



## TERMS OF REFERENCE

### **PNG COMPREHENSIVE FISCAL REGIME (TAXATION AND NON -TAXATION) REVIEW 2013 -14:**

#### **Introduction**

The Government has announced a comprehensive review of the fiscal regime (taxation and non-tax revenues) to ensure that the regime remains relevant, efficient and effective and is congruent and reflects the current state of the economy and the medium term economic development trends of Papua New Guinea.

Analysis by Treasury Department revealed that the growth in the economy is not translating sufficiently into optimum fiscal and revenue yields (i.e. measured as a percentage of GDP). Furthermore, the tax regime has not been updated, realigned and modernized to make it more congruent with present practices of businesses.

The tax review is an important component of the Government's Medium Term Fiscal Strategy which aims to reduce the size of Government deficits over the medium-term and ensure debt is held at sustainable levels.

Further, Papua New Guinea presently draws significant part of its wealth and revenues from natural resources, particularly from the Mining and Petroleum sectors and in the very near future the LNG sector. Resources from these sectors are non-renewable and it is absolutely critical that windfall gains derived from these sectors must be leveraged and strategically deployed and prudentially reinvested to support sustainable medium and long term growth.

Considering the risks posed by shifting vagaries and volatility of prices of resource commodities (e.g. the present substantial drop in gold price and its adverse impact on the mining sector) there is absolutely no guarantee of uninterrupted revenue streams for the State in the long-run. Although it is noted that establishment of a sound and effective Sovereign Wealth Fund in the near future may assist to mitigate this volatility.

The last comprehensive taxation review was done in the year 2000. It is over 12 years and a full review is now overdue and this presents an opportune time to take stock of the Fiscal Regime (taxation and non-taxation) with the view of instituting appropriate reforms in order to realign the tax system to support the country's present, medium and long-term economic and social development objectives.



While formally titled a "Tax Review", the review will also consider non-taxation revenues because revenue collections from these sources have fallen significantly as a share of the overall revenue in recent years.

## Background

The Government in a National Executive Council (NEC) decision No. 83/2013 approved the establishment of a Fiscal (Taxation and Non-Taxation) Committee (FTR Committee) comprising:

- (i) Sir Nagora Bogan (Chairman);
- (ii) David Sode (Deputy Chairman);
- (iii) Sir John Luke Critten (Committee);
- (iv) Lady Aivu Tauvasa (Committee); and
- (v) Mr. John Lohberger (Committee).

The same NEC decision approved a budget of K9.5 million for the review of the fiscal regime.

Mr. Peter Costello, former Australian Treasurer will provide high level technical and political advice.

## Tax Review Broad Objectives

The framework of the tax review will focus on well known classical tax reform axioms, but more importantly, it will also strike a delicate balance with broader economic, social and political aspirations and strategies for improving the lives of the people of Papua New Guinea.

So in conducting the review, it will be vital to judge the recommendations against the usual tax axioms as well as the prevailing and future strategic development plans.

These axioms includes the axiom of efficiency to ensure the tax system collects optimum revenue and is effectively managed in ways that has the best possible impact on growth and jobs. This includes avoiding tax distortions that can in the long-run harm growth prospects, but at the same time attaining the objective of achieving a higher yield of revenue as a percentage of GDP.

The review will also consider the tax axiom of equity. This includes horizontal equity - to ensure that people and firms who are in similar circumstances are treated in similar ways. This is vital for consistency and fairness. It also includes vertical equity - which means that those who are better off should share more with those that are not as fortunate.



The third tax axiom is simplicity - a tax system that is simple, easy to understand, minimizes costs of compliance and is consistent with the capabilities of our key revenue agencies as well as local firms.

Apart from axioms of tax, the review will include administrative dimensions of tax reform. This is because how a tax system is administered affects its *yields, incidence* and *efficiency*.

In essence, the real tax system people and businesses face reflects not just the tax law, but how that law is implemented and whether there is administrative capacity and competency to administer the tax law and, equally important, ensuring that the system is frequently updated and refreshed and is congruent with economic (i.e. includes business practices and culture), social (includes demographic shifts), political and technological shifts and trends.

In addition, these considerations must also be aligned with the overarching strategies embodied in Vision 2050 and the Medium Term Development Strategy and other important strategic policy initiatives such as the SME policy as an enabler for wealth, employment and empowering indigenous Papua New Guineans in economic ventures.

There are also important challenges facing Papua New Guinea as our economy is rapidly maturing.

Accordingly, reform and design of the tax regime must ensure that Papua New Guinea's regime is also internationally competitive. This dimension of competitiveness should also go beyond our resources sector into other areas of simplicity and ease of doing business, cost of energy and public utilities, strategic infrastructure, and transport portals, export and efficient domestic production.

