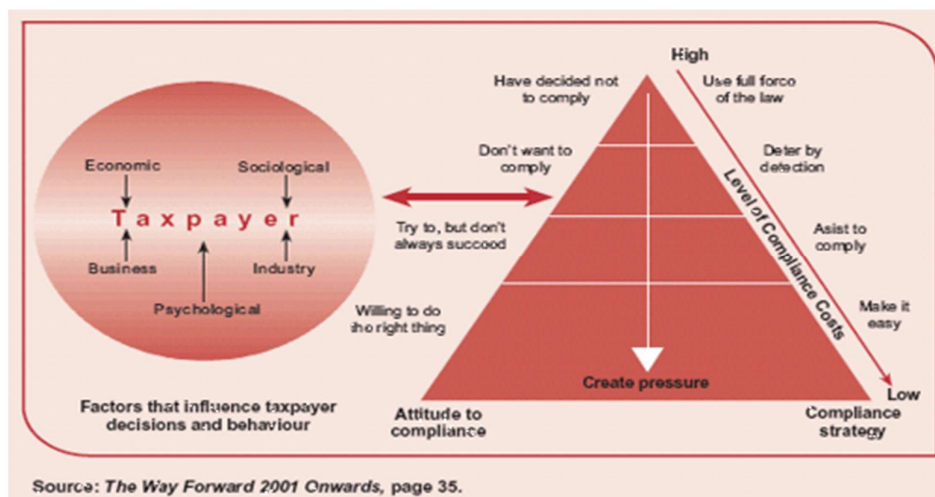
1. Register in the tax system,
2. Collect data and store electronically,
3. Participate fully in their statutory tax reporting requirements (returns are completed and filed),
4. The amounts returned are in accordance with tax laws,
5. The returns are filed on time,
6. Any amounts due are paid on time, and
7. Full participation in any post-assessment activities by the Commissioner (tax audits).

The reality is that every jurisdiction will have non-compliant taxpayers on a spectrum of non-compliant behaviour. With limited resources, a tax authority must decide where to employ its resources such that it gets maximum return for the resources expended. A tax compliance model is a critical component of any tax authority's compliance strategy. The tax compliance models currently used in Australia and New Zealand are derived from the wider body of work done by Ayres and Braithwaite (1992) in relation to regulatory risk differentiation and are encapsulated in a Compliance Triangle framework (CTF), see Figure 1 below.

3.1 Disengagement

Starting at the top of the CTF, the posture of 'disengagement' describes a taxpayer who is both resistant to complying with the tax system and who feels a sense of hopelessness. The state of disengagement is accompanied by non-responsiveness and the tax system is viewed as something to be avoided at all cost and any demands for compliance should be dealt with in a minimalist fashion (Braithwaite & Braithwaite, 2001).

Figure 1: Taxpayer Compliance Model



The reader will notice the CTF is divided into four sections of the pyramid (Figure 1).

3.2 Resistance

The second highest level on the CTF is the posture of resistance. This describes taxpayers who have a confrontational approach to the taxing authority and who regard the tax system as oppressive and burdensome, inflexible, and unforgiving.⁹ Braithwaite and Braithwaite (2001) suggest that within this group: Tax officers are likely to be construed as unhelpful, incompetent, mistrustful, and unwilling to consult with taxpayers.¹⁰

Both these postures are termed non-compliant.

3.3 Capture

The second to lowest posture on the CTF is capture which is similar to accommodation but with the taxpayer adopting a more laissez faire approach. This posture is associated with the expectation that trust and cooperation will prevail.

⁹ *Ibid.*

¹⁰ Braithwaite and Braithwaite conclude (incorrectly in our opinion) that the posture of disengagement is different from that of resistance in the fact that the resistor has a desire to be respected by the authorities whereas the disengaged does not.

3.4 Accommodation

Working now from the base of the CTF, the lowest posture is 'accommodation', which describes a taxpayer who is 'willing to do the right thing'. Such a taxpayer will display an explicit commitment to support the system, accept responsibility for compliance, and manage their compliance obligations. The postures of accommodation and capture are termed 'compliant' postures.

3.5 Compliance strategies

Associated with the 'model' of taxpayer compliance behaviour represented by the four postures are the corresponding compliance strategies to be adopted. The overall theme is to create downward pressure from the top of the CTF to the bottom with the highest pressure at the top and the lowest at the bottom. This makes sense in that top of the CTF represents the 'worst' compliance behaviour while that at the base is the 'best'. There are four micro-compliance strategies that associate with each posture. Briefly, these are 'making it easy' for taxpayers at the bottom of the CTF and who are accommodative. Next for those taxpayers who are captured, the strategy is to assist them to comply. For the third level of taxpayers, those who are resistant, the strategy involves deterrence by detection (audit). For those at the top who are disengaged, it is recommended that the full force of the law is used to achieve compliance.

3.6 Criticisms of CTF

Current research by Ohms (2014a,b) shows that the CTF is flawed in that it fails to recognise:

1. The compliance 'process' is a system involving the steps of registration, recording, return filing, assessment, collection, post-audit, and disputes. A single two dimensional model basically amalgamates different statutory steps into one. This is hardly correct; given that each step has a different form, shape, and set of jurisprudence.
2. The compliance process involves both the compliance population and the compliance authority: the CTF assumes the compliance authority operates 'perfectly' and has no compliance obligations. This is fallacious.
3. The CTF ignores the fact the scheme of, say, the Australian tax legislation requires that assessment takes place at an individual level. It is against the scheme and purpose of the legislation to 'lump' taxpayers into one amorphous group.

