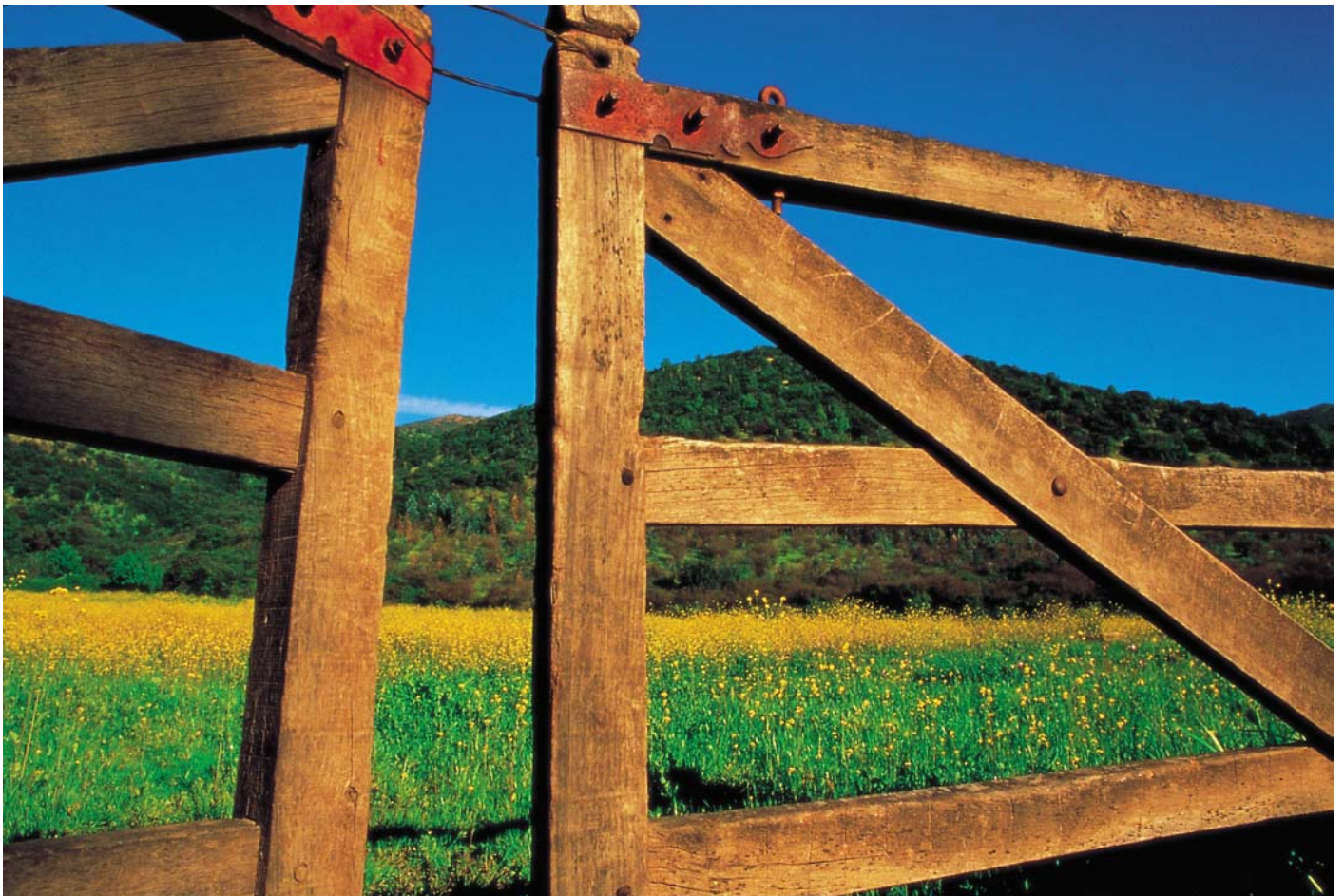




2004 PAPUA NEW GUINEA NATIONAL BUDGET



25 November 2003

PWC BUDGET COMMENTARY

The Minister for Finance and Treasury, the Honourable Bart Philemon, MP, today handed down the 2004 National Budget.

