



# Papua New Guinea Resource Project Taxation

## A guide for investors and operators

November 2005



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01

# Introduction



# Introduction

Papua New Guinea is a nation rich in mineral and petroleum resources and the continued exploitation of these resources will have a major impact on the country's development during the next decade. Major resource developments have taken place at Gobe, Hides, Kutubu, Moran, South East Manada, Lihir, Misima, Ok Tedi, Porgera and Tolukuma. Recently introduced income tax incentives have led to an increase in exploration activity as illustrated by the fact that applications for new exploration licences have risen from just 5 in 2002, to 15 in 2003 to 45 by the end of 2004. A new gold mining project is being developed at Kainantu. Progress is also being made in respect of a number of other potential projects, including gold deposits at Hidden Valley, Simberi Island, Sinivit and Wafi, the Ramu nickel cobalt project, the copper deposit at Golpu and deep sea exploration. The PNG to Australia Gas Pipeline Project has progressed to front end engineering and design. This activity confirms that the resource development potential in Papua New Guinea remains strong.

The mining and petroleum sectors have been major contributors to the PNG economy in recent years. During the last 10 years these sectors have on average contributed around 70% of total merchandise exports, 25% of GDP and 20% of total government revenues.

PricewaterhouseCoopers is the leading accounting firm in Papua New Guinea specialising in the mining and petroleum sectors. The firm has an established reputation for its audit, accounting, taxation and consulting services to these industries, both internationally and in Papua New Guinea. This booklet summarises the special provisions of the Papua New Guinea income tax legislation relevant to mining and petroleum extraction, and reflects our understanding of the application of those provisions in practice. More specific advice on taxation and investment considerations in relation to Papua New Guinea can be obtained by contacting either of the offices of PricewaterhouseCoopers listed on page 39.

Our mining and petroleum specialists would be delighted to advise on matters concerning investment in mining and petroleum industries in Papua New Guinea and can arrange introductions to relevant authorities and organisations in this country.

The comments herein are based on the law expected to be in force at 1 January 2006 and represent a summary of a complex body of legislation. They should not however, be used as the basis for specific investment decisions without reference to the legislation itself and proper professional advice.

It is important that all potential investors keep up to date with changes in legislation, and we invite you to subscribe to our mailing list by visiting our website, writing to us at our Port Moresby Office or contacting one of our partners.

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# Overview

## Resource Projects

### *Rates of taxation*

1. The income tax law contains a basic set of rules which apply to the taxation of all types of resource projects. There are then further specific rules which apply to different types of resource projects ie. mining, petroleum and gas projects.
2. The rates of taxation on mining, petroleum and gas income in Papua New Guinea are:

	Resident	Non-resident companies
Mining	30%	40%
Petroleum – existing projects	50%	50%
Petroleum- new projects	45%	45%
Petroleum-incentive rate	30%	30%
Gas	30%	30%

3. A resident company may be defined broadly as a company either incorporated in or managed and controlled in Papua New Guinea.
4. A new petroleum project is one that did not derive income from petroleum operations until after 1 January 2001. An incentive rate petroleum project is one that arises from a prospecting licence granted between 1 January 2003 and 31 December 2007 from which a development licence is subsequently issued prior to 31 December 2017.
5. Resident companies are also generally liable to deduct dividend withholding tax at the rate of 17% on dividends. This rate is reduced to 10% for dividends paid out of mining income and nil for dividends paid out of petroleum or gas income. This brings the effective rate of tax for resident companies on distributed mining, petroleum and gas income to:

Mining	37%
Petroleum – existing projects	50%
Petroleum- new projects	45%
Petroleum-incentive rate	30%
Gas	30%

### *Additional profits tax*

6. Resource companies have the option of applying for fiscal stability for the first 20 years of the project or the original financing period if this is less than 20 years. Where such a fiscal stability provision is in operation a 2% premium applies to the rates of income tax outlined in paragraph 2.



	7. An additional profits tax previously existed in respect of all resource projects. This tax has now been abolished in respect of mining and petroleum operations but can still potentially apply in respect of a gas project. Details of the additional profits tax are outlined in the section on the specific tax provisions applying to gas projects.
<i>Basics of the tax computation</i>	<p>8. In general terms, all costs incurred in the exploration and development phases of the project are accumulated and amortised over the life of the project. Once production starts, an immediate deduction is allowed for “normal” operating and administration expenses. Capital expenditure incurred after the start of production is capitalised and amortised over the life of the project.</p> <p>9. Limits apply to the amounts that can be claimed in respect of management fees and interest.</p> <p>10. Exchange gains and losses incurred in respect of foreign currency borrowing are generally assessable / deductible on realisation. For exchange gains and losses made in respect of foreign currency deposits, or other assets, it is necessary to determine whether the gain / loss was on capital or revenue account to determine whether the amount is assessable or deductible.</p>
<i>Project basis of assessment</i>	11. A project basis of assessment (“ringfencing”) is adopted for all resource projects. This means losses from other operations whether or not resource related cannot generally be offset against resource project income from a particular ringfenced project. Expenses which are attributable to more than one ringfenced project are apportioned to each on a reasonable basis. There are however, some concessions to the ring fencing principle in respect of exploration expenditure and expenditure in respect of discontinued projects.
<i>Foreign currency tax returns</i>	12. Taxpayers may seek approval from the Commissioner General to allow their income tax returns to be prepared in a currency other than PNG Kina. To date a number of resource projects have obtained approval to lodge in United States dollars. This may have administrative or other benefits in certain circumstances.
<i>Royalties and development levies</i>	13. Resource projects are subject to a royalty which is basically equal to 2% of the gross revenue from resource sales. New petroleum and gas projects are also subject to a development levy which is again basically equal to 2% of the gross revenue from resource sales. Where a project is liable for both royalty and development levy the royalty is claimable as a credit against income tax payable.
<i>GST issues</i>	14. Supplies to resource companies, other than the supply of cars, are zero rated for GST purposes. Most sales by resource companies are zero rated as they are generally export sales however any domestic sales by a resource company will generally be subject to GST.