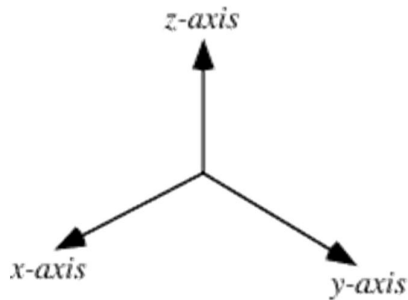
Ohms suggest that in fact a three dimensional model is appropriate. The model (which is the subject of a continuing work) takes the steps seen in a typical tax administration cycle (such as the PNG Income Tax Act 1959 (ITA59)):

1. Registration
2. Recording financial transactions for an income year
3. Classifying transactions
4. Undertaking return/self-assessment

5. Payment of tax liability
6. Resolution.
7. Participation in post-assessment activity such as audit and disputes.

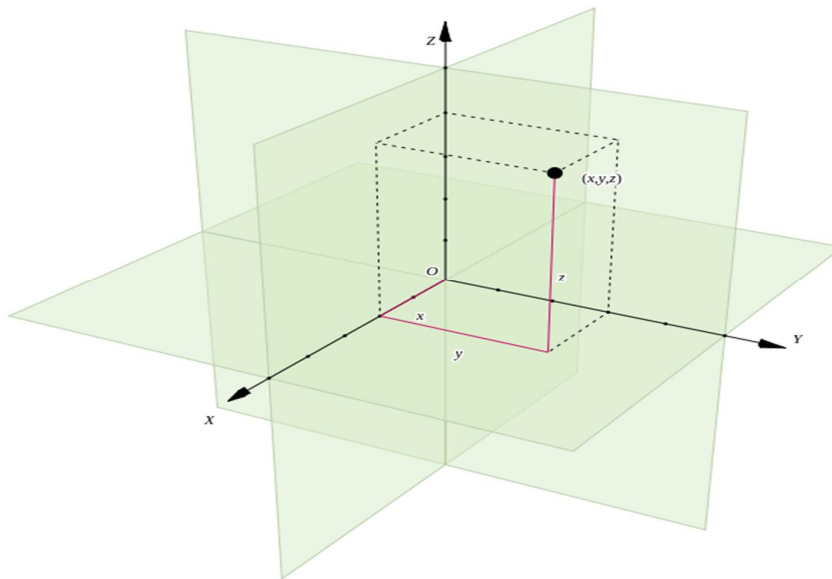
It then recognises that the scheme of the ITA59 and similar legislation adopts a yearly assessment cycle. This is denoted as P0 ó P365 in the first simple representation and plotted along a Cartesian plane as the Y axis in Figure 2. Taxpayer compliance (measured as a monetary value) is plotted along the Z axis while tax authority compliance is plotted along the X axis as follows:

Figure 2: Typical Tax Administration Cycle

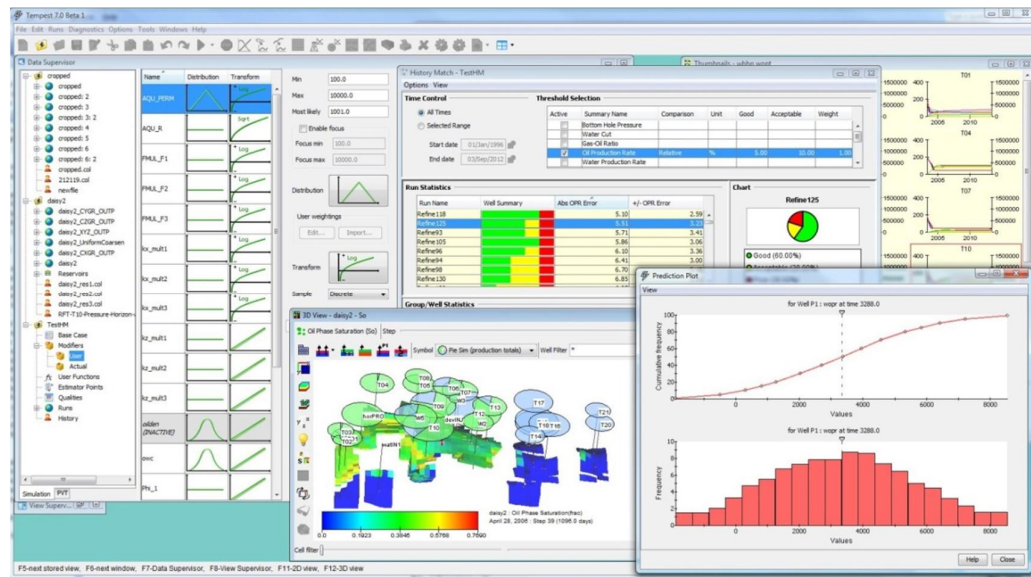


Ultimately, this scheme will be developed to include transfer payments such as benefits for the single taxpayer entity, as illustrated in Figures 3 and 4 below:

Figure 3: Compliance matrix table



An IT system will then provide a dashboard view and dataset for each taxpayer and taxpayer groups and the entire taxpayer population, as illustrated in Figure 4 below:

Figure 4: Compliance Dashboard

3.7 The Netherlands Approach

Another somewhat revolutionary tax administration change has been taking in in the Netherlands and is gaining attention worldwide. It represents a move away from the traditional *vertical* monitoring, which involves retrospective auditing of tax positions of taxpayers. The new approach involves *horizontal* monitoring whereby taxpaying entities with strong tax control mechanisms are in effect able to enter into an *agreement* with the Dutch tax authority in relation to future tax positions.

