

2008 Papua New Guinea National Budget



PricewaterhouseCoopers

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20 November 2007

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The Minister for Treasury and Finance, the Honourable Patrick Pruaitch, MP handed down the 2008 National Budget on 20 November 2007.

Executive summary

The theme of the 2008 National Budget 'Empowering the People' continues the 'Investing in the Future of Papua New Guinea' policies underpinning the 2007 National Budget. The budget, in part, is focussed on the Government's stated commitment to secure broad based, balanced and lasting development for all Papua New Guineans.

Key components include:

- It is expected that this budget will deliver a surplus equal to 1.0% of GDP in 2008 (while the 2007 budget originally forecasted a deficit equal to 0.2% of GDP, the revised estimate indicates a surplus equal to 1.7% of GDP in 2007).
- There appear to be no new taxes or increases in existing taxes and reductions are to be made in personal income tax rates, the non-resident corporate tax rate, certain stamp duties (including the debits tax) and the continued phasing out of the mining levy and further progress on the tariff reduction program.
- Introduction of a new Medium Term Fiscal Strategy (2008 to 2012) formulated to ensure recurrent expenditures are limited to what can be sustained over the medium term.
- This budget is delivered in the context of seeking to continue capturing the benefits of higher revenue collections, largely derived from higher commodity prices, and translating these current benefits into continuing and future benefits for the people of Papua New Guinea via sustainable growth.

Key budget assumptions

The major assumptions on which the budget has been based are summarised in the table below. Historic indicators are also included for reference purposes.

Principal economic indicators	2002 actual	2003 actual	2004 actual	2005 actual	2006 actual	2007 proj.	2008 proj.	Average (2002 - 2007)
Real GDP Growth (%)	(1.0)	2.2	2.7	3.4	2.6	6.2	6.6	2.7
Non-mining GDP Growth (%)	1.5	2.1	3.1	3.1	3.7	6.5	6.5	3.3
Inflation (year average) (%)	11.8	14.7	2.1	1.7	2.3	1.8	5.2	5.7
Oil Price (US\$ per barrel)	24.0	27.4	42.1	53.4	64.3	67.3	61.9	46.4
Gold Price (US\$ per ounce)	311	363	409	445	604	662	662	465.7
Copper Price (US\$ per pound)	0.71	0.81	1.30	1.67	3.05	3.28	2.45	1.9
Interest rates % (yearly average 182 day T-Bill)	13.3	18.3	9.0	4.5	5.0	5.0	6.0	9.2
Source: National Statistical Office, IMF, Department of Treasury, BPNG								

Financing the budget

The following table summarises the financing requirements arising as a result of the estimated budget surplus for 2008 and also includes historic information for reference purposes.

Financing the budget (K millions)	2005 (actual)	2006 (actual)	2007 (revised)	2008 (projection)
Total revenue and grants	5,327	6,312	7,200	7,201
Total expenditure and net lending	5,319	5,776	6,879	6,999
Budget surplus / (deficit)	8	536	321	202
Budget surplus / (deficit) as a % of GDP	0.1%	3.1%	1.7%	1.0%
Net External Financing - inflow / (outflow)				
Concessional	(84)	(145)	(287)	(210)
Commercial	(18)	(11)	(15)	(15)
Extraordinary	(61)	(63)	(53)	(54)
	(163)	(219)	(355)	(279)
Net Domestic Financing - inflow / (outflow)				
Domestic borrowing	225	(304)	34	77
Asset sales	-	-	-	-
Other	(70)	(13)	-	-
	155	(317)	34	77
TOTAL	(8)	(536)	(321)	(202)

Source: Department of Finance and Treasury

The key points in relation to financing the 2008 budget are:

- The total domestic financing requirement for 2008 is expected to be K77 million, consisting only of net receipts from domestic borrowings – no receipts from asset sales have been factored into the financing of the 2008 budget.
- While new external borrowings of K164 million are expected to be drawn down in 2008, provision for the repayment of existing external borrowings in the amount of K443 million is made in the budget. The forecast surplus provides for some of the funding for these repayments.
- K1,630 million of new debt is to be raised domestically via the continuation of the Inscribed Stock program. Of the new debt raised, K1,553 million is required for the repayment of existing debt.

