OIL SEARCH LIMITED

Tax Incentives

Oil Search Submission to the Tax Review Committee

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H E A D   O F F I C E

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This paper contains the response from Oil Search Limited to the Papua New Guinea Taxation Review Issues Paper No.5: An Examination of the Advantages and Disadvantages of Tax Incentives

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Section 1: Introduction

The utilisation of tax incentives to drive investment behaviours has a long history in both developed and developing economies. In the PNG context various incentives has been very successful, particularly in the Mining and Petroleum industries where exploration and other incentives have driven foreign capital investment into PNG and largely underwritten PNG economic growth in the last decade. To that end, the analysis of the issues surrounding the awarding of tax incentives should start from a positive place.

Tax incentives can influence investor behaviour by enhancing the rate of return on an investment. Tax incentives such as tax holidays can be particularly attractive for foreign investors, but ultimately the award of a tax incentive needs to be governed by a national interest test which ensures that the awarding of the incentive creates an overall net positive economic effect for PNG. Given the calculation of future economic returns can be more art than science, we agree with the Committee that there needs to be robust transparent processes surrounding the awarding of tax incentives.

However, tax incentives are also awarded at times to recompense for additional tax burdens that arise due to the operation of other provisions in the tax law. For example, the Mining and Petroleum industry is said to receive a number of ‘tax incentives’, but in reality these ‘incentives’ only partially offset the additional tax burden incurred by operators in this industry. Overall, Mining and Petroleum industry participants have a higher effective tax rate than standard corporate entities in PNG. Hence, any analysis of the merits of a particular incentive can only be examined in the broader context of how an industry operates and how that industry is taxed.

This Oil Search submission addresses the issues contained in the Tax Review Committee’s *Issues Paper No.5: An Examination of the Advantages and Disadvantages of Tax Incentives*. As PNG’s largest listed company and long term contributor to the country’s development, Oil Search has a strong commitment to working with all levels of Government and with the communities in which we operate to ensure the future prosperity of PNG. We look forward to continuing our work with the Tax Review Committee and exchanging views on potential reforms as part of developing a balanced taxation regime for PNG.

Section 2: Executive Summary

The continued refinement of the tax system to ensure that it meets the needs of the PNG economy is an important part of the responsibilities of the PNG Government. To that end Oil Search considers that the current tax review is vital to providing the platform for the next phase of economic growth in PNG. Tax incentives have a critical role to play in driving that future economic growth, particularly as PNG seeks to attract additional foreign investment capital.

This submission contains detailed explanations of our views on the operation of the current system under which tax incentives are awarded and also comments on potential structural improvements. Furthermore, we have also provided views on certain tax incentives discussed by the Committee as part the consultation paper. In summary our views on the critical issues are as follows:

- A framework already exists through the operation of the National Executive Council for the awarding of tax incentives. Whilst improvements can and should be made in the administration and governance of applications for tax incentives, we are of the view that the National Executive Council should remain the ultimate arbiter on whether or not an incentive is awarded.
- We concur with the Committee that in an ideal world, tax incentives would not be required and incentives in the tax system would take the form of lower overall rates of tax for all industry participants. However, some projects require unique assistance to make them commercially viable and hence any system for the awarding of tax incentives needs to maintain a degree of flexibility.
- We agree that the awarding of tax incentives should be a transparent process and to the extent any individual project incentives are awarded, then these should be made public.
- We would caution the Government that the tax incentive process is not broken and does not need substantial resources to improve its administration. Further, it does not need to implement individual reporting obligations to try and track the tax foregone due to incentives. The resources should largely already be located in Treasury and the IRC.
- The Committee's final report needs to differentiate between real tax incentives, such as tax holidays, and those which merely partially alleviate a higher tax burden on certain industries or which are simply infrastructure delivery models, such as the tax credit scheme. Once that allocation process is undertaken, the number of true incentives available in PNG should greatly diminish.

The question of tax incentives is often an emotive one which is prone to misinformation and misinterpretation. Oil Search is full supportive of any Government review of the existing tax incentives and the framework which governs them and would be happy to assist the Committee in any future deliberations surrounding these issues.