The Dutch approach has its genesis in the rumblings in the corporate governance world after the collapses of giants such as Enron, which in turn led to the spectacular collapse of Arthur Anderson. A significant reason for these collapses was the failings in the internal and external control systems of the corporations that were affected. The enactment of legislation known as The Sarbanes-Oxley Act of 2002 was felt necessary to restore confidence in large businesses and the professional services firms.¹¹ The Act imposes stringent internal control reporting requirements on the boards of corporations listed in the United States. The Netherlands adopted its own version in the form of the Netherlands Corporate Governance Code. While full compliance is not absolutely necessary, the Code does impose an obligation on the management of affected entities to issue an *in control statement* outlining the extent to which its internal control systems lead to compliance with the Code.

Tax obligations are a significant aspect of the overall compliance by a corporation. The Netherlands *vertical* monitoring scheme latches on to the work that must be

¹¹ (Pub.L. 1076204, 116 Stat. 745, enacted July 30, 2002)

done by Netherlands corporations in issuing their financial control statements. The basic idea is that since these entities would need to set up effective internal controls for tax issues (Tax Control Framework (TCF)), the Dutch tax authority may as well become involved at an early stage and review the tax controls¹². If the internal tax controls are robust, then it is highly likely that tax positions taken from the internal controls will be compliant with tax laws.

The TCF mechanism is premised on a significant degree of trust and transparency between the corporations covered by the TCF and the Netherlands tax authority. It provides for a mutually beneficial situation for both parties.

For corporations participating in the TCF, the following advantages generally apply (CHMTCA, 2012):¹³

- a. Greater certainty
- b. Less audit activity
- c. Room for disagreement
- d. Previous-year issues are resolved in a more timely manner

a. Greater certainty

The TCF mechanism works in real time, hence the focus is not so much on what tax issues arose in the past. Instead it focuses on present and future tax issues. This focus facilitates greater transparency between taxpayers and tax authorities and leads to more timely determinations on tax issues from the tax authority. It greatly reduces uncertainty and provides the taxpayer with a fixed point of contact in the tax authority.

b. Less rigorous audits afterwards

Having tested and approved the internal tax controls of a corporation, the tax authority would have a greater confidence in the ongoing compliance. Hence, future audits will be limited.

c. Agree to disagree

The TCF mechanism is not rigid and does allow for corporations and the Dutch tax authority to disagree on certain tax issues. There is provision for further discussion between the parties on contentious issues and the possibility of taking the matter to court if unresolved.

¹² Refer < <http://www.iota-tax.org/iota-news/tax-control-framework-the-netherlands.html>>

¹³Committee Horizontal Monitoring Tax and Customs Administration, Ministry of Finance, The Netherlands at https://www.ifa.nl/Document/Publicaties/Enhanced%20Relationship%20Project/tax_supervision_made_to_measure_tz0151z1fdeng.pdf

d. Speedy resolution of previous year's tax issues

Prior to participating in the TCF, all tax issues relating to the past would need to be resolved. The Dutch tax authority has stated that it will endeavour to do this in a positive atmosphere and very efficiently.

3.8 Lesson for PNG

In the context of PNG, arguably the most significant area of tax activity in the coming years will be in taxing the resources sector. As part of the ongoing work in finalising PNG's resource tax rules and structure, it is recommended a Dutch-style horizontal monitoring system should be considered. The nature of taxing resource extractions is such that complicated timing of income and expenditure issues will be involved and the issues will remain static over a long period of time. Further, it is likely that the issues will be generic across the taxpayers involved in the resources sector. If so, it will be an ideal environment for the implementation of a Dutch-style approach.

As noted above, this approach should not be compulsory for taxpayers and can sit alongside the traditional vertical monitoring approach.

3.9 Technology and social media

No discussion on tax compliance strategies will be complete without discussing the significant changes that have taken place in technology and social media and their ever-growing impact on tax administration. For many tax authorities in the developed world, this has often meant adopting new opportunities to relatively old tax administration strategies. Such change has often posed significant challenges; especially in relation to secrecy legislation that was written well before the advent of the technological era. But for a country like PNG embarking on an ambitious and exciting plan to enhance its tax administration capabilities, there is the opportunity to incorporate technology and social media in a seamless way.

As the PNG economy grows and more of its population participates fully economically, technological and social media tools will play a crucial and cost effective role for the IRC in engaging with taxpayers. As discussed earlier, resourcing of tax authorities is often limited and always there is an expectation of a certain return (in terms of tax collected). Increasingly a greater proportion of resources will need to be invested in technology infrastructure; hence it is likely that there will be a requirement to move away from the existing investigation heavy, costly approach toward a less resource-intensive approach that is also less confrontational in nature. The introduction of technology and social media in a tax administration context will not be without challenges. As the OECD notes:¹⁴

¹⁴ OECD (Organization for Economic Co-operation and Development). 2011. Information Note: *Social Media Technologies and Tax Administration*, Forum on Tax Administration.

As with any new technology, there are challenges and risks to be taken into account. However, these appear manageable within the framework of properly considered and coordinated strategies; and given the relatively low costs and barriers to entry, there would seem to be a convincing business case for the deployment of social media technologies as a new communication tool with exciting possibilities.

