Overview consultation paper

All Papua New Guineans have an interest in the future of the country's tax system - taxation impacts many members of society directly (e.g. through the tax they pay on their wages) or indirectly (e.g. through buying goods that have been subject to tax).

An effective taxation system can deliver revenues that are essential for the country's development – including to build the infrastructure to grow the economy and to build and staff the schools to teach the future generations of the country.

How a tax system is designed can also say much about the country – its priorities, its sense of fairness and the relationship that exists between citizens and Government.

Coming 15 years since the last comprehensive tax review, this current Review presents an opportunity for Papua New Guineans to have a say in the future of their tax system.

This paper draws on the significant work and consultations undertaken by the Tax Review Committee to date and sets forth proposed broad directions for reform being considered by the Committee.

The Committee welcomes and encourages any comments on these proposed directions.

Key principles for reform

The Tax Review Committee is drawing on a number of broad principles, used commonly to guide the design of tax systems around the world, in determining what a 'good' tax system should be in PNG.

- A good tax system should **raise sufficient revenue** to ensure that the government can deliver services that meet the community's needs.
- A good tax system should **promote economic growth** and thus drive more jobs, higher incomes, more services, lower prices and less poverty.
- A good tax system should be **fair** – it should create a level playing field for businesses and it should ensure that taxpayers each pay their fair share.
- A good tax system should be **simple** to enable taxpayers to understand their obligations and for the agencies to administer the law.
- A good tax system should **build trust and confidence in government** and should **be transparent and encourage greater government accountability** and integrity.

Forward

This is a simplified and more condensed version of the complex research evaluation work done by the Tax Review Committee and include its findings.

The primary objective of the paper is to enable all Papua New Guineans to take part in the ongoing dialogue and debate about the design of the country's tax system.

Work on the design of the tax review is ongoing and expected to be completed by the fourth quarter of 2015

Key findings

The Committee has received numerous formal submissions and met with many stakeholders in the Review to date. Drawing on these submissions and meetings, its own analysis and having regard to the experience of other countries around the world, the Committee has made some preliminary findings about PNG's tax system.

Finding #1: PNG relies too heavily on its income taxes

PNG is more reliant on its personal and corporate income taxes than most other countries in the region and developing countries more generally. A relatively small group of salary and wage earners and companies bear most of the taxation burden.

Finding #2: PNG needs to broaden its tax base

Related to finding #1 – PNG needs to find a way to broaden its tax base – that is, to ensure that more people and businesses contribute their fair share of tax.

Finding #3: PNG has a relatively low reliance on consumption taxes

PNG draws proportionally small amounts of revenue from consumption taxes such as the GST, relative to other like countries. PNG's GST rate of 10% is low by regional and developing country standards.

Finding #4: PNG's tax system is not well suited to small businesses

The Tax System is designed with large taxpayers in mind. For most small businesses in PNG, complying with tax obligations is complex and difficult and may be acting as a barrier to entering the formal economy and, as a consequence, growing.

Finding #5: Tax administration challenges are significant

Ensuring effective enforcement of the existing law remains one of the greatest challenges for PNG's tax system.

Finding #6: PNG could improve the way it taxes its extractive sectors

There is scope to improve the way in which PNG taxes new extractive projects to ensure a better return for Papua New Guineans on their non-renewable resources. Moreover, the provision of project specific incentives increases perceptions of unfairness amongst other stakeholders, undermining efforts to promote broader compliance.

Finding #7: Tax Incentives have been widely used but with little effect

Tax incentives have been widely used in PNG but appear to have little success – largely because they are trying to address problems that are not caused by the tax system. It is unclear how much incentives currently cost in terms of foregone revenue and there is confusion as to the basis upon which they are granted.

Directions for reform

Guided by these principles and preliminary findings, the Committee is considering the following broad directions for reform. Many of these directions are interrelated. It will not be possible, for example, to lower personal income taxes without raising more revenue elsewhere.

Direction #1: Improve tax administration

Improving administration of the tax system is and will remain the most significant priority for PNG going forward. As well as ensuring that the existing law is effectively enforced an effective tax administration is also crucial in implementing any significant tax policy reforms. Adequate resourcing of both the IRC and PNGCS is critical and the Committee is exploring other ways to assist the work of both organisations.

Direction #2: Reduce and simplify personal income taxes

Papua New Guinea needs to lower its personal income tax rates for all income earners but particularly for lower income earners. At the same time, the system can be made simpler by removing a number of the offsets and rebates currently available. Lowering tax rates will both increase incentives to work and ensure that PNG's salary and wage earners are not shouldering too high a revenue burden. However, **lowering personal income taxes requires increasing taxes elsewhere**.

Direction#3: Increase GST collections

As well as administrative efforts to increase existing GST collections (see Direction #1) PNG should consider increasing its GST as a means of paying for reductions in personal income taxes. PNG's GST rate of 10% is low by regional standards (for many countries 15%) and compared to the average of other developing countries (16%). Suggestions of raising the GST can be controversial given that it impacts so many people – yet this is one of its strengths when compared to personal income tax. The question facing PNG is this – should a lot more people pay a little more tax, in exchange for the few salary and wage earners paying less?

Direction#4: Lower corporate income taxes

PNG's corporate income tax rate (30%) is at the higher end, when compared to other like countries. This will be an issue in the medium term as higher corporate tax rates can deter investment – investment is crucial in encouraging economic growth and the creation of jobs. As with reductions in personal income taxes, moves to lower corporate income taxes will require raising revenue elsewhere.

Direction#5: Taxing Capital Gains

A reduction in PNG's corporate income tax could coincide with an introduction of a system for taxing capital gains. Capital gains (the gains earned when an asset is sold for more than it was bought for) are simply another form of income and not taxing them increases the inequality in the tax system. Designing a system of taxing capital gains that is appropriate for PNG will be important and may take some time. Not all assets should be subject to such a system – for example, whilst it appears reasonable to tax the gains earned when companies sell mining/gas rights, an individual's family home and any customary land should likely be excluded.

Direction#6: Reducing tax incentives and managing them transparently

Rather that introducing specific tax incentives to help encourage certain businesses, or certain sectors PNG should focus on making its tax system overall simpler, fairer and more competitive. Focussing on efforts to reduce corporate income taxes, for example, could be more effective in encouraging investment than introducing ad-hoc incentives. For those tax incentives that remain, there should be better public reporting of their cost (foregone revenue) and if incentives are to be provided in the future a clear and transparent framework should be put in place for their awarding (making it clear the criteria on which incentives will be granted).

Direction #7: A simpler tax system for small businesses

A simple and clear tax system for PNG's small businesses should be introduced to help them to enter the formal economy and grow. Similar systems exist in many other countries and often involve businesses being able to determine their tax liability based on an easy to identify characteristic of the business (such as turnover).

Direction #8: A more effective resource tax regime

PNG should put in place a resource tax regime that maximises the return to the State (particularly when commodity prices are high) including considering a rent tax in exchange for a reduction of state equity rights in the mining sector. Fiscal terms should be clear and transparent and, consistent with Direction #6, PNG should focus on a resource tax system that is overall more competitive as compared to one that relies on incentives and ad-hoc negotiation of terms.

Next Steps

The Tax Review Committee will be considering all feedback before finalising its recommendations to Government. If you want to have your say, contact the Tax Review Secretariat on info@taxreview.gov.pg, by phone on 325 3775 or via the website www.taxreview.gov.pg.