Revenue and grants

The total budgeted revenue and grants for 2008 is expected to be derived from:

- Taxation revenue of K5,516.8 million (2007 estimate = K5,693.4 million)
- Non-taxation revenue of K487.5 million (2007 estimate = K459.8 million)
- Infrastructure tax credits of K73.7 million (2007 estimate = K33.0 million)
- Project support grants of K1,123.7 million (2007 estimate = K1,013.4 million)

Of the K5,516.8 million expected to be derived in the form of taxation revenue, K4,142.0 of this balance is forecast to be in the form of taxes on income and profits comprised of:

2008 taxes on income and profits	K million	%
Mining and petroleum tax	2,011.8	48.6%
Personal income tax	1,053.7	25.4%
Company tax	699.7	16.9%
Dividend withholding tax	195.5	4.7%
Gaming tax	86.5	2.1%
Other direct tax	73.4	1.8%
Interest withholding taxes	21.4	0.5%
	4,142.0	100.0%

Source: Department of Treasury

Total taxes collected from income and profits in 2008 are expected to decrease by around K244.9 million when compared with the estimates for 2007. This is largely due to a decrease in mining and petroleum tax collections of K350.2 million – which is attributable to an assumed reduction in commodity prices and a moderate reduction in oil production. Given that mining and petroleum taxes are expected to contribute 27.9% of all revenues and grants in 2008 the underlying assumptions with respect to commodity prices and production levels from resource projects are particularly sensitive items in the composition of the 2008 budget.

This decrease in mining and petroleum tax is expected to be offset to some extent by increased collections of personal taxes (K59.6 million) and company taxes (K66.5 million). The increase in personal tax collections has been achieved in spite of the recent reductions in personal tax rates which suggests growth in either or both employment numbers or salaries.

The net decrease in revenue derived in the form of taxes is offset by an increase in revenue from non-tax sources and project support grants resulting in a minor overall increase in total revenue and grants for 2008.

Recurrent, development and additional priority expenditure

The total appropriation for 2008 of K6,999.4 million comprises:

- Recurrent budget of K3,636.3 million (2007 estimate = K3,370.0 million)
- Development budget of K1,887.1 million (2007 estimate = K1,718.4 million)
- Additional priority budget of K1,476.0 million (2007 estimate = K1,790.0 million)

The recurrent budget

From the recurrent budget, National Departments will receive K2,262.3 million of which 41.2% represents employee costs (including superannuation contributions and retirement payments) and 58.8% represents the purchase of goods and services. Provincial Governments will receive K293.1 million of which 56.7% represents salary and wages and 43.3% represents the purchase of goods and services.

The portion of the National Departmental and Provincial Governmental allocations represented by salary and wages has increased compared with the 2007 estimates, particularly at the National Departmental level. The costs of running both the National Departments and Provincial Governments are expected to increase in 2008 by around K246.3 million.

Interest payments and fees are expected to account for K373.5 million or 10.3% of the 2008 recurrent budget, a reduction from the 11.1% estimated for 2007.

The development budget

65.4% of the development budget (K1,123.7 million) is expected to be in the form of project grants from donors. While the Government's share of funding of the development budget is forecast to increase on the 2007 estimates, the contribution by donors has increased by a greater amount. Of the expected K168.7 million increase in the development budget in 2008, 65.4% is represented by increasing funding from donors.

Australia continues to be the largest project grant donor providing over 70.4% of this component of the development budget. This contribution has decreased from an estimated 78.3% in 2007 due mainly to the contribution from the European Union in 2008 which is expected to increase by K92.3 million to K212.8 million (Australia's contribution is expected to be K791.0 million in 2008).