02

## General rules for resource project taxation



# General rules for resource project taxation

## Introduction

1. This section deals with the basic taxation rules which apply to all types of resource project. A resource project is defined as:  
*“a designated gas project, a mining project or a petroleum project”*
2. A *“designated gas project”* means such one or more gas projects as are defined to be a gas project under a gas agreement made pursuant to the Oil and Gas Act 1998.
3. A *“mining project”* means mining operations conducted pursuant to a mining lease or a special mining lease.
4. A *“petroleum project”* means a petroleum project as prescribed by regulation or petroleum operations conducted pursuant to a development licence or a pipeline licence.

## Project basis of assessment

5. Income derived from a resource project is assessed as if it were the only income of the taxpayer. Deductions are generally only available for expenditure attributable to the project. Where there is deductible expenditure or income which does not relate exclusively to the project, then the expenditure or income is apportioned on a reasonable basis. There are however, some concessions to the ring fencing principle in respect of exploration expenditure and expenditure in respect of discontinued projects.

## Deductions allowable

6. Deductions allowable against assessable income from a resource project include normal operating and administration expenses, interest, management fees, realised exchange losses, consumable stores and depreciation/amortisation of “allowable exploration expenditure” and “allowable capital expenditure”.

## Allowable exploration expenditure

7. Allowable exploration expenditure includes any expenditure, capital or revenue, incurred for the purpose of discovering petroleum or minerals in Papua New Guinea, and includes geophysical analysis and geophysical surveys, exploration drilling and appraisal drilling and appraisal in relation to such petroleum or minerals, whether pursuant to a petroleum prospecting licence, a retention licence, a development licence or a mining exploration licence.
8. It may also include residual exploration expenditure on transferred interests or subject to the type of resource project, expenditure allocated from an exploration licence or development licence which has been surrendered, cancelled or expired.
9. Allowable exploration expenditure is reduced by rent, interest (other than certain exempt interest) or other income derived by the taxpayer in the course of carrying out the exploration, so that such income in the exploration phase is not taxed as it is derived.
10. Deductions are allowed for exploration expenditure incurred up to twenty years before the issue of the resource development licence and which was incurred pursuant to an exploration licence from which the resource development licence was drawn and also includes exploration expenditure incurred in relation to the areas (including relinquished areas) of an exploration licence which has been surrendered or cancelled or has expired.

11. Exploration expenditure in respect of an area which is incurred after the issue of a resource development licence for that area, is classified as allowable capital expenditure rather than allowable exploration expenditure.
12. Allowable exploration expenditure is amortised over the life of the resource project. The deduction is calculated by dividing the unamortised balance by the lesser of the remaining life of the project or four.
13. The amount of the deduction is limited to the amount of income remaining after deducting all other deductions. In other words the deduction cannot create a tax loss.

#### *Allowable capital expenditure*

14. Allowable capital expenditure is expenditure of a capital nature incurred in carrying on the resource operations comprising the project, including expenditure on:
  - provision of buildings and other improvements or plant
  - testing deposits or winning access to them
  - provision of water, light, power, for use on, or access to or communication with, the site of mining operations
  - residential accommodation for the use of employees or their dependants, being accommodation situated on or adjacent to the site of operations
  - health, educational, law and order, recreational or similar facilities and facilities for the supply of meals on or adjacent to the site of operations, provided for employees or dependants and or not conducted for profit-making purposes.
  - feasibility and environmental impact studies
  - depreciable plant (but subject to an election to treat short-life assets as depreciable plant)
  - construction and operation of port or other facilities for ships or barges in connection with the transport of minerals
  - general administration and management expenditure relating primarily and principally to resource operations incurred after the date of issue of the relevant resource development licence pursuant to which the resource project is conducted and prior to the date on which the taxpayer first derives assessable income from resource operations.
  - exploration expenditure which is incurred after the issue of a resource development licence is to be treated as allowable capital expenditure rather than allowable exploration expenditure.
15. "Allowable capital expenditure" does not include:
  - a ship for transporting minerals other than a ship used primarily in connection with the carrying on of mining operations
  - an office building not at or adjacent to the mine site
16. Allowable capital expenditure is amortised over the life of the resource project. The allowable capital expenditure is split into two categories: capital expenditure with an estimated effective life of more than 10 years (long-life ACE) and capital expenditure with an estimated effective life of less than 10 years (short-life ACE).

17. The annual deduction for long life ACE is claimed on a straight line basis over ten years. Where the remaining life of the project is less than ten years the rate at which the deduction is allowed is calculated by reference to the remaining life of the project.
18. For short life ACE the annual deduction is calculated by dividing the unamortised balance by the lesser of the remaining life of the project or four.
19. Alternatively the taxpayer can elect for assets resulting from short life allowable capital expenditure to be depreciated under the normal tax depreciation rules which apply to plant and equipment. Under these rules the assets would be subject to depreciation on either a straight line or diminishing value basis at rates ranging from 5% to 20% under the straight line method and from 7.5% to 30% under the diminishing value basis.
20. Allowable capital expenditure on an asset which costs less than K1,000 is subject to an immediate write off for tax purposes.
21. The amount of the deduction that can be claimed under the allowable capital expenditure amortisation provision is limited to the amount of income remaining after deducting all other deductions, other than the deduction for allowable exploration expenditure. In other words the deduction cannot be used to create a tax loss.

#### *Disposal etc. of property*

22. Where deductions have been allowed or are allowable under the resource provisions in respect of capital expenditure on property which has been disposed of, lost or destroyed or the use of which in relation to a resource project has been otherwise terminated, a balancing deduction may be allowed if the consideration receivable is less than the balance of undeducted expenditure. If the consideration receivable is greater than that amount, a taxable balancing charge may arise.

#### *Transfers of allowable exploration expenditure and capital expenditure*

23. When interests are transferred from one taxpayer to another the vendor and purchaser can agree to transfer deduction entitlements for exploration expenditure, allowable exploration expenditure and allowable capital expenditure to the purchaser. Where the vendor is not in a position to give a notice transferring exploration expenditure, allowable exploration expenditure or allowable capital expenditure to the purchaser, expenditure incurred on the acquisition of the site of mineral deposits or rights over the site or the deposits may still form part of the allowable capital expenditure of the purchaser.