4. TAX ASSESSMENTS AND RETURN FILING: SIGTAS

IRC has joined a growing number of tax authorities in committing to use the Standard Integrated Government Tax Administration System (SIGTAS); and work is currently underway in the rollout, led by Adam Smith International. The sheer number of countries that have adopted SIGTAs indicates that it has widespread acceptance in developing countries.

However, it should be noted that SIGTAS is not a customised product and as such is somewhat generic in nature. It is assumed that the suitability of SIGTAS to PNG has been fully considered as part of the procurement process. The scope of this paper does not extend to conducting a detailed review of SIGTAS capabilities and its implementation in PNG so far. Proper implementation will of course be key to getting maximum value from SIGTAS.

SIGTAS has been used by the Tax Administration of Kosovo since 2001 and a review was conducted by the Kosovo Office of Auditor General (OAG) into the effectiveness of SIGTAS. In its report¹⁵ the OAG noted the following shortcomings:

Significant shortcomings related to the SIGTAS design are:

- É Shortcomings in the management of information in the system; and
- É Lack of information update related to several activities developed in the system.

Significant issues regarding the use of SIGTAS are:

- É Delay in applying the use of system modules;
- É Incomplete reporting and incorrect information from the system;
- É Lack of interface between the activities within the system;
- É Delays in the processing of information in the system; and
- É Lack of system information reconciliation with [another tool] used by [the Tax Administration of Kosovo].

The writer stresses that he is not an expert in the mechanics of SIGTAS and does recognise that the version of SIGTAS used today is likely to be different from that initiated by Kosovo in 2001. The point being stressed here is that the SIGTAS roll out is critical to the success of IRC in the long term and all efforts should be undertaken to ensure that any shortcomings are minimised.

The New Zealand lesson is another good one to note. The FIRST system used by the New Zealand Inland Revenue Department is now very much out-dated and in need of replacement. The options now being considered involve costs of up to \$1.5 billion (NZD). One of the structural issues with FIRST was its very limited ability to adapt

¹⁵ Office of the Auditor General Kosovo, *Audit Report: Effectiveness of Standard Integrated Government Tax Administration System (SIGTAS)* at < http://oag-rks.org/repository/docs/RaportiAuditimit_SIGTAS_2012_Eng_705585.pdf>

to new requirements (such as social policy initiatives administered by Inland Revenue). Since the new system will be a completely different product there is likely to be a logistical and expensive migration issue from FIRST to the new system. In respect of SIGTAS, it is unclear whether modules can be changed and added to suit the needs of the particular revenue authority using it.

4.1 Self-assessment and voluntary disclosure

The IRC Corporate Plan states that one of its objectives is to position the IRC for taxpayer self-assessment and voluntary disclosure.¹⁶ In order for self-assessment to function effectively, taxpayers should be tax literate and/or have cost effective access to tax advisors. At present neither appears to be the case in PNG to a significant degree. Hence it will be imperative to carry out taxpayer education on at least tax basics as part of the roll out of self-assessment.

With the model proposed by Ohms, self-assessment would be done in real-time, with the individual taxpayer unit having the same screen as the taxing authority as regards ongoing compliance. This would be encrypted in a unique card carried by the taxpayer.

¹⁶ Ibid n5, at p9

5. TAX INVESTIGATIONS AND COMMISSIONER'S POWERS

Another important aspect of tax administration relates to the Commissioner's ability to conduct tax audits and the Commissioner's rights and duties during this process. Specialist tax controversy teams are now common in large tax practices in professional services and law firms that are trained to critically examine the Commissioner's actions in an audit. It is likely that the tax advice industry in PNG will also take this path (if not happening already). As such, there is greater scrutiny of the Commissioner's powers and actions. This necessitates the enactment of clear rules and regulations governing the ambit of these powers and ensuring that field staff are adequately trained.

There are numerous aspects of investigations and Commissioner's powers that will need to be considered. In particular the following need to be considered:

- É Audit methodology
- É Information gathering powers ó timelines for requests
- É Right to withhold refunds
- É Search and seizure powers

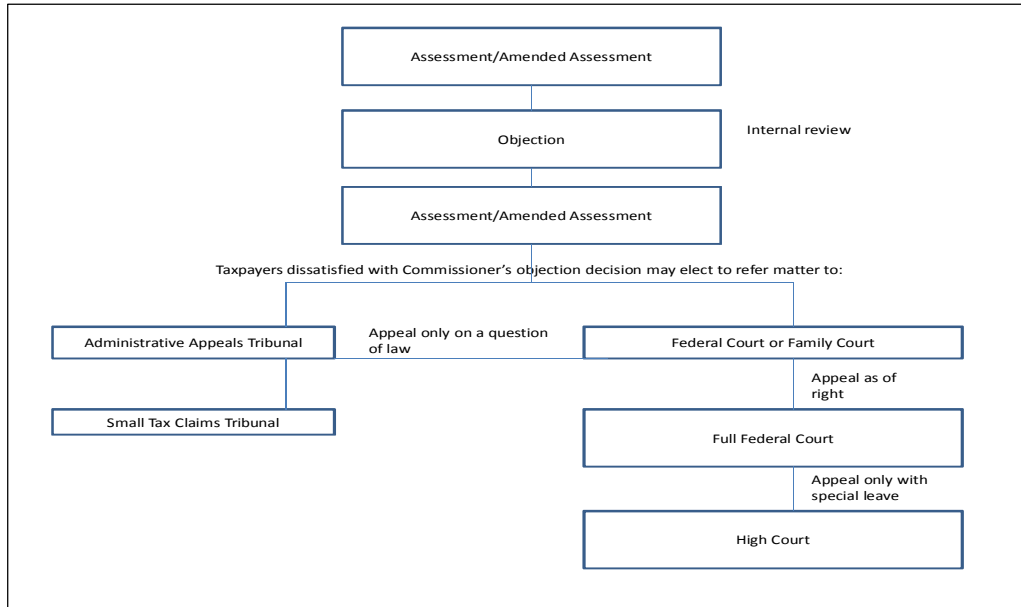
As the authors of the ADB report note, the PNG tax legislation does give the Commissioner powers in relation to most areas of compliance activity and information gathering. Most are contained in the Income Tax Regulation 1959. However, information gathering powers do not extend to third parties, which should be amended in line with international practices.

