

OIL SEARCH LIMITED



## Other Indirect Taxes

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### Oil Search Submission to the Tax Review Committee

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This paper contains the response from Oil Search Limited to the Papua New Guinea Taxation Review Issues  
Paper No. 10: Other Indirect Taxes

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## Section 1: Introduction

As the consultation work of the Tax Review Committee draws to a close, the focus moves to the smaller taxes that are imposed in PNG. These taxes may not raise as much tax as company tax, personal tax and GST, but they are all part of the tax mix and we commend the Committee on considering their state and whether they should continue to be part of the ongoing PNG tax system. However, the consideration of environmental taxes which are included at the end of the Committee's Issues Paper is a very substantial matter and could easily have formed a single Issues Paper all on its own.

The impact of the continuing urbanisation of PNG and the effects of development in the resources and agricultural sectors on the environment are challenges that many nations around the world are facing and notwithstanding global emissions targets and various carbon taxes and trading schemes, there is still significant ground to be covered. The challenges of one nation on environmental issues will markedly differ from the issues facing another nation. It is imperative that PNG be 'self-aware' of the state of its economy and what the drivers of that economy are before embarking on environmental measures that are more suited to a large developed economy. Further, PNG needs to be aware that due to the varied nature of the country, activities which may be extremely harmful to the environment in certain parts of PNG may not be in other parts. PNG needs to always keep in mind that environmental regulation should never be one size fits all. Sometimes the optimal solution requires flexibility.

When considering issues associated with stamp duty, gambling taxes and so on, we would encourage the Committee to continue to look for opportunities to eliminate inefficient taxes and taxes that raise little or no revenue. As part of the rebalancing of the PNG tax mix through this consultation process, there is an ability of the Committee to design a broader more efficient tax system which reduces the number of taxes and refines those that continue on without reducing the total tax revenue collected by the Government. In particular we would encourage the Committee to look at the potential to eliminate particular stamp duties.

This Oil Search submission addresses the issues contained in the Tax Review Committee's *Issues Paper No.10: Other Indirect Taxes*. As part of this response, we note that Oil Search has declined to address some of the issues raised as it is beyond the scope of our industry and our knowledge base. 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 is vital to providing the platform for the next phase of economic growth in PNG. The tax system can best help PNG achieve this aim by being a system that is as efficient and effective as possible. This includes the elimination of taxes that are not consistent with a focus on efficiency and effectiveness. In our view, an area of particular focus for elimination should be in the area of stamp duty. Unfortunately the Issues Paper does not outline the revenue raised pursuant to the various applicable stamp duties so it is beyond the scope of this submission to prescribe which stamp duties should be removed with any degree of precision. As a principle, we would favour the abolition of all stamp duties in favour of more efficient consumption based taxes such as GST and land tax. However, we are aware that undertaking such a course of action is a significant step and suggest that a more considered course of action would be the gradual elimination of stamp duty, especially where real property is not involved. Stamp Duty on real property arguably should not be removed until such time as PNG introduces a capital gains tax given that stamp duty operates as a de facto capital gains tax. There is little inherently wrong with the way in which the PNG stamp duty system operates, however there is an open question as to whether maintaining a system of stamp duties is good for PNG in the long term.

Whilst we have not sought to comment on gambling taxes and departure taxes in this paper, we have also limited our comments on the area of environmental taxes. It is our strong view that environmental issues must be addressed by environmental regulation, not by ad hoc taxes. The Issues Paper considered the PNG environmental issues in a cursory way and in our view, the Committee has not undertaken sufficient consultation and, based on the consultation paper, enough detailed work to provide any recommendations to Government in relation to the introduction of additional environmental taxes. We are of the view that environmental policy and regulation should be left to the environmental experts. Tax may have a role to play in that environmental regulatory regime, but it should not be the driving force and tax professionals should not be devising environmental tax policies in isolation.

We encourage the Committee to continue to examine ways in which to reform the PNG taxation system in a structural way that results in a broader, simpler, more efficient and fairer tax system that will provide the foundation for future economic growth in PNG.

