OIL SEARCH LIMITED

Personal and Retirement Income Taxation

Oil Search Submission to the Tax Review Committee

September 4th, 2015

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.8: Personal and Retirement Income Taxation

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Section 1: Introduction

The Personal and Retirement Income Taxation consultation paper is the most important publication of the Tax Review Committee to date with respect to PNG citizens because it will directly impact on the net income they will derive from their labours. The reform of personal tax regimes tends to be a substantive political issue and that will hold true for the current process in PNG. Most individuals will seek reform that is most advantageous to their personal circumstances with little regard as to what is best for the country. The self-interest motive will govern submissions and hence the Tax Review Committee has a critical role to play in ensuring that the altruistic goals of the Review are achieved. The Committee must keep focus on the reform of the whole tax regime whilst ensuring sufficient tax revenues are being collected by Government.

Notwithstanding the above comments, there is a real case for reform of the personal tax system in PNG as part of a broader rebalancing of the PNG tax regime. PNG's personal tax rates step-up quickly at relatively low levels of income and with high levels of inflation resulting in wage growth, PNG citizens working in the formal sector have become victims of 'bracket creep' such that they are paying increasingly higher average rates of tax on the same income in real terms. This has a particularly adverse effect on low to middle income earners in PNG. Further, bracket creep creates a disincentive to work and if not addressed will provide an additional barrier to future productivity growth in the PNG workforce. PNG must be focussed on increasing the workforce participation rate and productivity rate if is going to achieve the long term economic goals set out by the Government as part of *Vision 2050* and personal tax reform must be a critical component of that agenda.

In correcting for these and other issues, any reforms must be carefully balanced against the needs of the PNG economy in a time where commodity prices are depressed and the Government's expected corporate tax revenues are likely to fall short of budget. It follows that any reforms proposed to personal taxes need to be part of a broader response whereby any tax cuts are offset by increased tax revenue from elsewhere in the tax system.

This Oil Search submission addresses the issues contained in the Tax Review Committee's *Issues Paper No.8: Personal and Retirement Income Taxation*. 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 this and other potential reforms as part of developing a balanced taxation regime for PNG.

Section 2: Executive Summary

The continued refinement of the PNG 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 vital to providing the platform for the next phase of economic growth in PNG. Chief among the drivers of future economic performance in PNG will be productivity and PNG needs to create incentives for citizens to work harder. Personal tax reform can be the catalyst for a drive in productivity and hence Oil Search supports personal tax reform as part of a broader package of tax reforms.

As part of considering the broader process of tax reform, we urge the Committee to follow the global trend by focussing on collecting tax revenue through the use of efficient, broad based consumption taxes as opposed to maintaining high personal income tax rates. Middle income groups in emerging economies still face important economic and organizational challenges that prevent them from playing the transformative role often attributed to the working and middle class in the historical development of today's advanced welfare state democracies. PNG is a developing economy where a large proportion of the population still operates in the informal sector and those persons are largely outside of the current tax system, despite the fact that they still utilise the infrastructure and services that the Government provides. It is an ongoing challenge for the PNG Government to collect a fair share of tax from those persons in the informal sector and utilising GST on consumer goods as a collection mechanism is likely to be much more efficient than seeking to increase compliance in the informal sector. For these reasons we favour a new policy approach, which has been countenanced by the Committee, whereby there is a reduction in personal tax rates offset by an increase in the rate of GST.

This submission contains detailed explanations of our views on the potential reforms raised by the Committee in the consultation paper in relation to the personal tax system and also contains comments on other tax design and policy issues. In summary, our key comments are:

- The tax free threshold should be increased to K15,000;
- There should be a simplification of the existing marginal tax rates, reduced to only four tax bands and rates should be lower than under the existing system;
- Non-resident and resident tax rates should be harmonised;
- Retrenchment, redundancy and medical retirement termination payments should be taxed on a concessional basis with reference to the age and length of service of the individual in question;
- Only 50% of the Housing allowances received by an individual should be subject to tax, replacing the existing system; and
- The net tax cuts that would arise from the above measures should be funded by an increase in the rate of GST, potentially to 15%.

In our view, these reforms can effect a structural change in the way PNG citizens are taxed that will result in a broader, simpler, more efficient and fairer tax system that will provide the foundation for future economic growth in PNG.

Section 3: Options for Reform of the Tax Free Threshold and Personal Income Tax Rates

Tax Free Threshold

As foreshadowed in our previous submission to the Tax Review Committee, we are firmly of the view that the greatest challenge in the PNG tax system is the strength of the administration. To that end, we have consistently supported any measures which would simplify the tax system and allow IRC personnel to concentrate on the integrity of the tax system as opposed to collections.

The consultation paper highlights the fact that based on 2014 survey data, 36% of employees earned less than K14,000 and that they contributed less than 2% of the total amount of personal income taxes collected. Increasing the tax free threshold to K15,000 should free up some capacity in the IRC as well as provide tax relief for the low to middle income earners in PNG. In order to manage the budgetary impact of such an increase, compensating changes to other taxes will be required to be made. We are in favour of an increase in the base rate of GST as GST is an efficient broad-based consumption tax, as opposed to increases in other marginal tax rates.