The writer is also of the view that the current legislation covering taxpayers rights and the Commissioner's powers need to be reviewed urgently and preferably codified in a separate Tax Administration Act. As the complexity of tax issues increases, it is likely that PNG taxpayers (especially larger ones) will test the ambit of tax administration legislation. It appears that tax administration legislation has been introduced in PNG on an ad hoc basis and no comprehensive study has been done to study the effectiveness of the laws/regulations. A comprehensive tax administration review should be the first step in the modernisation.

6. TAX DISPUTES

If, after the investigation stage, problems are found, the next stage is to proceed to the disputes stage. The PNG tax legislation contains an objections system that is similar to the Australian system.

Figure 5: Income Tax Dispute Resolution Model (based on Chapple, 1999:315)



The Australian income tax disputes resolution system starts from the initial self-assessment undertaken by the taxpayer under s166A Income Tax Assessment Act 1936 (Cth Aust).¹⁷ The deemed assessment is then subject to post-assessment checking and audit. The Federal Commissioner of Taxation¹⁸ may then issue an amended assessment under s170 ITA36 or objection s175A if a difference arises between the initial self-assessed taxable or net income and tax payable. The taxpayer then has the right to issue a Notice of Objection pursuant to s14ZU of the Tax Administration Act 1953 (Cth Aust).¹⁹ The FCT then is required to consider the objection and issue an Objection Decision (s14ZY TAA53). If the taxpayer is not satisfied with the outcome, the matter may be referred to the Administrative Appeals Tribunal²⁰ or the Federal Court as appropriate (s14ZZ TAA53). These steps are outlined in Figure 5 below.

¹⁷ Herein ITA36. Note difference between self-assessment and full self-assessment

¹⁸ Herein FCT

¹⁹ Herein TAA53

²⁰ Herein AAT

6.1 Assessment

Under the Australian self-assessment system there are two classes of taxpayers. The first are those taxpayers subject to withholding tax such as 'pay as you go'.²¹ These taxpayers are not subject to full self-assessment in that there is no deemed assessment on the filing of their income tax return.²² However, the FCT does not check the application of the law before issuing a notice of assessment; and returns are only examined to ensure they are suitable for computer input and are coded to enable the correct calculation of tax and the balance payable or refundable.²³

The second group of taxpayers is termed 'full self-assessment' taxpayers and includes companies, superannuation funds, approved deposit funds, and public trading trusts and unit trusts.²⁴ Section 166A(3) ITA36 deems an assessment to be made by the FCT in respect of returns lodged by full self-assessment taxpayers. It provides that if a taxpayer gives a return in respect of an income tax year for which the taxpayer is a full self-assessment taxpayer (and no previous return has been given nor assessment made), the FCT is taken to have made an assessment of the taxable income or net income and the tax payable on that income equal to those respective amounts specified in the return. The assessment is taken to have been made on the day on which the return is lodged and the return is taken to be a notice of assessment under the hand of the FCT, served on that day. The same situation applies to the deemed assessment of instalment taxpayers.²⁵

Despite the apparent distinction between self-assessment taxpayers and 'full' self-assessment taxpayers there is no real difference in practice. As noted by Deputy President RK Todd in *Case V10*²⁶:

In the past taxpayers have been able to include imaginative if not bizarre claims in their taxation returns ... knowing that, at worst, the claims could be expected to be rejected at the time of assessment. Pursuant to self-assessment provisions, however, the assessments that issue will not be final, and in a number of years' time the taxpayer may be subjected to an audit following which, if the claims are disallowed, the taxpayer will be presented with penalties for late payment.

Certain 'instalment' taxpayers²⁷ ó those who are small to medium taxpayers and who are basically not subject to withholding tax but instead pay instalment tax ó are also deemed to undertake self-assessment.²⁸

²¹ <http://selfassessment.treasury.gov.au/content/discussion/05Chapter1.asp>

²² <http://selfassessment.treasury.gov.au/content/discussion/05Chapter1.asp>

²³ AFTR 79-550

²⁴ See s6(1) ITA36 and Div 1B s166A

²⁵ Div 1c

²⁶ Case V10, 88 ATC 154 at p 156.

6.2 Post self-assessment audit and reassessment

Under the self-assessment system the clear emphasis of the FCT is now on post-assessment audit and checking.²⁹ Under the self-assessment system the FCT will accept or is deemed to accept the taxpayer's calculations as presented in their income tax return. The distinction between the former FCT assessment and self-assessment has been described in these terms:³⁰

The old administrative assessment system requires the Commissioner, from returns lodged and any other information in the Commissioner's possession, to make an assessment of the amount of a taxpayer's taxable income and tax payable thereon [s 166 ITA36]. When this process is complete a formal notice of assessment is served on the taxpayer. In contrast, under the self-assessment system, the Commissioner initially accepts a taxpayer's own calculations in order to determine the taxpayer's liability to tax.

