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Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Topic 5

In this issue

This is the fifth of our series of Special Alerts summarising the major proposed changes under the Income Tax Act rewrite.

Trusts

The draft rewrite of the Income Tax Act contains many important implications for taxpayers. In this article we summarise the implication for Trusts and Trust beneficiaries.

Principles for the Taxation of Trust income

The new rules seek to formalise "flow through" rules for trusts. Where a beneficiary is entitled to income, the beneficiary becomes taxable on that income at their marginal tax rate and not the trustee. Expenses incurred by the trustee in respect of that income are treated as incurred by the beneficiary.

It would appear that losses incurred by a trust could pass through to the beneficiary where they are entitled to the assessable income. For these purposes the word entitled is defined to mean "a vested and indefeasible interest." An amount also retains its character and geographic source in the hands of the beneficiary, and is treated as derived or incurred by the beneficiary at the time it was derived or incurred by the trustee.

Where the income does not vest in the beneficiary, the trustee is taxable at the rate of 42%. Consequently, there are good reasons to pass through the income to beneficiaries on a lower tax rate.

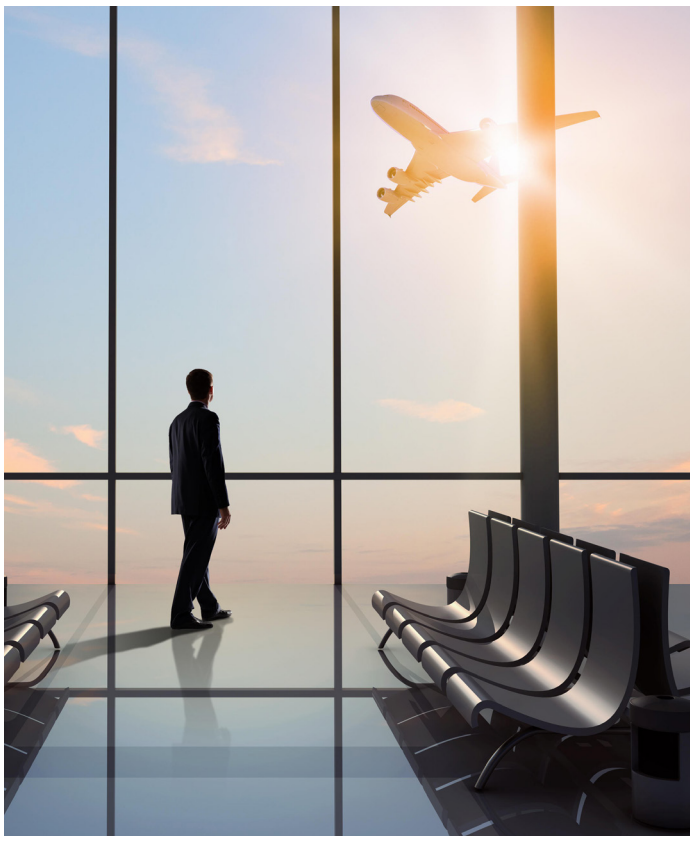
Where income has been taxed to a trustee that income will not be taxed again in the hands of the beneficiary.

Tax Residence of Trusts

A trust is resident in PNG for tax purposes when the trust:

(a) Was settled or established in PNG;
(b) Is the estate of a deceased resident individual; or
(c) Is administered in PNG at any time during the year.

Potential issues are likely to arise in particular for expatriates who become resident in PNG but have foreign assets in view of (b) above. The implications of Double Tax Treaties (DTA) may also impact the foregoing and therefore require consideration. A non-resident trust is taxable on PNG source income but only to the extent the income (and allowable deductions) have not flown through to a beneficiary.



Implications for PNG Resident Beneficiaries of Foreign Trusts

If a PNG beneficiary is entitled to income of a non-resident trust, the beneficiary is taxable on that income. Otherwise, the PNG beneficiary will be assessed at the time the distribution from the non-resident trust is received. A distribution is widely defined and includes a loan, payment for goods, use of assets or anything which in substance would be regarded as a distribution of accumulated income.

These provisions may lead to a need to rethink the use of offshore family trusts or how the income in such trusts are dealt with. For example, Australian discretionary trusts often contain a provision for the vesting of income in family beneficiaries. Such a provision could result in tax payable in PNG for the beneficiary. We would recommend that such structures are revisited before the legislation comes into effect, to ensure the implications are understood. We would be happy to assist, should you require.

Non-Resident Trusts and Non-Resident Beneficiaries

The new Act also creates some other unusual outcomes for cross border situations. For instance, it suggests a non-resident beneficiary of a trust with PNG sourced income will have to lodge a return to declare income which he or she is entitled to, and which was not taxed on the resident trust. This can arise for both resident and non-resident trusts with PNG sourced income. Such a compliance burden would seem unintended.

Unit Trusts and Collective Investment Fund.

Unit Trusts and Collective Investments vehicles are often used for investment purposes. Investors subscribe for units, can buy and sell such units, redeem the units and receive distributions. They are generally (but not always) structured as trusts.

The new tax rules do not seek to distinguish such trusts from other trusts such as discretionary family trusts or fixed interest trusts. Consequently, the same rules as outlined above apply.

As the unit holders can often sell or redeem units, the trust would generally not vest the income in unit holders. The new rules would therefore tax the Trustee at 42% on income not distributed. This could be a major impediment to the use of such vehicles for funds management. The old Act uses a deemed company approach for unit trusts which is likely to be more suitable for such vehicles.

Landowner Resource Trusts

There are current complex rules in the Income Tax Act for Landowner Resource Trusts. Not only are they liable to income tax but also "additional profits tax" (APT) on amounts derived from resource projects. However, concessions apply on distributions from such trusts.

The new rules contain no specific provisions for Landowner Resource Trusts. Therefore, the general trust rules as outlined above will apply. However, amounts derived from resource projects would continue to be liable to APT at 30%. See our separate Alert on the Resource Sector for further details.

In our view the treatment of Landowner Resource Trusts will need to be revisited before the legislation is finalised.

Tax Payable

Under the new Act the payment dates for provisional tax for all taxpayers are aligned, being the last day of the month following the end of the 3rd, 6th and 9th month of the year. Any residual tax is due on the date that the income tax return is due to be filed.

Submissions

The abovementioned changes to the taxation of trusts are significant and taxpayers should take time to ensure they understand the implications for themselves their families and investors. A restructure of family arrangements may be desirable especially where foreign trusts are involved. In addition, landowner resource trusts, unit trusts and other collective investment vehicles need to consider if treatment as a corporate vehicle would better meet their needs.

If you would like to discuss the draft changes, their impact or the making of a submission to Treasury, please let us know. Please note that submissions are due on or before 9 April.

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