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2012 Papua New Guinea

National Budget

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The Minister for Treasury and Finance, the Honourable Don Polye, MP handed down the 2012 National Budget on 6 December 2011.

Executive summary

The theme of the 2012 Budget is “Sharing the Wealth and Empowering our People”.

The Government views this as a ‘people budget’ with a view towards ensuring the benefits of strong economic growth are shared more fairly. It also attempts to lower the cost of living for the people. While global economic events are impacting the volatility of commodity prices and on currency value the Government remains very upbeat about the PNG economy and its continued robust growth.

Key components of the 2012 Budget include:

- It is expected this 2012 balanced budget will be PNG’s biggest ever at K10.6 billion.
- Economic growth is forecast to decline slightly to 7.8% in 2012 (the revised 2011 estimate is 8.9%), while inflation is forecast to drop slightly to 7.6% in 2012.
- As with the prior year, the 2012 Budget continues to recognise the significance of the PNG LNG Project as a driver of economic growth.
- The Government has reiterated its commitment to the establishment of a sovereign wealth fund to address the downside macroeconomic risks associated with large scale projects such as the PNG LNG Project.
- A focus on free education, the 2012 National Elections, the 2015 South Pacific Games, and improving the road infrastructure.
- K900 million of domestic debt securities to be issued to fund the State’s share in the PNG LNG project.

Key budget assumptions

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

Principal economic indicators	2006 actual	2007 actual	2008 actual	2009 actual	2010 actual	2011 est.	2012 proj.
Real GDP Growth (%)	2.3	7.2	6.6	5.5	7.6	8.9	7.8
Non-mining GDP Growth (%)	3.9	8.1	7.6	6..3	8.5	10.8	7.4
Inflation (year average) (%)	2.4	0.9	10.8	7.0	6.0	8.7	7.6
Oil price (US$ per barrel)	64	71	97	62	79	90	85
Gold price (US$ per ounce)	604	697	881	973	1,225	1,566	1,884
Copper Price (US$ per ton)	6,731	7,132	6,963	5,100	7,538	8,800	8,819
Interest rates % (yearly average T-Bill)	5.0	5.0	5.9	7.3	5.5	7.5	7.5

Financing the budget

The following table summarises the financing requirements arising as a result of the balanced 2012 Budget and also includes historic information for reference purposes.

Financing the budget (K millions)	2009 (actual)	2010 (actual)	2011 (projection)	2012 (projection)
Total revenue and grants	6,651.3	8,278.9	9,840.2	10,560.3
Total expenditure and net lending	6,687.5	8,092.6	9,928.3	10,560.3
Budget surplus/(deficit)	(36.2)	186.3	(88.1)	0.0
Budget surplus / (deficit) as a % of GDP	(0.2)	0.7	(0.3)	0.0

Revenue and grants

The total budgeted revenue and grants for 2012 are expected to be derived from the following sources:

Financing the budget (K millions)	2010 (actual)	2011 (projection)	2012 (projection)
Taxation revenue	6,437.7	7,896.8	8,519.7
Non-taxation revenue	435.1	357.2	520.1
Grants	1,391.1	1,526.1	1,390.5
Total revenue and grants	8,278.9	9,840.2	10,560.3

Total revenue is forecast to increase from K9.8 billion to K10.6 billion in 2012. This is largely driven by higher tax collections on income and profits underpinned by strong economic growth driving up wages and profits. Of the K8.5 billion expected to be derived in the form of taxation revenue, K6.5 billion of this is forecast to be in the form of taxes on income and profits. The composition of the tax revenue is as follows:

Taxes on income and profits (K million)	2012 (projection)	% change on 2011	2011 (projection)	2010 (actual)
Personal income tax	2,417.4	10.2%	2,194.5	1,494.0
Company tax	1,692.1	19.9%	1,411.3	1,192.1
Dividend withholding tax	282.1	5.6%	267.1	278.8
Mining and petroleum tax	1,872.1	(4.0%)	1,950.8	1,476.3
Interest withholding tax	45.5	1.8%	44.7	42.3
Other direct tax	111.7	14.0%	98.0	104.3
Gaming tax	122.1	14.0%	107.1	92.9
Total	6,543.0	7.7%	6,073.5	4,706.7

Taxes on income and profits are forecast to be 29.0% higher in 2011 than in 2010 and a further 7.7% increase is budgeted for 2012 over 2011 collections. Mining and petroleum related taxes are anticipated to fall slightly with revenue growth from commodity price increases expected to be to reduced by lower production levels.

Revenue from personal income taxes is forecast to increase by 10.2%, a significant increase, given the number of personal income tax payers is not expected to change significantly. The high marginal tax rates compared with neighbouring jurisdictions will impact on the ability of PNG to retain or attract talent and head offices.

Net revenue from GST is expected to fall by 3.5% with the cost of clearing an outstanding backlog of GST refunds.

The value of donor funding is expected to drop slightly to K1.4 billion due in part to the appreciation of the Kina and in part to completion of a number of key donor funded projects in 2011.