#### *Off licence exploration expenditure*

24. One major relaxation of the ring fencing principle applies to taxpayers which are involved in a producing project, where the taxpayer, or a related party, incurs exploration expenditure outside the area of the productive project. In this situation the taxpayer can elect to add such exploration expenditure to an exploration pool which can be amortised against income from the producing project.

25. The amount allowable as a deduction from this exploration pool in respect of resource operations carried on by the taxpayer or a related corporation is the lesser of:
  - (a) 25% of the total undeducted balance of expenditure in the exploration pool; or
  - (b) such amount as reduces the income tax (other than additional profits tax) which would, but for this deduction, be payable by the taxpayer and its related corporations in respect of those resource operations for that year of income, by 10% or by 25% for mining projects.
26. Where a taxpayer elects to add exploration expenditure to the general pool and a resource development licence is subsequently issued in respect of an area of exploration, the taxpayer may elect to transfer the unclaimed balance of exploration expenditure incurred in respect of that area to the project ring fence applying to the new development licence. The amount transferred will be treated as allowable exploration expenditure in respect of the new project. For mining projects a double deduction is available for certain exploration expenditure which has been included in the exploration pool. This arises because no amount is transferred from the exploration deduction pool and the original cost of exploration in relation to the licence area is treated as allowable exploration expenditure of the new project.
27. Interest is not deductible prior to the commencement of a resource project. Following the issue of a resource development licence a person carrying on a resource project or exploration in relation to a resource project may claim a deduction against resource income for interest on money borrowed for the purpose of carrying on the relevant operations or exploration.
28. Interest incurred in connection with the construction or acquisition of an item of plant or capital asset is not deductible to the extent it is incurred prior to the date on which the taxpayer first derives assessable income or first uses the plant or capital asset for the purpose of producing assessable income, whichever is the later. Interest incurred prior to this date must be capitalised together with the cost of the capital asset.
29. Interest will only be deductible in relation to a loan from a person who, in the opinion of the Commissioner General, is at arm's length if the taxpayer has notified the Bank of Papua New Guinea of the terms of the borrowing, including the interest rate and other fees and charges related to the borrowing, and the Bank of Papua New Guinea has given its authority for the borrowing under the relevant Foreign Exchange Regulations.
30. Where the Commissioner General is of the opinion that the lender is not at arm's length, the interest deduction is limited to the market rate of interest which the Commissioner General determines in consultation with the Bank of Papua New Guinea.

## *Interest deductions*

### *Debt/Equity Ratio*

31. When the debt of the taxpayer and all related corporations in relation to a resource project exceeds 300% of the equity of the taxpayer and all related corporations in relation to that project, the deduction allowable to the taxpayer for interest incurred during that period will be limited to the following:

$$\frac{TI \times 3E}{D} \quad \text{where -}$$

TI: total interest incurred by the taxpayer during the period in relation to the project,

D: debt of the taxpayer and related corporations in relation to the project; and

E: equity of the taxpayer and related corporations in relation to the project.

### *Interest paid to an associate*

32. Interest received by a PNG resident taxpayer from an associate that is carrying on a resource project in PNG will be taxed at the same rate applying to income from the resource project. This provision is intended to prevent arrangements aimed at exploiting the higher tax rates which can apply to resource projects. However, this provision has no impact on non-residents as interest income received by a non-resident from an associate that is carrying on a resource project in PNG is exempt from income tax and interest withholding tax in PNG.

### *Management fees*

33. Once a resource project derives assessable income the deduction for management fees paid to associates is restricted to 2% of operating expenses other than these management fees. During the exploration phase of a project the amount of management fees which can be treated as allowable exploration expenditure is limited to 2% of exploration expenditure other than management fees. Furthermore, during the development phase the amount of management fees which can be treated as allowable capital expenditure is limited to 2% of allowable capital expenditure other than management fees.
34. Management fees are defined as a payment of any kind in consideration for any services of a technical or managerial nature including consultancy services where the Commissioner General is satisfied those services are of a managerial nature, but excluding salaries or royalties.

### *Joint venture financial statements*

35. Joint venture operators must submit a “consolidated financial statement” for the joint venture as a whole, within two months of the end of the year of income. This consolidated financial statement must list details of all expenditure incurred during the year. Further, each joint venture partner will be required to reconcile their tax return to the consolidated financial statement.

### *Good and Service Tax*

36. All supplies of goods or services other than cars, to a resource company for use in resource operations are zero rated. The terms “resource company” and “resource operations” are specifically defined to include mining, oil and gas projects.

## *Prescribed infrastructure development*

37. Where a taxpayer engaged in resource operations has incurred expenditure in relation to a prescribed infrastructure development, the amount of expenditure incurred in the year may be deemed to be income tax paid in respect of that resource project.
38. A prescribed infrastructure development is a project to improve the infrastructure in the area surrounding or affected by the resource project. In order to qualify for the tax concession the project and anticipated expenditure requires prior approval from the government.
39. The amount taken to be income tax paid cannot exceed the sum of the relevant amount for the year of income, being the lesser of:
  - (a) 0.75% of the assessable income derived in the year of income from the resource project; and
  - (b) the amount of tax payable in respect of income derived during the year of income from the mining project.
40. To the extent that actual expenditure incurred on prescribed infrastructure development in a year is less than the limit specified in paragraph 39, the shortfall amount can be carried forward to be applied in a future year when actual prescribed infrastructure development expenditure exceeds the limit for that later year. However, the shortfall can only be carried forward for two years
41. Alternatively, where actual prescribed infrastructure development expenditure incurred in a year exceeds the limit specified in paragraph 39 for that year the excess expenditure may be carried forward to future years.
42. Infrastructure tax credits can also be claimed in respect of expenditure on the Highlands Highway. The credit claimable is in addition to amounts claimable under the standard infrastructure tax credit scheme. The credit claimable is limited to 1.25% of assessable income or the tax actually payable for the year. At present the Highlands Highway credit scheme operates in respect of the 2005, 2006 and 2007 years of income based on income derived during the year ended 31 December 2005.
43. Similar rules apply to the carry forward of shortfall amounts and excess expenditure as apply under the general infrastructure tax credit provisions.
44. An illustration of the calculation of the taxable income of a resource project is set out in the following pages.