Section 3: Tax Incentives in PNG

Like many developing nations, PNG has a long history of differential taxation regimes applying to various industries and changing regimes as they apply to an industry over time. The regimes that apply outside of the ordinary income provisions contained in the Income Tax Act do offer some incentives as the Committee's paper outlines, but at times these incentives merely offset other taxes which are imposed at a higher rate. No better example exists than that of the regime applying to Mining and Petroleum industries. As the Consultation Paper highlights, there are a number of 'tax incentives' offered to the industry, but in reality these merely lessen the higher tax burden that is imposed under other provisions of the Act. For example, the Petroleum industry can access a concessional dividend withholding tax rate, but is subject to tax on its assessable income at the rate of 50%, 20% higher than the standard corporate tax rate. Hence, it is disingenuous to examine the incentives that apply without considering the broader application of the Income Tax Act to a taxpayer or industry. The petroleum industry pays tax at a much higher effective rate than ordinary PNG corporates, but this is not discussed in the context of incentives being available to the industry. We encourage the Committee to take a holistic view of these issues as part of the broader reform of the PNG taxation regime.

Tax Incentives offered in PNG

Attachment A to the Committee's consultation paper offers a substantial list of PNG tax incentives, but does omit the concessional application of dividend withholding tax to petroleum companies paying dividends out of previously taxed petroleum profits. We are not aware of any other incentives which may be available which are not listed at Appendix A of the Consultation Paper.

Infrastructure Tax Credit Scheme

We have previously provided detailed comments on the Infrastructure Tax Credit Scheme in our submission on *Issues Paper No.1: Review of the Fiscal Regime for Mining and Petroleum Projects in Papua New Guinea*. Whilst not wanting to be repetitive in our submissions, we re-iterate out strong support for this program. The tax credit scheme was introduced in 1992 and to date over 423 projects across 12 provinces with a total spend of over K644 million have been undertaken. In recent times, many of the projects undertaken as part of the scheme have been completed in regional areas where National and Provincial Government programs have been unable to deliver improvements to infrastructure, security, schools and hospitals. Companies with large operations such as Oil Search have been able to deliver these projects efficiently due to the relative proximity of their operational footprint, saving the National Government significant expenditure compared to comparable Government-managed projects.

Beyond the increased cost efficiency, these projects also contribute greatly to community relationships with large companies operating in their region and also foster a greater level of appreciation and recognition of Government due to their role in the approval process. Hence, the tax credit scheme is a significant success as highlighted by the Minister for National Planning and Development, in his presentation to the National Parliament of March 2013*, The Socio-Economic Impact of the Tax Credit Scheme 1992-2012.*

Research and Development

Effective from 1 January 2014, the Research and Development ("R&D") tax concession was removed. As previously discussed in our submission to *Issues Paper No.2: Corporate and International Taxation*, we understand that the principle reason for this change was not because the PNG Government thought that providing an additional R&D deduction was bad policy, but simply because it didn't have the technical resources to effectively administer the regime. This development was a significant disappointment to the corporate taxpayers in PNG and we would encourage the Committee to further consider R&D as part its deliberations. Investing in R&D creates value for taxpayers and PNG alike. Further, by providing for the additional deduction it increases investment by corporates in sectors that will lead to increased numbers of PNG citizens in highly skilled jobs. This should have a trickle-down effect of increasing the quality and number of graduates coming out of PNG's universities.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 1.1 – are stakeholders aware of any other tax incentives not captured in the table?	The table omits the concessional dividend withholding tax treatment available to petroleum companies when paying dividends out of previously taxed petroleum profits.
Question 1.2 – do stakeholders agree with the stated purpose of each incentive, as provided for by the Review?	Yes, the stated purposes are broadly accurate for those incentives applicable to the Mining and Petroleum industries. We make no comment in relation to the purpose of incentives available to other industries.
Question 1.3 - are relevant stakeholders able to indicate how individual incentives helped to achieve the stated policy goal?	By way of example, the interest withholding tax exemption available to the mining and petroleum industries enabled the PNG LNG project to obtain cost effective financing from senior bank lenders. Lenders would generally have sought a gross-up for any withholding tax imposed which would have harmed the economic returns on the project. Another example is the 155N pooling incentive. This allows companies such as Oil Search to be able to undertake substantial exploration programs and still receive some benefit for the costs incurred. Without the 155N pool being available, it is doubtful whether the current level of exploration in PNG would be maintained as it would effectively increase the cost of exploration by 30%-50% depending on what companies are exploring for.