Executive Summary

The theme ‘Restructuring for Recovery and Development’ of the 2004 National Budget continues the “Stabilisation with Growth” fiscal policies underpinning the Revised Budget for 2003. Key components include:

- Implementation of a debt sustainability framework which will reduce public debt to manageable levels over the medium term;
- A budget deficit path that continues to track downwards resulting in deficits of no more than 1.4% of GDP in 2004;
- A reducing cap on government borrowing from the domestic financial sector;
- Strict controls on expenditures and particularly public sector salary costs; and
- An emphasis on reallocating expenditures to improve the range of government services and operations

Key Budget Assumptions

The major assumptions on which the budget has been based are summarised in the table below –

STATE OF THE ECONOMY						
	2000 act.	2001 act.	2002 act.	2003 est.	2004 Proj	Avge (2000- 2003)
Real GDP Growth (%)	-1.2	-2.3	-0.8	2.0	2.8	- 0.6
Agriculture (%)	9.1	-5.3	7.3	1.6	3.0	3.2
Mining (%)	5.4	9.6	-16.9	3.5	-0.2	0.4
Petroleum (%)	-22.9	-9.6	-28.1	2.8	7.7	-14.4
Non-mineral GDP Growth (%)	-0.5	-4.1	4.5	1.7	3.1	0.4
Inflation (year average) (%)	15.6	9.3	11.8	15.3	8.7	13.0
Oil Price (US\$ per barrel)	29.5	26.2	24.0	27.4	25.5	26.7
Gold Price (US\$ per ounce)	302	283	311	335	360	308
Interest rates (182 day T-Bill)	18.0	12.6	13.3	18.3	11.7	15.6
(average for year) (%)						
Courtesy: Department of Finance and Treasury						

Significant challenges

The Government considers the challenges of economic management immense both in the short-term and medium-term. The 2004 Budget strategy aims to continue the momentum towards macroeconomic stability while at the same time providing a basis for improving the medium-term growth and development outlook. The situation and outlook for 2004 requires some tough decisions as the combination of rising debt servicing costs and a reduced fiscal deficit in 2004 means fewer funds available for recurrent expenditure in real terms:

New expenditure control measures for 2004 include:

- Tightening operational expenditure controls, identifying priority programs, rationalisation of government agencies and amending public sector retrenchment provisions;
- Concentration on measures to cut down on excessive public sector salary and wage costs including strengthening the recruitment freeze, restrictions on recruitment of casual workers, termination of non-essential casual employees, removal of ghost workers and elimination of salary and wages overruns;

Structural Reform Program

The Government will continue to implement a reform agenda based on four core principles:

- Promotion of good governance by:
 - o Strengthening oversight agencies, by the establishment of a National Anti-Corruption Alliance comprising the Ombudsman Commission, Auditor-General and other anti-corruption State agencies; and guaranteeing their independence and adequate funding;
 - o Ensuring that the Central Supply and Tenders Board is used for all government procurement and introducing new measures to promote good practice and improved efficiency in procurement
- Improving economic management by:
 - o Strengthening fiscal discipline;
 - o Improving resource allocation requiring an agency-wide review of functions, expenditure patterns and staffing levels, outputs and results;
 - o Continuing the work of the Financial Management Improvement Program;

Improving debt management including the establishment of a semi-autonomous office to manage its portfolio of public debt and a move away from reliance on

- o Treasury Bills to re-activation of the Government's domestic securities market with fixed rate debt instruments of longer duration;
 - o Improving expenditure control especially at provincial and district level and with a range of measures including appointment of Financial Controllers within large agencies, enhanced financial systems and procedures, capacity-building for government internal auditors, and the use of the Authority to Pre-Commit (APC) system introduced in March 2003.
- Improving public sector performance by:
 - o Building a performance-oriented public service with a new Performance Management System for Departmental Heads, merit-based appointments
 - o Reorienting personnel management systems and processes to improve service delivery including a Service Improvement Program (SIP) aimed at re-engineering cumbersome government processes, and new provincial and local level government funding arrangements recommended by the National Economic and Fiscal Commission.
 - Removing barriers to investment and economic growth by:
 - o Improving access to credit by rehabilitation of the Rural Development Bank and integration of its operations with micro-finance facilities;
 - o Giving priority to a review of the migration laws and the efficiency and effectiveness in their administration and the possible introduction of permanent residency;
 - o A review of the Tariff Reduction Program
 - o Amendments to the Superannuation (General provisions) Act 2000 to incorporate implementation of broader retirement income policy issues, including extending mandatory superannuation coverage to agricultural workers and giving contributors the option of drawing down savings on a periodic basis. In addition the State's contribution to the POSF will now be paid at the same time as that of the employee and this will be phased in over the next six years;
 - o Ongoing commitment to the broader policy of privatisation of Public Enterprises but with consideration for Public Private Partnerships (PPP) in the case of core Government assets;
 - o Improved forestry management and commitment to and reactivation of the World Bank Forestry and Conservation Project.