## Section 3: Stamp Duty

As indicated by the Committee, stamp duties are largely inefficient transaction based taxes that inhibit the optimal allocation of capital due to their punitive impost. However, stamp duties have a long history in many countries and it is only in developed countries that have a solid revenue base where they are starting to move away from stamp duties and other inefficient taxes to more efficient taxes such as GST and land tax. The quantum of duty collected in PNG suggests that there is scope to refine the number of different duties that are applicable and potentially restrict duty only to transfers of real property and gaming. In order to progress these types of reforms, further detail would be required from the IRC to analyse what type of stamp duties are being collected to ensure that the stamp duty regime is optimised without damaging the state of the Government's budgetary position.

### Indirect Interests in Land-Rich Companies

We note that a number of Australian States have in the past decade reformed their land rich provisions and moved toward a model whereby a company is land rich if it holds property over a certain dollar value. Given the substantial increases in Australian property prices, it effectively means that all transactions in Australian property where there is a beneficial change in ownership, will attract stamp duty. As outlined in the Issues Paper, stamp duty on real property is a de facto capital gains tax, notwithstanding that it applies to the purchaser, the theory being that the buyer will be prepared to pay less to the purchaser (thereby reducing the purchaser's gain) due to the stamp duty liability that will arise.

The Committee has already published a paper outlining the need for the introduction of a capital gains tax in PNG and if the Committee is going to recommend that outcome, it follows that stamp duty on property transfers should be abolished, including the land rich provisions. If however the introduction of a stamp duty is not recommended or will only be introduced in the longer term, then stamp duty on land-rich transactions should be maintained. Oil Search would support the revision of the land-rich test to impose duty on the land component of a transfer of beneficial ownership of a land-rich company, akin to the rules in Victoria.

We are somewhat surprised that the IRC has rarely encountered this issue. Oil Search has paid significant amounts of duty under these provisions in recent years. We would query as to whether the avoidance of this duty is being undertaken by utilising transfers of entities off-shore, i.e. outside of PNG. There is an open question as to whether the PNG Stamp Duty provisions could ever have extra-territorial application to prevent these types of transactions.

### Transfers of Mining and Petroleum Interests

As countenanced by the Committee in the Paper, the concessional treatment for mining and petroleum interests and information are a direct incentive for taxpayers to undertake exploration activities. In the current climate of reduced commodity prices, there has been a marked decrease in the level of exploration spend in PNG and we would find it to be exceptionally poor policy to remove incentives to undertake exploration.

It must always be kept in mind that the cost of undertaking exploration is significantly higher in PNG on a like for like comparison with other countries due to the geographical, geological, topographical and infrastructure challenges that PNG presents. Whilst PNG has a high degree of prospectivity, this alone does not offset these challenges in a decision making process, especially where the rewards, in terms of commodity prices, have been severely reduced. More and more companies are seeking to optimise their existing projects to drive revenue growth and are pulling out of exploration plays. In a globally competitive market for capital investment by resource companies, it is of critical importance that PNG keeps its fiscal regime as attractive as possible and hence we would strongly advocate against any increases in the way in which mining and petroleum interests are taxed under the stamp duty provisions. In fact, such has been the level of reduction in PNG based resources exploration that a case can be made for increased duty concessions to underwrite a faltering PNG economy and an under pressure currency.

### Responses to Tax Committee's Questions

Consultation Questions	Responses
<b>Question 1: Do the current stamp duty rules including their rates significantly impede business activity, reorganisations, etc?</b>	Stamp duty does impede business activity as it prevents the optimal allocation of capital due to the high cost of moving that capital to an alternative investment. However, there are sufficient concessions for corporate reorganisations and in the absence of a capital gains tax in PNG, the current system is still appropriate.
<b>Question 2: The arrangement for charging for transfers back to vendors seems inequitable. What experience do people have of this arrangement?</b>	Oil Search has not had any experience with these arrangements and will leave it for other parties to comment. On the face of the issue as presented, it does appear to an inequitable outcome.
<b>Question 3: What other problems are there with the existing stamp duty system?</b>	The stamp duty on leases whereby it is assumed that the lease will continue where there is an option period, is completely inappropriate. It accelerates the duty that may become payable in the future, and in the event that the option is not exercised, the onus is on the lessee to obtain a refund from the IRC. These duty arrangements should be altered so that where a lease is extended beyond its initial contracted period, the duty should only be imposed at that point
<b>Question 4: Are the land-rich company rules effective? Do they achieve their intended purpose?</b>	The land-rich rules are effective. However, they could be strengthened to ensure that the rules operate as intended as outlined in our comments above.
<b>Question 5: Are the current stamp duty exemptions, originally designed to provide incentives for exploration, still justified?</b>	Yes. Given the substantial reductions in exploration in PNG already, these concessions must be maintained otherwise it will further damage the operation of the resources industry in PNG.
<b>Question 6: What is the purpose in having both stamp duty and bookmakers' turnover</b>	Oil Search is not in a position to comment on this issue.

tax? Is stamp duty on betting tickets inequitable? Is there a way of removing stamp duties and adjusting turnover tax to compensate, which ensures current distributions to national and provincial governments are retained?