Section 4: Advantages and Disadvantages of Tax Incentives

The Committee's consultation paper outlines in broad terms the advantages and disadvantages associated with government's providing tax incentives. In an examination of the incentives offered in PNG, most are generally aimed at increasing economic growth in PNG. As previously discussed in our submission to *Issues Paper No.1*, Oil Search generally supports a level playing field for all market competitors. Therefore, we generally do not support individualised tax incentives for new projects, albeit that we believe that certain concessions are sometimes required for marginal projects.

These comments should not be construed as opposing tax incentives for an industry where the government is seeking to stimulate growth. For example, the double deduction for exploration that was granted to mining companies was provided to stimulate mining investment and as it was available to all mining companies, was an appropriate action. Oil Search supports tax incentives in those circumstances. It is against provision of tax incentives to a single taxpayer in an industry to the exclusion of their competitors.

The Government of PNG needs to keep in mind that when an ultimate investment decision is to be made by a non-resident, the rate of tax that is payable is typically a secondary concern which ranks behind such fundamental issues as security of in-country staff, government stability, public infrastructure (especially if the produced commodity is to be exported) and exchange controls.

Strengths and weaknesses of particular incentives

We agree with the Committee's summary of the relative strengths and weaknesses of differing forms of tax incentives. As flagged in our previous submission, we do not support the use of tax holidays. Where relief from income tax is being considered we recommend the adoption of a system which still ensures that an appropriate amount of tax is paid where the taxpayer in question makes 'super' profits.

Instead of governments providing tax holidays, the consultation paper favours the use of accelerated depreciation and investment allowances which are excellent options. If however a taxpayer is seeking direct relief from income tax from the Government as part of a negotiation for a substantive project, we would favour the use of graduated rates of tax instead of a blanket tax holiday. This ensures that the taxpayers can make a commercial return on their investment, but not to the detriment of the tax revenue.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 2-1 – what other advantages do tax incentives have, particularly in the PNG context?	The summary of the advantages provided by the Committee broadly summarises the potential benefits of tax incentives. Ultimately tax incentives should bring about a broader benefit to the PNG economy, predominantly in the area of economic growth.
Question 2-2 – what other disadvantages do	The summary of the disadvantages provided by

tax incentives have, particularly in the PNG context?	the Committee broadly summarises the potential challenges of tax incentives. In particular the Government needs to ensure that the incentives are awarded to parties who are making a long-term commitment to operating in PNG and not parties who are shopping for a tax holiday only to move on from PNG when the holiday expires.
Question 2-3 – do stakeholders have any other views about the merits of particular types of tax incentives?	As stated above, Oil Search supports incentives which are offered to the whole of an industry or where they support marginal projects that will create long term benefits for PNG. Oil Search does not support the provision of tax holidays.

Section 5: Directions for Reform

The Committee's consultation paper outlines the somewhat muddled history and current status of tax incentives in PNG. As strong proponents of the Extractive Industries Transparency Initiative and its introduction into PNG, we concur with the view that the awarding of tax incentives needs to be an accountable and transparent process.

Further, we support this tax reform process and its aims to creating a simpler, fairer tax system for PNG to maximise its economic growth potential. We agree that the lack of a comprehensive management framework governing tax incentives does undermine public confidence in the tax system. However, when we look at the current tax incentives on offer in PNG for the Mining and Oil industry, we consider the incentives to be appropriate and well-targeted on the whole. Hence, we consider that the direction of reform here should not be to scrap all existing incentives. Rather, the reforms should be directed at cementing in place the governance structure for the awarding of incentives. In our view, this is largely already in place and hence some of the work that needs to occur should be focussed on education on how such issues are managed by the Government, as opposed to re-imagining how the incentives should be awarded.