Financing the Budget

2004 FINANCING		
Kina Millions	2003 (rev.)	2003
Tax revenue and grants	3,682	3,837
Total expenditure and net lending	3,879	4,032
Deficit(-) / Surplus(+)	-197	-195
% of GDP	-2.8%	-2.1%
External Financing	-127	-70
Concessional	-63	-61
Commercial	-6	176
Extraordinary	-58	-185
Domestic Financing	324	265
Domestic borrowing	500	345
Temporary advance	-75	0
Asset sales	40	0
Other	-141	-80
TOTAL	197	195

The Government's total financing requirement for 2004 will be K265.7 million. This consists of the deficit of K195.6 million and net external repayments of K70.1 million.

- New external commercial borrowing of K225.6 million will be undertaken, offset by amortisation of K28.3 million on old commercial borrowing leaving net commercial borrowing of K197.4 million;
- External commercial borrowing is being undertaken to fill in the financing gap and to refinance large estimated amortisation due in 2004
- K185.7 million in repayment of exceptional financing is expected in 2004, most of which relate to an earlier Australian Government loan provided on commercial terms
- K396.8 million of new debt is to be raised domestically, of which K51.1 million is required to amortise existing domestic loans leaving net domestic borrowings at K345.7 million. The new domestic borrowing will be done through issuance of at least K150 million of inscribed stock with the balance in Treasury Bills.

Recurrent and Development Expenditure

The total appropriation for 2004 of K4,532.1 million comprises:

- Recurrent budget of K2,756 million (2003 revised= K2,703 million);
- Development budget of K1,276.6 million (2003 revised = K1,176 million)
- Amortisation of domestic and external debt amounting to K495.5 million

From the recurrent budget, National Government departments will receive K1,273 million of which 50% comprises salaries and wages, while Provincial Departments will receive K607 million, of which 84% will be consumed by salaries and wages and only 10% by goods and services. Interest payments will account for K692 million or 25 %.

K850 million or 66% of the development budget is in the form of project grants or donor assisted development programs. Of this Australia is the largest contributor providing over 80%, with the EU, Japan and New Zealand providing the balance. The remaining 34% of the development budget is in the form of loans from the World Bank, Asian Development bank, Korea and Yumi Yet Bridges.

Key 'Impact' Programs within the development budget include:

- Highlands Highway maintenance and rehabilitation and other roads and bridges maintenance programs (K418 million) and airport and maritime infrastructure rehabilitation (K25 million)
- Export promotion through agricultural and commercial fisheries research and development (K58.8 million), skills development and employment (K20 million)
- Law and Justice strengthening of key agencies to the tune of K73 million
- Public sector reform and governance programs totalling K43.6 million
- Basic Education and Primary Health Services programs amounting to K47 million.

❖ *INCOME TAX*

Corporate Tax Rates

- There has been no change to the general corporate income tax rate of 30%. However there is a decrease in the income tax rate from 30% to 25% for authorised superannuation funds. This will apply to income derived on or after 1 January 2004.
- The tax rate on the net income of a resident trust estate has been increased from 28% to 30%.

Personal Tax Rates

- There has been no change to the general personal income tax rates.
- There is a change to dependant rebates. Under the existing law a rebate was allowed for up to four dependants. The rebate will now apply for up to three dependants. This is an increase in tax for those currently claiming four dependants. Depending on income level the annual increase will be between K30 and K300.

Double deduction – PNG Sports Federation

- The Income Tax Act is amended to include a double deduction for gifts to the PNG Sports Federation announced earlier in the year. The double deduction applies in respect of gifts for the 2003 South Pacific Games and the 2004 Inaugural PNG National Games.

Superannuation

- Currently, distributions from authorised superannuation funds (other than the employee's own contributions) are taxed at the employee's marginal rate unless the distribution to the employee qualifies for concessional taxation at 2%. The taxation of those distributions, which are not subject to tax at 2%, will be amended from 1 January 2004 based on years of membership of a fund. The new rates of tax are set out in the following table:

Years of Membership of a fund	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 Rate	The lesser of 15% or the marginal rate of tax	The lesser of 8% or the marginal rate of tax

- The Budget introduces a concept of a “retirement savings account” (RSA) to encourage retirees to invest up to K100,000 of their retirement benefit in a tax free investment and to draw from that account tax free “pensions”.
- The amount which may be drawn down from an RSA is covered by a new regulation. The effect of this is to limit the amount which may be drawn down in a particular year by reference to the opening balance on 1 January.

