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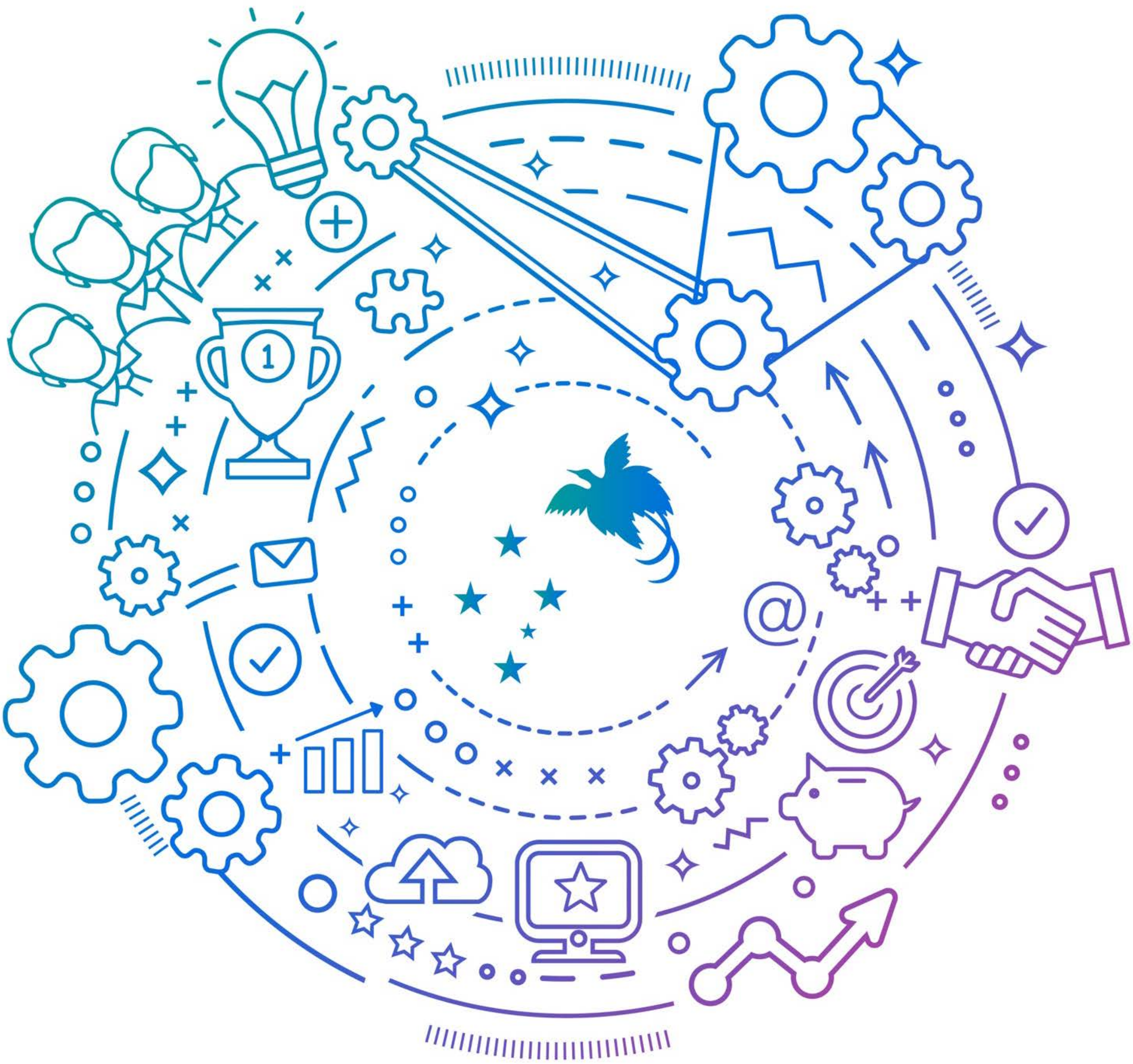


Papua New Guinea Budget 2018

Budget Alert

Contents

"Strengthening the macroeconomic and fiscal fundamentals of the economy, and get the economy moving forward"

Executive summary

The 2018 National Budget has today been handed down by The Honorable Charles Abel, MP and is the first substantive Budget from the new O'Neill-Abel Government. The Budget has been set in a challenging local and global economic environment.

Commodity prices are expected to rebound slightly in 2018, providing some minor relief, while news of major extractive industry projects, such as Papua LNG, is expected over 2018 / 2019.

As a result, recognising that revenues are likely to remain largely subdued over the short term, the Government prudently seeks to employ fiscal discipline – by ambitiously aiming to reduce recurrent spending and simultaneously diversify the economic base with investments in nation building infrastructure, hospitals and education.

"Our promise to maintain fiscal discipline, grow our revenues, strengthen our economic base, improve governance and act strategically."

The Honorable Charles Abel
Deputy Prime Minister and Treasurer

In parallel, the Budget looks to encourage investment in agriculture and small-to-medium enterprises. Finally, the Government seeks to improve efficiency of the public sector. This shapes the tone of the Budget, whose theme is "Review our Priorities, Refocus our Energies and Reinforce our Strengths".

These initiatives are worthwhile, but will require significant political will to execute effectively in order to realise the benefits, especially with regard to pursuing agency amalgamations to remove duplications, reducing Government agency personnel emolument ceilings, and achieving a reduction in headcount. There will also be immense pressure on the Internal Revenue Commission (IRC) and State Owned Enterprises (SOEs) for tax and dividend revenue.

In an effort to diversify the economic base, capital expenditure is budgeted to grow in 2018. However, in the absence of major new borrowings or achieving the recurrent spending savings, some of these projects remain at risk of being cut, as occurred in the 2017 Supplementary Budget.