The 'Medium Term Development Strategy 2005 – 2010' in part guides the allocation of funds from both the recurrent and development budgets to 7 priority areas. These areas and the distribution of the K3,305.3 million budgeted for allocation to each area in 2008 are (comparatives from the 2007 budget are also shown):

MTDS Priority area	2008 (K million)	2007 (K million)
1. Basic education	713.7	518.5
2. Primary and preventative health care	679.7	427.5
3. Rehabilitation and maintenance of transport infrastructure	623.9	165.8
4. Law and justice	503.7	385.3
5. Generation of income-earning opportunities.	456.3	184.8
6. HIV/AIDS prevention	22.7	18.1
7. Development oriented adult education	19.5	24.9
Other expenditure	285.8	456.9
	<u>3,305.3</u>	<u>2,181.8</u>

Source: Department of Treasury

Additional priority expenditure

The budget for additional priority expenditure first featured in the 2007 budget and is a feature again in the 2008 budget. This part of the budget represents allocations for spending the revenue collected due to the continuing higher commodity prices. This methodology is seen as being consistent with the new proposed Medium Term Fiscal Strategy and helping to manage expectations of ongoing expenditure allocations by not including “windfall” revenue collections in either the recurrent or development budgets.

Whilst the budget papers do not provide detailed information on the exact projects upon which these allocations will be utilised between now and 31 December 2008, the following table summarises the budgeted allocation of the K1,476 million additional priority expenditure:

2008 additional priority expenditure budget	2008 (K million)
District services improvement programs	534.0
Additional priority expenditures (various)	446.0
National infrastructure development program	196.0
Reduction of superannuation liability	150.0
State equity in gas project(s)	100.0
Konebada petroleum park infrastructure	50.0
	<u>1,476.0</u>

Source: Department of Treasury

The main source of funding for the additional priority expenditures is from additional mineral revenues. In addition to the above K1,476 million, a further K200 million has been earmarked for debt repayments.

It is also significant to note that the Government has now set aside funds in the amount of K600 million for the financing of State equity in gas commercialisation projects. The budget papers note that the Government remains committed to supporting the commercialisation of PNG’s gas resources.

Taxation developments and amendments – income tax

Corporate tax rates

There has been no change to the general corporate income tax rate of 30%. However, the rate of income tax for non-resident companies (other than those engaged in mining, petroleum or gas operations) has been reduced from 48% to 45%. This reduction in the tax rate does not apply to non-resident companies which derive income subject to the foreign contractor provisions of the income tax law.

Personal tax rates

Personal tax rates have been reduced with effect from 1 January 2008 and the rates from this date are set out below. The tax-free threshold for residents has increased from K6,600 to K7,000 and the lowest marginal rate has decreased from 25% to 22%.

From 1 January 2008 the rates for residents are as follows:

Taxable income	Tax thereon (K)	Rates of tax on excess (%)
7,000	Nil	22
18,000	2,420	30
33,000	6,920	35
70,000	19,870	40
250,000	91,870	42

From 1 January 2008 the rates for non-residents are as follows:

Taxable income	Tax thereon (K)	Rates of tax on excess (%)
Nil	Nil	22
18,000	3,960	30
33,000	8,460	35
70,000	21,410	40
250,000	93,410	42

Tourism incentives

The 2006 and 2007 budgets included income tax amendments targeted at benefiting the tourism industry.

In 2006 the definition of “eligible property” was amended to include plant used by hotels or other short-stay accommodation facilities. This enabled tourism plant to qualify for initial year depreciation of 20% of the cost of the property. For tourism plant installed ready for use on or after 1 January 2007 the depreciation allowed in the year of acquisition has been increased to a maximum of 55%. An amendment has been made to extend this accelerated depreciation to restaurants.