A Framework for Tax Incentives in PNG

In terms of establishing the framework to govern tax incentives, the critical question is how much flexibility/scope should be provided to a decision making body in the awarding of tax incentives. The consultation paper highlights the spectrum along which tax incentives policies can be set, from no incentives at all to a case by case negotiation. In this context we favour a system which still provides for a degree of flexibility for decision makers so that they are not overly constrained in agreeing incentives that maximise the economic benefits for PNG. At the same time we acknowledge the concerns around the existing framework and we share the Committee's concerns around individual taxpayers obtaining tax incentives such as tax holidays. As discussed previously in this submission, we recommend that any incentives that are provided are done on an industry-wide basis so that it ensures a level and competitive playing field, albeit that there may be occasions where taxpayer specific incentives may be warranted, such as the case of stranded resource projects as discussed in response to *Issues Paper 1*. Hence, we suggest that the optimal place for PNG along the tax incentive management spectrum is ideally somewhere in the middle and the following comments are predicated on that approach.

The process for granting tax incentives

As we currently understand the process for the awarding of tax incentives, a submission must be made to the National Executive Council of the PNG Government ("NEC"). The NEC consists of the PNG Government ministers who are appointed by the Governor-General on the recommendation of the Prime Minister. Given that the membership of the NEC is taken only from elected Government officials, a high degree of confidence should exist with respect to their decisions being only in the best interests of PNG.

Tax Incentive Committee

The use of the NEC as the ultimate arbiter of tax incentives manners is appropriate but we believe that there is room in the governance structure for a Tax Incentive Committee which would report to the NEC in relation to tax incentive applications. If a Tax Incentive Committee was established it would effectively replicate the model adopted by the Solomon Islands that is highlighted by the Committee in the consultation paper.

In our view, the scope of the Tax Incentive Committee's work would essentially be the management of tax incentive applications and schemes, but ultimate decision making would still be the sole province of the NEC. In this scenario, the NEC would be able to focus on the macro-level strategic initiatives needed to drive economic growth. The Tax Incentive Committee would effectively administer the tax incentives and be the intermediary between taxpayers and the NEC. It would be expected that the Tax Incentive would provide recommendations to the NEC, but unlike the Solomon Islands structure, we would not recommend that it be binding on the NEC to any degree. The Tax Incentive Committee would also be responsible for any transparency reporting which may be imposed.

In relation to the constituency of a Tax Incentive Committee, we agree with the Tax Review Committee that it should include members of the IRC, Treasury and various other Government departments. We would also suggest that it include several external appointments of experienced business personnel who can bring their commercial acumen to the decision making process. We would encourage the Committee to guard against staffing a Tax Incentive Committee solely with economists and revenue officials as it will likely lead to an imbalanced decision making process. Further, we would see the Tax Incentive operating on a relatively small budget and only meeting on an 'as-needs' basis.

National Strategic Development Plans

We note with interest the discussion in the consultation paper surrounding the potential establishment of a separate body which would formulate and manage various National Strategic Development Plans. Whilst the establishment of such a body is not strictly a tax reform issue, we would be supportive of such a body, and we would envisage it working co-operatively with the Tax Incentive Committee as part of monitoring tax incentive policy. We would caution that the development of any new body would need to have a delineated purpose and clear lines of accountability.

The policy basis upon which incentives are granted

We have reviewed the statement of proposed principles which would govern the allocation of tax incentives in PNG and broadly agree with them save for one comment. Principle 8 suggests that taxpayers should be required to report the benefit of any incentive each year to the IRC. We believe that this could lead to onerous reporting requirements on taxpayers and needs to be limited only to those taxpayers that have received reduced rates of tax or tax holidays. To ask taxpayers to maintain multiple sets of depreciation records to track the benefits associated with accelerated depreciation or investment allowances is inappropriate. Further, for industries such as Mining and Oil where the tax incentives only mitigate a higher tax rate and other additional taxes which are payable, any reporting is going to give a misleading view on the taxation of the industry.

The legislative framework underpinning tax incentives

We note the proposal from the Department of Trade, Commerce and Industry and their submission that all incentives should be amalgamated into a single piece of legislation. Whilst this may be a noble idea, in reality this is impractical and probably leads to little economic benefit. Taxpayers who can access incentives are generally aware of them and we would be surprised if many taxpayers in PNG are overpaying tax due to a lack of awareness about a potential tax incentive. Further, trying to extricate the incentives from the various pieces of legislation would be a massive drafting exercise not only for this new Tax Incentives Act, but also to amend all of the existing law to ensure that all cross-references in the existing law still link to the appropriate incentive. Given the resource limitations in the Government's drafting team, we would recommend against this exercise and encourage the Committee to look forward in terms of the legislative framework without seeking to re-invent the existing legislation, at least in the short term.