No new taxes have been introduced in the 2018 Budget, but instead there has been some adjusting of existing taxes and a focus on greater compliance, especially with respect to personal and corporate income, representing the two major components of tax revenue.

Looking forward, the Government is focused on successfully hosting the APEC Summit in November 2018, as a method of improving PNG's global image and attracting foreign investment.

The 2018 Budget is being handed down in stubborn economic conditions. The Government realises that it has to do more with less and success will come down to how effectively the O'Neill-Abel administration can implement the ambitious, but necessary, structural and operational reforms.

Key facts and figures

Table 1: Key macroeconomic indicators *(Source: Department of Treasury)*

	2016 Proj	2017 Proj	2018 Proj	2019 Proj	2020 Proj
Economic growth					
Total Real GDP (%)	2	2.2	2.4	2.2	2
Non-Mining Real GDP (%)	0.7	1.9	3.5	3.5	3.6
Inflation					
Average on Average (%)	6.7	5.9	6.9	5.8	5.7
Dec on Dec (%)	6.6	5.9	6.9	5.1	5.7
Real Exchange Rate Index					
(2007 = 100)	129.4	131.5	136.5	140.8	145.2
Interest rate					
Kina Rate Facility (KFR)	6.25	6.25	6.25	6.25	6.25
Inscribed Stock (3 year yield)	9.7	9.7	9.7	9.7	9.7
Mineral Prices					
Gold (US$/oz)	1,248	1,254	1,281	1,293	1,310
Copper (US$/tonne)	4,865	5,945	5,960	6,059	6,183
Oil (Kutubu Crude: US$/barrel)	44	50	51	52	54
Nickel (US$/tonne)	9,595	10,010	10,516	11,065	11,819

Table 2: Overall Budget balance *(Source: Department of Treasury)*

	2016 Actual	2017 Actual	2018 Budget	2019 Proj	2020 Proj	2021 Proj
Revenue	10,486	10,979	12,731	12,583	13,552	14,666
Expenditure	13,572	12,856	14,718	14,480	15,227	16,074
Net deficit	-3,087	-1,876	-1,987	-1,898	-1,676	-1,409
% of GDP	-4.6	-2.5	-2.5	-2.2	-1.8	-1.4
Government debt (Km)	21,944.0	23,820.4	25,807.6	27,705.1	29,380.9	30,789.4
Government debt (% GDP)	32.60%	32.30%	32.20%	32.20%	31.90%	31.10%

Economic overview

The 2018 Budget is framed amidst an increasingly challenging and uncertain economic backdrop, with both domestic and international factors complicating the near term outlook.

The broader economic outlook

The 2018 Budget is set against a backdrop of challenging international and domestic factors.

Internationally, in the short term, global growth continues improve, although there are headwinds in terms of increased US protectionism and the timing & magnitude of the US Federal Reserve's monetary unwinding. Nevertheless, Deloitte Insights sees positive growth over the medium to long term in Asia, especially India, Philippines and Indonesia, with quickly growing demographics and citizens of working age. Papua New Guinea's (PNG) resources will be able to tap into this growth, where the country can leverage its proximity to Asia.

Domestically, PNG has experienced relatively strong economic growth over the last decade. However, the path of growth for Gross Domestic Product (GDP) has not been smooth. PNG's economy is reliant on resources extraction which exposes it to changes in global commodity prices and the irregular timing of new resources investment.

Real GDP growth was 2.0% in 2016, significantly lower than growth in 2015 of 10.5%. The PNG economy faced headwinds from low export commodity prices and the lingering effects of a major drought. This has weakened PNG's external position and prompted Government expenditure cuts. The Government expenditure cuts focused on the capital expenditure components of the 2018 Budget. Economic growth has remained subdued over 2017, estimated at 2.2%. This has seen a further decline in Government revenue.

Looking forward domestically, PNG Treasury estimates GDP growth at 2.4% in 2018. This is based on commodity prices trending higher (World Bank economic forecast), increased international capital flowing into emerging markets and more productive capital expenditure. This continued environment of subdued economic activity pending new extractive industry investment over the short to medium term is causing the Government to seek a rebalancing of the country's finances through the 2018 Budget.

Over the horizon there are a number of proposed major extractive industry projects that are well known:

1. ExxonMobil (PNG LNG) expansion
2. Papua LNG
3. Wafi Golpu (gold, copper and silver)
4. Frieda River (gold and copper).

The 2018 Budget

The 2018 Budget is ambitious and looks to implement a medium term fiscal strategy, centered on the following pillars:

- Halting the declining revenue in the short term, with a trend to higher sustained income over the medium term.
- Reducing recurrent expenditure, redeploying those funds for productive capital expenditure (with a focus on diversification of the economic base, especially into agriculture) and improve efficiency of the public sector.
- Improving debt management, cost of financing and extinguishing the foreign exchange imbalance.

Pillar 1 – Revenue

In short, the PNG Government is not introducing new taxes as part of the 2018 Budget, though some existing taxes are being adjusted. There is instead increased attention on improved tax compliance through the IRC, with a particular focus on improved employer registrations targeting personal and corporate income (forming the largest component of tax revenue at ~60%). Tax reform is being rolled out in line with the Government's medium term revenue strategy.

There is also a strong focus on recovering dividends from State Owned Enterprises (SOEs), with fisheries expected to contribute the largest component.

In our view many of the changes proposed in the 2018 Budget are on the road to modernising the tax regime.