Recurrent and development expenditure

The total appropriation for 2012 comprises:

Recurrent and development expenditure budget (K millions)	2010 (actual)	2011 (revised)	2012 (projection)
Recurrent expenditure	4,160.4	5,338.0	6,123.2
Development expenditure	3,278.9	3,924.5.	4,437.1
Reappropriation into Trust Account	0.0	0.0	0.0
Supplementary budget	653.3	665.8	0.0
Total	8,092.6	9,328.1	10,560.3

Recurrent and development expenditure is forecast to increase for 2012 by 6.4% over 2011 to a level 30.5% higher than the 2010 outcome.

The Recurrent Budget is responsible for the funding the ongoing delivery of the essential services and will support Government priorities including the introduction of Tuition Fee Free Education in 2012, establishing quality national road transport corridors , improving health and enhancing law, order and justice.

The recurrent budget

Total recurrent expenditures are forecast to increase by 14.7% from K5.3 billion to K6.1 billion in 2012. In addition to expenditure on wages and goods and services by government, the 2012 recurrent budget provides for funding for new spending decisions. These include the following:

- **Tuition Fee Free Education**

  Tuition fee free education is to be provided to all students from elementary through to grade 10, and 75% of fees free for grade 11 and 12 students. A further 6,700 teachers are expected to be recruited to work in the Provinces. Additional expenditure in many areas of education is budgeted for.

  Increased funding will be provided to the Department of Education, the Provinces and Universities to assist with the purchase of equipment and wage costs of additional teaching staff. This funding will also support the subsidy of school fees.

- **Improving transport infrastructure**

  The sector is to receive an additional 9.1% in funding for general road maintenance activities. The bulk of the funding in this sector is provided through the Development Budget. However, the Government recognises constraints on heavy machinery and skilled workers limit what can be done.

- **Improving health outcomes**

  An additional 8% expenditure over 2011 levels will be provided for medical equipment replacement, some refurbishment of facilities and additional medical supplies, primarily for the Provinces.

- **Improving law and order**

  Additional funding will be provided for 400 additional police recruits, 160 new officers for the Department of Correctional Institutional Services and 500 new recruits for Defence. A further K15 million is also being provided to the Police for LNG support.

- **2012 National Elections**

  Funding of K330.5 million will be provided for the 2012 National Elections including K150.5 million proposed to fund security operations in support of those elections.

The development budget

The development budget for 2012 is 13.1% higher than 2011, increasing to K4.4 billion. All areas for funding under the development budget are expected to increase in 2011. The large increase reflects the Government's commitment to investing in projects that will further development opportunities for Papua New Guineans. The largest expenditure is K180 million for the 2015 Pacific Games to be held in Port Moresby, to be spent on infrastructure, participant accommodation, and upgrading of existing sports facilities.

The development budget includes over K700 million for road improvements, including a substantial sum for the upgrade of the Highlands Highway.

Funding for the development budget (k millions)	2010 (actual)	2011 (revised)	2012 (projection)
Direct government funding – 'ordinary'	1,769.7	1,950.0	2,437.2
Infrastructure tax credits	18.0	60.0	130.0
Concessional loans	100.1	388.4	479.4
Commercial loans	0.0	0.0	0.0
Project grants for donors	1,391.1	1,526.1	1,390.5
Total	3,278.9	3,924.5	4,437.0

The medium term development plan

The *'Medium Term Development Plan 2011 – 2015'* is a revision of the *Medium Term Development Strategy 2005 – 2010* that has directed the structure of past budgets. The revised development plan continues the theme of guiding the allocation of funds from both the recurrent and development budgets into six priority areas. These priority areas, and the source and allocation of funding for 2012 may be summarised as follows:

Expenditure priority area	Government funding	Donor grant funding	Total
Transport	1,283.4	231.6	1,515.0
Law, order and justice	805.4	81.8	887.2
Health	820.5	175.6	996.1
Education	1,616.3	338.6	1,954.9
Utilities	177.6	23.4	201.0
Land	20.5	0.7	21.2
Total	4,723.7	851.7	5,575.4

A total of 53.4% of the development and recurrent budgets is directly targeted at the seven MTDP priority areas. The key areas of focus for donor grant funding in the expenditure priority areas relative to government funding are basic education, and health, as well as transport infrastructure.

Establishment of a sovereign wealth fund

The 2011 Budget outlined the commitment by the Government to the establishment of a sovereign wealth fund. This fund will have a single governance framework for the Government to manage a Stabilisation Fund and a Development Fund. The sovereign wealth fund will be onshore managed, offshore invested and onshore spent, and will integrate fully with the budget and fiscal framework.

Governance is a key concern of such funds and there is a clear commitment by Government to have governance, transparency, disclosure, accountability and asset management rules based on international best practice and the SWF Generally Accepted Principles and Practices. However, the details in these areas remain under development and preparation of deposit and withdrawal rules for the fund has yet to commence.

The sovereign wealth fund is to be established under Organic Law, with the Bill to be tabled on 7 December 2011, and with passage expected in the first quarter of 2012.

