ExxonMobil
PNG Taxation Review (2013-2015)
Issues Paper # 3

Principles for Good Tax Policy

Question 1.1 – do stakeholders agree that the principles identified in this Chapter should help to guide PNG's tax reform process? In the PNG context, are some principles more important than others?

The paper identifies five broad principles for the design and administration of good tax policy, being: the raising of adequate revenue, promotion of economic growth, fairness, simplicity and trust in the tax system and government accountability. All of these aspects are all relevant, but are founded upon an assumption that PNG will draw new international as well as domestic investment going forward. As such an overriding consideration is that PNG's tax system and tax rates should be optimized to allow it to remain an attractive destination for investors. This will support a foundation that keeps PNG's economy strong, generates government revenues to support infrastructure and other socio-economic development programs and creates new jobs.

Optimization requires fair and balanced policies and a stable and reliable tax regime. With an apparent trend for countries to reduce corporate tax rates, it will become important for PNG to similarly reduce rates and imposts to attract its share of global capital. Tax rates and tax incentives should be adjusted to enhance PNG's ongoing global competitiveness, particularly for large-scale projects and high-cost exploration in PNG.

Global competition for capital is intense. A favorable fiscal regime can help reduce investor risk and tip the balance in PNG's favor when companies evaluate exploration and development decisions.

Consideration of the global economic climate is important. In recent times we have seen deterioration in global investor sentiment, with the potential for global financial markets to be hit again by further economic shocks over the next decade. Commodity prices have seen significant price falls recently and their direction remains uncertain. Capital markets are increasingly risk-averse and concerned about projects with a long-term investment outlook due to the perceived increased risk.

PNG has its own set of challenges that, in aggregate, operate as a de facto tax on business and projects. These challenges include poor infrastructure, harsh topography, law-and-order and community concerns, a number of human health risks and exposure to natural disasters. Investors are inevitably forced to compensate for these challenges and risks - which adds substantial cost to project economics.

To be genuinely effective, a holistic review needs to not only consider how much tax can be generated but, perhaps equally as important, the optimal productive use of state revenues in advancing the nation's long-term development aspirations.

How tax reform relates to PNG's development challenges and priorities

Question 3.1 – how can PNG take advantage of this current tax reform process to help it to achieve its development goals and priorities?

All tax systems have two key, interdependent elements. One is the tax regime's structure and technical rules. The other is the institutions governing tax compliance and tax collection.

We consider that the structure of the PNG tax system is broadly sound and not in need of major reform. Benefit can be achieved by allocating increased resources to enhance the IRC's technical, professional and administrative capacity. This should be the primary tax reform objective. Focus should turn to ensuring that non-compliant entities are identified and brought into the system, paying their fair share of tax. In instances where the tax rules are unclear and a source of uncertainty for business, the tax office should seek to assist taxpayers by issuing rulings and other guidance to clarify matters.

The architects of any tax reform program must be acutely aware of the potential risks and unintended outcomes. If the pendulum is skewed to short-term revenue generation – to the detriment of long-term private investment – this could burden the PNG economy for years to come.

Assessment of PNG's tax system: broad directions for reform

Question 4.1 - would stakeholders support a reduction in personal income taxes, particularly for those on lower incomes, if this were paid for through an increase in the GST?

Our view is that the absence of a CGT regime has made the PNG tax system simpler and easier to navigate, with a positive impact on economic activity. On balance, this outcome outweighs the structural weakness in the tax base and perceived inequity resulting from the absence of a comprehensive tax on capital gains. We note that, under existing rules, the disposal of a capital asset may still be subject to tax in PNG – to the extent the disposal takes place as part of a "profit-making scheme" or is part of the ordinary business activities of the taxpayer.

In considering the introduction of a Capital Gains Tax (CGT) regime, various factors should be taken into account. From a taxpayer's standpoint, the desire to make a capital gains involve risk-taking by the investor. Such income can be distinguished from salary and wages – the receipt of which is usually guaranteed by the employer for the duration of the employment. Introduction of a CGT regime will reduce investor incentive to take risks in PNG. This, in turn, reduces investment in new projects and the creation of new jobs and community wealth.

A capital gains tax regime is complex by nature. No CGT regime taxes all gains in all circumstances. From a policy perspective, the question is to what extent capital gains should be taxed and there will inevitably be a border between taxed income and untaxed gains. The introduction of a CGT regime will increase the complexity of the tax system at a time when tax administration appears under-resourced. It will also result in increased administrative costs for taxpayers in meeting their tax obligations.

If a CGT regime is introduced, it should tax only future gains (i.e. gains from the date of introduction) and provide an indexation mechanism, to protect against taxing gains arising purely as a result of inflation. CGT gains and losses usually crystallize on asset disposal. For these reasons, CGT revenues will likely be relatively low in the first five to ten years following introduction.

Consider excluding from the CGT regime the transfer of mining and petroleum rights, so as not to impede the transfer of such assets between potential buyers and sellers, as this may stifle exploration activity. Licenses often move from parties with a lower risk appetite and/or limited capital to parties with different attributes. Allowing the free movement of interests will keep PNG's mining and petroleum sectors dynamic.

Question 4.2 - what are stakeholder's preliminary reactions to the broad reform directions outlined in this Chapter?

We agree with the broad direction of tax reform. From our perspective, the key consideration is to ensure that PNG continues to attract its share of foreign investment, by offering attractive fiscal terms.

National output depends in large part on such variables as the capital stock, the size and quality of the labor force, and the technological capabilities of the economy. The tax system should be positioned to attract foreign inbound investment and encourage firms to locate their South Pacific headquarters to PNG. This will directly increase job creation and economic activity in PNG.

Question 4.3 - do stakeholders agree to the need for a staged tax reform? process?

Staged or phased tax reform can offer increased risk to the state and investors alike. For instance, if the reform package is designed to be revenue-neutral, changes would need to be implemented concurrently, in order to avoid revenue dislocation that might jeopardise the tax reform program itself. A phased reform program may result in a period of instability and uncertainty as investors struggle to guess the nature and implications of the next tranche of tax reform measures. Such uncertainty adds to investor risk.

By its very nature, a tax reform process usually results in people that benefit and others that lose. In a phased program, interest groups may mobilise for constant lobbying and debate to counter previous changes that they perceive to have adversely affected their interests.

For these reasons, contemporaneous reforms on major, interdependent aspects are generally preferred.

We recognise, however, that changes made in several successive steps will allow the various stakeholders – primarily taxpayers and the tax authorities – to adapt to the new tax rules incrementally.

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