### **Tax Review Specific Objectives**

The review aims to:

- Align PNG's revenue system with its development aspirations of being a competitive middle income nation in the Asian century;
- Improve the competitiveness and efficiency of the tax system to encourage investment, savings, employment and economic development;
- Consider and determine a delicate balance between revenue raising and incentives to stimulate economic and social growth and development;
- Enhance the fairness and simplicity of the taxation system;
- Consider options to change the tax mix between the levels of taxation on land (including resources), capital and labour;



- Consider optimum income to consumption tax mix (i.e. in the context of taxation of income relative to taxation of consumption);
- Improve taxpayer compliance including through considering options to enhance services to taxpayers and reduce the cost of compliance through use of modern technology; and
- Review non-tax revenues (land rates and other Government imposts and rates) with the aim of ensuring that fees are appropriate, fair, and adjusted in line with CPI.

The focus of the review will be on revenues collected and administered by the National Government. However, where appropriate and subject to existing demarcation of fiscal/tax powers, it can extend to review of revenues collected by sub-national levels of Government.

### Scope of the Review

The review will cover:

- 1) Personal Income Tax Regime;
- 2) Corporate Income Tax Regime;
- 3) Excise and Customs Tariff Arrangements (Import and Export Duties and other tariffs);
- 4) Operation and Efficiency of Goods and Services Tax and by extension implications of fiscal federalism;
- 5) Mining and Petroleum Taxation Regime;
- 6) Non-tax revenues(i.e. land taxes and other state charges and levies);
- 7) Process of tax and fiscal policy formulation;
- 8) Taxpayer compliance;
- 9) Efficiency and simplicity of tax administration (business model, governance framework, structure, system, process) including use of Information and Communications Technology (ICT) as a business enabler;
- 10) Advantages and disadvantages of tax incentives. This will include consideration of viable tax incentives options for SME's and other strategic and renewal sectors or initiatives; and
- 11) Ensure that all sectors of the economy pay their fair share of taxes.

### Extractive Industries Fiscal Regime Review

The Government has commissioned a separate review of the extractive industries (gas, petroleum, and mining) by a team of technical team from the Fiscal Affairs Department of the International Monetary Fund (IMF).

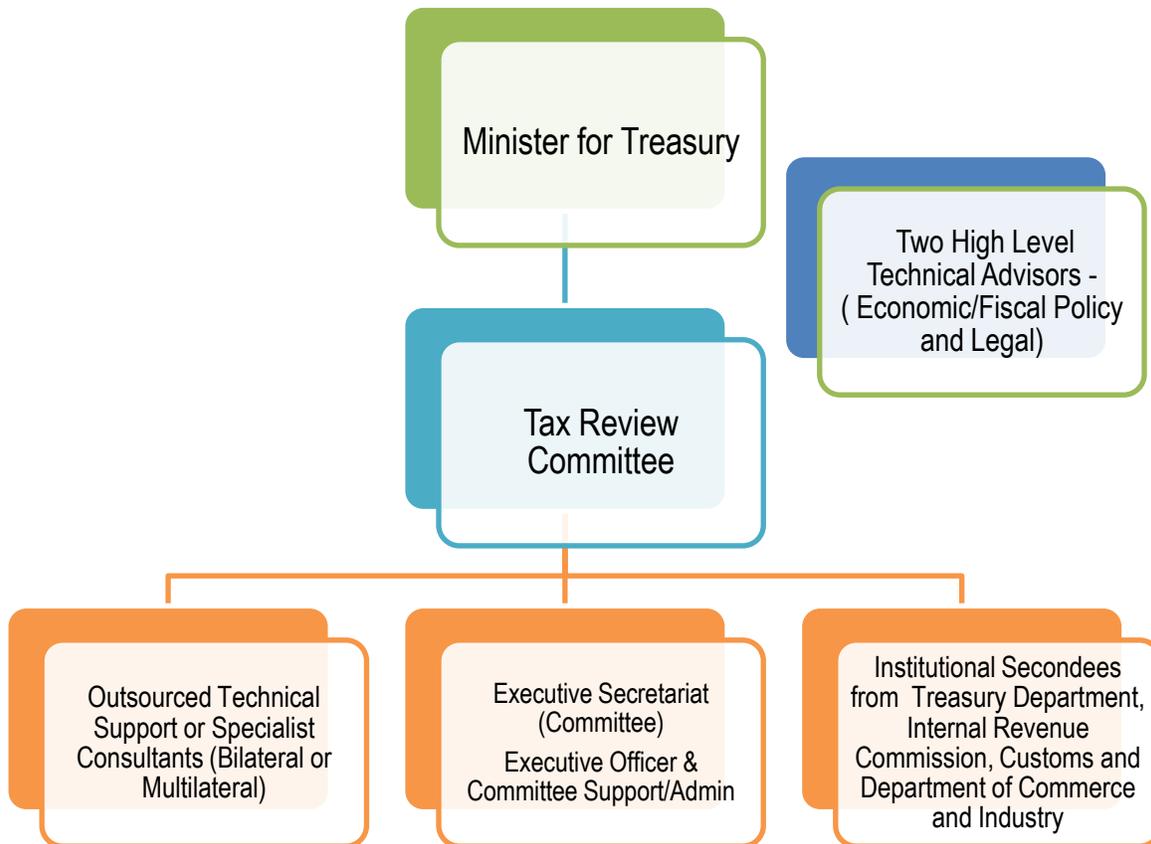
This review titled “Reform of the Extractive Industries Fiscal Regimes” has been completed and handed over to the Government.

