Papua New Guinea Budget 2017
Budget Alert

Contents

"Responsible fiscal consolidation for future growth and development"

Executive summary

The 2017 Budget is the last National Budget before the 2017 elections. The Budget has been set in a challenging global and local environment and in what will be a challenging year for the sitting Government. Despite this, the temptation to spend in an election year has been largely resisted and the need for fiscal discipline has been recognised. This shapes the tone for the Budget, whose theme is "Responsible Fiscal Consolidation for Future Growth and Development".

"It has been no secret that we are faced with a tight budget."

Hon Patrick Pruaitch, CMG, MP
Treasurer

Global events and depressed prices in the commodities market, particularly LNG prices, have placed pressure on revenues being generated by the Government. These pressures are expected to continue, with LNG prices forecast to remain relatively low and development of new major resource projects not expected to have a significant impact on revenues in the 2017 year. To further compound revenue difficulties, grants and loans from development partners are also budgeted to continue to trend downwards.

This has forced the Government to look within, and further pressure will be placed on State Owned Enterprises for dividend revenue and the Internal Revenue Commission and Customs for increased tax revenues. Suggested tax reforms designed to balance tax revenues have largely been put on hold, with the Government concentrating on revenue collection for 2017. In addition, the possibility of sovereign bonds being issued remains alive, with the Government waiting for the right moment to move on these again.

These revenue measures will be coupled with structural reforms to streamline the public sector. This includes such agendas as pursuing agency amalgamations to remove duplications, government agency personnel emolument ceilings, and a reduction in headcount. It also requires significant cuts and cost savings to be identified across all Government funded sectors.

As a result the Government has stated it must focus on its core objectives and defer expenditure on non-necessary projects. For instance, only key capital projects that will achieve future revenues will receive ongoing funding in 2017.

While the Government remains committed to its key focus areas of health, education, law and order and transport, each of these areas will receive less funding in 2017 than in 2016. Two sectors that are notable exceptions to funding cuts are Provinces and Administration. The latter contains the budget for the 2017 National Election and the 2018 APEC summit.

Despite the 2017 Budget being the last of the current Government's term, it is probably the most difficult it has faced. The reduction of revenue streams means the Government sectors will need to do more with less, and much of the success of the current budget will come down to how well structural and operational reforms are implemented and adhered to in the lead up to the next election.

Key facts and figures

Table 1: Key macroeconomic indicators

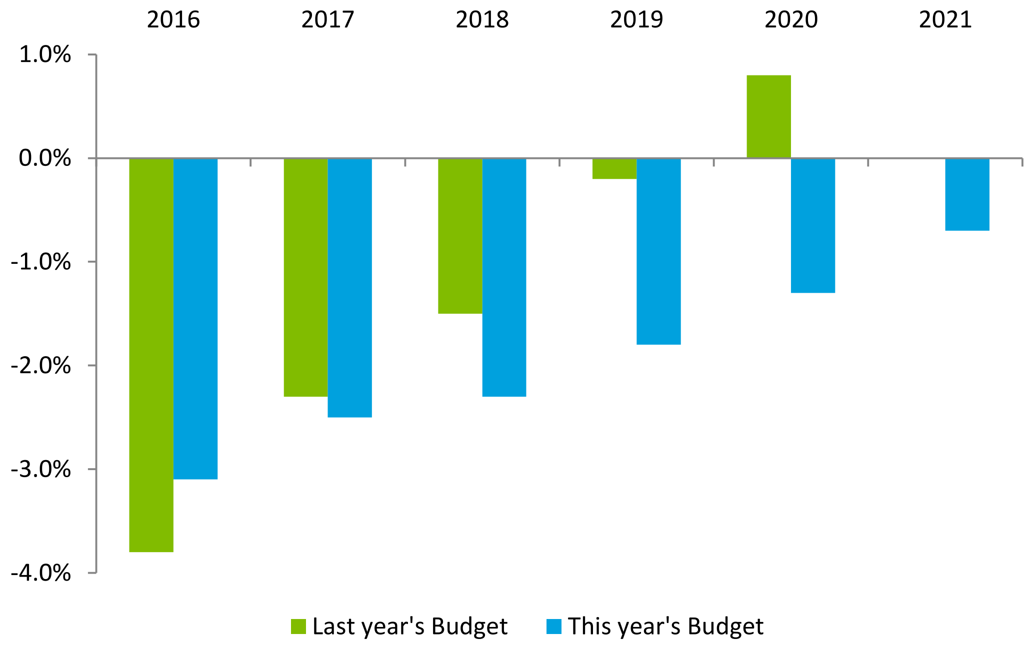
	2016 Proj	2017 Proj	2018 Proj	2019 Proj	2020 Proj
Economic growth					
Total Real GDP (%)	2	2.8	2.7	2.7	2.6
Non-Mining Real GDP (%)	2.5	3	3.5	3.5	3.5
Inflation					
Average on Average (%)	6.6	7	6.6	5.6	5.2
Dec on Dec (%)	6.4	6.5	6.3	6	6
Real Exchange Rate Index					
(2007 = 100)	129.4	133.2	137.8	141.8	145.6
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$/oz)	1,267	1,301	1,315	1,331	1,354
Copper (US$/tonne)	4,724	4,832	5,084	5,123	5,294
Oil (Kutubu Crude: US$/barrel)	42	50	54	55	57
Nickel (US$/tonne)	9,351	10,459	11,374	12,148	12,683