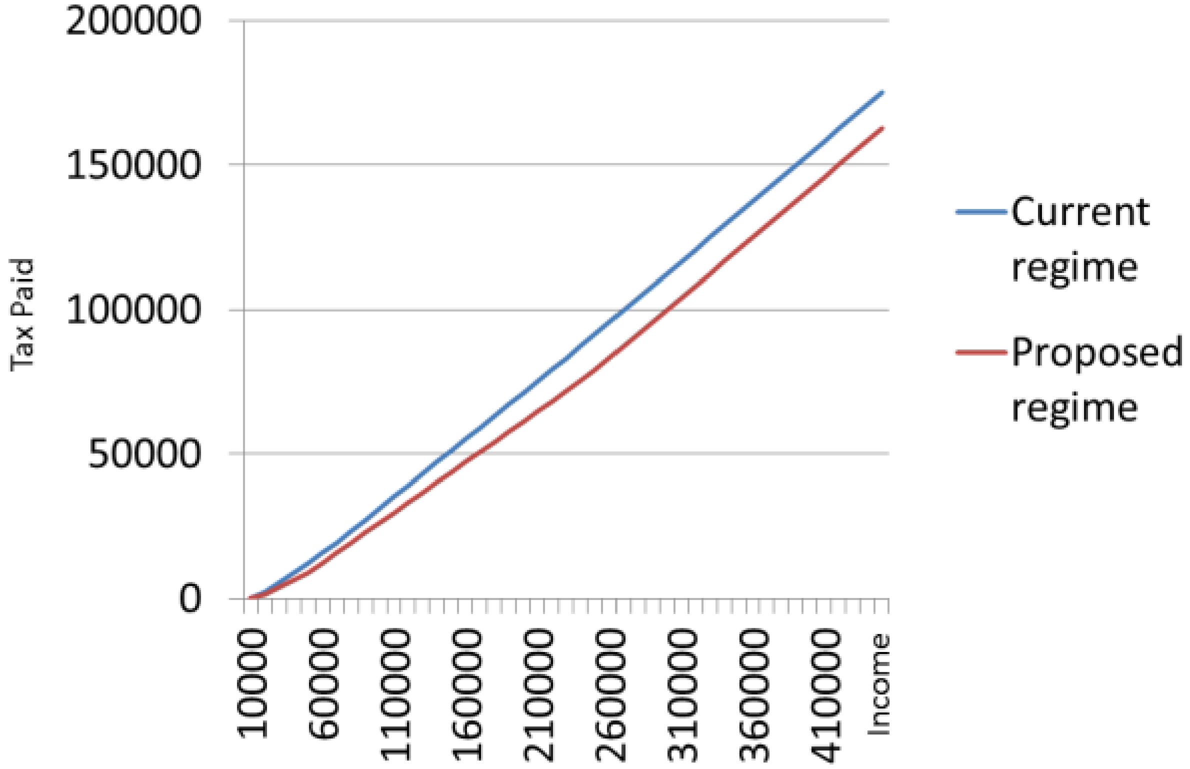
Marginal Tax Rates and Tax Bands

There has been significant PNG public support for tax relief for low to middle income earners, with a belief that the PNG tax rates apply at a relatively low level and escalate quickly compared to other jurisdictions. Whilst the current PNG tax rates do rise quickly, personal tax is a substantial part of Government revenue and any changes must be funded given the current state of the Government budget. Hence, without significant other reforms, progressivity of tax rates must be retained and it would seem that budgetary needs will require the rates to still escalate relatively quickly otherwise any reforms risk creating a shortfall in Government revenues

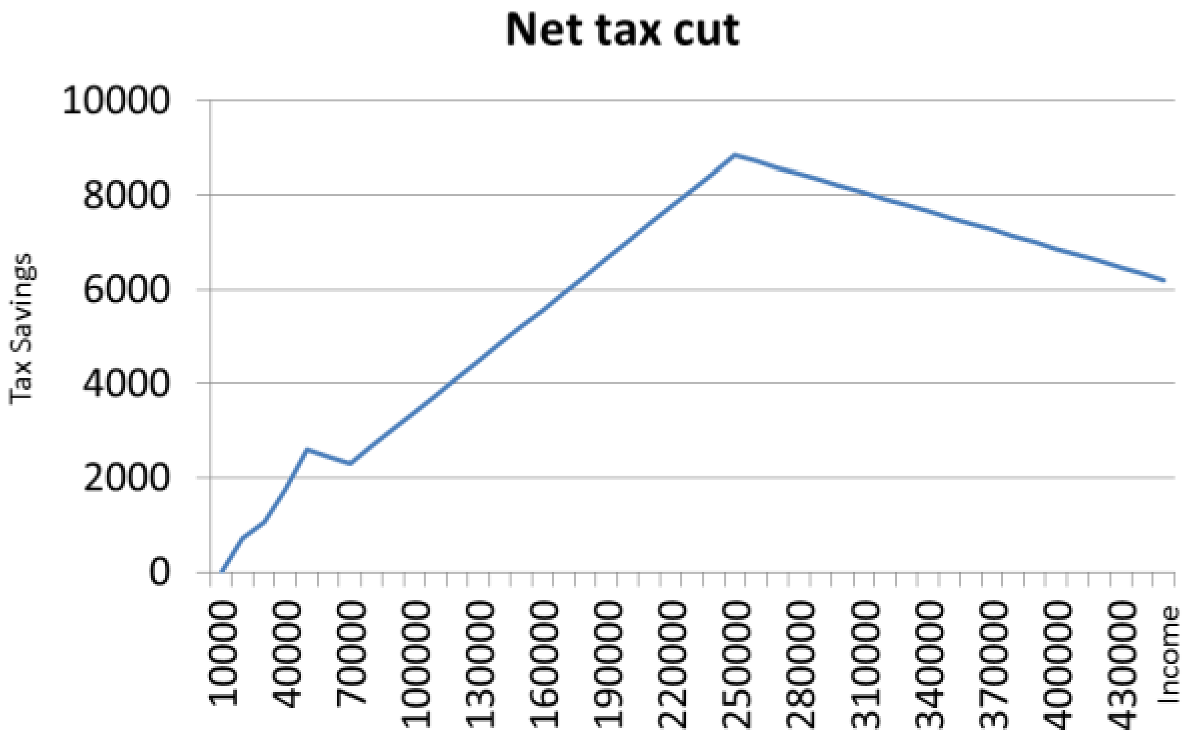
As they currently stand, there are too many different marginal tax rates in PNG. We would recommend a simplification whereby there would be only three marginal tax rates above the tax free threshold. Without having undertaken an analysis of the budgetary impacts (as we do not have access to the necessary data to perform such an analysis), the marginal tax rate thresholds could be simplified as follows:

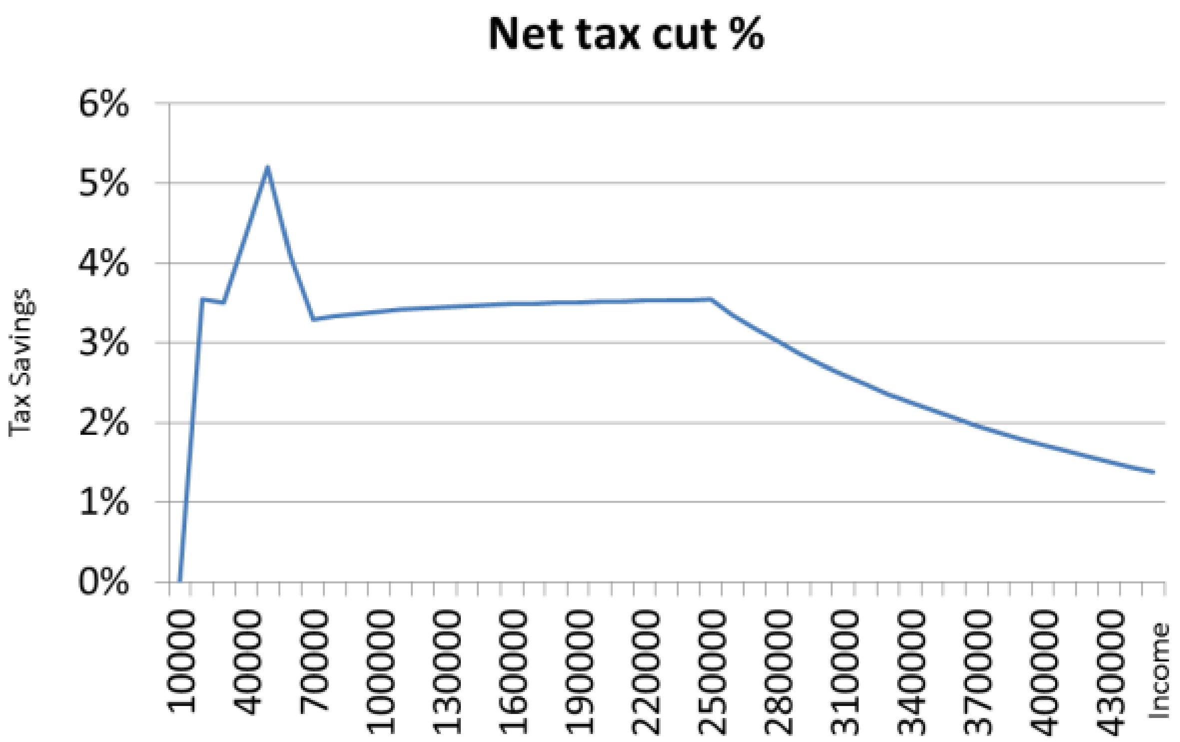
Taxable income	Tax	Rate on excess
K15,000	**Nil**	**25%**
K50,000	**K8,750**	**35%**
K250,000	**K78,750**	**42%**

We note that there is a substantial jump in the tax rate once earnings exceed K15,000, but to some degree this is necessary to fund the increase in the tax free threshold. To illustrate this point we have graphed the tax take per individual under the existing tax rates and the proposal above, up to K450,000.



Obviously such a tax cut would have to be funded and to that end, we have assumed a 5% increase in the level of GST to 15% and 50% consumption by taxpayers. In that scenario, the dollar tax cuts and the percentage tax cuts such a system would create are shown below.





In this scenario, tax cuts would be provided to all PNG tax residents with the greatest proportional tax cuts for those on low to middle incomes. To the extent that the consumption was higher than the modelled 50% of post-tax income, the tax cuts can turn negative at higher income levels. Given the relatively higher tax imposts on high income earners who currently pay a significantly greater proportion of the personal taxes collected and the likelihood that an increased GST will raise additional taxes from those operating in the informal sector, the overall proposed framework may actually increase the total tax take. Detailed testing would need to be undertaken to derive the optimal model which takes into account the fundamental drivers of tax reform as well as the current budgetary position.