## *Example*



## Example 1 – Resource Project Taxation

	Years 1-5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Allowable exploration expenditure	20,000	3,000	-	-	-	-	-	-
Allowable capital expenditure – short life	-	-	15,000	5,000		4,000	3,000	
Allowable capital expenditure – long life			40,000	10,000	15,000			
Plant elected to be depreciated								
5 year life	-	-	4,000	6,000				
Exploration outside Project Area	-	-						
Assessable income other than interest	-	-	30,000	57,000	75,000	105,000	125,000	175,000
Deductions other than interest and amortisation of A,B,C,D & E			2,000	25,000	30,000	35,000	40,000	45,000
Interest received	-	-	-	-	3,250	4,000	2,500	5,000
Interest paid	-	-	-	2,000	10,500	10,000	6,000	2,000
Life of project at end of year				15 years	14 years	13 years	12 years	11 years

## Income Tax Calculations

	Years 1-5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Assessable income			30,000	57,000	75,000	105,000	125,000	175,000
Deductions			(2,000)	(25,000)	(30,000)	(35,000)	(40,000)	(45,000)
Interest received			-	-	3,250	4,000	2,500	5,000
Interest paid			-	(2,000)	(10,500)	(10,000)	(6,000)	(2,000)
Income before depreciation			28,000	30,000	37,750	64,000	81,500	133,000
Amortisation/depreciation								
Plant - 5 year life			(600)	(1,920)	(2,244)	(2,000)	(2,000)	(1,236)
Allowable capital expenditure – long life			(4,000)	(5,000)	(6,500)	(6,500)	(6,500)	(6,500)
Allowable capital expenditure – short life			(3,750)	(4,063)	(3,047)	(3,285)	(3,214)	(2,410)
Allowable exploration expenditure			(5,750)	(4,313)	(3,234)	(2,426)	(1,819)	(1,365)
Taxable income			13,900	14,705	22,725	49,789	67,967	121,489
Tax payable at 30%			4,170	4,412	6,817	14,937	20,390	36,447

## Example 1 – Resource Project Taxation

### Calculation of Depreciation and Amortisation

Allowable Exploration Expenditure	
Original cost	23,000
Deduction Year 7	(5,750)
Deduction limitation	0
	17,250
Deduction Year 8	(4,313)
Deduction limitation	0
	16,938
Deduction Year 9	(3,234)
Deduction limitation	0
	9,703
Deduction Year 10	(2,426)
Deduction limitation	0
	7,277
Deduction Year 11	(1,819)
Deduction limitation	0
	5,458
Deduction year 12	(1,365)
Deduction limitation	0
	4,094

Allowable Capital Expenditure – Short Life	
Original cost	15,000
Deduction Year 7	(3,750)
Deduction limitation	0
	11,250
Additions	5,000
	16,250
Deduction Year 8	(4,063)
Deduction limitation	0
	12,188
Additions	0
	12,188
Deduction Year 9	(3,047)
Deduction limitation	0
	9,141
Additions	4,000
	13,141
Deduction Year 10	(3,285)
Deduction limitation	0
	9,855
Additions	3,000
	12,855
Deduction Year 11	(3,214)
Deduction limitation	0
	9,642
Additions	0
	9,642
Deduction year 12	(2,410)
Deduction limitation	0
	7,231

## Example 1 – Resource Project Taxation

### Calculation of Depreciation and Amortisation

Allowable Capital Expenditure – Long Life		Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Additions							
Year 7	40,000	4,000	4,000	4,000	4,000	4,000	4,000
Year 8	10,000		1,000	1,000	1,000	1,000	1,000
Year 9	15,000			1,500	1,500	1,500	1,500
Total deduction		4,000	5,000	6,500	6,500	6,500	6,500

Plant – 5 year life		Year 7 (a)	Year 8	Year 9	Year 10 (b)	Year 11	Year 12
Year 7	4,000	600	1,020	714	800	800	66
Year 8	6,000		900	1,530	1,200	1,200	1,170
		600	1,920	2,244	2,000	2,000	1,236

(a) Start with reducing balance as gives higher depreciation

(b) Switch to straight line as gives higher total depreciation



03

## Specific rules for mining projects



# Specific rules for mining projects

## Introduction

1. This section deals with the specific rules which apply to mining operations. Mining operations are defined as:  
*“the extraction of minerals in Papua New Guinea from their natural site and includes prescribed ancillary activities in Papua New Guinea, and exploration activities within a mining lease or special mining lease area.”*
2. “Minerals” include precious and base metals and their ores, hydrocarbons in the form of coal shale or other rock and valuable earths and substances.
3. A Special Mining Lease is granted under the Mining Act for projects for which other forms of lease are inappropriate by reason of the size of the mineral deposit and the methods of mining and treatment to be employed or the cost of development of the project. It is likely that all large projects will be carried on under a Special Mining Lease.
4. A Special Mining Lease may be held by:
  - (a) a natural person;
  - (b) a corporation that is incorporated or registered under the Companies Act; hence a branch of a registered foreign company qualifies;
  - (c) an unincorporated combination of:
    - (i) natural persons; or
    - (ii) a natural person or natural persons and a corporation or corporations to which paragraphs (b) applies.
5. A mining lease is required for mining operations which fall outside the scope of a special mining lease.

## Project basis of assessment

6. Mining operations are subject to a project basis of assessment.
7. The project will generally be defined as mining operations conducted pursuant to a specific mining lease. However, mining operations conducted on any number of special mining leases, mining lease or special mining leases combined with general mining leases may, with the consent of the tax authorities, be combined into one mining project.

## Allowable exploration expenditure

8. For mining operations the definition of allowable capital expenditure is extended to include the situation where a mining development licence is surrendered, cancelled or expires and there is undeducted allowable exploration expenditure in relation to that development licence. In such a case the Commissioner General may allocate that undeducted exploration expenditure to another mining project from which income is being derived by the taxpayer or a related corporation, or if no such project exists, to any such licence issued to the taxpayer or a related corporation within twenty years of the expenditure being incurred. A similar concession does not apply in respect of undeducted allowable capital expenditure.