Table 2: Overall Budget balance

	2016 Supp Budget	2017 Budget	2018 Proj	2019 Proj	2020 Proj	2021 Proj
Revenue	11,722	11,473	11,139	11,646	12,210	12,907
Expenditure	13,835	13,350	12,978	13,216	13,425	13,607
Net deficit	(2,113)	(1,877)	(1,840)	(1,570)	(1,215)	(699)
% of GDP	-3.1	-2.5	-2.3	-1.8	-1.3	-0.7
Government debt (Km)	19,785	21,623	23,463	25,033	26,248	26,948
Government debt (% GDP)	29.4	28.8	28.8	28.7	28.1	27

The overall Budget is now expected to be in deficit over the forward estimates period, in contrast to last year's Budget which forecast a return to surplus in 2020. As shown in Chart 1, this contrasts with the Government's previously stated position in the 2016 Budget of returning to surplus by the end of the decade.

Chart 1: Net Budget deficit, surplus (% of GDP) - this year's and last year's Budget



Economic overview

The 2017 Budget is framed amidst an increasingly challenging and uncertain economic backdrop, with both national and international factors complicating the near term outlook.

The broader economic outlook

The overall Budget objective for 2017 is responsible fiscal consolidation for future growth and development. The Budget is framed amidst a lull in mining construction, which has been seen as key to economic growth in recent years. Offsetting that, to some extent, will be development works surrounding the 2018 APEC Summit and investments relating to the 2017 National Election.

By and large though, it remains the case that the next couple of years seem set to be tough times for Papua New Guinea. Inflation is up, economic growth is down, and foreign exchange shortages continue to affect all sectors of the economy.

The main challenge facing the Treasury in this year's Budget is that commodity prices have fallen considerably from last year's projections, squeezing government revenues. At the same time, demands on spending continue to grow.

There are, nevertheless, some positives on the immediate horizon.

Firstly, some large scale investments seem likely to secure government approval in 2017, including the Freida River and Wafi-Golpu projects. Furthermore, the large scale Papua LNG project still looks likely to be approved in 2018.

Secondly, there are also some short term opportunities for domestic tourism and construction related to the APEC Summit in 2018. Major tourism investments in Port Moresby and other regions (e.g. Madang), many of which have been developed as a direct consequence of the Summit, should generate stronger economic activity in the next few years. Ongoing investment in tourism and other assets, especially in the lead up to APEC, will support construction.

However although these factors seem likely to support the near term outlook, and may indeed be behind the more optimistic Treasury forecasts in this year's Budget, they will do little to address the underlying challenges.

Therefore, with mining in a lull period over the next few years, there are really only a few logical sources of income:

- Growing alternative industries
- Cutting back on spending
- Increasing dividends from State Owned Entities (SOEs)

To date the focus has been on the latter two. In particular, the Secretary for the Department of Treasury noted in his remarks that the Government's attitude towards the public sector and SOEs was to 'squeeze as much blood out of the stone' as possible. Although reform of SOEs is acknowledged as important, in the absence of such reform it is not clear how much additional revenue will be achievable from this source.

Further, with economic growth slowing, and monetary policy focussed largely on the simultaneous objectives of maintaining a high exchange rate as well as sufficient levels of FOREX reserves, then cutting back on spending without accompanying growth measures risks further slowing of economic activity.

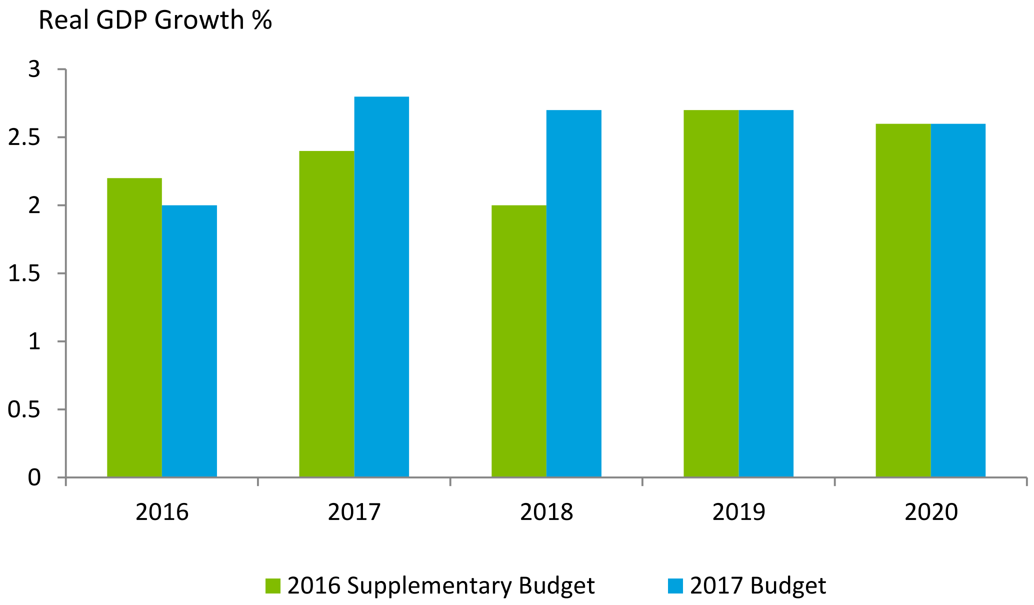
While budget repair is essential in the short term, so too is growing alternative industries that, ultimately, will be needed to take over the growth task from the resources sector.