If the Committee did consider that the existing incentives should be amalgamated, we would recommend that these should form a schedule to the Income Tax Act and the Department of Treasury should have carriage of the drafting of the new law as opposed to the Department of Trade, Commerce and Industry.

Ongoing reporting and monitoring of tax incentives

We note the comments of the Committee in the consultation paper in relation to transparency and re-iterate our support for any initiatives which increase transparency in tax matters. As noted above however, we believe that the reporting obligations countenanced by the Committee are punitive and unnecessary. We would expect that the IRC should be able to estimate the cost of a tax incentive through its data systems without the need for taxpayers to potentially manage multiple sets of books to track the benefits of incentives. To that end, we support the IRC and Treasury working together to estimate the revenue foregone, but again flag that this needs to be counter-balanced against the revenue raised by additional taxes that certain industries are subject to.

We would encourage Treasury and other Government departments to continually evaluate the tax incentives that are offered and to proactively manage them by repealing them, modifying them or expanding them as required.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 4.1 – do stakeholders agree that PNG should focus on creating a tax system that is overall simpler, fairer and more competitive?	As an overarching principle we agree that the Committee should focus on creating a simpler and fairer tax system.
Question 4.2 – would stakeholders agree to a trade-off between removing existing incentives with other reforms that focused on making the tax system simpler, and more competitive overall?	Again, as an overarching principle we agree that the Committee should focus on creating a simpler and fairer tax system. In terms of trade-offs for removing incentives, Oil Search is not in a position to comment without seeing the detail behind any proposal.
Question 4.3 – do stakeholders agree that there is a need for a framework to guide the granting and management of tax incentives?	We believe that a framework already exists, but that the framework can be enhanced to provide for greater transparency on the decision making process.

Question 4.4 –should PNG consider formalizing the process for the granting of tax incentives, similar to the process adopted recently in the Solomon Islands?	We would support the adoption of a Solomon Islands model provided that the ultimate decision making power on the awarding of tax incentives still resided with the National Executive Council.
Question 4.5 – do stakeholders consider that there is a need to create a new body for the carriage and formulation of National Strategic Economic Development Plans in PNG, with part of its role being to ensure that consideration of targeted interventions using the tax system are placed in a broader economic context?	We would support the creation of a new body to manage and formulate National Strategic Development Plans and it working closely with any Tax Incentive Committee that might be established and the National Executive Council in managing tax incentives to drive economic growth in PNG.
Question 4.6 –what are stakeholder's views on the proposed principles to guide the award of tax incentives in PNG? Are there any other principles that should be included?	Subject to the above comments in relation to Principle 8, we are supportive of the proposed principles.
Question 4.7 –do stakeholders consider that there is any merit in amalgamating existing incentives into a single piece of legislation or into a part of existing legislation, such as the income tax act?	For the reasons outlined above, we do not consider such an amalgamation to be an efficient or effective use of resources.
Question 4.8 –which Government portfolio is best placed to have ultimate responsibility for tax incentives?	Subject to our comments above in relation to the management framework for tax incentives, we submit that Treasury is best placed to manage the administration of tax incentives.
Question 4.9 – do stakeholders agree that the tax incentive report should be given greater prominence in the annual Budget, and include the policy rationale for each incentive? Should a separate report be prepared?	We see little additional value in preparing such a report. That said we would support Treasury enhancing its ability to maintain a database on the value of incentives which can be used to inform the budgetary process and potentially assist in targeting any new incentives which may be under consideration.
Question 4.10 – how can PNG most simply estimate the value of the tax incentives it provided?	Oil Search is not in a position to assess this issue given the broad spectrum of incentives that are available across a range of industries. It is likely that the assessment of these benefits is more of an institutional capacity issue, particularly in relation to Department of Treasury.
Question 4.11 – do stakeholders agree that the annual report on the value of tax incentives should include the value of any taxpayer of project specific incentive?	Again we would be happy for the report to contain project specific data, but believe that this should be populated by data gathered by the IRC and Treasury as opposed to mandatory reporting requirements on taxpayers.
Question 4.12 – do stakeholders agree that there needs to be some effort in evaluating the ongoing value of revenue incentives provided in PNG? Which incentives are most in critical need of evaluation?	As discussed above, we believe that there should be an ongoing process of evaluation of the benefits to PNG from existing tax incentives. Oil Search is not in a position to comment on incentives given to industries other than Petroleum. In relation to incentives provided to the Petroleum industry, we believe that these are all appropriate and only partially mitigate the

effect of the higher taxes applied to the industry.