### *Allowable capital expenditure*

9. For mining operations the definition of allowable capital expenditure is extended to include:
- expenditure of a capital nature incurred by the taxpayer on the acquisition of—
    - (i) the site of mineral deposits; or
    - (ii) rights over the site or over the deposits; and
  - expenditure of a capital nature incurred by the taxpayer on testing deposits of minerals or in winning access to the deposits; and
  - expenditure on the study of—
    - (i) the feasibility of the development of smelting and refining and related facilities in and in relation to the mining project or proposed mining project; or
    - (ii) the environmental impact of the mining operations proposed to be carried on by the taxpayer.

### *Off licence exploration expenditure*

10. As noted earlier, a taxpayer involved in resource operations may elect, at the end of each year of income, to add exploration expenditure incurred by the taxpayer or by a related corporation during that year of income, to an exploration pool, from which deductions may be claimed.

Where the taxpayer is carrying on mining operations the limit on the amount which is deductible is the lower of 25% of the pool balance or such amount as reduces the tax otherwise payable by the taxpayer and its related corporations in respect of the mining project for that year of income, by 25%.

### *Double deduction for exploration expenditure*

11. A double deduction is allowed in respect of allowable exploration expenditure incurred after 1 January 2003 and which has been included in the exploration pool discussed in paragraph 10 above. The double deduction arises when a development licence is issued. The exploration expenditure will be deductible as allowable exploration expenditure of the new project and the unclaimed balance remains deductible in the off licence exploration pool.

### *Mining Levy*

12. Mining levy is imposed on every person who held a Mining Development Licence on 31 December 2000. The amount payable is calculated in accordance with the following formula:

$$(C - Y) + \frac{A(E - G)}{F} \quad \text{where -}$$

C= Amount of customs and excise duties payable at the rates in force as on 30 June 1999 on the value of goods of any kind imported by the taxpayer during the month under consideration; and

Y= Amounts of customs and excise duties payable at the rates effective on the date of importation of the goods on the value of goods imported by the taxpayer during the month under consideration; and

A = Total value of all purchases made by the taxpayer during the month under consideration as reduced by the value of goods imported during the month under consideration; and

E = Amount of customs and excise duties and Provincial sales tax payable on total value of all purchases made as reduced by the value of goods imported by the taxpayer in the calendar year 1998 at the rates in force in 1998; and

F = Total value of all purchases made by the taxpayer in the calendar year 1998 as reduced by the value of the goods imported during that year; and

G = Amount of customs and excise duties and Provincial sales tax payable on total value of all purchases made as reduced by the value of goods imported by the taxpayer in the calendar year 1998 at the rates in force during the month under consideration.

12. Mining levy is payable within 21 days after the end of the month to which it relates.
13. The mining levy is being be phased out over 4 years, commencing on 1 January 2004.

04

## Specific rules for petroleum projects



# Specific rules for petroleum projects

## *Introduction*

1. This section deals with the specific taxation rules which apply to petroleum operations. Petroleum operations are defined to mean all or any of the following:
  - (a) operations in Papua New Guinea for the purposes of recovering petroleum, including the construction or acquisition of facilities for that purpose;
  - (b) operations for or related to the processing or transporting of petroleum prior to
    - (i) entry of the petroleum into a facility which is located in Papua New Guinea for the refining of petroleum or liquefaction of natural gas; or
    - (ii) export of the petroleum;whichever occurs first;
  - (c) the refining of petroleum or petroleum products where such refining is solely for the purpose of or incidental to the operations in Papua New Guinea for recovering petroleum or the construction of facilities used in those operations or where the Commissioner General considers the refining is required in order for the taxpayer to be able to conduct those operations;
  - (d) exploration activities within the area of and pursuant to a development licence; but does not include exploration or gas operations.
2. “Petroleum” has the same meaning as it has in the Oil & Gas Act 1998 and includes all naturally occurring hydrocarbons whether in a gaseous, liquid or solid state.
3. Petroleum Development Licences and pipeline licences are granted under the Oil & Gas Act 1998. A Petroleum Development Licence or a pipeline licence may be held by:
  - (a) a natural person;
  - (b) a corporation that is incorporated or registered under the Companies Act: hence a branch of a registered foreign company qualifies; or
  - (c) an unincorporated combination of:
    - (i) natural persons; or
    - (ii) corporations to which paragraph (b) applies; or
    - (iii) a natural person or natural persons and a corporation or corporations to which paragraph (b) applies.

## *Project basis of assessment*

4. Petroleum operations are subject to a project basis of assessment.
5. A petroleum project will usually consist of petroleum operations conducted under only one development licence or pipeline licence. However, petroleum operations conducted under any number of development licences and / or pipeline licences may, where a regulation so prescribes and with the consent of the licence holders, be combined into one petroleum project.

6. The specific petroleum provisions expand the definition of allowable exploration expenditure to include exploration expenditure, wherever incurred, which the Head of the Department of Mining & Petroleum certifies has been undertaken to delineate a petroleum deposit in the prospecting licence from which the development licence was drawn.

*Allowable exploration expenditure*

7. Allowable exploration expenditure is also extended to cover expenditure on exploration activities in the area of an exploration or development licence which is adjacent an exploration licence from which a development licence has already been drawn, which the Head of the Department of Mining & Petroleum certifies as being for the purpose of proving the existence or extent of a commercially exploitable petroleum pool which might be developed in a co-ordinated development.
8. A taxpayer may elect at any time prior to the date of lodgement of the first tax return in relation to a petroleum project, that all or any amount of the allowable exploration expenditure will not be allowable exploration expenditure of that project but shall remain as allowable exploration expenditure of a subsequent petroleum project or designated gas project for which it qualifies to be allowable exploration expenditure.
9. Where a taxpayer has made an election in respect of allowable exploration expenditure, that taxpayer may, at any time prior to that expenditure becoming allowable exploration expenditure of another petroleum project or designated gas project, further elect that that allowable exploration expenditure should become allowable exploration expenditure of the original petroleum project.
10. Where a prospecting or retention licence is surrendered, cancelled or expires and there is undeducted exploration expenditure in relation to that licence, the Commissioner General may allocate that undeducted exploration expenditure to a development licence in which the taxpayer, or a related corporation, holds an interest. If no such licence exists at that point in time, the expenditure can be carried forward and allocated to any such development licence issued within twenty years from the date that the expenditure was originally incurred.
11. Where a petroleum development licence is surrendered, cancelled or expires, or where a taxpayer disposes of their interest in a petroleum development licence, and there is undeducted exploration expenditure in relation to that licence, the Commissioner General may allocate that undeducted exploration expenditure to any other petroleum project or designated gas project in which the taxpayer or a related corporation has a beneficial interest.
12. Where a taxpayer derives income from the sale of petroleum from operations conducted pursuant to a petroleum prospecting licence, the amount of the income is applied to reduce allowable exploration expenditure in relation to the that petroleum prospecting licence. Where the amount of income exceeds the accumulated exploration expenditure the excess is deemed to be assessable income from petroleum operations.