Key assumptions

Macroeconomic variables

The projected GDP growth profile over the forward estimates has changed considerably since last year. This year's Budget has a slightly lower 2016 growth forecast (2% compared to 2.2%), with higher forecasts for 2017 and 2018, before reverting to trend projections for the rest of the decade.

Chart 2: Forward growth projections - this year's and last year's Budget



The altered growth profile in the near term likely reflects large scale mining investments being factored into this year's growth forecasts, but not last year's. However, without further detail on the modelling approach it is difficult to comment further.

Projected inflation has increased to 7%, which is attributed to exchange rate depreciation and volatile movements in the prices of seasonal items. Spending commitments related to the 2017 National Election and hosting of the APEC Summit in 2018 may also add to inflationary pressures in the short term.

PNG's Trade Weighted Index (TWI) fell considerably over 2016, declining 10.8% since the start of the year. Despite the depreciation observed earlier, the Budget continues to project an upward trend in the exchange rate over the forward estimates (albeit at a lower level).

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.

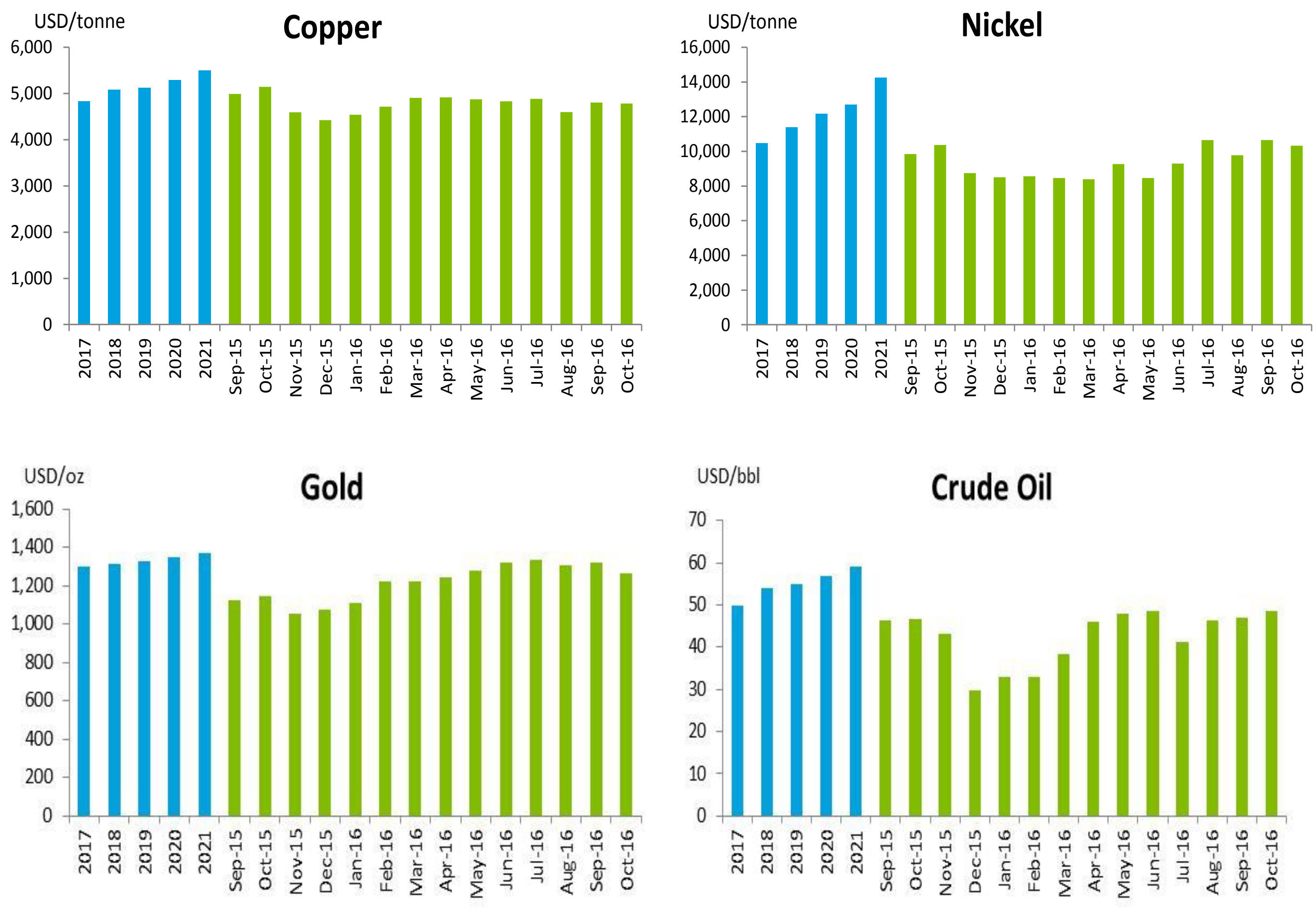
A sudden drop in the exchange rate would potentially be damaging to the economy – while it would benefit exporters, it would add considerable cost pressures on an import dependent economy. And, of course, even those in export oriented sectors would potentially feel the pain of higher input costs.

However downward pressures on the exchange rate are mounting, meaning 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.