Section 6: Other Issues

Mining and Petroleum Sector

We note with interest the comments contained in the consultation paper regarding incentives provided to the Mining and Petroleum sector, in particular the comment that there is a degree of 'unfairness' about the sector accessing concessional tax treatments. As previously stated, this position is completely misguided and ignores the fact that the Mining and Petroleum sector is the most heavily taxed industry in the PNG economy, even without taking into account the right of the State to back into resource projects on a historical cost basis which severely dilutes the economic return available to project sponsors. Any 'incentives' which may be provided to the sector merely offset part of the tax burden that would otherwise be borne and, in the case of certain measures, incentivize exploration activity in PNG.

We concur with the Committee that the focus should be on developing a taxation regime for the sector that is competitive, fair and sustainable as opposed to specific exemptions, but again caution that there needs to be an element of flexibility in the awarding of tax concessions so that resource projects are not left 'stranded' due to insufficient economic returns. We have previously provided comments on these issues in our response to *Issues Paper 1* and we would direct you to that paper for further consideration of this issue.

Further, we believe that there is further scope for new incentives in the Mining and Petroleum industry to incentivize other activities. For example, the PNG Government has in recent times been focussed on domestic power supply and recently signed an MOU with Exxon Mobil in relation to accessing domestic gas as part of the process of awarding of a development licence for P'nyang. As the future of PNG exports moves towards LNG, domestic gas reservation will become an increasingly important issue and the tax system may be a lever that can be utilised to ensure adequate investment in gas resource development. We would be pleased to open a dialogue with the Committee on this important issue and discuss how incentives for this industry might be developed.

Infrastructure Tax Credit

Oil Search made a substantial submission on the Infrastructure Tax Credit Scheme ("ITCS") as part of our submission on Issues Paper 1 and again we re-iterate our strong support for the scheme and the National Infrastructure Tax Credit Scheme ("NITCS"). Further, we would support any independent third party audit that may be undertaken in respect of the effectiveness of the scheme. Whilst we are not in a position to comment on how the scheme is manifesting itself in the primary production and tourism industries, Oil Search continues to see tangible benefits in the communities in the areas in which we operate through the building of new schools, hospitals, roads and police stations. We are confident that any third party analysis of the programs that Oil Search has conducted will see these tangible benefits, especially when contrasted against the historic lack of delivery of infrastructure by Government to remote communities in the PNG highlands. Oil Search re-iterates its support for an expansion of the ITCS in terms of the amount of credits that can be utilised in a given income year and we firmly believe that the ITCS is still the most efficient infrastructure delivery system for remote communities.

The other issue that the Committee fails to recognise in relation to the TCS and NITCS is that these programs effectively allow Government to defer capital expenditure which assists Government in managing its finances. For a particular project, taxpayers are incurring costs in real time whereas taxpayers only receive the benefits in terms of lower tax payments on a deferred basis. In these times of reduced commodity prices, it may be several years before the full benefit of the spend on a large scale ITCS or NITCS project comes to fruition due to the fact that underlying profitability has been reduced. Companies like Oil Search who are committed to building and fostering their relationships with the communities with which they interact will continue to invest in these types of projects as giving back to the community goes to the social 'licence to operate'. In this scenario, commitments to projects are effectively a prepayment of tax which can only be a benefit to the Government.

Research and Development

We acknowledge the difficulties that PNG has had in administering the previous Research and Development ("R&D") tax incentive. Ultimately the demise of the incentive should be seen as a failure in PNG's institutional capacity as opposed to the R&D scheme being poor policy. As previous studies[1] have shown, tangible benefits can arise in developing countries through the use of R&D tax incentives. The challenge is in the administration of these systems. Many developing economies lag behind in terms of education and building a sufficiently technologically competent population. The use of an R&D tax incentive is a proven mechanism for the development of educational standards, albeit that they come at a cost. The PNG Government has made a decision that this cost is too great at the present time, but we trust that in the future this policy decision will be re-assessed and an R&D incentive re-instated. In Oil Search's experience, the previous incentive was appropriately targeted. It was only the administration of the scheme that was lacking and hence we would like to see any re-instated scheme operate in substantially the same way.