### *Allowable capital expenditure*

13. In addition to the amounts included as allowable capital expenditure under the general resource project provisions, the following are specifically included as allowable capital expenditure of a petroleum project:
- Capital expenditure on plant used by the taxpayer for the purpose of purification and stabilisation of petroleum in order to facilitate transport of the petroleum.
  - Capital expenditure incurred in providing or contributing to the cost of pipelines or any transport facility constructed for the transport of petroleum, that has not been treated at a refinery, obtained from the petroleum operations.
  - Plant (including pumping apparatus, storage tanks, port facilities and other terminal facilities) for use primarily, principally and directly in connection with the operations of such pipeline or other transport facility.
  - Exploration expenditure, wherever incurred, which the Head of the Department of Mining & Petroleum certifies has been undertaken to delineate a petroleum deposit within a development included in the petroleum project.
  - Expenditure which is incurred by the taxpayer for exploration activities in the area of a petroleum exploration licence or development licence adjacent to a development licence included in the petroleum project where the exploration activities are certified (and to the extent to which they are so certified) by the Head of the Department of Mining and Petroleum to be for the purpose of proving or disproving the existence or extent of a commercially exploitable petroleum pool which might be developed in a co-ordinated development with a petroleum pool or pools wholly or partly underlying such development licence.
  - Expenditure on certain feasibility and environmental impact studies.
14. Where a petroleum development licence is surrendered, cancelled or expires, a taxpayer disposes of the whole of its interest in a petroleum project, or a petroleum project is abandoned; and there is undeducted allowable capital expenditure in relation to that project, the Commissioner General may allocate that undeducted allowable capital expenditure to any other petroleum project or designated gas project in which the taxpayer, or a related corporation, has a beneficial interest and where no such project exists to any project for which a development licence is issued within twenty years of the date of the cessation or abandonment.

### *Petroleum used in petroleum operations*

15. Where a taxpayer uses petroleum from a petroleum project carried on by the taxpayer in Papua New Guinea in the course of petroleum operations, the value of the petroleum used is determined by reference to the “norm price” and the value so determined shall be:
- a) the cost of the petroleum for all purposes of the income tax law; and
  - b) deemed to be assessable income from petroleum operations.

### *Coordinated Development Agreement redeterminations*

18. Special provisions apply to compensation payments made pursuant to redeterminations between Coordinated Development Participants (whether in cash or kind or by way of change in lifting entitlements) to compensate one participant for having incurred more allowable exploration expenditure or allowable capital expenditure or expenditure on plant or operating expenses or having derived less petroleum or income, according to the result of the redetermination. These provisions generally require appropriate adjustments to be made between the individual allowable exploration expenditure, allowable capital expenditure and other expenditures of the Coordinated Development participants to reflect the results of the redeterminations arising under the relevant Coordinated Development Agreement.

### *Conversion to a designated gas project*

19. Special rules provide a mechanism for the conversion of a petroleum project to a designated gas project. Where all of a petroleum project is converted to a designated gas project or part of a designated gas project the petroleum project ceases on the date of conversion.

20. Where the conversion occurs part way through a year of income the deductions allowed in respect of residual exploration expenditure and allowable exploration expenditure are apportioned on a monthly basis.

### *Royalty and development levy*

21. Petroleum projects are subject to a royalty which is basically equal to 2% of the gross revenue from petroleum sales. New petroleum projects are also subject to a development levy which is again basically equal to 2% of the gross revenue from petroleum sales. Where a project is liable for both royalty and development levy the royalty is claimable as a credit against income tax payable.





05

## Specific rules for gas projects



# Specific rules for gas projects

## *Introduction*

1. This section deals with the specific rules which apply to gas operations. Gas operations are defined to mean “petroleum operations relating to the recovery of, processing, transportation or sale of petroleum recovered from a gas field”.
3. A gas field means a field producing petroleum under a petroleum development licence which, by reason of the application of a gas to oil ratio in the manner prescribed, constitutes a gas field.
4. A “designated gas project” means such one or more gas projects as are defined to be a gas project under a gas agreement made pursuant to the Oil & Gas Act 1998.

## *Project basis of assessment*

5. Gas projects are subject to the same ring fencing rules as apply to other resource projects so that income derived from a designated gas project is assessed as if it were the only income of the taxpayer.
6. A designated gas project will consist of one or more gas projects being gas operations conducted in accordance with one or more development licences or pipeline licences.

## *Conversion of petroleum project to a gas project*

7. A field that is part of a petroleum project becomes a designated gas project or part of a designated gas project on the “conversion date” in respect of the field.
8. The conversion date occurs on the last day of the month prior to the date on which its production of gas exceeds the prescribed ratio of gas production to oil production.
9. The consequences of the conversion of a field from a petroleum project to a gas project include:
  - (a) The residual exploration expenditure in relation to the field that is converted becomes residual exploration expenditure in relation to the designated gas project and the deduction available in respect of the residual exploration expenditure is calculated on the same basis as it would have been had the field in respect of which it was originally incurred continued to be part of the petroleum project.
  - (b) The undeducted balance of allowable capital expenditure in relation to the field that is converted becomes undeducted allowable capital expenditure in relation to the designated gas project and the deduction available in respect of the undeducted allowable capital expenditure is calculated on the same basis as it would have been had the field in respect of which it was originally incurred continued to be part of the petroleum project.
10. In the year in which the conversion occurs the deductions for residual exploration expenditure and allowable capital expenditure are apportioned on a time basis between the petroleum project and the designated gas project.