Consideration should also be given to legislating or codifying the indexation of the tax bands (for example to movements in the consumer price index) so as to avoid bracket creep issues. Bracket creep is a convenient way to increase tax collections, especially in a high inflation economy like PNG, but principles of equity and fairness would suggest that indexation is appropriate. Obviously this will need to be counterbalanced against the long term budgetary forecasts, including the PGK/USD exchange rate.

We note that the committee has also flagged reducing the top marginal rate as a mechanism to attract highly skilled workers to PNG. In our experience, these types of workers typically have a structure such that any additional tax payable over and above their home country taxation is paid for by their employer as part of their package. Hence, the reduction in the top marginal rate is unlikely to have a material effect on their employment decisions.

We concur with the Committee's views that dropping the top marginal rate should be a second stage priority, unless there is an increase in other taxes, i.e. GST, for which the top marginal rate taxpayers need to be compensated for. As outlined above in our proposal, tax relief for high income earners can be provided by an increase in the tax-free threshold and other marginal rate changes as opposed to a straight reduction in the top marginal rate.

Non-resident Tax Rates

As discussed above, most non-residents working in PNG have arrangements with their employers whereby any amounts of tax payable in PNG over and above their home country taxation is a cost of the employer, i.e. the employee is kept whole and net amounts of pay are grossed up. Hence, we agree with the Committee's views that the top marginal rate as it applies to non-residents should not be altered other than as part of a broader reform of personal tax rates where the top marginal rate is abolished as countenanced above.

Further, we are of the view that in the interests of simplicity, the distinction between non-residents and residents should be abolished. We would expect that this change to access to the tax free threshold would not be of a material nature given the relatively low tax-free threshold and the relatively high incomes of non-resident taxpayers.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 4.1 – Do you agree that adjustment to the tax free threshold is the best	We agree that the adjustment of the tax free threshold is the best mechanism to provide tax

mechanism to give tax relief? Do you have any views on whether adjustments to individual marginal tax rates could provide a similar level of relief? And if so, what changes could be made?	relief to low and middle income earners. Obviously adjustments to marginal rates can also be used to provide tax relief and hence we have proposed a comprehensive simplification of the tax rate scale, reductions in individual tax rates and an offsetting increase in the rate of GST.
Question 4.2 – What is your response to the Committee's observation that the tax free threshold could be raised to at least K15,000 as part of a package of possible reforms that include reductions in concessions and removal of rebates and an increase in the GST?	We agree with the Committee that K15,000 is an appropriate level for the tax free threshold, taking into account our proposed increase in the rate of GST.
Question 4.3 – What are your views on maintaining the progressivity of the existing marginal tax rates but with adjustments reflecting changes to the tax free threshold and the number of tax bands?	We agree that the maintenance of a progressive tax system is vital to ensure fairness (i.e. low to middle income earners pay a lower average tax rate of tax than high income earners). We have highlighted above our proposed approach to personal taxation which includes a reduction from the existing 6 bands to just 4 bands.
Question 4.4 – What are your views on the Committee's proposal that current top marginal tax rate be retained for the time being?	As part of a broader package of reforms, we favour the abolition of the top 42% marginal tax rate. In the event that GST reform is delayed, then we would support the retention of the top marginal rate at the present time given the budgetary constraints the Government is currently facing as a result of the drop in global commodity prices.
Question 4.5 – Do you agree with the proposal that future reductions in the top marginal tax rate be considered in conjunction with reductions to the corporate tax rate?	No. We see the assessments of personal taxes and company taxes as related, but not mutually dependent. The Committee and the Government should assess the company tax rate and the personal tax rates independently and as a collective in optimising the tax mix in PNG.
Question 4.6 – Do you have a view on whether the number of tax bands should be reduced in number? If so what tax bands are appropriate for PNG?	See above comments where we have recommended that the number of bands be reduced to four.
Question 4.7 – Do you have views on what the marginal tax bands should be and at what income levels should they apply?	See our above comments setting out our initial views as to the rates and thresholds that should apply. It is noted that any modelling done by Oil Search in assessing the impact of these measures and an associated increase in the level of GST was done at a high level and without access to the detailed economic data that the Committee has access to that would be required to analyse their budgetary impact.
Question 4.8 – To what extent are non-resident salaries likely to be grossed up?	In our view, non-resident salaries will almost certainly be grossed-up in the event that the top marginal rate for non-residents is increased.

Question 4.9 – Do you agree with the Committee's recommendation that resident and non-resident tax rates and thresholds be harmonised?	We agree with the recommendation as it simplifies tax affairs for non-resident taxpayers.

Section 4: Options for Reform of the Tax on Termination Payments

Early Retirement on Medical Grounds

We note the comments from the Committee and acknowledge that there is not a common international standard in terms of providing tax relief for forced retirement on medical grounds. However, given the proportion of individual taxpayers in PNG who work physical 'blue collar' jobs as opposed to sedentary 'white collar' jobs, Oil Search is of the view that tax relief, in some form, is appropriate. It must be kept in mind that PNG does not have a comprehensive social security system and hence where taxpayers are physically unable to continue in their profession, some degree of support must be provided. The policy rationale supporting this concession would seem to be stronger than the existing redundancy concessions available to public servants.