Pioneer Act

Whilst Oil Search does not have a view of the operation of the Pioneer Act vis-à-vis manufacturing investment, we note with interest the comments of the Committee with regard to the offering of tax holidays under this Act as opposed to an overall lowering of the corporate tax rate so that all non-extractive industries, not just manufacturing can benefit. We find it interesting that a proposed corporate tax rate cut would exclude extractive industries on the basis that the Committee would seek to make those industries more competitive. Given reductions in commodity prices and reduced capital investment in exploration and development in the extractives industry, it would seem an odd policy to exclude the extractive industry from any incentive designed to boost international competitiveness.

Special Economic Zones

At a practical level, the creation of Special Economic Zones ("SEZ") is not relevant to a company such as Oil Search, however we concur with the IFC view that special tax incentives should not be offered to a SEZ, rather companies should be attracted to operate in the zone because of infrastructure and services available within the SEZ.

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[1] Mercer-Blackman, The Impact of Research and Development Tax Incentives on Colombia's Manufacturing Sector: What Difference Do They Make?, IMF, 2008.

Incentives relating to GST/Import Duties/Excise

We acknowledge the comments in the consultation paper which highlight the fact that GST exemptions for inputs that will ultimately be exported such as in the resource industry are appropriate and should not be seen as an incentive. Rather such exclusions simply assist project sponsors with their cash flow as they do not need to pay the GST, only to have it refunded at a later date.

An exemption from import duties and excise comes back to the question of whether the current PNG tax system is internationally competitive. Many other nations operate on a free trade basis and import duties and excise duties are not applicable. At times the PNG Government has recognised this disparity and sought to level the playing field from PNG's perspective in order to attract investment capital. Ultimately those awarding these types of exemptions need to undertake the analysis and decide whether granting such exemptions is in the best interests of PNG. By way of example, the exemption from import duties for the PNG LNG project was clearly a decision made in the best interests of PNG given the economic growth that the project has driven and the long term cash flows from taxes and equity participation that accrue to the Government.

International Aid Organisations

Whilst the taxation of international aid organisations and their employees and subcontractors is not an area that Oil Search has significant experience in, we are aware of some confusion about how these rules operate in the PNG context, especially when contrasted with the rules that apply to domestic aid organisations such as the Oil Search Health Fund. At present there seems to be an incentive for professionals to work for certain aid organisations in preference to others due to the taxation outcomes that may arise. Such anomalies cannot be the intention of the law and we support a review and clarification of these rules as they apply to international and domestic aid organisations.

In relation to the question of whether certain tax incentives, such as GST exemptions, should extend to individuals representing these organisations, we would question whether such incentives are necessary, but are not in a position to support such a move at present pending further analysis on how this would affect the deployment of aid in PNG.

Project Agreements

Typically project agreements do not require restatement of tax incentives that are generally available at law and hence we agree with the views of the Committee that these restatements should be excluded from future project agreements.