Pillar 2 – Reducing recurrent expenditure, increasing capital expenditure and improving public sector efficiency

Reducing recurrent expenditure

Total expenditure exceeded forecast in the 2017 Supplementary Budget by a considerable 14.5%. Accordingly, the 2018 Budget seeks to limit and reverse the upward trend in recurrent expenditure by primarily halting the rise in personnel emoluments expenditure and placing stricter controls on utilities and office rentals.

Public sector efficiency

As stated in the 2018 Budget Economic and Development Policy document, improved public sector efficiency is sought by:

1. Amalgamating Government agencies; and
2. Reviewing the structure of the Kumul Consolidation framework (covering Kumul Consolidated Holdings, Kumul Mineral Holdings and Kumul Petroleum Holdings) to ensure more prudent fiscal management.

Additionally, the Honorable Charles Abel MP mentioned today in relation to the State Owned Enterprises (SOE) that there is legislation before Parliament (as an amendment to the Public Finances (Management) Act 1995) seeking to regularly capture and sweep funds held by the SOE's into consolidated Government revenue and then manage these funds centrally.

Our view is that while these initiatives are worthwhile and likely to yield reduced recurrent expenditure and improved SOE profitability if pursued vigorously, there will need to be significant political capital applied to ensure success.

Reorganisation of the Kumul Consolidation framework will require underlying operational restructures of the SOE's to ensure they are financially viable and capable of distributing dividends in the future.

Further, while we see the merit in the centralisation of SOE funds, any mechanism that sees SOE funds controlled outside of the legal group structures may introduce a range of risk factors, from a slow-down in SOE operations to potential weakening of commercial bank security (which will likely require complex negotiations with financiers). These risk factors may be mitigated in the proposed legislation as we have not sighted the bill at this time.

Increased capital expenditure

The 2018 capital investment Budget is K4.6b, up from K4b in 2017. Given that the loans and grants components of that funding has remained consistent, the PNG Government element is increasing by K660m. Capital expenditure will be focused on:

1. Hosting APEC, increasing PNG's positive international profile and attracting investment
2. POM sewerage upgrade
3. Redevelopment of the Highlands Highway
4. A gas fired power station, using local LNG
5. A state equity fund to encourage investment in domestic agriculture
6. State funding for small to medium enterprises (SME) incubation
7. New district hospitals
8. A new university in the Western Highlands.

Again, we see the merit in the Government's commitment to APEC, nation building infrastructure and direct involvement in agriculture and SME incubation. However, we note that in the 2017 Supplementary Budget capital expenditure was reduced by ~50% from PGK 2.6 billion to PGK 1.25 billion. In the absence of major additional borrowings or success in realising very substantial savings from recurrent expenditure, the risk of a reduced Budget during 2018 remains high. We also note that whilst the addition of new district hospitals and a university are worthy pursuits, they are likely to add significant recurring expenditure to the Budget going forward.

Pillar 3 – Improved debt management and foreign currency imbalances
The 2018 Budget aims to:

- Minimise funds held with commercial banks that are then invested in Government inscribed stock
- Raise a US dollar bond and generally shift the mix of debt from domestic to foreign currency
- Mandate the use of local currency (ie: Oil Search providing a minimum of 50% of the crude oil needs to the Napa Napa refinery in PGK and use of local LNG in the gas fired power station).

These initiatives are valuable, but ultimately only the commencement of major extractive industry investments will see a major structural shift alleviating both the debt overhang and foreign currency shortages.

Key assumptions in 2018 Budget

Macroeconomic variables

The projected GDP growth profile over the forward estimates is between 2.0% - 2.4% over 2016 – 2020.

Without further detail on the modelling approach it is difficult to comment further, but it appears that Treasury is not forecasting major projects to come on stream until after 2020.

Projected inflation will increase to 6.9%, which is attributed to exchange rate depreciation and volatile movements in the prices of seasonal items. Spending commitments related to the 2018 capital expenditure Budget and hosting of the APEC Summit may also add to inflationary pressures in the short term.

PNG's Trade Weighted Index (TWI) continued to ease over 2017, reflecting mixed performance of the Kina against PNG's major trading partner currencies.

PNG's exchange rate is heavily controlled by the Bank of PNG which only allows fluctuations within a narrow trading band.

The exchange rate is kept high in order to keep inflation at acceptable levels and maintain foreign currency reserves for critical imports.

The Honorable Charles Abel MP did mention the potential for further gradual depreciation of the Kina in his Budget speech. A sudden drop in the exchange rate would potentially be damaging to the economy – while it would benefit exporters, it would add considerable cost pressures on an import dependent economy. And, of course, even those in export oriented sectors would potentially feel the pain of higher input costs.