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 3 compares the forward estimates for four of PNG's major commodity exports – copper, nickel, gold and crude oil – with month end spot prices of those commodities for the last 12 months.

Chart 3: estimated commodity prices v recent spot prices

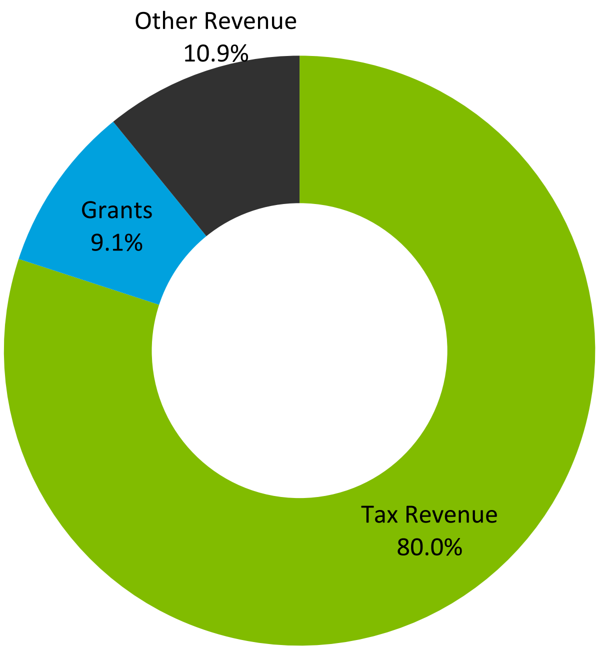


Whether or not commodity prices end up following the same broad profile as that projected in the budget is a matter for conjecture. It is worth noting however that to the extent that the projected price rises do not eventuate, the forward estimates of the remainder of the Budget will come under considerable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

Revenue

The revenue trajectory is down on last year's Budget as commodity prices and the broader economic outlook continue to decline

Chart 4: Where does PNG's revenue come from?



Tax revenue

Table 3: Tax revenue by source

Tax Revenue (Kina million)	2015 Actual	2016 Budget	2016 Sup. Budget	2016 Revised	2017 Budget
Personal Income Tax	3,037.1	3,511.7	3,077.4	2,849.1	3,035.7
Company Tax	2,374.8	2,793.2	2,230.3	2,230.1	2,433.9
Mining and Petroleum Taxes	195.4	129.9	88.8	21.9	77.1
Withholding and Other Income Taxes	304.8	346.6	278.4	291.0	289.6
GST	1,567.0	1,759.0	1,430.3	1,459.0	1,484.7
Stamp Duties	126.1	117.8	115.8	55.8	42.9
Excise Duty	503.3	734.8	569.8	571.2	691.1
Import Excise	298.7	316.7	272.9	273.7	300.3
Bookmakers' and Gaming Machine Turnover Tax	171.5	191.4	178.5	140.4	222.9
Other Taxes on Goods and Services	13.4	17.8	16.5	13.6	20.2
Import Duty	249.1	332.4	240.4	220.8	232.9
Export Tax	316.2	274.5	326.8	326.8	326.6
Grand Total	**9,157.4**	**10,525.8**	**8,825.9**	**8,453.4**	**9,157.9**

As expected, the 2017 Budget does not include a major overhaul to the tax legislation before the National Election next year but there are some unexpected and significant changes proposed by the Government mostly in line with the Tax Review Committee recommendations that were published in 2015.

It also has become clear that the main priority of the Internal Revenue Commission for the Budget is on collecting revenue and focusing on compliance matters. The IRC is to become "stronger and tougher" on taxpayers as mentioned by the Commissioner General during the Budget announcement. For this purpose also a Joint Task Force is being established that will comprise of senior Treasury and IRC officials whose terms of reference are to be finalised in early 2017. According to the Budget, reputable international accounting firms will be engaged or work outsourced by the Task Force (or the IRC) in the auditing of major companies.

We have provided a summary of the key proposed changes in the tax legislation followed by an overview of the smaller and technical changes to the legislation.

The Budget does not mention any grandfathering of existing rules except for so-called 'stability clauses' as to dividend withholding tax in connection to resources companies.

Actual tax reforms are discussed in detail under the Special Areas of Interest section.

Grants revenue

A detailed breakdown of grants revenue received from different countries is provided in the following section.

Other revenue

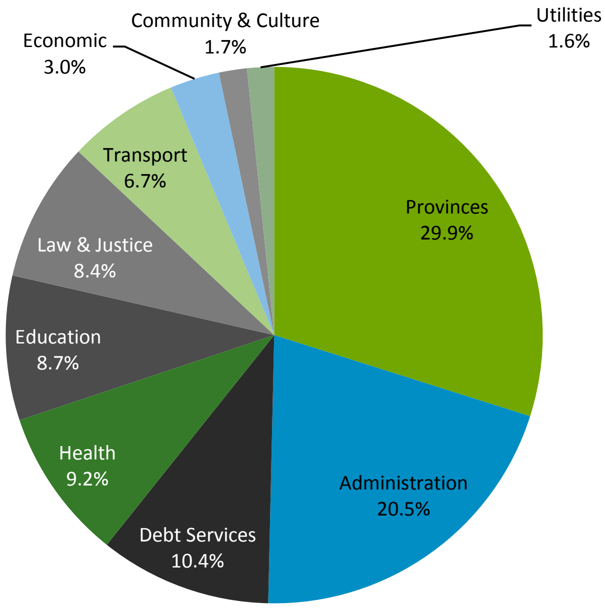
Table 4: Other revenue by source

Other Revenue (Kina million)	2015 Actual	2016 Budget	2016 Sup. Budget	2016 Revised	2017 Budget
Property Income	943.1	516.9	853.3	653.3	1,130.1
Sales of Goods and Services	65.6	85.4	31.1	85.4	91.2
Fines, Penalties and Forfeits	2.8	0.8	0.8	0.8	0.8
Transfers, not elsewhere classified	14.4	8.2	8.2	8.2	23.6
Grand Total	**1,025.9**	**611.3**	**893.4**	**747.7**	**1,245.7**