There is a risk that such a system could be subject to abuse and hence any forced retirement on medical grounds would need to be authorised by a registered and appropriately qualified medical practitioner. Further, we would ask that the Committee consider whether it may be appropriate to impose integrity provisions which afforded more concessional treatment to individuals forced to stop work because of an accident or illness as opposed to people no longer able to perform physical activities as part of the natural aging process.

Section 46CA reform

We concur with the Committee that there is no strong policy rationale to have an arbitrary 30 person limit on redundancy tax relief which only applies to private sector companies. We strongly favour a removal of the limitation in Section 46CA and recommend that it provides relief to any genuine redundancy, i.e., where the role is actually eliminated. The benefit that should be provided should be limited based on the age and length of service of the employee who is made redundant, as is countenanced by the Committee in the consultation paper. As a point of comparison, under the Australian system where there is a genuine redundancy, there is a tax free component (A$9,780) plus an additional amount for each completed year of service (A$4,891). The age of the individual then determines the rate of tax payable on the taxable portion, i.e. the amounts in excess of the tax free component. If the individual is over the preservation age (60 years) then up to A$195,000 of the taxable amount is taxed at 17%. If the individual is under the preservation age then amounts are taxable at 32%. Both rates are well below the current top marginal Australian tax rate of 49% (including the Medicare levy).

By adopting a similar policy, the amount of the redundancy that is subject to concessional tax rates is limited. Whilst there would still be an opportunity for structured redundancies to manipulate these rules, we would encourage the use of an appropriate penalty regime for employers who fraudulently make workers redundant when in reality, the workers have been terminated for poor performance or they have retired or resigned. The penalties in such a regime should be sufficient such that any employer will be dissuaded from treating a worker leaving as redundant in a situation which is anything other than a genuine redundancy.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 5.1 – Should the taxation of redundancy payments in cases of medically caused retirements be taxed more lightly? What do you think the policy rationale should be for reducing tax on redundancy payments in this situation?	As outlined above, we are in favour of concessional treatment for medically based retirements. From a policy perspective, providing such concessions recognises that these persons may have relatively higher medical expenses going forward (which may no longer be covered by their employer scheme) and given there is not a comprehensive social security system in PNG, concessional tax treatment of their termination payment is warranted.
Question 5.2 – Should Section 46CA be amended to remove the 30 person redundancy requirement as discussed? If so what integrity measures should be applied to ensure only genuine redundancy is covered?	Yes, the 30 person limitation should be removed. To address potential integrity issues, we strongly recommend a penalty regime which focuses on the employer, should they be found to have been complicit in a non-genuine redundancy.
Question 5.3 – If concessions are to remain should Section 46CA be replaced by a simple Kina cap on the amount of termination payments subject to the concession?	No, we prefer a construction which takes into account the age and length of service of an employee who is made redundant. A simple cap does not recognise the potential disparity in the length of service employees may have provided or their respective remuneration
Question 5.4 – Should the taxation of termination payments be determined according to the length of service an employee has with his/her employer? Should the age of an employee be another consideration in the provision of tax concessions?	Yes. As flagged above, these factors need to be recognised in the determination of the concession.
Question 5.5 – Should long service leave be included in any new arrangements or should it continue to be taxed under the existing tax rules?	We favour the maintenance of the existing treatment of long service leave as the pre-1993 components have all but washed through the system now.

Section 5: Reform of Rebates and Credits

Rebate on Dependents

We note the Committee's comments on the under-utilisation of the dependent rebate by PNG taxpayers. Based on our quick review, it would seem that the existing definition is sufficiently wide enough such that many taxpayers in PNG should be able to claim the rebate. Further, the policy behind the existence of the rebate, that there is an incrementally higher burden on a taxpayer supporting multiple dependents, is fundamentally sound. Hence we would recommend retention of the rebate and encourage the IRC to continue its education programs so that all taxpayers are aware of what rebates they are entitled to claim. It is noted that many employees would receive the benefit of the dependent rebate through a reduction in their fortnightly income tax deducted by their employer.

Rebate on Education Expenses

The rebate on educational expenses cannot be looked at in isolation. The rebate is typically not used because employers are paying education expenses on behalf of employees as part of their remuneration package. Hence, the taxpayer does not have anything to claim under the rebate.

If the Committee is only examining the rebate and not the broader exemption under Section 40(3) of the Income Tax Act, then it would seem that there may be some merit to abolishing the rebate in the interests of administrative simplicity. However, if there proposal is a broader change to disallow the salary sacrifice of school fees, then this would be a substantial issue for all large companies who have employed highly skilled non-residents and skilled residents. These resident and non-resident taxpayers typically put their children into international schools which are relatively speaking, high cost. Paying the fees out of post-tax dollars would be a substantial reduction in the value of their remuneration package and in the case of non-resident employees; employers would need to gross-up the employee's wage.

Rebate on Salary and Wage Expenses

We agree with the Committee that the rebate on salary and wage expenses has been ineffective and little utilised. We favour a removal of the rebate, but taxpayers should be allowed to deduct any expenses they incur in relation to the earning of their salary and wages as part of a self-assessment tax system without having to seek an amended assessment.

Rebate on Non-Salary or Wage Loss

Following on from the rebate on salary and wages expense, the rebate on non-salary and wage loss should also be abolished in the interests of simplicity. Any revenue account loss incurred by a taxpayer should be available to offset their salary and wages tax position as a matter of law, not via a limited rebate.