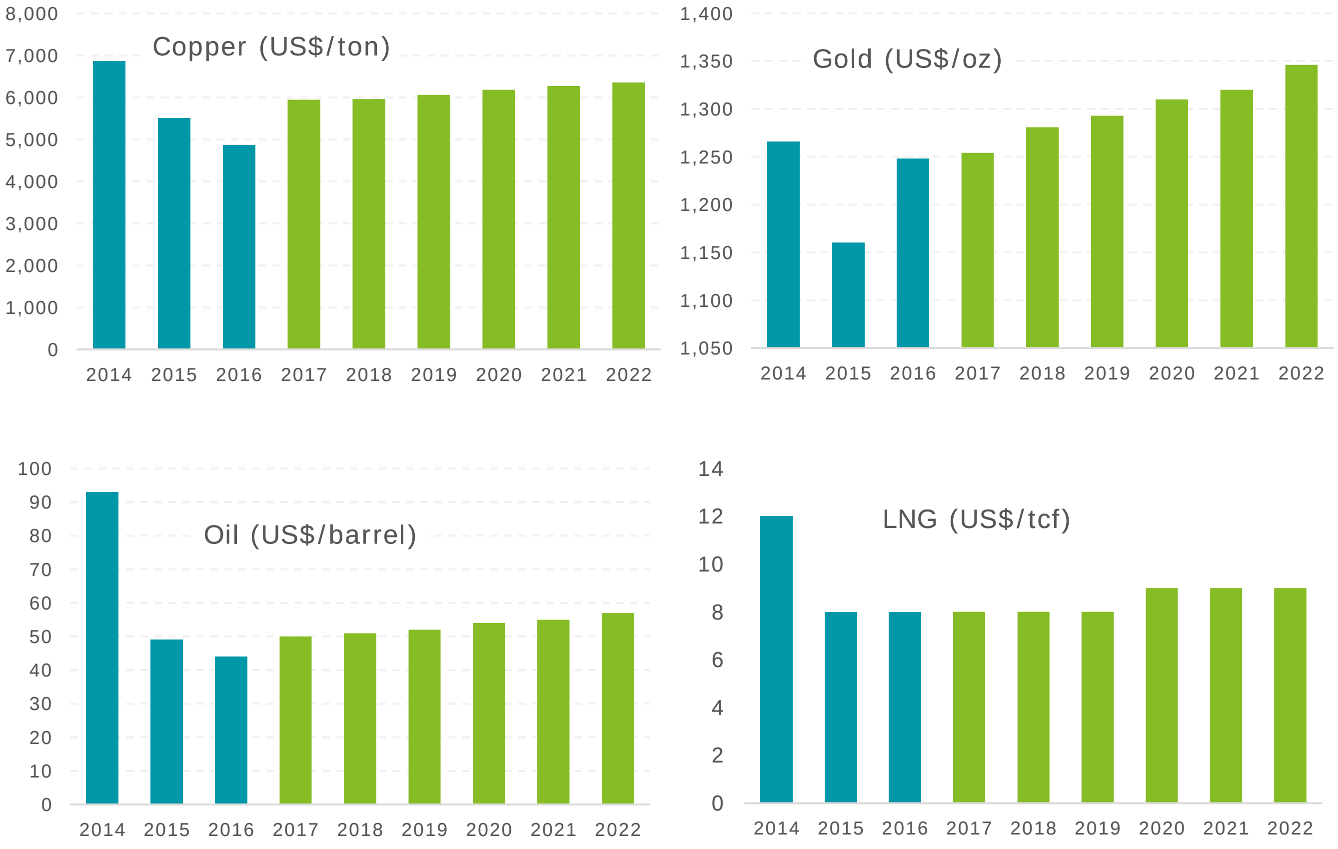
With downward pressures on the exchange rate mounting, the task of maintaining the high rate will become ever harder. The upshot is that the growth task in the near to medium term will be almost solely down to fiscal policy as released in the National Budget.

The Deputy Prime Minister also acknowledged that foreign currency shortages had constrained the economy and was looking into additional Government actions to release further foreign currency into the market.

Commodity prices

As with most resource driven economies, PNG's Budget is heavily dependent on global commodity markets. To assess the Budget forecasts for global commodities, Chart 1 compares the forward estimates for four of PNG's major commodity exports – copper, oil, gold and LNG.

Chart 1: Estimated commodity prices *(Source: Department of Treasury)*



Whether or not commodity prices end up following the same broad profile as that projected in the Budget is a matter for conjecture. It is worth noting, however, that to the extent that the projected price rises do not eventuate, the forward estimates of the remainder of the Budget will come under considerable pressure.

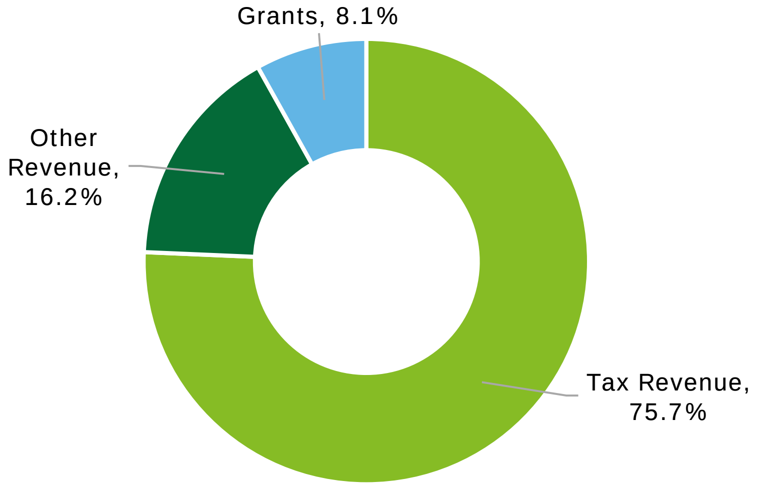
High risk capital flowing to emerging markets

Our research shows that there is indeed increased investment seeking higher returns, but these funds are flowing to emerging economies with comparatively higher levels of sophistication, coupled with increased deregulation (such as Vietnam). Additionally, the US Federal Reserve has been signalling the unwinding of historically low interest rates, which will push the desired yields from emerging markets higher. It remains to be seen whether the PNG Government will accept the returns expected by investors over 2018 and press forward with the expected US dollar sovereign bond issue.