Agriculture Incentives

- The Prime Minister announced on 5 June 2003 a number of potential concessions for primary production. Some of these concessions have been included in this Budget.
- Major new primary production projects undertaken by a company which commence in the next three years will have a tax rate of 20% from the date of commencement of construction to the end of the tenth full tax year after the commencement.
- To qualify for the lower tax rate the primary production project must also satisfy the following conditions:

The capital cost must be not less than K5 million.

The project must be located in an area in which primary production of the crop or livestock was not previously carried out.

The project must not be an extension of an existing primary production project.

- A 150 percent deduction will be available for expenditure on “primary production extension services”. The guidelines for eligibility for this deduction have been included in a new income tax regulation. Broadly, primary production extension services are services provided free of charge to smallholder growers including the provision of advice and training and technical assistance related to their primary production to assist growers with production, processing, packaging and marketing problems.
- A 150 percent deduction will be available for expenditure on research and development. The guidelines for eligibility for this deduction have been included in a new income tax regulation. In the case of research and development, the deduction is available to all sectors of the economy. Broadly, research and development expenditure is for systematic, investigative and experimental activities that involve innovation or high degrees of technical risk carried out for the purpose of:
 - (a) acquiring new knowledge; or
 - (b) creating new improved materials, products, devices, processes or services.
- In both cases the regulations also establish an Approval Committee to which applications must be made to approve the proposed expenditure. The persons

required to be members of the Committees are set out in the regulations:

Extension services Approval Committee:

- (a) A person with experience in agricultural matters appointed by the Secretary of the Department of Agriculture and Livestock (Chairman);
- (b) A person with experience in taxation matters appointed by the Commissioner General of Internal Revenue;
- (c) A person appointed by the Rural Industries Council; and
- (d) A person appointed by the Fresh Produce Development Corporation.

Research and Development Expenses Approval Committee:

- (a) The Commissioner General of Internal Revenue or his delegate (Chairman);
- (b) Two persons who are involved in or have expertise in Research and Development appointed by the Minister responsible for taxation; and
- (c) Two persons who are involved in or have expertise in financial or business administration appointed by the Minister responsible for taxation.

❖ **THE MINING, PETROLEUM AND GAS INDUSTRY**

In prior years there have been a number of amendments relating to the Mining, Petroleum and Gas Industries. The 2004 Budget contains only a few amendments which impact these industries. The changes are:

- In the 2002 Budget the provisions of the Income Tax Act dealing with the acquisition of a 15% interest in the Porgera Project Acquisition were repealed on the basis that the amount due to the vendors had been paid. As the obligations under the Porgera Sale agreement extend beyond the payment of the purchase price some aspect of these provisions needed to be reinstated.
- The mining levy applicable to current mining projects was to be phased out over four years. In the 2003 Budget the Treasurer announced that no further reductions will apply, leaving the mining levy at 75% of the full amount. In the 2004 Budget, the phasing out of the mining levy has been reinstated, albeit over a longer period. The amending legislation provided with the Budget papers did not include an amendment to reflect this change.
- Special tax credits of up to 1.25% of assessable income will be available for expenditure on the construction of Gobe-Semberigi-Erave roads. These tax credits may be utilised to offset any income tax payable.
- Stamp duty payable on the transfer of an interest in a mining or petroleum exploration licence and mining or petroleum information has been increased from K5,000 to K10,000.

❖ ***GOODS AND SERVICES TAX***

- The Goods and Services Tax Act 2003 (the GST Act) was passed by Parliament this month. This is a complete replacement of the Value Added Tax Act. However, the GST Act is identical to the Value Added Tax Act and the change has been forced by constitutional issues relating to the Value Added Tax Act.
- The GST Act applies from 1 January 2004. For those businesses which are currently registered for VAT purposes there will be no change in practice other than that the tax is called Goods and Services Tax (GST).
- There is an amendment to the GST Act in relation to coffee exporters. This amendment deals with the failure by suppliers to coffee exporters to properly account for and remit VAT under the existing law. The amendment provides a mechanism for the purchaser to be required to remit GST due to suppliers or specified suppliers to the Commissioner.

❖ ***STAMP DUTIES***

- There have been a number of amendments to the Stamp Duties Act. Many of the amendments vary stamp duty rates and tax thresholds to account for inflation.
- In some cases corporate reconstructions are exempt from full rates of duty. In the case of a subsidiary there is a requirement that the company be owned for at least three years. However, it is possible that full rates of duty have been paid on the acquisition of the subsidiary through the landholder private corporation provisions. The Stamp Duties Act is amended to allow the Commissioner General to exempt a corporate reconstruction from full stamp duty, where the subsidiary has been owned for less than three years provided stamp duty was paid in full on the acquisition of assets owned by the company or on acquisition of company shares.
- Schedule One of the Stamp Duties Act has also been amended to update the amount of duty payable to reflect inflation. Similarly, the thresholds which apply to determine duty on the transfer of property have been increased. No duty will apply to the acquisition of property by citizens where the value of the property does not exceed K210,000.
- Other amendments to Schedule 1 include:

The repeal of duty on bills of exchange and promissory notes.

