Deloitte.

Papua New Guinea

Tax Alert

March 2020

In this issue

In this issue we bring you the updates from the proposed Income Tax Act rewrite.

Introduction

Welcome to another issue of the Deloitte PNG Tax Insight!

Every month, our tax team brings to you updates in the tax legislation, policy, practices and technical tax awareness that impact taxpayers every day.

Income Tax Act rewrite

Last year the Income Tax Act (ITA) saw its 60th year of being in force. A rewrite of the ITA has been long overdue. In the last week, the rewrite has gained significant momentum. We attended the initial presentation by Treasury in advance of the draft new ITA being published for comment. It is expected that the draft of the new ITA will be published for comment this week. With such a significant change, Treasury is seeking consultation and written submissions on the new draft ITA will be accepted until around Easter.

It is important to note at this stage that the scope of the rewrite is not only to consolidate, simplify and modernise the ITA but Treasury is using this opportunity to undertake a policy review of the fundamentals of income tax. In Treasury's words the goal is to adapt the ITA such that "the income tax legislation is suitable for the needs of PNG as a developing country". Accordingly, it is critical that taxpayers individually and collectively, consider the draft new ITA and the impact thereof and make meaningful submissions to Treasury before the new ITA is finalised.

In anticipation of the draft new ITA being published for comment, we set out below some of the key aspects highlighted to us in Treasury's presentation. We will be sending out a more detailed alert discussing and confirming the key aspects of the draft new ITA after it has been published.

Greater reliance on financial accounting principles

The new ITA will have greater reliance on financial accounting principles for income tax purposes to limit timing adjustments. Some general rules are to be harmonised with International Financial Reporting Standards (IFRS). For example, the tax treatment of trading stock, long-term contracts and financial leases will follow the financial accounting treatment.

In line with this principle:

- Banks may be able to recognise loan loss provisions (up to 75%) for tax purposes; and
- The taxation of insurance companies will be aligned with the financial accounting treatment.

Depreciation provisions

The general depreciation provisions are being revised as follows:

- There will be changes to the accelerated depreciation rules.
- Asset pooling will be introduced, but only on a diminishing value basis. Assets not pooled will be depreciated on the straight-line basis only.
- The new ITA will contain revised depreciation rates / effective life tables.
- Intangible assets will be included in the depreciation regime. We understand that it will only apply to business intangibles with a fixed useful life. The depreciation allowance will be based on the useful life (there will be a ceiling on the period for long life intangibles) and only the straight-line method will be available. Goodwill will not qualify for a depreciation allowance.

New rules for repairs and improvements

The new ITA will seek to "simplify" the tax rules regarding repairs and improvements to depreciable assets. It proposes specific rules that will allow an outright deduction if the repair cost does not exceed 20% of written down value of the asset. Any excess is to be depreciated.

Incentives

A review of all tax incentives is being undertaken to, amongst other things:

- Determine the benefit versus cost to the country
- Remove incentives that are outdated; and
- Determine whether the incentives comply with the required Base Erosion Profit Shifting (BEPS) implementation to which PNG has joined.

Employee benefits

Employee benefits are being reviewed:

- Housing and motor vehicle benefit prescribed rates to be updated. It is being considered to move to more market-based valuation rules instead of prescribed amounts, alternatively there will be a mechanism in the new ITA to regularly review the prescribed rates. We have been advised that this will be done on a phase-in basis.
- Exemption of medical insurance premiums to be included.
- School benefit exemption to be extended to tertiary education.
- Salary sacrifice arrangements to be formalised.

International Tax rules

The international tax rules will be updated in line with the scope of the rewrite. Furthermore, the review and rewrite of the international tax rules will be done to ensure compliance with the minimum required implementation of BEPS: for example, introducing a simplified Controlled Foreign Corporation (CFC) regime etc. We understand this will only apply to territories with low tax rates (likely 10%).

Foreign Contractor Withholding Tax (WHT) rules

The Foreign Contractor WHT regime to be revised again. We understand that the following will be included in the revised regime:

- Non-resident companies will be required to lodge a return if they have a permanent establishment in PNG. Tax rate will be 30% plus an additional branch profits tax at 15% of after tax income. Unclear if this is only to apply to companies resident in countries with which PNG has a tax treaty.
- If no permanent establishment then non-resident company subject to withholding tax regime.
- Management fee withholding tax to be broadened to a technical fee withholding tax.

Intra-group transactions

The new ITA will include rules to facilitate tax free transfers of assets intragroup. However, the existing Amalgamations regime will not be retained.

Dividends

It is proposed that local intercompany dividends to be exempt. Foreign dividends will remain taxable, with no rebate, but a foreign tax credit will be available.

Capital Gains Tax

The implementation of Capital Gains Tax (CGT) still not confirmed. However, during the meeting with Treasury the following changes were confirmed in relation to CGT:

- POMSOX listed share to be excluded from rules.
- Chargeable assets will predominantly be real estate and entities where more than 50% of the value is represented by real estate.
- Taxpayers allowed to use the actual cost instead of the market value as the value for asset cost bases on entry to the CGT regime.
- Capital gains tax losses to be carried forward indefinitely.

Resource sector specific tax rules

Division 10 of the existing ITA, which deals with resource sector specific rules, is part of the rewrite. The following is understood to be included in the draft new ITA:

- Exploration expenditure to be expensed in year incurred. This includes costs of acquiring interests in licences. The flip side will be proceeds on disposing licences will be assessable.
- Development expenditure to follow a similar regime to the existing (ACE) regime, in that it is capitalised and amortised at a rate depending on remaining life of project, though there may be some changes in the simplification of the provision.
- Rehabilitation / decommissioning expenditure to be deductible when paid into a fund. No additional claim unless amounts paid into fund are exceeded by actual expenditure and only amount paid into fund within 10 years of project close to qualify.
- Ring fencing concept will stay.
- Farm-outs to be specifically addressed under capital gains provisions.
- The expenditure uplift rate for additional profits tax (APT) will move down from 15% to 13%.

Insurance and Banking industry specific tax rules

Both the insurance and banking sectors will have special rules. The banks will likely be allowed to deduct loan loss provisions (mentioned at up to 75%) and insurance companies aligned more closely to accounting. Life insurance risk based business to be treated like general insurance whereas life assurance will be treated differently.

Superannuation

Superannuation rules will likely be preserved for the present as Treasury understands that BPNG is undertaking a broader review of superannuation.

Tax administrative aspects

Some administrative measures on the way:

- Transitional rules to be inserted, but likely to require amendment.
- Procedural and administrative rules being moved to Tax Administration Act, unless income tax specific (for example provisional tax).
- Various Rates Acts are being abolished, with tax rates incorporated into the new ITA.
- Binding Private ruling provisions to be inserted into the Tax Administration Act.
- Greater use of schedules to the new ITA, and greater use of Regulations (despite Regulations being able to be amended more easily).

For more details please contact your key Deloitte contacts or any of the following:

Leadership Contacts

Andrew Harris
Partner
Tax & Business Services
Tel/Direct: +675 308 7010
andrewharris@deloitte.com.pg

Declan Mordaunt
Principal
Tax & Business Services
Tel/Direct: +675 308 7037
dmordaunt@deloitte.com.pg

Sanchika Sutharshan
Director
Tax & Business Services
Tel/Direct: +675 308 7160
ssutharshan@deloitte.com.pg

Antonio Bernabe
Principal
Tax & Business Services
Tel/Direct: +675 308 7057
abernabe@deloitte.com.pg

Kristel Van Rensburg
Director
Tax & Business Services
Tel/Direct: +675 308 7149
krensburgh@deloitte.com.pg