Revenue

2018 revenue is projected to be PGK12,730.7 million, principally funded from tax revenues and based on an improved economy outlook

Chart 2: Where does PNG's revenue come from? *(Source: Department of Treasury)*



Tax revenue

Table 3: Tax revenue by source *(Source: Department of Treasury)*

Tax Revenue (Kina million)	2016 Actuals	2017 Sup. Budget	2017 Revised	2018 Budget
Personal Income Tax	2,844.3	3,035.7	2,996.7	3,250.2
Company Tax	2,093.8	2,155.6	1,792.2	1,971.5
Mining and Petroleum Taxes	92.0	77.1	52.6	89.5
Withholding and Other Income Taxes	256.1	278.3	243.4	253.7
GST	1,442.6	1,484.7	1,734.0	1,974.2
Stamp Duties	79.2	50.9	58.9	60.0
Excise Duty	603.7	691.1	618.2	782.3
Import Excise	272.2	300.3	298.7	395.1
Bookmakers' and Gaming Machine Turnover Tax	171.3	207.4	203.3	207.4
Other Taxes on Goods and Services	15.1	20.2	23.3	29.3
Import Duty	242.9	241.5	227.7	296.1
Export Tax	294.0	326.6	285.7	330.0
Grand Total	**8,407.2**	**8,869.4**	**8,534.7**	**9,639.3**

Corporate Tax did not perform as well as anticipated due to weak business profitability. Similarly Personal Income Tax did not achieve budgeted levels due to the unanticipated contraction in employment and income in the private sector. Regardless 2017 Personal Income Tax is expected to increase by 5% over 2016 levels.

The expected improvement in 2018 budgeted levels reflects a gradual recovery in the private sector employment growth, an improved economic outlook, higher Government spending and a further focus by IRC on compliance combined with a removal of some concessions. Of particular interest will be the establishment of a special team to focus on larger tax payers with the creation of a Large Taxpayer Office (LTO). This follows international trends where evidence shows that Revenue Authorities can substantially increase revenue by paying close attention to the “big end of town”. LTO will have a special focus on compliance of resource companies and will include a review of concessions as part of the medium term revenue strategy reforms.

The repeal of the training levy will be a welcome relief as noted in the tax section of this briefing.

Increases are also forecasted in GST, import and export duties, again reflecting the Government’s view of an improved economic outlook.

Grants revenue

A detailed breakdown of grants revenue received from different countries is provided later in the Expenditure section of this report.

Other revenue

Table 4: Other revenue by source *(Source: Department of Treasury)*

Other Revenue (Kina million)	2016 Actual	2017 Budget	2017 Sup. Budget	2017 Revised	2018 Budget
Property Income	551.3	1,130.1	925.1	898.5	1,321.9
Sales of Goods and Services	63.5	91.2	115.2	84.5	112.5
Fines, Penalties and Forfeits	1.8	2.8	0.8	1.7	1.0
Transfers, not elsewhere classified	17.2	23.6	100.7	70.8	631.4
Grand Total	**633.8**	**1,247.7**	**1,141.8**	**1,055.5**	**2,066.8**

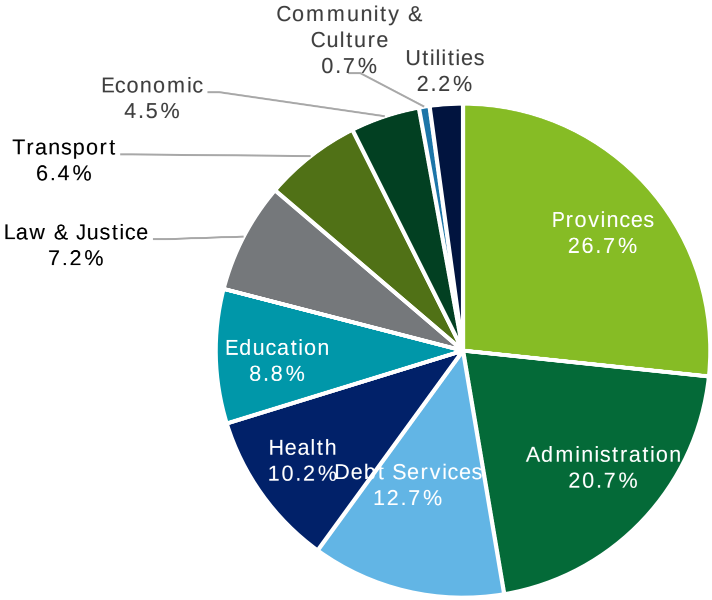
Sovereign Wealth Fund (SWF)

The projected mineral and petroleum revenues in the 2018 Budget and in the medium term capture the revenue flows between the Budget and the SWF, however the Government observed that the Fund is yet to be operationalized and accordingly the figures are indicative only. The estimates account for 50% of the mineral and petroleum tax channeled to the SWF Stabilization Fund whilst the other 50% flows directly to finance Government expenditure.

Expenditure

The operational budget has decreased by 1% whereas the capital budget has increased by 64%

Chart 3: Where does PNG's expenditure go? *(Source: Department of Treasury)*



Key areas of attention in the operational Budget include a focus on control of personnel emoluments and improved controls on goods and services.

The table below shows how foreign Governments will provide their funding for 2018.

Table 5: Funding by Donor *(Source: Department of Treasury)*

Donor	Grants	Loans	Total	Percentage
DFAT (Australia)	642.9	0	642.9	39.72%
EU	135.6	0	135.6	8.38%
UN	120	0	120	7.41%
USA[19]	0	0	0	0.00%
NZ	43.7	0	43.7	2.70%
China	2.5	110	112.5	6.95%
ADB	9.3	240.2	249.5	15.42%
WB	6.9	118	124.9	7.72%
JICA	63.7	47.4	111.1	6.86%
Ceska / Erste	0	20	20	1.24%
IFAD	0	3.2	3.2	0.20%
Indian EXIM	0	15	15	0.93%
EIB	0	40.1	40.1	2.48%
Grand Total	**1,024.6**	**593.9**	**1,618.5**	**100%**

[19] USAID was not able to provide their 2018 projections due to the absence of US Congress sitting

Key expenditure objectives for the 2018 Budget are:

- Facilitate the hosting of the 2018 APEC Summit
- Ensure free, fair and safe LLG Elections
- Halt the rise in personnel emoluments expenditure and impose stricter controls on the use of goods and services Budgets
- Continue to support major Government, social and economic priorities in education, health, infrastructure, agriculture, tourism, renewable and non-renewable sectors, rural development and SME's, and law and order
- Place a stronger emphasis on monitoring, evaluation and compliance
- Increase resources for revenue collection and broaden the tax base
- Strengthen efficiencies in the public sector
- Create a solid foundation for sustained growth and development of the country
- Adhere to the MTFS 2018-22 goals.