The Government has mandated that the FTR Committee assumed carriage of this review and undertake further consultation with stakeholders of the extractive industries, tax practitioners and other interested stakeholders.

This will culminate in a final report and recommendation to the Government.

**Tax Review Structure**

The Tax Review will have a Committee/Secretariat structure. The roles and responsibilities of each are outlined below and depicted in the structure;





## **(A) Tax Review or FTR Committee**

The role of the FTR Committee is to provide strategic leadership and oversight of the tax review in terms of review deliverables - paying particular attention to quality, quantity, and timeliness; set the policy context, framework and structure; ensure proper consideration of relevant tax axioms; initiate and set the scope of work for relevant empirical studies and analysis, ensure appropriate stakeholder review and engagement; and institute construction and design of the tax reform model.

### **(i) Responsibilities of the Committee**

- Provide strategic leadership and oversight
- Provide guidance on work programs and activities to be undertaken by the Secretariat and the technical advisors and support team including those seconded from Treasury Department, Internal Revenue Commission, Customs Department and Department of Treasury;
- Ensure the work done by the Secretariat is delivered on a timely basis;
- Consider tax review proposals presented to them by Secretariat and provide timely feedback to the Secretariat;
- Meet twice every month; and
- Provide regular reports and updates to the Minister of Treasury.

To ensure efficiency and effectiveness in the functionality and performance, each Committee member will assume carriage, responsibility and oversight for specific components of tax areas to be reviewed.

### **(ii) Administrative Assistants**

The Committee will be supported by an Executive Officer and Administrative Assistant. They will be responsible for arranging Committee meetings, travel, meeting agendas and perform other administrative duties required by the Committee and Chairman. They will also be responsible for liaising with Department of Treasury for processing and settlement of accounts for goods and services procured for the work of the Tax Review.



## **(B) Tax Review Technical Secretariat**

The role of the Secretariat led by the Department of Treasury is to provide technical support to the Committee through its Chairman.

### **(i) Responsibilities of the Secretariat**

- To provide technical resources and analysis of the review;
- Undertake technical research, empirical analysis and modelling as and when directed by the Committee;
- Initiate strategies to promote and advocate sound tax policy to improve the system and process and sustainability of policy promulgation and ensuring that policy is kept current and refreshed in alignment with political, social, economic, demographic and technological changes;
- Coordinate and facilitate meetings/discussions on tax policy issues; and
- Finalise high quality briefs and submissions on the review for consideration by the Committee in a timely manner.

### **(ii) Secondment of Staff**

Technical staff will be seconded from Department of Treasury, Internal Revenue Commission, PNG Customs Services and other relevant agencies as and when required.

### **(iii) External Support**

The Secretariat will look at the possibility of recruiting additional expertise from donor partners such as the International Finance Corporation, Asian Development Bank, World Bank and the International Monetary Fund as and when appropriate. This does not limit employing expertise locally in line with specific needs of the review as it progresses. Out-sourcing by the Secretariat would follow standard procedures after all other avenues are exhausted.

## **Relationship with Department of Treasury**

Department of Treasury is the primary agency responsible for researching and advising the Government on taxation and non-taxation revenue policy matters. It is therefore important that the Secretariat work closely with the department to utilize its resources and expertise.



Department of Treasury will take the first call when outsourcing of specific work is required by the Committee and its Secretariat. Any out-sourcing of work will be on the basis where the expertise is not available within the Treasury Department and also in other Government agencies.

Department of Treasury will be responsible for the funding of the Committee/Secretariat and its activities including remuneration payments.

## **TRANSPARENT AND EXTENSIVE CONSULTATION WITH STAKEHOLDERS**

### **Stakeholder Consultation Approach**

The review will be open, transparent and will involve extensive consultation and dialogue with stakeholders.

This includes;

- Inviting submissions from private sector and civil society through both written invitation and public advertisements;
- Inviting specific industry or sector specific submissions from the various industries and sectors such as Agriculture, Tourism, Forestry, Fisheries, Manufacturing and other Service sectors.
- Regional visits to Momase, Highlands, Islands and Southern regions and holding community forums and meetings with local business chambers and associations and other stakeholders;
- Industry or sector specific consultations and dialogue etc.
- Establish web site and use media to communicate and generate discourse where appropriate.

### **Review Methodology**

The above stakeholder consultation will be supplemented and include desk top analysis, and tailored technical research.