Expenditure

Overall expenditure in 2017 is projected to fall by some 3.5% relative to 2016

Chart 5: Where does PNG's expenditure go?



In recognition of the low resources to finance the Budget, the Government has reduced total spending to K13,349.5 million, a drop of 3.5% from the 2016 Supplementary Budget.

This fiscal discipline is being committed to despite the National Election occurring in 2017, though this will undoubtedly be put under pressure in the lead up to the election. Of this, K11,928.7 million is government funded, while K1,420.9 million (10.6% of total expenditure) is donor funded (through grants or loans).

Table 5 overleaf shows how foreign Governments provide their funding for 2017.

Table 5: Foreign donors by source

Donor	Grants	2017 Loans	Total	Percentage
DFAT (Australia)	727.1	-	727.1	51.7%
EU	104.3	-	104.3	7.4%
UN	29.1	-	29.1	2.1%
USA	18.0	-	18.0	1.3%
NZ	30.8	-	30.8	2.2%
China	-	15.9	15.9	1.1%
ADB	-	214.1	214.1	15.2%
WB	5.4	85.2	90.6	6.4%
JICA	53.5	111.4	164.9	11.7%
Ceska / Erste	-	12.0	12.0	0.9%
EIB	-	14.2	14.2	1.0%
Grand Total	**968.2**	**452.8**	**1,421**	**100.0%**

Source: Department of National Planning and Monitoring. *Note* the figures in this table are sourced from a separate presentation to the 2017 Budget lock up delivered by the DNPM. The 2017 Budget total for grants revenue is K1,045.3 million.

Importantly, 2017 budgeted grants and loans are down 14.6% and 51.3% respectively on 2016 Supplementary Budget levels.

Key expenditure objectives for the 2017 Budget are:

- The 2017 National General Election and 2018 APEC Summit
- Placing more emphasis on monitoring, evaluation and compliance to achieve improved development outcomes
- Continuing to support key priorities of education, health, infrastructure, agriculture, and SME sectors
- Further promoting the efficient and effective implementation of major projects through improving design, scoping and the implementation processes

Total expenditure is broken down into operational expenditure (70%) and capital expenditure (30%). In order to keep the deficit level to 2.5 % of GDP, adjustments were made to both, but the Capital Expenditure Budget was particularly subject to heavy cuts from the 2016 levels. On this, the Government notes that because it does not have the money, Budget cuts are simply a necessary reality.

The operational expenditure cuts are being achieved through the following:

- More discipline with respect to expenditure by the Government on goods and services
- Maintenance of personnel emoluments expenditure
- Addressing inefficiencies in the public sector. This will be achieved through pushing forward with non-financial instructions intended to improve agency performance, as well as through specific identification of efficiency opportunities in the various agencies. This includes amalgamations of agencies, and redeployment and reductions in staffing.

The Capital Expenditure Budget has a seen a K1,082.6 million fall from 2016 levels (being a decrease of 21.2%). This has been primarily achieved through reduced ongoing government funded projects, spread across all sectors (see sector analysis on the following page). A number of ongoing projects and all new priorities will not proceed in 2017.

No reductions were made to Provincial Service Improvement Plans (PSIPs), District Service Improvement Plans (DSIPs), and the newly introduced Ward District Service Improvement Plans (WSIPs).

Table 6: Medium term expenditure profile

Sector	2016 Supp Budget	2017 Budget	2018 Proj	2019 Proj	2020 Proj	2021 Proj
Provinces	3,565.8	3,989.9	4,020.2	4,040.7	4,059.5	4,090.1
Administration	2,219.2	2,732.3	2,702.1	2,549.3	2,476.0	2,443.8
Debt Services	1,479.6	1,382.9	1,367.6	1,290.3	1,253.2	1,236.9
Health	1,536.7	1,221.5	1,208.0	1,139.7	1,106.9	1,092.5
Education	1,242.8	1,162.5	1,149.7	1,084.7	1,053.5	1,039.8
Law & Justice	1,232.6	1,124.5	1,112.1	1,049.2	1,019.0	1,005.8
Transport	1,025.2	897.1	887.2	837.1	813.0	802.4
Economic	452.4	398.0	393.6	371.3	360.7	356.0
Community & Culture	149.7	224.6	222.2	209.6	203.6	200.9
Utilities	371.5	216.2	213.8	201.7	195.9	193.3
Grand Total	**13,275.5**	**13,349.5**	**13,276.5**	**12,773.6**	**12,541.3**	**12,461.5**

Provincial Sector

The main priority for the provincial sector is the implementation of the National Service Delivery Framework to provide a consistent delivery of services across the country. This sector received the largest allocation of the total budget, being 27.2%, an increase of 11.9% from the prior year. This funding feeds through to PSIP, DSIP and WSIP Budgets. There is now a removal of fixed sector allocations, providing Provinces and Districts with greater flexibility in utilising these funds to address local development priorities.