Provincial Sector

A large slice of the capital expenditure (PGK 1,355.7m) will go to sub-national governments in the form of Provincial Service Improvement Programs, District Service Improvement Programs and Ward Service Improvement Programs which should be spent in strategic development areas to grow the economy (for example, agriculture, tourism, fisheries, forestry and renewable energy).

Administration services

The Government has recommended the amalgamation of 5 agencies, of the current 31, which will reduce the size of the sector over time. The sector continues to focus on instilling high standards of public sector performance and delivery at all levels of Government.

Health

Significant progress has been made in achieving the health targets and improving indicators over recent years. This will continue to be supported by the National Government. The Health sector has been allocated PGK 1,505.9m which is an increase of 14.0% over the 2017 Supplementary Budget.

Education

Education continues to be a significant focus area for Government and it has increased the Budget allocation to PGK 1,293.4m which is an increase of 13.3% above the 2017 supplementary Budget. The Government has also reinforced its commitment to the Tuition Fee Free Policy and will also focus on increasing quality teacher training, children's learning and classroom infrastructure.

Law and Justice

The Government has decreased the level of funding to this sector to PGK 1,063.5m, a reduction of 4.2% from the 2017 Supplementary Budget.

Transport

Funding this sector which includes roads, air and maritime, has increased in 2018 by 2.1% relative to the 2017 Supplementary Budget. A significant portion of this Budget is for capital investments (PGK 642.3m).

Tax Policy Announcements

Medium Term Revenue Strategy and Strengthening of Internal Revenue Commission (IRC)

Reversing the trend of decreasing tax revenues relative to GDP and lifting collection significantly is a priority in the 2018 Budget policy. Despite this, the Treasurer noted that the Government would, in the immediate term, do this through a policy of increasing revenue through greater compliance with existing taxes rather than introducing a wave of new taxes.

In conjunction with a recent report from the International Monetary Fund (IMF) on PNG tax administration, the Government has developed a Medium Term Revenue Strategy (MTRS) for the period to 2022. A key part of the MTRS is strengthening the administrative capacity of the Internal Revenue Commission (IRC) to increase compliance with existing taxes. Initially, this will be achieved primarily through greater enforcement, particularly with respect to large taxpayers, encouraging voluntary compliance, broadening the tax base and removing concessions, tax exemptions and special arrangements currently in place. The medium term strategy includes, amongst other initiatives: introducing a capital gains tax; reviewing taxation of superannuation; removing zero rating for the resource industry and charitable organisations; reviewing the rate of GST; limiting tax loss carrying forward to 5 years; and reducing the corporate income tax rate once tax incentives are rationalised.

Increasing compliance within the existing tax framework should be a given for any revenue collection department. We, however, note that care should be taken to ensure efforts are not overly focused on taxpayers who are already in compliance with PNG taxes. While the informal sector by its very nature may be harder to target, efforts to increase compliance in this area may result in higher long term gains.

Removing the Training Levy and Double Income Tax Deduction for Training

The training levy applies to businesses with payroll over PGK 200,000 per annum. While this is at 2% of payroll, it is reduced by the amount of eligible expenditure on national staff. The training levy requires a separate training levy return be lodged with the IRC, thereby increasing compliance costs for businesses, with low levels of actual revenue collected (forecast at PGK 12.9 million in 2017). Effective from 1 January 2018 the training levy has been removed.

On the flipside, the double deduction allowed in calculating taxable income for eligible training expenditure has also been removed from 1 January 2018. The Government considers in the modern commercial environment companies already have an incentive to upskill and train employees. This measure is expected to more than offset the loss in revenue from the removal of the training levy, and resulting in a net increase in revenue of PGK 75 million in its first year.

Foreign Contractor Withholding Tax (FCWT)

In the 2017 Budget amendments, the discretion to allow foreign contractors to lodge income tax returns and pay tax on a net basis for prescribed contract income was removed for periods starting after 1 January 2017. Instead, prescribed contract income could only be taxed under the foreign contractor withholding tax regimes at the rate of 15%.

It was speculated that the withdrawal of the ability to lodge returns in the 2017 Budget may have been an inadvertent error and was also at odds with aspects of PNG's obligations under its double tax treaty network.

The 2018 Budget confirms that prescribed contract income of foreign contractors shall only be taxed under the FCWT regime. This confirmation leaves the following issues:

- The need to identify the treatment of payments since 1 January 2017 that have not been subject to FCWT. Given the current tax amnesty in force until 31 December 2017, persons who may be in this situation should act quickly to avail this amnesty.
- Foreign companies who have substituted accounting periods will not be able to include income or associated expenses from prescribed contracts, for periods from 1 January 2017. This means profit per the financial statements for the full financial year may not match profit used to compute taxable income. There is also a need to determine what income has been derived prior to 1 January 2017 and been subject to a final FCWT.
- Where foreign contractors derive income that is not income from prescribed contracts, then such income must still be declared by way of an annual income tax return. Foreign contractors that derive both income subject to FCWT and income that is not, will need to establish separate income and cost centres within their accounts so that income and expenses relating to either can be identified and declared separately.
- Foreign contractors with low margins may need to reconsider their operations in PNG including the use of a PNG resident subsidiary company that can lodge income tax returns and pay tax on a net income basis.
- No mention was made whether requirements of double tax treaties will be discussed with treaty partners.