Foreign Income Credits

The current rules applying to foreign income and the availability of credits are appropriate and can be maintained. That said, the alternative of exempting foreign income which has been subject to tax is also an appropriate treatment. Given that the existing system allows for PNG top-up tax to be paid where the underlying income has been lightly taxed or has not been subject to tax, the better course of action is probably to retain the existing system as opposed to providing a blanket exemption for foreign income. This would prevent PNG citizens avoiding PNG tax by directing foreign investment income to entities located in tax havens before remitting the profits back to PNG in some form.

Withholding Taxes

We note with keen interest the comments from the Committee in relation to the existing withholding tax regime in PNG and are in agreement that the regime should not be changed at this juncture.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 6.1 – For the purpose of simplifying the system for PIT and business, should the dependants rebate be abolished and folded into the standard tax rates?	No. The dependent rebate is good tax policy and should be retained.
Question 6.2 – What are your views on removing school fee rebate and rolling the savings into lower tax rates?	Yes, provided that the existing treatment of the provision of education expenses as part of remuneration packages remains untouched.
Question 6.3 – Do you support the removal of the salary and wage expenses rebate and rolling the savings into lower tax rates?	Yes, provided that salary and wage expenses are immediately deductible.
Question 6.4 – Do you agree with the Committee's reasoning that the election expenses rebate be retained?	Oil Search is not in a position to comment on the appropriateness of the existing treatment of election expenses.
Question 6.5 – Do you support the removal of the rebate on non-salary and wage loss?	Yes, provided that loss is immediately deductible against salary and wages .
Question 6.6 – Do you support the current arrangements in the Income Tax Act for the relief of double tax?	Yes, the current system is appropriate and well targeted.

Section 6: Taxation of Fringe Benefits

Salary Sacrifice Arrangements

Under current practices, the IRC allows taxpayers to receive up to 40% of their salary package in concessionally taxed benefits such as accommodation, education, motor vehicles and superannuation benefits. We strongly support a move to increase the portion of the salary package received in concessionally tax benefits to 50% and to codify this to eliminate the current ambiguity that surrounds the administration of these arrangements. The high cost of housing, particularly in Port Moresby means employees spend a significant portion of their income on accommodation – often up to 40% of their salary, leaving little or no scope for to access other concessionally taxed benefits, particularly education expenses where employees support young families.

Housing Allowances

The current system of housing allowances is complex. In many cases a subjective judgment has to be made as to the value of a house or flat to determine the tax outcomes for a particular taxpayer. Given the dynamic nature of property investment, the outcome can change throughout an income year putting taxpayers in an unenviable position.

As part of the overall theme of simplification within the broader Tax Review, we would encourage the Committee to examine ways in which the existing system of the taxation of housing allowances could be simplified. For example, we would favour a system which applies a benchmark percentage to a housing allowance and deems it to be taxable. We suggest that an appropriate benchmark could be 50%. We are of the view that such a scheme better captures the value of the benefit derived by the employee and does not rely on historic measures of rental yields on property. The taxable value will continue to move as rental costs change without the need for legislative intervention. For completeness, we note that under the Oil Search proposal the whole amount of the housing allowance would be taken into account in determining whether an employee had breached the 50% salary sacrifice cap that we proposed above.

We note with interest the comments of the Committee in relation to the ability for employees apply to the IRC for a variation where employees are paid an allowance in lieu of accommodation. As the system is currently administered, the onus is on the tenant to obtain the TIN of the landlord and provide it to the IRC. In our view this places an unfair burden on the tenant and all the tenant should need to provide is a duly stamped lease agreement. We are of the view that the solution lies with the IRC who should require the TINs of the parties to any lease as part of the stamping process.

When considering the potential for reform in the area of housing allowances, it must be kept in mind that a substantial portion of those persons receiving the housing allowance are part of a highly mobile labour force and any reforms which put them in a worse financial position will either be reimbursed by their employer or could lead to them re-evaluating their commitment to working in PNG.

A strong middle class or middle income group boosts economic growth in many ways, including consumption, investment in education, entrepreneurship, and promoting good governance. In urban PNG, housing supply and costs are placing constraints on the emergence of a sufficiently large middle class to drive economic growth. Consistent with current Government policy to make credit accessible for aspiring home owners, Oil Search suggests introducing the ability of first home owners to claim a salary sacrifice for both the principal and interest portions of home loan repayments.

Other Fringe Benefits

We note the comments of the Committee in relation to certain other fringe benefits that are commonly provided to employees, in particular expatriate employees, in PNG. Whilst we acknowledge the economic theory behind a proposed abolition of exemptions in return for lower individual tax rates, the reality is that the recipients of these types of benefits will seek to be 'made whole' by their employers to the extent that their net tax position is altered. This then leads to an increase in the cost of labour for the largest of PNG's companies which often rely on foreign employees where specialist technical skills are required.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 7.1 – The Committee welcomes stakeholder comments on the taxation of non-cash benefits including suggestions for changes to the existing taxation of benefits that would improve the overall fairness and administration of PNG's personal income tax system.	We would support a move to increase the portion of the salary package received in concessionally tax benefits to 50%. The high cost of housing, particularly in Port Moresby means employees spend a significant portion of their income on accommodation – often up to 40% of their salary, leaving little or no scope for to access other concessionally taxed benefits.
Question 7.2 – Do you agree that the taxable value of the housing allowance should be adjusted to take account of changes in house values and rentals in PNG?	Yes we agree. We propose a rule that 50% of the value of any housing allowance received by a taxpayer is exempt, replacing the existing complex system.