Administration services

This sector comprises 31 Government agencies (including the IRC and Customs) and is the largest sector of the Government. This sector will achieve a 23.1% increase in funding to K2,732.3 million, with funding to remain above 2016 figures for each year in the forecast period to 2021.

This sector will fund the 2018 APEC Summit and the 2017 National Election. Expenditure on these two items comprises K250 million and K400 million respectively. An additional 45 million is allocated jointly for security for the two events. These key activities form 25.41% of the Administration services sector.

The other areas to receive additional funding are the IRC and Customs, to assist with upgrading of their systems and to facilitate revenue raising initiatives. Stricter enforcement of the tax laws appears to be a key area of the Government's overall policy.

Debt servicing costs

In a broad sense debt servicing costs are expected to follow the same overall trends as last year. Interest rates are maintained at a level of 6.25% consistent with the Central Bank's neutral stance on monetary policy. The projected decline in debt servicing costs is not described in detail within the Budget documents. However with interest rates projected to remain constant, along with 7% annual inflation and a projected increase in the overall pool of debt, further clarity on how the debt servicing costs are expected to decline would be warranted.

Health

The Budget reiterates that the health sector remains a key priority under the millennium goals, with an emphasis on primary health care to the regions and the urban disadvantaged. The total funding for health (K1,221.5 million) has reduced significantly by 20.5% from the 2016 Supplementary Budget, with funding forecast to continue to decline each year over the forward estimates period to 2021. With a growing population this is only going to increase demand for already stretched health services, targeted spending of this budgeted amount will be more important than ever.

Education

While education also remains a key priority, it also has not escaped the budget cuts. Expenditure on this area in 2017 (K1,162.5 million) is 7.4% less than in the 2016 Supplementary Budget. Expenditure is budgeted to continue to decline over the forward estimates period to 2021. 51.8% of this sector's budget remains allocated to the Tuition Fee Free Policy.

The Government has recognised that the quality of education in PNG is a concern. This is being addressed through the development of a new Standard Based Curriculum for elementary, primary and secondary learners.

Like health services, there are continuing concerns with the adequacy of infrastructure. Therefore, the reduced funding means challenges for the education sector continue to lie ahead.

Law and Justice Sector

Despite being another key sector facing ongoing challenges, particularly with the 2018 APEC Summit and an election coming up, this sector has not been spared from budget cuts. This represents an 8.8% reduction from the 2016 Supplementary Budget.

Transport

This sector includes roads, air and maritime. Funding to the sector has dropped in 2017 by 12.5% relative to the 2016 Supplementary Budget. A significant portion of this budget is financed through loans and grants, and the Government will seek to mobilise additional funding from development partners while concentrating on key infrastructure which has economic potential.

Special areas of interest

Key policy announcements

Consistent with the overarching premise of fiscal consolidation and repair, the 2017 Budget did not hand down any major policy announcements apart from amendments to taxation arrangements which are discussed in this section.

Policy settings remained unchanged relative to last year's Budget. That said, it is worth noting that the Sovereign Wealth Fund (SWF) which was originally due to commence operations in 2016 (as stated in last year's Budget) is still in the process of approving a board of directors and as such has not yet come into operation.

The SWF will consist of two separate components: a Stabilisation Fund and a Savings Fund, with revenues above a certain amount to be disbursed into the Savings Fund. Projected revenue for the Stabilisation Fund is not expected to be sufficiently high so as to trigger disbursement into the Savings Fund, at only K77.2 million for 2017.

As such, current projections show zero dividends flowing to the Savings Fund with all monies flowing to the Stabilisation Fund being recirculated into general revenue.

APEC/ National Election spending

Budget allocations for APEC and election spending, totaling K250 million and K400 million respectively, cause spending for the near term to be elevated relative to projections from 2019.

The potential benefits from the APEC Summit in terms of additional spending or investment have not been factored into this year's Budget, which is appropriate owing to the considerable uncertainty surrounding the Summit's true cost and revenue profile. However they do present a potential upside to the revenue forecasts, which is worth briefly noting.

The potential benefits from the Summit are both direct and indirect. The direct benefits will be the expenditure of delegates and other tourists who visit PNG as a result of the Summit. Potentially of greater significance though, are the indirect benefits flowing from higher investment; to that end, the Treasurer stated that the key benefit is 'how many people bring their cheque-books to our country.'

Standardising Resident Company Income Tax at 30%

The Government proposes to standardise the resident company tax rate to 30% across all sectors of the economy as at 1 January 2017. Resident companies operating in the resources industry are currently taxed at different income tax rates of between 30 to 50%. This alignment is implemented together with the imposition of 15% dividend withholding tax across all industries which simplifies and harmonises taxation in the resources industry with those in the non-resources industries.

Removal of Double Deduction for Exploration Expenses

Currently mining companies have a potential double deduction for exploration expenditure for depreciation purposes in accordance with Section 156E of the Income Tax Act. This double deduction will be repealed as of 1 January 2017.