Concessional Treatment of Long Service Leave

From 1 January 2018, the taxation of long service leave payments shall be taxed similar to sliding rates applicable to superannuation lump sum payments, at the rates per the table below:

Years of Service	Less than 5 years	Not less than 5 years and not greater than 9 years	Not less than 9 years and not greater than 15 years
Rate of Tax	Marginal tax rates	The lesser of 15% or the applicable marginal tax rate	The lesser of 8% or the applicable marginal tax rate

This measure only applies to long service leave accruing at a rate not exceeding 6 months per 15 years of service with the employer (or an associated person of that employer).

Suspending the Tariff Reduction Program (TRP) and Increased Import tariffs

The Government will review the TRP policy to determine whether it has achieved its intended purpose of encouraging a more efficient and productive private sector through greater exposure to international competition. The last phase of the TRP, scheduled for 2018, has therefore been suspended.

Increases in import tariffs introduced in the 2017 supplementary Budget, that were designed to support local manufacturers, have been extended by moderate further increases. This includes eggs, meats and cooking oil.

The customs tariff rate for diesel and petrol will be increased from zero to PGK 0.10 per litre.

Tax Compliance Certificates (TCCs)

Currently, the transfer of funds to any place outside of PNG exceeding PGK200,000 in any calendar year requires the obtaining of a TCC where the transaction is one of the following types:

- Transfer of capital funds (this includes savings of expatriate employees back to home countries)
- Payments to a Trust Fund
- Payment of loans
- Payments of Dividends Payment of royalties, licence fees, management fees or similar; or
- Payments made on the sale or purchase of securities, land or other property and the transfer of shares from PNG register.

The threshold for requiring a TCC has now been increased to PGK 500,000 per annum. This is a welcome move, as the obtaining of a TCC was often an administrative bottleneck in the process of transferring of funds out of PNG, an area already constrained by limited foreign currency availability. It is hoped this move will ease the burden on the IRC tax clearance team, who now will be better able to concentrate on turning around larger TCC applications in shorter periods. It is also welcome news for many expatriates working in PNG who often didn't realise they required a TCC until their bank refused to transfer further funds.

Dividend Rebate

In a surprise move, the dividend rebate was removed in tax amendments made earlier in the year, effective 1 January 2017. This placed a significant disadvantage in using PNG company group structures, which were then taxable multiple times on the same income as it flowed through the group by way of dividend. This had far reaching implications for all industries, and particularly PNG entities which heavily invest in other PNG companies such as superannuation funds.

While it was thought the removal of the rebate was in error, there had been no confirmation of this by Treasury, and companies paying or receiving dividends in 2017 have been uncertain of the status of the rebate.

This has now been resolved with the reintroduction of the dividend rebate, reinstated effective 1 January 2018. This date is problematic for companies that received dividends in the 2017 calendar year. Further clarification will now be required as to whether the IRC will allow the rebate to be applied in the 2017 year, in line with their previous statements on the issue.

Dividend Withholding Tax on Payments to Superannuation Funds

In another positive move for the superannuation industry, subsection 189B(4)(f) of the Income Tax Act, 1959 (the "ITA") will be inserted to reinstated the exemption for superannuation funds from dividend withholding tax. This will be effective from 1 January 2017, being the date from which the exemption was previously removed.

Taxation of Resource Industry

Additional Profits Tax (APT)

Following concerns from the mining and petroleum sector about the impact of the APT rules applying to existing projects, the APT will be amended to clarify that expenditure incurred up to 31 December 2016, as well as revenue derived up to that date, will be recognised in determining the net projects receipts as at 31 December 2016.

While not as far reaching as the industry would have hoped, the change does provide some clarity as to the ability to include such costs and revenues.

Fiscal Stability Clauses in Project Agreements

Section 155(3) of the ITA will be amended to specifically carve out resource projects with Fiscal Stability Clauses in project agreements, including the PNG LNG Agreement, from the effects of changes to any part of the ITA.

This amendment does not result in any substantive change, but rather aims to clarify within the ITA the existing understanding of the operation of Fiscal Stability clauses and supporting legislative provisions.

Treatment of Royalties and Development Levy for Oil & Gas Projects

Oil & Gas projects are subject to a 2% royalty and a 2% development levy based on the wellhead value of petroleum or gas produced from a licence area. Presently, to the extent that the combined value of the royalty and development levy exceeds 2% of the wellhead value of petroleum or gas sales during the year, an income tax credit is available.

For periods from 1 January 2018, it is proposed that the total royalty and development levy payable shall instead be an allowable deduction. A transitional provision has been inserted to allow unclaimed tax credits as at 1 January 2018, to be carried forward to the next year of income until utilised.

This move will have the outcome of increasing the effective income tax rate for oil and gas projects.

Definition of Resource Company in the Goods and Services Tax Act, 2003 (GST Act)

The definition of a "resource company" in the GST Act has been tightened to apply only to an "operator" as defined in the *Oil and Gas Act 1998*, and a holder of a special mining lease, mining lease or exploration licence issued under the *Mining Act 1992*. This proposed amendment is effective from 1 January 2018.

Double Deduction for Mining Exploration Expenditure

Referencing in the ITA to the former section 156E has been removed. This section was in respect of the double deduction for mining exploration expenditure. Unfortunately, a sunset clause providing certainty that the repeal of the double deduction was prospective in application has not been included in the proposed amendments.