Policy on tax concessions

In addressing the policy on tax concessions it was noted in the budget papers:

“The tax system is compromised when concessions are given to specific projects or taxpayers. The use of project agreements to create special tax arrangements for individual projects has encouraged a wide range of investors to seek a growing list of tax concessions.

To enhance the integrity of the tax system, concessions provided to projects need to be confined to those available for the relevant industry in the existing law. This would ensure neutral and equitable treatment of projects in each sector, and transparency in tax policy. The assurance of equitable treatment for all investors would encourage further overall investment in the economy.”

Other amendments

A number of other minor amendments will be made to the Income Tax Act and Income Tax Regulations including amendments to:

- ensure the collection of revenue is not impeded by the absence of a Commissioner General of Internal Revenue;
- allow the Commissioner General to facilitate an exchange program with other jurisdictions;
- remove incorrect references to VAT and the Organic Law on the Integrity of Political Parties and Candidates; and
- add Abau, Aitape and Lake Kapiago districts to the list of districts for the purposes of the application of the Rural Development Incentive.

In addition, the Rationalisation of the Public Service Act is being amended to extend the expiry date for the imposition of a concessional rate of tax on redundancy payments to public servants to 31 December 2008.

Taxation developments and amendments – mining, petroleum and gas

As in prior years there have been a number of amendments relating to the mining, petroleum and gas industries. The 2008 budget contains several amendments which impact these industries. The changes are:

- A technical amendment to Section 155E(2)(a) to change the reference from Section 155G to Section 155L.
- Section 155E(6) of the Income Tax Act limits the amount of the deduction which can be claimed for allowable capital expenditure (“ACE”) to the amount of income remaining after deducting all other deductions. In other words the deduction cannot create a tax loss.

However, there were no rules for determining the order in which the deduction for long-life ACE and short-life ACE should be claimed. The Income Tax Act has been amended so that the order of deduction is long-life ACE first and if fully utilised a deduction for short-life ACE may then be claimed. Where there is insufficient income to use the deduction, the excess is deemed to be ACE incurred in the next year of income. This amendment follows representations made by PricewaterhouseCoopers and representatives of the resource industry.

- An amendment has been made to the Income Tax Dividend (Withholding) Tax and Interest (Withholding) Tax Rates Act to clarify the rates of tax payable by non-resident companies deriving income from resource projects. This amendment is a result of representations made by PricewaterhouseCoopers and representatives of the resource industry.

Taxation developments and amendments – goods & services tax

The Internal Revenue Commission (“IRC”) is concerned with the number of fraudulent claims being made for Goods & Services Tax (“GST”) refunds. As a result of this concern the GST legislation has been amended to regulate the activities of tax agents. These include a requirement for a written authority to act for a particular taxpayer and a provision to make the agent personally liable in the same way as the principal. In addition, substantial penalties have been introduced for persons who are unauthorised agents, who make false declarations or who influences an officer or the IRC in the performance of their duty.

A minor technical amendment clarifying the start date as 1 January 2007 of provisions introduced in the 2007 budget with respect to the zero rating of supplies of certain travel and accommodation services has been made.

Taxation developments and amendments – stamp duties

There were several significant amendments to the Stamp Duties Act which have been introduced as part of the Government’s continuing commitment to reduce impediments to doing business and investment:

- To abolish stamp duty on loan agreements from 1 January 2008 and in respect of other documents. This means stamp duty will not apply to the following:
 - (a) Agreement or contracts for loans;
 - (b) Loan securities, mortgages and foreign securities;
 - (c) Hire and credit purchase agreements;
 - (d) Credit arrangements; and
 - (e) Bills of lading.
- To abolish stamp duty on Certificates of Incorporation from 1 January 2008.
- To abolish stamp duty on insurance contracts from 1 April 2008. The reason for the deferred start date is to allow the insurance industry sufficient time to adjust their computer and billing systems for the change.