Additional Profits Tax to Resources Companies

Additional Profits Tax (APT) is a tax that applies in addition to the company income tax to companies operating in the resources industry. The tax only applies if the resources company receives a return that is above the average rate of return on its investments, being a so-called resource rent.

APT currently only applies to gas projects and in practice is only applied to the PNG LNG project.

The Government announced it will introduce a revamped APT that will apply to all resource projects. Under the revamped tax, the hurdle rate will be a flat nominal rate of 15%, a single APT threshold rate of 15% and an additional profits tax rate of 30%.

This measure intends to simplify administration, ensure a level playing field across the resources industry and ensure a fair return to the people of PNG.

Employer Provided Housing Benefits

Table 7: Proposed Prescribed Value for taxing employer provided accommodation (PGK)

Type of Housing	Area 1	Area 2	Area 3
Very High Cost house or flat (weekly rent K5001 and above)	2,500.0	1,500.0	0.0
Up-Market Cost house or flat (weekly rent from K3001 to K5000)	1,500.0	1,000.0	0.0
High cost house or flat (weekly rent above K1000 but less than K3000)	700.0	500.0	0.0
Medium cost house or flat (weekly rent K300 – K1000)	400.0	300.0	0.0
Low cost house or flat (weekly rent below K300)	160.0	150.0	0.0
Mess / barracks	60.0	50.0	0.0
Government mess / barracks	7.0	7.0	0.0
Employees in approved low cost housing scheme	0.0	0.0	0.0

Area 1- Goroka, Lae, Madang, Mt Hagen, Port Moresby, Kokopo, Alotau & Kimbe
Area 2- Bulolo, Daru, Kainantu, Kavieng, Kerema, Kiunga, Kundiawa, Lorengau, Mendi, Popondetta, Pogera, Rabaul,Tabubil, Vanimo, Wabag, Wau, Wewak, Buka, Arawa & Lihir
Area 3- any place in Papua New Guinea not included in Area 1 and 2.

A housing allowance received from the employer is fully taxable to the employee whereas the providing of housing accommodation by the employer to the employee is taxed at prescribed rates.

According to the Government, the appreciation of housing costs has provided a large tax subsidy to employees who receive housing from their employer, but particularly to high income earners.

Furthermore, due to changing market conditions in many cases "low cost" and "medium cost" are now assessed as "high cost".

For this reason, the prescribed rates have been increased to include two new brackets, reflecting an up-market tier of housing cost and a very high cost tier of housing. Also the areas have been adjusted accordingly to reflect the current market prices.

This measure is aimed to strike a better balance between encouraging and supporting employers who provide accommodation to employees and ensuring fairness for all taxpayers including those who do not benefit from employer provided housing.

Interest Withholding Tax

Foreign companies lending to a company engaged in the resources industry in PNG are currently exempt from income tax and interest withholding tax. This exemption is now being repealed in line with standardising the corporate income and withholding tax rates that apply to companies operating in the resources and the non-resources industries.

Foreign Contractor Withholding Tax

The foreign contractor withholding tax regime is no longer correlated with 25% of the non-resident income tax rate of 48%, being 12%. A standard 15% withholding tax will now apply to foreign contractors.

As a consequence to the amended foreign contractor withholding tax regime, foreign contractors will no longer be allowed to apply for taxation on a "net" basis whereby the contractor prepares and lodges an income tax return with the IRC annually. Taxation on a net basis has been especially beneficial to foreign contractors that received operating margins below 25% on their PNG contracts. This reform is therefore significant for foreign contractors working in PNG.

The liability to the PNG client, being the tax agent to the foreign contractor, is also being amended and becomes stricter to the tax agent. The tax agent is still required to submit the foreign contract with the IRC within 14 days of the signing and is guilty of an offense if it fails to do so. The tax agent is obliged to deduct and pay the foreign withholding tax to the IRC. If the tax agent fails to withhold the foreign withholding tax then the tax agent is potentially liable for the tax, any penalties, and can be sued by the IRC in order to pay the liability.

The payment of the foreign contractor withholding tax remains due by the 21st day of the following month when the payment was made, became liable to be paid or was credited.

Dividend Withholding Tax

Standard dividend withholding tax rate of 15%

The Government proposes to standardise the dividend withholding tax to 15% across all sectors of the economy as at 1 January 2017. The current rate is 17% in the absence of a Double Tax Agreement reducing this rate.

However, dividends paid or credited by mining companies are currently subject to a 10% dividend withholding tax whilst petroleum and gas companies are not subject to dividend withholding tax. The proposed standard dividend withholding tax rate therefore means a significant increase in the tax costs to the resources sector. This, however, is to be balanced against the reduction in the corporate income tax rate of 30% as explained above. Fiscal stability agreements will also play their part in this reform.

Simplifying the taxation of dividend withholding tax

Section 189B of the Income Tax Act is amended and simplified in the 2017 Budget.

Under the changes, a company will only be required to withhold dividend withholding tax if it pays or credits a dividend or an amount that is deemed to be a dividend to a resident individual, a resident trust estate or a non-resident person. In the other situations no dividend withholding tax applies.

This means for instance that if a company in PNG pays a dividend to another company in PNG, then dividend withholding tax is no longer required to be withheld.

The changes also mean that even where dividend withholding tax applies, the dividend income is not excluded from the assessable income of the recipient.