## Section 4: Environmental Taxes

Issues relating to the impact of development and urbanisation on the PNG environment are of the highest order and deserve consideration over and above the extremely limited timeframe which taxpayers were given to respond to this paper. Further, the issues require a deeper analysis than the high level overview afforded them in the Issues Paper. We strongly urge the Committee to omit environmental taxes from its final report to Government on the basis that it has not undertaken sufficient consultation with the community in relation to these issues. In our view, environmental degradation (in its broadest form) associated with economic development is generally more effectively dealt with via environmental legislation, not tax legislation. There are a number of reasons for this, including how the Government measures environmental impact and the non-uniformity of degradation. These matters create issues with determining an appropriate point to impose tax as well as ensuring the correct tax impost.

Further to our view that environmental legislation is the preferred manner to deal with these issues, we note that Schedules 2 and 3 of the Environment (Fees and Charges) Regulations 2002 already contains fees for water abstraction and discharge respectively.

### Options for addressing environmental concerns

We concur with the Committee's list of the options for addressing environmental concerns, however we note that the provision of physical infrastructure and services are other key options not mentioned in the paper that are available to government to address environmental issues.

Environmental issues that arise from household consumption choices may be a candidate for a tax but particularly in the case of PNG (and taking into account its stage of economic development), the potential for regressivity/social equity impacts need appropriate consideration beyond the scope of this paper.

Taxes that target waste management (waste related levies or refund mechanisms such as on plastic bags or recyclable bottles) have shown to be effective in other jurisdictions but alternatives and appropriate infrastructure need to be available to support such programs.

There needs to be consistency (in terms of overall objectives being sought) between the taxation schemes considered by the Committee, the environmental legislation being developed by the Conservation and Environment Protection Authority and the legislation and policies implemented by the Office of Climate Change and Development. Hence, before any reform options can be supported by major corporates like Oil Search, a coherent approach needs to be agreed between the various stakeholders.

### Vehicle Excise and Fuel Use

There is a range of literature on the effectiveness of various vehicle and fuel excise taxes so it is difficult to make conclusive remarks in this area. The Committee would need to have provided a detailed analysis of the new and second hand car markets in PNG in order for parties making submissions to be able to fully respond to the questions asked in the Issues Paper.

In general, the design of any fuel efficiency tax should consider the goal the tax is trying to achieve, e.g. fuel consumption vs carbon emissions vs number of cars on the road and the interaction between these objectives (e.g. higher fuel efficiency may induce more driving). In general, diesel has a higher impact on local air quality, whereas petrol has a higher greenhouse gas contribution. Further, the effects of diesel are higher in a dense, urban environment whereas remote use (for example in some areas of PNG) is less likely to impact the local air quality.

Fuel excise is a de facto pollution tax, and is an efficient tax as it is easy to collect and operates on a consumption basis. However, as discussed in our submission on excise, any increase in fuel excise could severely affect the road transport industry in PNG and so significant modelling would need to be undertaken to ensure that any increase in fuel excise, such as the huge impost of K0.10 per litre suggested by the OCCD, does not adversely impact an already fragile economy.

Turning to excise tariffs on cars, we note that vehicle efficiency has, and continues to improve rapidly and so vehicle standards may have decreasing utility in the medium term. Larger/specialist vehicles (with generally lower efficiency) are predominantly used in support of economic development activity (e.g. trucks) so any tax that targets these may be a disincentive to economic growth. Again we reiterate that there needs to be a longer term dialogue to address these issues rather than a quick superfluous overview to determine environmental policy.

## Resources

We agree with the proposition put forward by the Committee that the impacts from development activity are not best dealt with through a tax solution. Environmental regulation exists in PNG and is the most appropriate mechanism to deal with this. The lessons of Ok Tedi reinforce that environmental regulation is critical to resource development, particularly in the case of mining and that where things go wrong, a simple tax royalty will never be enough to compensate for what is sometimes, catastrophic environmental damage.