Section 7: Taxation of Investment Income

Oil Search has previously provided comments in relation to the application of withholdings taxes and the potential introduction of a capital gains tax in PNG. We continue our support for the retention of the existing withholding tax regime as it applies to petroleum companies such as Oil Search and also our support for the longer term introduction of an appropriately structured capital gains tax in PNG. As part of the design of a capital gains system, it will be important for the Government to ensure that there are appropriate anti-overlap provisions such that employees are not subject to tax on the same income twice including for example on income derived from participation in employee share schemes.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 8.1 –Do you have any comments on the taxation of investment income?	Please refer Oil Search's comments in submissions made in response to earlier consultation papers published by the Committee.

Section 8: Taxation of Retirement Benefits

Taxation of Contributions

The superannuation fund industry in PNG is still in its relative infancy given the large proportion of the PNG citizens who work in the informal sector. Further, with the absence of a Government funded pension scheme, it is imperative that PNG citizens be given every opportunity to fund their own retirement.

The current arrangements in PNG are appropriate, notwithstanding the relatively low level of voluntary employee contributions. Oil Search would support any measures which would allow greater employee pre-tax contributions. As the administrative practices of the IRC currently stand, the 40% cap on salary sacrifices can mean that the ability of employees to make additional tax-effective contributions is somewhat limited once school fees and housing arrangements are taken into account. To that end, we would prefer that the pre-tax superannuation contributions limit was raised to 10% as part of a broader move to allow up to 50% of pre-tax salary and wages to be sacrificed by employees.

Taxation of Superannuation Fund Earnings

Taxation of superannuation fund earnings impacts on the ability of taxpayers to save for their retirement as it ameliorates the balance in their accounts. Generally, most pension schemes in developed nations would provide for a greater spread between the company tax rate and the rate at which superannuation fund earnings are taxed. For example, in Australia the superannuation tax rate is half of the corporate tax rate (15% to 30%). Over time we would encourage the PNG Government to reduce the tax on superannuation fund earnings to incentivize contributions into the funds so that more PNG citizens can fund their own retirements. However, we recognise the potential budgetary constraints which may defer such a reduction. The data in the consultation paper is somewhat misleading (it suggests that the tax collected was only K9.7m on an asset base of K8.9b which would imply almost no earnings by PNG superfunds) so it is unclear as to what the cost of a reduction in the taxation rate applying to superannuation funds would actually be.

Retirement Savings Accounts

The policy supporting the use of RSA’s is sound and provides an excellent option for PNG citizens to manage their retirement. However, given the high rates of inflation and increased life expectancy in PNG, Oil Search is of the view that the K250,000 transfer limit is insufficient. We would favour an increase in the transfer limit to at least K$1m, with the potential for the limit to be significantly higher. An increased limit would give RSAs the breadth to be a real tool that can provide for retirement. At the current limit, the RSA is likely not much more than a stipend to support part of a retiree’s living costs.

Over time the RSA limit will need to revised given the high rates of inflation in PNG. As opposed to requiring ongoing legislative intervention to raise the transfer limit, we would support the introduction of indexation of the RSA limit from the time the proposed new higher limit is introduced.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 9.1 – Do you have any comments on the taxation of contributions to Superannuation Funds?	As outlined above we favour an increase in the cap on voluntary contributions by employees as part of a broader program to increase the amount of salary that can be sacrificed to 50% of earnings.
Question 9.2 – What transitional rules do you think would be required if the mandatory employee contributions of 6 per cent were made tax free?	Oil Search is of the view that detailed transitional rules would not be required. It will be critical to ensure that the relevant start date is the first day of a new income year.
Question 9.3 – What are the consequences on superfunds of current earnings tax?	Current earnings tax within superannuation funds reduces the ability of PNG citizens to save for their retirement and undermines the principle purpose of superannuation funds.
Question 9.4 – Do you have any examples of the taxation of retirement benefit withdrawals where there are inequitable outcomes for retirees?	Oil Search is not in a position to provide a response to this query.
Question 9.5 – How can RSAs be made more attractive for retirees as a way to manage their income during their retirement?	The RSA provisions are already quite attractive and should not require wholesale change. An increase in the amount that can be transferred to an RSA would be the only change we would recommend at this time. An K1m would appear to be a better cap than K250,000 given continued increases in living costs in PNG. Consideration should also be given to indexing the cap to account for the relatively high rate of inflation in PNG.
Question 9.6 – What tax changes could be introduced to encourage the take up of pensions in PNG? What features or aspects should pension accounts have and which are not already available in RSAs? How could or should market risks be managed?	Oil Search is not in a position to provide a detailed response to this query.

Section 9: Other Issues

Residency

We note the simplified test of residency proposed by the Committee which would be strictly governed by the number of days in country. However, such a test does not examine the surrounding factual circumstances and could lead to adverse tax outcomes whereby a taxpayer is subject to tax both in PNG (due to the 183 test being breached) and also his home country where he maintains a permanent place of abode. PNG already collects tax from non-residents where the income is PNG sourced. The proposed reform of the residency rule is an over-reach and would risk damaging PNG's international reputation.