We acknowledge the views of the Committee regarding project-specific tax incentives and are supportive of the Government's efforts in creating pro-forma project agreements for the Mining and Petroleum industries. However as we have previously stated, from time to time certain projects may need individualised incentives in order to be financially viable. This is where maintaining a degree of flexibility in the framework for the awarding of tax incentives becomes of the utmost importance. We understand the concerns about how this flexibility can distort behaviours, but provided there is a robust framework that features an overriding 'national interest' type test and that the ultimate arbiters of the award of incentives are elected officials, then the public should have faith in the system. Where new project agreements contain incentives not otherwise available at law, we would support the publishing of the details of the incentives offered in these agreements and a statement of reasons for awarding the incentive from the NEC or whichever body ultimately has responsibility for awarding tax incentives. Care needs to be taken that in publishing details of available incentives, other commercially sensitive information is not inadvertently published.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 5.1 – do stakeholders agree that, before any decision is taken to substantially change the ITC scheme (including guidelines) an independent, third-party audit of the scheme is requires?	We would welcome any third party audit of the ITC scheme provided that the remit for the audit included an analysis of how the scheme could be expanded given we believe it is the most efficient delivery method of infrastructure improvements in the PNG highlands.
Question 5.2 – for firms that have utilised the enhanced deduction for R&D that was previously available, how did the incentive promote investment in research and development that would not have otherwise occurred? What broader benefits to PNG and the PNG economy did that research and development produce? How might a future R&D concession be framed differently?	The previous R&D concession provided an incentive for corporates to invest in new technologies and new processes which has a flow on effect to the educational standards of the PNG workforce and by extension, the standard of PNG's educational systems as they respond to the demand for more highly trained professionals. Further, we believe that any future incentive for R&D should largely replicate the previous system which we considered to be an appropriately targeted policy.
Question 5.3 – what value, if any, do the existing research and development incentives (available under section 95) continue to provide?	The ongoing provisions are of limited or no benefit to Oil Search and as such we are not in a position to comment further.
Question 5.4 – do stakeholders agree that reform of the corporate income tax, with a view to making PNG more attractive to international investment, should focus on a reduction in overall rates rather than the provision of targeted tax holidays to specific sectors?	Yes, we agree that this should be the ultimate aim, but flexibility needs to be retained to assist projects that are marginal but which provide long term net benefits to the PNG economy.
Question 5.5 – on what basis should consideration be given to providing exemptions/reductions to GST/Import Duties/Excise?	These types of exemptions should be provided where the tax is merely a cash flow timing difference (GST) or where the incentive is required to ensure that PNG is competitive with other economies that offer free trade agreements.
Question 5.6 – is there value in clarifying, in law, the limitation on tax exemptions available to aid organisations (for example, in clarifying that exemptions apply to the organization and its employees only)?	We believe that this would be a useful endeavour so that the position can be contrasted to that of domestic aid organisations and charities.
Question 5.7 – what are stakeholder's views about the value of GST exemptions provided for individuals employed in relation to aid projects?	In theory we do not believe that individuals in their own capacity should be able to access these exemptions, however we would caution against any immediate action without understanding the potential impact on aid

	delivery into PNG.
Question 5.8 – should project agreements not include a reference to incentives already available in legislation?	We agree that project agreements should not restate the applicable law.
Question 5.9 – do stakeholder's agree that any provisions in a project agreement purporting to provide tax treatment not generally available under the tax law should be published?	In accordance with our support of international transparency initiatives, we would support the publishing of details from project agreements that relate to tax incentives.

Section 11: Conclusion

Tax incentives have had a track record of proven success in PNG and have become a vital part of the tax system as it applies to certain industries. Whilst a number of these tax incentives are not what we would consider to be true incentives as they merely offset an otherwise higher tax rate, the policy behind the incentives has been sound and has delivered significant economic benefits to PNG. No better example exists than the PNG LNG project and the positive effects that it has had on the PNG economy.

To some degree, the issue with tax incentives is the impression that they are awarded in a secretive manner and that certain parties may be favoured over others. To the extent that that practice is or has occurred, then we would encourage reforms to ensure that the process for the awarding of tax incentives is transparent. We re-iterate below the summary of our views on the critical issues:

- A framework already exists through the operation of the National Executive Council for the awarding of tax incentives.
- Ideally tax incentives would not be required and incentives in the tax system would take the form of lower overall rates of tax for all industry participants. However, some projects require unique assistance to make them commercially viable and hence any system for the awarding of tax incentives needs to maintain a degree of flexibility.
- The awarding of tax incentives should be a transparent process and to the extent any individual project incentives are awarded, then these should be made public.
- The process for the awarding of tax incentive process does not need substantial resources to improve the administration and it does not need to implement individual reporting obligations to try and track the tax foregone due to incentives.
- The Committee's final report needs to differentiate between real tax incentives, such as tax holidays, and those which merely partially alleviate a higher tax burden on certain industries or which are simply infrastructure delivery models, such as the tax credit scheme.

As highlighted in our previous submissions in response to the previous consultation papers, Oil Search sees itself as more than just a taxpayer in PNG. We consider ourselves an important development partner with our nation. Our responsibility does not end at payment of the tax cheque. It is our corporate priority to partner with the State in delivering meaningful projects across the nation for sustained long term development in the furtherance of the State's development goals. This includes working with the State in relation to the tax reform agenda and we would welcome the opportunity to further contribute to the process.

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