- To abolish bank account debits tax from 1 April 2008. The reason for the deferred start date is to allow the banking and finance industry sufficient time to adjust their computer and billing systems for the change.
- Division 10A which deals with the acquisition of interests in land owning private corporations, referred to as “land-rich provisions”, has been amended so that the amount of duty on the acquisition of an interest in a private corporation which holds an interest in a resource development licence or resource exploration licence is the same as the duty payable on a direct transfer of assets. Under the existing law a direct transfer of an exploration licence and related information attracted stamp duty of K20,000. However, the rate of duty on the indirect transfer is 5% of the unencumbered value of the resource exploration licence.

This amendment is a direct result of representations made by PricewaterhouseCoopers and representatives of the resource industry.

Taxation developments and amendments – customs, excise and indirect taxes

Excise duty - alcohol and tobacco

There are currently three rates of excise duty on beer based on the alcohol content. These are a “low strength” rate, a “standard” rate and a “high strength” rate. The lowest rate applies to beer with an alcohol content of not more than 2.5 per cent alcohol by volume. This low rate has not resulted in the production of “low strength” beer. However, a trial of “mid strength” beer has recently commenced.

The Government supports the production of lower strength beers. However, the existing structure does not cover “mid strength” beer which is taxed at the “standard” rate. To encourage the production of “mid strength” beer, the thresholds for the application of the beer excise will be restructured and a new concessional rate for “mid strength” beer will be introduced. This will apply to beer with an alcohol content of more than 2.5 per cent but not more than 3.5 per cent.

There have been no changes to the excise duty on tobacco products. However, the temporary concessional rate for roll your own tobacco has been extended for two years until 31 December 2009.

Excise tariff rates

In the 2007 budget a special excise rate of 30 toea per litre was announced for pre-mixed gasoline-oil fuel. It was intended this change would apply from 1 January 2007 and would apply for a trial period of one year. However, as the reform was not implemented until June 2007 there is insufficient data to make an assessment of this measure. Consequently, the measure has been extended until the end of 2008 so that an assessment can be made in time for the 2009 budget.

Excise Act

Amendments are being made to the Excise Act to:

- impose a penalty for late payment of excise duty;

- to broaden the meaning of excise prosecution; and
- to broaden the definition of excise prosecution to include all offences under the Excise Act and removes current restrictions on the procedures for prosecutions.

Customs Tariff Act

Schedule 1 of the Customs Tariff Act has been repealed and replaced with a new set of tariff classifications that reflect updated international standards.

In addition, to reflect the fact that bottle tops are no longer manufactured in PNG the tariff for bottle tops has been reduced from 25% to nil. The customs tariff categories for beer imports have also been adjusted to align with the new structure for beer excise.

Customs Act

Amendments are being made to the Customs Act:

- to ensure adequate notice is provided before action can be brought against Customs Officers; and
- to extend the definition of the offence of collusion to include activities such as colluding with agents to defraud the revenue or smuggle goods into PNG.

Customs Regulations

Amendments are being made to the Customs Regulations:

- to give the Commissioner General of Internal Revenue the discretion to apply a lower licence fee;
- to impose restrictions on the exportation of PNG currency, foreign currency or alluvial gold; and
- to correct errors concerning intellectual property rights and to align the period of disposal with the period of suspension of clearance for suspected counterfeit goods.

Further information

Further information in relation to the 2008 National Budget can be obtained from David Caradus, Jason Ellis or Carl Valentine at PricewaterhouseCoopers in Port Moresby.

The PNG Budget commentary has been prepared to provide a prompt overview of the general issues raised in the 2008 National Budget. It does not cover exhaustively the subjects discussed. When specific issues occur in practice it is necessary to refer to the laws and regulations and to obtain appropriate professional advice.

While every care has been taken in the preparation of this publication, no warranty is given as to the correctness of the information it contains and no liability is accepted for any statement or opinion, nor for any error or omission.

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