Taxation of Rental Income

We understand the challenges faced by revenue authorities in terms of collection of rental income. However, it would be bad policy to impose a withholding requirement on tenants. Not only does it put a tax collection obligation on a party who may be relatively unsophisticated, there is a substantial risk that landlords would simply seek to gross up rents to ensure they maintain their cashflow without declaring the rental income in their tax return. In that scenario, the persons who will be most disadvantaged will be the tenants. We recommend that the Committee continue to examine this issue and focus on imposing taxes directly on landlords as opposed to tenants by using Government land holding records together with the TIN reforms that were part of the 2015 Budget package. Further, the proposal to only impose the withholding on the high-end rental market is arbitrary and prone to mistake and manipulation.

Responses to Tax Committee's Questions

Consultation Questions	Responses
Question 10.1 – Should the definition of residence for tax purposes be revised? Are there any issues associated with using the 183 day rule discussed above?	Any test must consider the surrounding factual circumstances otherwise it runs the risk of creating inappropriate tax outcomes. We favour retention of the existing residency definition.
Question 10.2 – Withholding tax regimes need careful analysis, taking into account PNG circumstances. In particular, are the incentives for tenants to comply with these rules greater than those of landlords to comply with the existing rules including potential TIN matching?	It is inappropriate to put a withholding obligation on a party because the IRC has trouble enforcing its own rules. There would be no incentive for a tenant to comply with such withholding rules as it could create animosity between landlord and tenant and the landlord could simply seek to increase the rent charged so that they do not suffer the cashflow burden of the withholding tax. Instead they will look to pass it on to the tenant.
Question 10.3 – What would be the issues associated with the developing a rate that would collect a suitable amount of tax while limiting the need for the extensive issue of refunds?	Trying to determine a rate that captures the right amount of profit is impossible as each landlord will have a different historic basis in a property and will have a unique set of operating costs. The focus should be on ensuring

	compliance by landlords. Ultimately, landlords will only seek refunds to the extent that they have been overtaxed. Otherwise the IRC should expect that the landlords will not lodge returns, consistent with the current operation of the Foreign Contractor Withholding Tax regime.
Question 10.4 – Are there any issues on the taxation of income or benefits that this chapter has not covered? If yes, what are they?	None that Oil Search is aware of.

Section 11: Conclusion

Taxpayers the world over are always clamouring for personal tax cuts. Individuals will always seek to maximise their after tax pay because they are then in control of how they utilise the funds, either by consumption or saving. Individuals prefer that the choice on how to deploy their funds rests with them as opposed to Government. However, society needs certain infrastructure and services that only Governments can provide and this necessitates a tax system. Over the past 20 years there has been a global move away from high rates of personal and company taxes and towards an increase in consumption taxes. Consumption taxes are efficient, broad based and allow the individual taxpayer to make the choice as to how much they choose to consume and how much they save from their salary and wages. PNG has started down this path with the introduction of the GST and the time is right to take the next step and increase the reliance on GST as a primary source of tax revenue with a reduced focus on personal taxes. Further, GST is a better mechanism to capture tax from those individuals operating in the informal economy. The IRC is already faced with significant challenges in raising taxes from this sector of the workforce and increased GST will assist them in that endeavour.

As we have discussed throughout this submission that one of the key drivers of the future economic performance in PNG will be productivity. It follows that PNG needs to create incentives for citizens to work, and work harder. Personal tax reform can be the catalyst for a drive in productivity and there is a groundswell of support for reform throughout PNG society. Low to middle income earners have been affected by the rapid growth in the PNG economy which has pushed up prices of all goods and services. Through the tax reform process there is an opportunity to rebalance the tax system and ensure that the interests of low to middle income earners are looked after.

To re-iterate, our key comments are:

- The tax free threshold should be increased to K15,000;
- There should be a simplification of the existing marginal tax rates, reduced to only four tax bands and rates should be lower than under the existing system;
- Non-resident and resident tax rates should be harmonised;
- Retrenchment, redundancy and medical retirement termination payments should be taxed on a concessional basis with reference to the age and length of service of the individual in question;
- An individual should be able to salary sacrifice up to 50% of their total fixed remuneration;
- Introduce the ability to salary sacrifice both principal and interest portions of loan repayments for 1st home buyers;
- Subject to the above, only 50% of the Housing allowances received by an individual should be subject to tax, replacing the existing system; and
- The net tax cuts that would arise from the above measures should be funded by an increase in the rate of GST, potentially to 15%, or a mix of GST rates for different goods and services or urban, peri-urban and rural or a combination thereof, from 10-15%. Oil Search will

consider the potential reform options for GST as part of a response to the indirect taxation consultation paper which we understand is yet to be released by the Committee.

Subject to detailed economic modelling, we believe that the above suite of changes can be implemented to give rise to a tax revenue neutral outcome for the PNG Government whilst effecting a structural change in the way PNG citizens are taxed that will result in a broader, simpler, more efficient and fairer tax system that will provide the foundation for future economic growth in PNG.

As PNG's largest company, Oil Search sees itself as more than just a taxpayer in PNG. We consider ourselves an important development partner with our nation. 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 consultation process on the reform of personal taxation and other associated issues.

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