Exemption to Certain Dividends

Dividends paid out of assessable income of petroleum or gas operations can no longer be classified as non-assessable income to the shareholder if the dividends meet the defined criteria. This means dividends paid out of petroleum or gas operations are treated similarly to dividends paid out of other business operations.

Refund of Dividend Withholding Tax

PNG resident companies can no longer offset dividend withholding tax incurred on dividends received from dividend withholding tax due on dividends paid. This is in line with the scrapping of dividend withholding tax on these companies.

Transfer Pricing – Country by Country Reporting

The Budget proposes a new Division 16A named "Country by Country Reporting" which follows after Section 15 (Section 16 has been repealed in the past) concerning "Business Controlled Abroad" in relation to transfer pricing.

The new Division 16A applies such that where a parent company of a Multinational Enterprise Group (MNE) is located in PNG for tax purposes, it is required to file country-by-country reports with the IRC annually. Separately, a qualifying subsidiary located in PNG or a PNG branch of a foreign subsidiary of an MNE Group has to file a country-by-country report with the IRC under specific circumstances.

The PNG subsidiary or the PNG branch of a qualifying foreign subsidiary of an MNE Group will also be required to notify the IRC about its status no later than the last day of the reporting fiscal year of the MNE Group.

The country-by-country report should contain aggregate information relating to the amount of revenue, profit or loss before income tax, income tax accrued, stated capital, earnings, number of employees and tangible assets other than cash or cash equivalents with regard to each jurisdiction in which the MNE Group operates. In addition the report is to disclose the identity of each qualifying entity of an MNE Group, setting out the jurisdiction of tax residence of such entity, and where different from such jurisdiction of tax residence, the jurisdiction under the law in which such entity is organised and the nature of the main business activities of such entity.

The country-by-country report needs to be prepared in a standard template of the OECD and is to be lodged with the IRC no later than 12 months after the last day of the reporting fiscal year of the MNE Group.

The IRC shall use the country-by-country report for purposes of assessing high-level transfer pricing risks and other base erosion and profit shifting related risks in PNG. However, transfer pricing adjustments by the IRC will not be based on the reports. The IRC may also use the reports for economic and statistical analysis. However, it has an obligation to keep the information confidential.

Overview of the smaller and technical changes

We have set out some of the smaller and technical changes to the tax legislation and customs below that are to be effective as of 1 January 2017.

Excise Tariff

- The excise on alcohol is raised from the current bi-annual capped indexation rate of 2.5% to 5% bi-annually
- A one-off increase in 15% on the effective base rate for tobacco excise
- Diesel excise is increased from 6 toea to 10 toea to support increased road networks and maintenance of existing national road networks

Customs Tariff – Export rate on logs increased

- The current fixed export duty rate of 28.5% applying on unprocessed old-growth logs is being replaced by a progressive export duty rate. The purpose of the increase is to encourage downstream processing and to fully capture the resource rent of varying log species of exploitable old-growth logs that are exported unprocessed.

Bookmakers Turnover Tax and Stamp Duties

- The Budget proposes an amendment to repeal stamp duty on bookmakers betting tickets and to increase the Bookmakers Turnover Tax, with revenue to be shared between the eligible Provincial Governments and the National Government.

Gaming Machine Taxes

- Gaming machine profit distribution to the community benefit fund is reduced by 4% and permit holders' portion by 5%, with those shares reallocated to increase consolidated revenue in support of the 2017 Budget.

Departure Tax

- The departure tax is increased from K30 to K114 to adjust for inflation.

National Reform Agenda

The Budget also addressed ongoing reforms to the public sector to improve the quality of spending, sector efficiencies and ensure more effective delivery of services. The Government announced it will work with key stakeholders to reduce impediments to doing business in PNG. Broadly, the reform areas highlighted in the Budget are as follows:

1. Public Sector Reform
    a. Equitable resource allocations to Provincial Governments
    b. Mergers of National Departments and Agencies
    c. Budget reforms to improve quality of financial data
    d. Management of staffing and personnel emolument ceilings
    e. Industrial pay fixation agreement
    f. Superannuation reform
    g. APEC Policy
2. Private Sector Reform
    a. Consumer & Competition framework review completion and development of a roadmap to reforms
    b. Improved economic regulation and consumer protection
    c. Information and Communications Technology Industry Reviews
    d. Financial services sector review, including completion of Financial Sector Development Strategy to be presented to the NEC in 2017
    e. Financial inclusion and microfinance expansion program
    f. National land development program to facilitate commercial use of customary land, while protecting communal ownership.
    g. Informal economy regulation and participation
    h. Support for Small to Medium Enterprises, including set-up of a Credit Guarantee Corporation to address financing issues in this sector
    i. Domestic Market review
    j. Aviation industry review
    k. Investment promotion reforms
3. Implementation of the Sovereign Wealth Fund

Resource Sector

Under the heading of managing mining and petroleum assets, the Budget touched on a number of potentially significant areas in the resource sector. These include the following:

1. Further participation in the Extractive Industries Transparency Initiative
2. Development of policy on State equity participation in resource projects. This is in light of Tax Review report recommendations on the subject. Policy development is stated to include wider consultation with external stakeholders in 2017
3. Completion in 2017 of a template Gas Agreement to ensure transparency and more consistency in negotiating oil and gas project agreements
4. The Government will finalise a policy on domestic market obligation for oil and gas projects in 2017. This is to provide low cost oil and gas supplies in country

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