It is beyond the scope of this paper to describe in any depth the audit program that is undertaken by the Taxpayer Audit Group within the ATO. All that need be said at this juncture is that post-assessment audit and checking *together* with the power of the FCT to amend assessments that are inaccurate is a lynchpin of the self-assessment/disputes resolution system in Australia. As noted by one commentary:³¹

Amendment of assessments is particularly important because of the self-assessment system. Under this system, taxpayer's returns are not checked to the same degree before the assessment is issued so if the return is inaccurate, any necessary correction is more likely made by amendment to

The Federal Commissioner of Taxation³² may then issue an amended assessment under s170 ITA36 if a difference arises between the initial self-assessed taxable or net income and tax payable.

6.3 Notice of objection

Part IVC TAA53³³ establishes the statutory disputes procedure for a taxpayer to follow once an amended assessment (or assessment) is made by the FCT and the taxpayer wishes to dispute that new assessment. The next step in the Australian disputes resolution process is the issuance of the Notice of Objection pursuant to

²⁷ Simply put, those taxpayers other than wage and salary earners and retirees and so forth.

²⁸ See s6(1) ITA36 Act and Div 1C s 166A

²⁹ AFTR 79-550

³⁰ AFTR 79-550

³¹ AITR 10-535

³² Herein FCT

³³ TAA53 part IVC (ss14ZL to 14ZZS)

s14ZW. Section 14ZQ sets out what is meant by a taxation decision that can be objected to.³⁴ Section 14ZU TAA53 governs the form of the notice. Under s14ZU a taxation objection is made by a taxpayer lodging it with the FCT in the approved form, within the time period set out in s14ZW TAA53³⁵ and most importantly stating the grounds upon which the taxpayer relies fully and in detail.³⁶

6.3.1 Objection notice

Under s14ZY the FCT on receipt of a taxation objection must make a decision on the objection and notify the taxpayer of the decision in writing; although there is no time limit that is specified. The decision by the FCT is called the objection decision.

6.3.2 Taxpayer's right to appeal objection decision.

If dissatisfied with the objection decision, the taxpayer may elect to refer the matter to the Administrative Appeals Tribunal in the case of a reviewable decision or to the Federal Court if it is a question of law under s14ZZ.

6.4 Contrast with the New Zealand System

This is to be contrasted with the New Zealand system which is a classic system of what not to do. Its dispute resolution system is contained in Part 4A of the Tax Administration Act 1994. If, upon the completion of the audit, the Commissioner's delegated officers do not agree with the taxpayer's position, the delegated officers must enter into a protracted dispute resolution system. It is a multi-layered system consisting of a number of steps. The dispute process can also be initiated by taxpayers if they wish to dispute a fiscal decision by the Commissioner (although the vast majority of disputes are initiated by the Commissioner).

The steps involved are:

- É Issuing of a Notice of Proposed Adjustment by the party initiating the dispute.
- É A Notice of Response to be issued by the other party.
- É Followed by a conference stage at which the parties attempt a resolution of issues.
- É If the matter is unresolved Statements of Position are prepared by the parties. Evidence disclosure rule applies after this point (i.e. no further evidence can be produced in respect of the matter). However, in practice, this rule does not sit

³⁴ S14ZQ **taxation decision** means the assessment, determination, notice or decision against which a taxation objection may be, or has been made.

³⁵ Under s170(2) &(3) from the income year ending 30 June 2005 the FCT has a two year time limit for amending assessments in respect of most individual taxpayers and those who conduct a small business. For those taxpayers with more complex affairs the time limit is four years: s170(4). If the FCT is of the opinion that fraud or evasion is involved there is no time limit: s170(5). Finally the FCT may amend an assessment at any time to give effect to a decision of the Administration Appeals Tribunal or a court: s170(6)(a)-(b).

³⁶ S14ZU TAA53

well conceptually with discovery rules that apply in any litigation that may follow.

É The matter is referred to the Adjudications Unit of Inland Revenue. Designed as a totally independent unit but only decides matters on documentary evidence. Therefore the decisions reached are not based on any testimonial evidence that may be pertinent to the matter. The Adjudication decision represents the Commissioner's final decision on the matter.

In the past a number of criticisms have been levelled at this system. The main criticism is that the disputes system is a costly one for taxpayers.

If a taxpayer prevails at the Adjudication level, the Commissioner will not take the matter to the courts. As a matter of practice, the Adjudicator's view represents the Commissioner's final view on the matter. And if the Adjudicator has decided that it agrees with the taxpayer's arguments, which will generally be the end of the matter.

However, if the taxpayer does not succeed with its arguments at the Adjudication level (after having spent considerable sums during the process), the taxpayer then has to go through another costly procedure – litigation. This "double whammy" often means that taxpayers with good cases concede unless the tax sums involved are significant.

Justice Susan Glazebrook of the New Zealand Supreme Court (and a tax specialist lawyer prior to her promotion to the bench) gave an excellent critique of the New Zealand tax disputes system in 2013. Her Honour noted in her conclusion:³⁷

While there are aspects [of the tax disputes system] that operate well, I have argued that certain aspects of the dispute resolution process may prevent worthy cases from being brought before the courts. This not only threatens justice being achieved in the particular situation, but also may impede the development of taxation law, with obvious implications for the rule of law [writer's emphasis].