The repeal of duty on guarantees.

Amendment of the stamp duty applicable to incorporation and registration of companies to reflect the requirements of the Companies Act 1997. The rate of duty on certificates of incorporation and registration is K60 and on company constitutions adopted under Part V of the Companies Act 1997 is K40.

Exemptions from duty in relation to wills, letters of administration, and in consequence of the appointment of new trustees to a trust.

Amendment to the heading of Item 16 to make it clear that transfers of securities with both a land component and non-land component are taxable under both Items 16 and 16A. The non-land component is liable for stamp duty under Item 16 and the land component under Item 16A.

The repeal of the specific duty rate applicable to policies of fire insurance. This means a reduction in the duty rate for fire policies from 12% to 6.5% and from 7.5% to 6.5% for composite policies.

❖ ***CUSTOMS, EXCISE AND INDIRECT TAXES***

Excise Duty- Alcohol and Tobacco

- The excise duty on alcohol and tobacco products is currently subject to 5% increases at six monthly intervals on 1 June and 1 December of each year. These increases will be put on hold until 31 December 2004.

Excise Duty- Diesel –Commercial Fishing Vessels

- There is a current administrative practice where commercial fishing vessels are provided with diesel fuel at a duty rate of K0.03/litre (half the standard rate of K0.06/litre). The Customs Tariff Act is amended to give legal effect to the current administrative practice.

Excise Duty- Other

- The 10% excise on agricultural tractors has been reduced to nil.
- The 150% excise on poker machines has been reduced to 50%.

Customs Duty

- An import levy of 2% has been introduced for all imports (including those which are currently duty free). This applies from the time the budget is introduced into Parliament.
- Some exemptions to the import levy will apply. These are the mining and petroleum industries, medical and education supplies, charities and duty free aid projects.
- The duty free allowances for travellers have been increased from K250 (K125 for children) to K1,000 for adults and K500 for children.
- New provisions have been included in the Customs Act for administrative fines.
- The maximum administrative fine is 200% of the unpaid duty.

- The Commissioner General may impose the penalty where the entry of the goods contains an error or omission and as a result duty is underpaid or the entry is otherwise “materially incorrect”.
- The protective tariff for the sugar industry has been extended to 2011 and a new definition of Icing Sugar has been included to prevent abuse of the duty free status of icing sugar.
- The period of warehousing under the Customs Act has been increased from 6 months to 12 months.
- The record keeping rules of the Customs Act are amended to allow for records to be kept on computers and other information retrieval systems.

Export tax

- The export tax on the export of logs is reduced by 5% .

Gaming Machine Tax

- The Gaming Machine Act has been amended to encourage permit holders to promptly collect revenue from the gaming machines and bank daily. Operators are now liable for gaming machine tax on receipts both “paid and payable” to them from site permit holders.

Interest Withholding Tax

- A new regulation is introduced to require financial institutions to advise account holders in writing, at the end of each financial year, the total amount of interest paid to them and the amount of Interest Withholding Tax paid to the Internal Revenue Commission on their behalf.

Head Tax

- In order for Provinces and Local Level Government to impose taxes allowed to them, an enabling Act must be passed by the National Government.
- The 2004 Budget includes an enabling act which will allow Local Government Councils to impose an annual head tax of between K20 and K50 on persons over 18 living in their area and K100 for companies carrying on business there. Where it is not paid in cash, the Local Level Government may impose a work requirement instead, being five days community work for individuals and 10 days for companies.
- There is no obligation on a Local Level Government to impose the tax and it will only be imposed by those which choose to do so. Collection and administration of the tax will be up to Local Level Government.

Industrial Development (Wages Subsidy) Act

- This Act is amended to provide that the Review Tribunal established under the Income Tax Act is also the Review Tribunal for the Industrial Development (Wage Subsidy) Act.

Further information in relation to the 2004 National Budget can be obtained from John Leahy or David Caradus at PricewaterhouseCoopers in Port Moresby.

The PNG Budget commentary has been prepared to provide a prompt overview of the general issues raised in the 2004 PNG Budget. It does not cover exhaustively the subjects discussed. When specific issues occur in practice it may be necessary to refer to the laws and regulations and to obtain appropriate professional advice.

Whiles 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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