### *Allowable exploration expenditure*

11. In addition to the amounts included as allowable exploration expenditure under the general rules applying to all resource projects the following amounts are specifically included as allowable expenditure of a gas project:
- exploration expenditure, wherever incurred, which the Head of the Department of Mining & Petroleum certifies has been undertaken to delineate a petroleum deposit in the prospecting licence from which the development licence in relation to the designated gas project was drawn.
  - exploration expenditure, incurred in the area of a petroleum exploration licence or development licence adjacent to the designated gas project, which the Head of the Department of Mining & Petroleum certifies has been undertaken for the purpose of proving or disproving the existence or the extent of a commercially exploitable petroleum pool which might be developed in a co-ordinated development with a petroleum pool or pools wholly or partly underlying such petroleum exploration licence.
  - Residual exploration expenditure allocated to a designated gas project upon the conversion of a petroleum project to a gas project.
  - Any other expenditure which is classified as allowable exploration expenditure in the relevant gas agreement.
12. Where a petroleum prospecting licence in relation to which no development licence has been issued is surrendered, cancelled or expires and there is residual exploration expenditure in relation to that licence, the Commissioner General may allocate so much of that residual exploration expenditure as he considers reasonable to a designated gas project in which the taxpayer or a related corporation holds a beneficial interest.
13. Where a taxpayer ceases to have an interest in a designated gas project upon:
- (a) the surrender cancellation or expiry of a development licence or pipeline licence; or
  - (b) the taxpayer disposing of its whole interest in the designated gas project; or
  - (c) the abandonment of the gas project.
- and there is residual exploration expenditure in relation to that designated gas project, the Commissioner General may allocate that residual exploration expenditure to any other designated gas project or petroleum project in which the taxpayer or a related corporation has a beneficial interest.

## *Allowable capital expenditure*

14. In addition to the amounts included as allowable capital expenditure applicable to resource projects, the following are specifically included as allowable capital expenditure of a designated gas project:
- the undeducted balance of allowable capital expenditure as at the date of conversion of any petroleum project that converts to become a designated gas project or part of a designated gas project
  - all expenditure classified as allowable capital expenditure for the designated gas project in the gas agreement in respect of the designated gas project
  - expenditure on exploration activities, wherever carried out, for the purpose of delineating a petroleum deposit within the development included in the designated gas project
  - expenditure which is incurred by the taxpayer for exploration activities in the area of a petroleum exploration licence or development licence adjacent to a development licence included in the designated gas project where the exploration activities are certified (and to the extent to which they are so certified) by the Head of the Department of Mining and Petroleum to be for the purpose of proving or disproving the existence or extent of a commercially exploitable petroleum pool which might be developed in a co-ordinated development with a petroleum pool or pools wholly or partly underlying such development licence
15. The following amounts are specifically excluded from allowable capital expenditure in relation to a designated gas project:
- ships and aircraft unless certain conditions are satisfied
  - plant for use in refining of petroleum products or the products of petroleum, unless the plant is for the purpose of an operation included in the definition of gas operations
16. Where a taxpayer ceases to have an interest in a designated gas project upon:
- (d) the surrender cancellation or expiry of a development licence or pipeline licence; or
  - (e) the taxpayer disposes of the whole of its interest in the designated gas project; or
  - (f) abandonment of the gas project occurs.
- and there is undeducted allowable capital expenditure in relation to that designated gas project, the Commissioner General may allocate that undeducted allowable capital expenditure to any other designated gas project or petroleum in which the taxpayer or a related corporation has a beneficial interest.

## *Related corporations*

17. Where related corporations hold an interest in the same designated gas project each corporation is required to lodge a separate return in respect of their interest in the designated gas project unless an election is made by all of the related corporations.

18. Where an election is made, each related corporation is required to provide to the Commissioner General with its return of income a consolidated statement of taxable income derived from the designated gas project, calculated as if all interests of the related corporations in the designated gas project were held by a single taxpayer.
19. The consolidated statement must still show an allocation to each taxpayer of all items making up the taxable income from gas operations and a calculation of taxable income from gas operations of each taxpayer.
20. Where the calculation of the individual taxpayer's ("the transferor") taxable income from gas operations is a loss for the year that loss may be allocated to any other related corporation ("the transferee") or corporations, to the extent that the related corporations have taxable income from gas operations. The amount transferred is deemed to be assessable income of the transferor and an allowable deduction of the transferee.

#### *Petroleum and gas income*

21. Where a pool is discovered in a field which is part of a designated gas project and the pool does not exceed the prescribed ratio of gas to oil production, the income from the sale of petroleum produced from that pool shall be assessable income from petroleum operations. This also applies to a field or fields in a petroleum project which converts to a designated gas project.
22. Where this situation arises there will be assessable income from petroleum operations and assessable income from gas operations derived from a designated gas project. Consequently, special rules exist for the apportionment of deductions between the assessable income from petroleum operations and the assessable income from gas operations.

#### *Additional Profits Tax*

23. Additional profits tax is imposed on the basis of cash flow. Additional profits tax potentially applies to a designated gas project in the year in which the accumulated value of "net cash receipts" becomes positive.
24. Net cash receipts in a year of income can be broadly defined as the sum of:
  - (i) assessable income (other than interest) less deductions (other than interest, amortisation of allowable capital expenditure or allowable exploration expenditure, or depreciation in respect of plant)
  - (ii) contributions received towards the cost of designated gas project facilities
  - (iii) proceeds from the sale of gas project assets
 less
  - (i) allowable capital expenditure and allowable exploration expenditure and the cost of plant
  - (ii) income tax paid
  - (iii) approved expenditure on prescribed infrastructure projects.