The royalties applicable to mining and petroleum activities have already been addressed as part of Issues Paper No.1 and environmental issues should not impinge on that specific analysis. Again we re-iterate that environmental issues are best considered by environmental experts, not tax experts.

## Taxes/Levies proposed within the Climate Change Act

We noted with interest the comments of the OCCD and its recommendations for potential additional taxes. In our view, a carbon levy on tourist accommodation will likely be complex in its construction and costly to administer (administration costs likely to outweigh revenue). The same levy cannot be imposed on tourists staying at 5-star resorts as those staying at a 2-star motel without the tax being regressive. Hence, any such levy would need to be graduated which will likely give rise to issues with consistency of calculation which may damage the credibility of the scheme.

Further, a carbon levy on inbound international flights should ensure that it is consistent with the emissions management efforts being led by the International Civil Aviation Authority. As we understand it, the aviation sector is in the process of designing a market-based mechanism to manage global emissions in that sector and we would encourage PNG to adopt a consistent approach with this forthcoming international standard.

The previously mentioned carbon levy for fuels not designated as ‘clean’, apart from being very substantial and regressive in nature, will likely have methodological and enforcement challenges regarding what fuels are designated as ‘clean’.

## Responses to Tax Committee’s Questions

Consultation Questions	Responses
<b>Question 11: What are the priority environmental issues for PNG? Is an environmental tax approach the most effective mechanism to deal with these?</b>	The most critical environmental issues in PNG are the impact of urbanisation and the impact of development activities. Tax is not the optimal way to address these issues. These matters should be addressed through appropriate environmental regulation.
<b>Question 12: Is engine displacement, emissions or fuel efficiency the best approach for distinguishing between vehicles? Is a tax or standards approach the most effective?</b>	This is a difficult question which can only be addressed once it is clear what the policy objective is. These and the other matters addressed in this paper need further detailed consideration.
<b>Question 13: Should some imports of motor vehicles be restricted on environmental and/or safety grounds? Is a differential tariff an effective way to limit such imports?</b>	Again this question which can only be addressed once it is clear what the policy objective is. These and the other matters addressed in this paper need further detailed consideration
<b>Question 14: Should the tariff be used to influence the choice of vehicles imported?</b>	Theoretically yes, but again the use of tariffs should only be addressed as part of a broader environmental policy
<b>Question 15: Do the royalty/export tax arrangements for mining and logging adequately reflect environmental outcomes?</b>	It is not possible to answer this question without detailed analysis. Again we re-iterate that these matters should be addressed by environmental regulation. Royalties and export taxes should be used to ensure that the State and landowners obtain a sufficient share of the proceeds from the natural resources extracted, not to address environmental degradation.

## Section 11: Conclusion

To be a catalyst of economic growth in PNG, the tax system at the very least needs to improve its efficiency and effectiveness. In past submissions, both the Committee and Oil Search have identified potential structural changes to the tax system which can alter the tax mix and improve the overall system. This reform agenda must include the elimination of taxes that are not consistent with a focus on efficiency and effectiveness. In our view, inefficient transaction based stamp duties are exactly the form of taxes that PNG should be looking to eliminate. In the long term Oil Search favours the abolition of all stamp duties in favour of more efficient consumption based taxes such as GST and land tax. However, we are aware of the challenges currently faced by the PNG economy and recommend the gradual elimination of stamp duty, with stamp duties on real property and gaming probably the last to be eliminated. As we have highlighted in this submission, Stamp Duty on real property should not be removed until such time as PNG introduces a capital gains tax given that stamp duty operates as a de facto capital gains tax. To reiterate our key observation, there is little inherently wrong with the way in which the PNG stamp duty system operates, however the PNG stamp duty system may not be good for PNG in the long term.

At several points in this submission we have strongly urged the Committee to step away from any recommendations on the introduction of new environmental taxes in PNG. It is our strong view that environmental issues must be addressed by environmental regulation and it should not be the place of a tax review to dictate environmental policy, regardless of the fact that the Committee may have sought the input of certain environmental bodies. In our view, the Committee has not undertaken sufficient consultation to provide any recommendations to Government in relation to the introduction of additional environmental taxes. The Committee can assist environmental regulators with implementing environmental policy, but it should not determine the policy.

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 indirect taxation.

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