³⁷Justice Susan Glazebrook, *Tax Disputes in New Zealand*, Australasian Tax Teachers Association (ATTA) Conference (22 January 2013) at p. 24

7. TAX ADMINISTRATION REFORMS CURRENTLY UNDERWAY IN PNG

The IRC Corporate Plan contains a number of objectives aimed at achieving a world class tax administration status. In terms of achieving its objective of being able to administer taxes and collect revenue, the following objectives have been set³⁸:

- É All types of returns and other lodgements are efficiently processed in a timely manner
- É All taxpayers are fairly assessed with the legally correct amount of tax payable
- É Non-compliant returns, withholding statements, and reconciliations are promptly identified
- É Overpaid taxes are promptly processed and refunded
- É Non-payment of tax liabilities are promptly followed up, debt recovery is enforced, and aged debts are minimised.
- É Well researched and professionally presented advice on all aspects of taxation is provided to internal stakeholders and taxpayers alike
- É Operational files are well managed throughout their life-cycle.
- É Taxpayer ledger accounts are up to date
- É Tax Agents are provided with efficient services
- É IRC Regional Offices are well managed and productive
- É Objections are quickly resolved and in accordance with the law
- É Revenue transfers are regularly made in accordance with Department of Finance and Provincial Administration expectations
- É Revenue analysis is regularly conducted and reports are distributed to internal and external stakeholders on a timely basis

The following apply to the stated objective of improving compliance:

- É Taxpayer compliance is increased through better structured and targeted taxpayer education and awareness activities.
- É An Annual Audit Plan is developed and implemented supported by an audit quality assurance program.

³⁸ Ibid n5, at p9

- É A Tax help-desk and contact centre is established for all taxpayer enquiries to improve communication with taxpayers.
- É The Commissioner General has been granted additional enforcement and debt recovery powers.
- É Improved compliance enforcement strategies are developed and implemented.
- É Taxpayer satisfaction surveys are conducted.
- É IRC shopfronts are established to better provide personal tax administration services to taxpayers.

Objectives have to be realistic to be achievable and the writer is of the view that the IRC has set itself a realistic set of objectives. The objectives and action steps show that a steady path of growth has been set that is both practical and achievable.

8. CONCLUSION

The PNG tax administration is undergoing a phase of advancement. Based on the material reviewed, it appears that at this stage much of the work is going towards establishing the basic tax administration infrastructure (such as legislation and technology). Tax administration is a very wide subject that has numerous facets. At this stage, it appears that the work being done is sufficient to establish the infrastructure and is being done in a coherent manner. The next phase would be to get the micro aspects in place (i.e. the numerous components that together make up the tax administration framework).

In the short term, the following matters should be attended to:

1. It is difficult to envisage a modern tax administration system for PNG that does not include a tax compliance strategy. Tax compliance strategies have been used with considerable success in, among other countries, Australia and New Zealand to focus tax compliance activities to where they are needed the most. With the total resources available to the IRC being limited, an effective tax compliance strategy will go a long way to ensuring that the PNG Treasury gets the maximum return for every dollar that it puts into the IRC. While the Braithwaite model has been used in Australia and New Zealand in the past, the writer is of the view that a modern compliance strategy is available for use based on the work done by Professor Chris Ohms.
2. Urgent overhaul of the tax administration legislation to modernise and streamline the administration of tax in Papua New Guinea. As the complexity of tax issues in PNG increases, it is likely that taxpayers will test the ambits of tax administration laws and regulations. Existing laws/ regulations are simplistic in places and inadequate. All tax administration legislation should be codified in a separate Tax Administration Act.
3. Ongoing and regular reviews of the tax administration modernisation process.
4. Regular monitoring of the SIGTAS implementation process to ensure it meets expectations for the medium to long term.
5. As part of SIGTAS implementation, build e-filing capabilities.
6. Consider the introduction of a Netherlands style horizontal monitoring approach in relation to large mining companies.

REFERENCES

Books and Journal Articles

Araki, Satoru and Iris Claus, *A Comparative Analysis of Tax Administration*, Asian Development Bank, Manila City, 2014

Ayres, Ian and John Braithwaite (1992) *Responsive Regulation: Transcending the Deregulation Debate* [New York] Oxford University Press

Braithwaite, Valerie., and John Braithwaite, 2001. *An evolving compliance model for tax enforcement in Shover, Neal and John Paul Wright (eds.), Crimes of Privilege: Readings in White Collar Crime.* Oxford University Press, New York

Chapple, S, 1999, 'Income tax resolution: Can we learn from other jurisdictions?', *Journal of Australian Taxation*, Volume 2, No 5.

Committee Horizontal Monitoring Tax and Customs Administration, 2012, *Tax Supervision – Made to Measure.* Ministry of Finance, The Netherlands, June

Justice Susan Glazebrook, *Tax Disputes in New Zealand*, Australasian Tax Teachers Association (ATTA) Conference (22 January 2013)

New Zealand Inland Revenue, 2001, *Inland Revenue Business Plan: The Way Forward 2001 Onwards*, Inland Revenue Te Tari Taake, Wellington.

Ohms, Chris, 2014a, *The role of “other taxes” within an economy based on a competitive economic paradigm or “free market” philosophy.* Paper presented at the National Taxation Research and Review Symposium, 29 ó 30 May, 2014, Port Moresby.