25. There are two calculations of additional profits tax. The first calculation is referred to as calculation X and under this calculation the cumulative amount carried forward is uplifted using Accumulation Rate X. The second calculation is referred to as calculation Y and under this calculation the cumulative amount carried forward is uplifted using Accumulation Rate Y. In addition, any additional profits tax payable under calculation X is a deduction in calculation Y.
26. Accumulation Rate X is 15% and Accumulation Rate Y is 20% unless the taxpayer has made an election to adopt the alternate rates. Where such an election is made the rate is 12% plus the percentage rate of inflation for the year of income in the United States of America, as measured by the Producer Price Index of the United States of America for Accumulation Rate X and 17% plus the percentage rate of inflation for the year of income in the United States of America, as measured by the Producer Price Index of the United States of America for Accumulation Rate Y.
27. When “net cash receipts” are negative, the cumulative amount is carried forward and uplifted at the Accumulation Rate required for each calculation. Where the calculation is in Kina the cumulative amount is also adjusted for movements in the PNG Kina/US dollar exchange rate (expressed as Kina per dollar).
28. The uplift begins on the “uplift commencement date” which is the later of:
  - (a) date of the grant or last extension, whichever is later, of the resource right from which the resource project was drawn; or
  - (b) the date upon which the taxpayer first obtained an interest in the resource project or a petroleum right held by the taxpayer first became part of the resource project, as the case may be.
29. When cumulative “net cash receipts” are positive, this positive amount is the amount of profits subject to tax. The amount carried forward then becomes nil.
30. The rate of additional profits tax is 20% of the amount of taxable additional profits determined under calculation X and 25% of the amount of taxable additional profits determined under calculation Y.
31. Where related corporations have an interest in the same designated gas project their liability to additional profits tax is calculated on a group basis unless they make a written election to be assessed separately.
32. Where the net cash receipts of the related corporations is positive they are jointly and severally liable for the additional profits tax and the amount payable by each corporation shall be determined on a reasonable basis.
33. The operation of the additional profits tax provisions is illustrated on pages 36 and 37.



### *Royalty and development levies*

34. Gas projects are subject to a royalty which is basically equal to 2% of the gross revenue from gas sales. New gas projects are also subject to a development levy which is again basically equal to 2% of the gross revenue from gas sales. Where a project is liable for both royalty and development levy the royalty is claimable as a credit against income tax payable.

### *Infrastructure tax credits*

35. In addition to the infrastructure tax credits available to all resource projects additional tax credits are available to gas project participants in respect of expenditure incurred on behalf of the state in respect of the State's share of construction costs of new roads or highways in the Southern Highlands and Gulf provinces.
36. The credit claimable is limited to:
- (a) 1.25% of the assessable income derived in the year of income from the gas project; or
  - (b) 50% of the tax payable.
37. Such credits can be carried forward separately from amounts carried forward under the general infrastructure tax credit provisions. The standard two year carry forward rules and under or overspend is treated in the same manner as under the general infrastructure tax credit provisions.

## Example 2 – Additional Profits Tax

Calculation X

Accumulation Rate -15%

	Years 1-6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Taxable Income	-	-	13,430	21,769	49,072	67,429	121,086
Add	-						
Allowable Exploration Expenditure Deduction	-	650	5,588	4,191	3,143	2,357	1,768
Allowable Capital Expenditure Deduction – Short Life	-	3,750	4,063	3,047	3,285	3,214	2,410
Allowable Capital Expenditure Deduction – Long Life	-	4,000	5,000	6,500	6,500	6,500	6,500
Depreciation	-	600	1,920	2,244	2,000	2,000	1,236
Interest paid	-	-	2,000	10,500	10,000	6,000	2,000
Less							
Assessable Interest received	-	-	-	(3,250)	(4,000)	(2,500)	(5,00)
Income Tax paid	-	-	(4,029)	(6,531)	(14,722)	(20,229)	(36,326)
Allowable Exploration Expenditure for the year	-	-	-	-	-	-	-
Allowable Capital Expenditure for the year	(23,000)	(50,000)	(15,000)	(15,000)	(4,000)	(3,000)	-
Additions to plant for the year	-	(4,000)	(6,000)	-	-	-	-
<i>Net Cash Receipts in year</i>	(23,000)	(50,000)	6,971	23,469	51,278	61,771	93,674
Amount brought forward (after uplift)	(23,000)	(26,450)	(87,918)	(93,088)	(80,062)	(33,101)	0
<i>Amount carried forward</i>	(23,000)	(76,450)	(80,947)	(69,619)	(28,783)	-	-
<i>Additional Profits</i>						28,670	93,674
<i>Additional Profits Tax @ 20%</i>						5,734	18,735

## Example 2 – Additional Profits Tax

Calculation Y

Accumulation Rate - 20%

	Years 1-6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12
Taxable Income	-	-	13,430	21,769	49,072	67,429	121,086
Add	-						
Allowable Exploration Expenditure Deduction	-	650	5,588	4,191	3,143	2,357	1,768
Allowable Capital Expenditure Deduction – Short Life	-	3,750	4,063	3,047	3,285	3,214	2,410
Allowable Capital Expenditure Deduction – Long Life	-	4,000	5,000	6,500	6,500	6,500	6,500
Depreciation	-	600	1,920	2,244	2,000	2,000	1,236
Interest paid	-	-	2,000	10,500	10,000	6,000	2,000
Less							
Assessable Interest received	-	-	-	(3,250)	(4,000)	(2,500)	(5,000)
Income Tax paid	-	-	(4,029)	(6,531)	(14,722)	(20,229)	(36,326)
Allowable Exploration Expenditure for the year	-	-	-	-	-	-	-
Allowable Capital Expenditure for the year	(23,000)	(55,000)	(15,000)	(15,000)	(4,000)	(3,000)	-
Additions to plant for the year	-	(4,000)	(6,000)	-	-	-	-
Additional profits tax calculation X	-	-	-	-	-	(5,734)	(18,735)
<i>Net Cash Receipts in year</i>	(23,000)	(50,000)	6,971	23,469	51,278	56,037	74,939
Amount brought forward (after uplift)	(23,000)	(27,600)	(93,120)	(103,379)	(95,891)	(53,535)	0
<i>Amount carried forward</i>	(23,000)	(76,600)	(86,149)	(79,909)	(44,613)	-	-
<i>Additional Profits</i>						2,502	74,939
<i>Additional Profits Tax @ 25%</i>						625	18,735

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# Photo listings

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*(top)* Hides gas to electricity facility (used with permission of Oil Search Limited)

*(bottom)* Map of proposed pipeline route to be used for PNG Gas Project (used with permission of Oil Search Limited)