Taxation of Forestry / Timber Operations

Progressive Duty Rate on Export of Unprocessed Old-Growth Logs

The Government is concerned that the existing export duty rate of 32.5% on unprocessed old growth logs does not act as an appropriate resource rent tax. To address this, progressive tax rates are proposed as follows (excludes plantation logs):

New 2017 Thresholds (FOB Prices, US$/m3)	Proposed 2018 Export Duty Rates	Average Duty as a % of Log Price
0	P*0.2500	25.0%
Above $60.00	P*0.3583 - 3.56	31.4%
Above $100.00	P*0.3765 - 4.76	33.8%
Above $150.00	P*0.4305 - 12.26	36.1%
Above $200.00	P*0.4805 - 18.26	40.0%
Average Duty as % of FOB Price/M3		**35.3%**

Amendment of the Definition of Primary Production

The definition of "primary production" in the ITA has been amended to exclude forestry, logging or timber operations. This clarifies that such operations are outside of the specific tax treatments in the ITA for primary production, many of which are concessional.

Tax Administrative Measures

We have set out some of the proposed administrative changes to the tax legislation.

Pay Now Litigate Later Policy

A taxpayer who wishes to file an appeal from a decision of the Commissioner General to the Review Tribunal or National Court must now, amongst other requirements, pay the full amount of any tax due and payable on the assessment to the IRC. This includes the penalty for unpaid tax that has accrued to the time of making the appeal. Payment of the full amount, and to the IRC, shifts the balance in equity firmly away from the taxpayer, particularly given the length of time it takes for reviews and appeal to be concluded. This measure is proposed to be effective from 1 January 2018.

Joint and Several Liability for Outstanding Tax - Shareholders and Related Entities

Under a new Division in the ITA, and after taking reasonable steps to recover an amount due, the IRC may recover an amount of income tax due and payable by a corporate taxpayer from a shareholder and / or related entity. After 14 days of receiving a notice from the Commissioner General, shareholders shall be deemed jointly and severally liable for the outstanding tax of the defaulting company. If the amount is still outstanding after 14 days, the shareholders shall be liable to pay the shareholders' portion of the amount due and payable within 30 days from that time. Where the amount due and payable is still outstanding after the expiry of the 30 days, notice may be served on related entities, who have 30 days from that time to make payment.

Shareholder and related entities are broadly defined. In its present form, the draft legislation is also not restricted to corporate shareholders. There also is no minimum ownership requirement for a shareholder.

An entity will be a related entity if: it holds as little as a one twentieth interest in a shareholder company; it can control the board of a shareholder company; or it can exercise a majority of votes in that company. However, these rules do not appear to apply to commonly owned sister companies of the same shareholder company.

A shareholder's liability is restricted to their "shareholder's portion", being its percentage interest in shares of the defaulting entity. Legal action in the National Court may be taken by the Commissioner General to recover amounts due and payable.

This proposed measure applies to outstanding taxes from 1 January 2018 and not just liabilities arising to periods after that date.

New Requirements for Tax Identification Numbers (TIN)

The requirements for when a person must obtain a TIN have been greatly expanded. This now includes any person wishing to open a bank account. This is even for persons who otherwise would not require a TIN and are not required to lodge an income tax return. Penalties now apply for failure to apply for a TIN if otherwise required.

Providing Taxpayers Option to Pay Taxes as they Lodge

At present, the payment of income tax is due on the 30th day after the service of the notice of assessment. The amending legislation will allow taxpayers to pay any income tax upon lodgment of a tax return or prior to the 30 days. The earlier payment of tax is voluntary, and in the case of late lodgments, may assist in limiting the accrual of penalties.

Imposing Penalties for Incorrect Disclosure of Losses and Deductions

Penalty provisions have been widened to cover the claiming of deductions in the incorrect year or overstating allowable deductions.

Bribery of IRC Officers

A person who bribes, induces, colludes, threatens or otherwise attempts to influence an IRC officer shall now be guilty of an offence, punishable by imprisonment not exceeding 5 years.

Landowner Trusts

The Commissioner General may by Gazettal Notice declare a trust to be a landowner resources trust. Presently, this must be done by the Minister of Treasury, which has led to delays in the past.

Tax Administration Act (TAA)

The 2018 Budget notes there are different administrative rules for different taxes. A TAA setting out common procedures for different taxes with respect to the tax administration is currently in draft format and expected to come into force on 1 January 2019. Based on the draft TAA, it is expected to cover:

- Tax returns and tax assessments
- Decisions of the Commissioner General and objections and appeals
- Public and Private rulings
- Collection, recovery, and refunds
- Electronic lodgments and payments
- Information collection, communications, forms and notices
- Administrative penalties and tax offences.

Overview of the smaller and technical changes

We have set out some of the smaller and technical changes to the tax legislation below that are to be effective as of 1 January 2018.

Excise Tariff

Diesel excise is proposed to increase from 10 toea to 23 toea per litre to bring it closer to the rate applicable to petroleum, which is 62 toea per litre.

GST on Educational Supplies

Educational institutions will no longer be able to claim input tax credits paid in respect of the supply to them of text books, writing materials and other educational materials. This measure is to address abuse of this concession, with the Government of the view that educational institutions claim input tax credits on other costs under the guise they are “other educational materials”.

Taxation of Insurers

The Government will simplify the administration of the non-resident insurers’ tax so that the amount of tax withheld by the insurance brokers is paid to the IRC in the subsequent month after being withheld and not in the following year.

Customs Harmonised System (HS) 2017

Drafting errors made previously to the *Customs Tariff Act, 1990* which unintentionally omitted some tariff items, descriptions, codes and tariff rates, and placed under wrong headings tariff rates, will be corrected.

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