Ohms, Chris, 2014b, *The Application of the Comprehensive Tax Base Paradigm in the new Millennium: The Case for a Capital Gains Tax and Base Broadening.* Paper presented at the National Taxation Research and Review Symposium, 29 ó 30 May, 2014, Port Moresby.

Ohms, Chris, 2014c, *The Application of the Comprehensive Tax Base Paradigm in the New Millennium: The Role of Incentives.* Paper presented at the National Taxation Research and Review Symposium, 29 ó 30 May, 2014, Port Moresby.

Websites

<<http://www.oecd.org/site/ctpfta/abouttheforum.htm>>

< <http://www.pftac.org/page/tasectors/revenue/>>

<http://irc.gov.pg/PDF_files/IRC_CorpPLan2013.pdf>

<<http://selfassessment.treasury.gov.au/content/discussion/05Chapter1.asp>>

<https://www.ifa.nl/Document/Publicaties/Enhanced%20Relationship%20Project/tax_supervision_made_to_measure_tz0151z1fdeng.pdf>

< <http://www.pftac.org/page/tasectors/revenue/>>

<http://oagrks.org/repository/docs/RaportiAuditimit_SIGTAS_2012_Eng_705585.pdf>

<<http://vab.anu.edu.au/pubs/1/anevolvingcopliance.pdf>>

< <http://www.iota-tax.org/iota-news/tax-control-framework-the-netherlands.html>>

Comments for the PNG Taxation and Research and Review Symposium³⁹

Port Moresby 29-30 May

Chris Evans⁴⁰

Any discussion of tax administration needs to commence with a very obvious point: a good tax system will only exist where good tax policy is matched by good tax administration. Tax administration matters ó and it matters a lot. If that aspect of the tax system is not correctly in place, it is unlikely that the tax system will operate either effectively or efficiently. Tax administration matters, not simply because it generates revenue but because it also constitutes one of the major interfaces between states and their citizens and is thus a key element in constructing and sustaining a viable governance system in any country.

Moreover, tax administrations reflect and are shaped by the ðcultureø and environment in which they function. How a tax administration works is influenced both by history (path-dependence) and its current environment (context-specificity). Attempts to reform tax administrations must be sensitive to a wide variety of environmental and cultural conditions.

It is not hard to lay down a series of ðgood principlesø for ðgoodø revenue administration on the basis of either theory or international bench-marking exercises.⁴¹ Nor is it difficult to identify those features of any actual tax administration that may differ from the standards thus set. However, it may be much more difficult to get to ðthereø from ðhereø than experts, international agencies, or politicians are prone to think. Indeed, in some circumstances major tax administration reform may not even be possible in the absence of major political, social, and economic changes.

In summary, how well a tax administration works is no small matter. Nor is reforming it simply a matter of doing ðrightø that which is now done ðwrong.ø However, this does not mean that much cannot be done to improve tax administrations in most countries without inducing major national trauma. On the contrary, much can be done, provided it is done properly given the circumstances prevailing in the country concerned.

³⁹ Note: these comments are based on the version of the scoping paper ðA Modern and Rational Tax Administration System for Papua New Guineaø submitted to the National Research Institute by Roneil Vijay Prasad and received by me on 18 May 2014, and may not reflect the content of later versions of that paper.

⁴⁰ Professor of Taxation, School of Taxation and Business Law, Australian School of Business, University of New South Wales, Australia.

⁴¹ For a good example of the many benchmarks that can be used to assess the efficiency and effectiveness of tax administrations, see Satoru Araki and Iris Claus, ðA comparative analysis of tax administration in Asia and the Pacificö, Asian Development Bank, 2014.

Significant changes have taken place in the way that taxes are administered over recent years. Most notably there have been major changes in the ways that revenue authorities have been organised and the manner in which they have approached the tasks of administering the law and collecting the tax revenue that is properly due – extracting the maximum amount of feathers [from taxpayers] with the minimum amount of hissing.

Major trends in this sphere have included:

- É the modernisation and professionalization of tax administrations, promoting increased flexibility in human resource organisation and pay scales with greater emphasis on externally validated merit based performance targets;
- É the introduction of autonomous and semi-autonomous structures whereby tax administrations operate independently, or more independently, of their political masters;
- É the growth of the internal organisation of revenue authorities by reference to market segments (eg, Large Taxpayer Units) rather than solely by reference to the type of tax being collected or the function being performed by revenue officers;
- É an increased reliance on self-assessment as opposed to official assessment;
- É far greater use of technology in all aspects of revenue administration work; and
- É above all, a shift away from a command and control regulatory frameworks reliant on penalties and enforcement to ensure compliance to a risk management approach designed to foster voluntary compliance – making it easy for those who wish to comply and providing plausible and effective deterrence to those who do not.

The scoping paper by Roneil Vijay Prasad covers some, though not all, of these points in the context of the operation of the Inland Revenue Commission in Papua New Guinea. It represents a sound start, although clearly a work in progress at this stage. It will be very important for the paper, as it develops, to recognise the path dependence and context specificity of developments in Papua New Guinea's tax administration. In particular, the notion of introducing ideas from abroad – such as the Netherlands' horizontal monitoring – may look superficially appealing. On closer examination, however, such a cultural transplant, and particularly one from a country with a very different culture and at a very different stage of development, may not be appropriate for a country such as Papua New Guinea.

Chris Evans

4 June 2014