Proposed funds

The sovereign wealth fund will receive its funds from State revenues arising from the PNG LNG project and other mineral and petroleum projects. The revised plan for the sovereign wealth fund is to have two funds as follows:

- A Stabilization Fund to manage the impact of fluctuating mineral and petroleum revenues on the PNG economy and on the Budget. The purpose of this fund is to provide a ready source of funding that may be needed to counter the damaging effects of commodity price fluctuations and volatility;
- A Development Fund to provide a definite and ongoing funding source for the provision of development of key economic and social priorities in accordance with the development plans as determined by the Government from time to time.

LNG Financing

It is expected IPBC will require an additional K560 million to fund the State's share of the development costs of the PNG LNG project. Government has decided to fund the shortfall plus an additional K340 million as a contingency for the cost of any project overruns.

The total of K900 million is to be raised by the issue of domestic debt securities.

Taxation developments and amendments

There were a number of amendments to existing tax law that will generally take effect on 1 January 2012. These are either technical in nature, or have been introduced to reflect the rising costs of doing business in PNG.

Corporate and personal tax rates

There has been no change to the general corporate income tax rates of 30% for residents and 48% for non-residents. There has been one change to personal tax rates to increase the tax free threshold for resident taxpayers to K10,000 with effect from 1 July 2012.

From 1 January 2012 the rates for residents will continue to be as follows:

Taxable income	Tax thereon (k)	Rates on 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 July 2012 the rates for residents will be as follows:

Taxable income	Tax thereon (k)	Rates on tax on excess (%)
10,000	Nil	22
18,000	1,760	30
33,000	6,260	35
70,000	19,210	40
250,000	91,210	42

From 1 January 2012 the rates for non- residents will continue to be as follows:

Taxable income	Tax thereon (k)	Rates on 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

Concessional Taxation of Redundancy Payments

Concessional taxation treatment will apply to redundancy payments made under an approved redundancy scheme. The Commissioner General shall approve a redundancy scheme if he is satisfied that at least 30 employees are to be genuinely made redundant under that scheme or employees are genuinely made redundant from the public sector. The rate of tax applicable to a redundancy payment is 15% up to a cap determined by reference to years of services, Amounts in excess of the cap will be subject to tax at marginal rates. In addition, the Internal Revenue Commission will implement a simplified annual calculation for the taxation of termination payments and redundancy payments in excess of the cap.

2015 Pacific Games

Three amendments have been introduced to support the 2015 Pacific Games.

- Provide exemption from income tax for income of 2015 PNG Pacific Games Limited and for income arising from or in connection with participation in the games as an athlete or competitor.
- Provide a 150% deduction for donations of K500,000 or more made in respect of the 2015 Pacific Games to the PNG Sports Federation & Olympic Committee, the Pacific Games (2015) Authority or PNG 2015 Pacific Games Limited.
- Provide for zero-rating for GST purposes of supplies of goods and services to the PNG Sports Federation & Olympic Committee, the Pacific Games (2015) Authority or PNG 2015 Pacific Games Limited to the extent supplies relate exclusively to the 2015 Pacific Games. Similarly goods, other than cars, imported by these organisations will be exempt from import GST. In addition goods imported by natural persons are exempt from import GST where the goods are to be used by the person to train or compete in the games.

Abolition of Manufacturing Export Exemption

Under the current law income derived from the export sale of certain new manufactured goods is exempt from income tax. As PNG is a member of the World Trade Organisation it is bound by a wide range of international obligations. These include a requirement not to subside exports in any form. To ensure PNG meets this obligation the 2012 Budget provides for the abolition of the manufacturing export incentive from 1 January 2015 except in respect of goods which qualified for the incentive prior to 1 January 2015.

Property Unit Trusts

Some years ago the income tax law was amended to provide concessional taxation treatment in respect of the income of a property unit trust. To qualify for concessional treatment, the trust must be a resident of Papua New Guinea, and the unit trust's only undertaking must be investing funds of the trust. Funds invested must be not less than K10m, and no less than 80% of the funds must be invested in property in PNG.

Where the concessional tax treatment applies the trustee is taxed at 30% and distributions to unit holders are exempt from income tax. Although the taxation of property unit trusts is relatively favourable they have not been widely used as an investment vehicle in PNG. The Government has recognised this and amended the law to encourage the establishment of property unit trusts by:

- Relaxing the ownership rules for property unit trusts and by allowing property unit trusts to invest outside PNG.
- Reducing the rate of stamp duty on the transfer of property to a property unit trust from 5% to 2% where the transfer occurs within the two years from 1 January 2012 to 31 December 2014.

Banking – Community Service Obligations

Under the current law banks that invest in banking services in rural areas are entitled to a tax credit in respect of that investment. As there is a strong public policy benefit in the establishment of banking services in rural areas the 2012 Budget extends the concession for the roll-out of rural banking services until 31 December 2017. The amendment replaces the requirement to provide 52 free transactions per year with a cap on transaction fees of K1 per transaction which recognises the banking products currently provided and the high cost of providing rural services.

Taxation of resource projects

Two significant changes have been made that are relevant for taxpayers carrying on resource operations.

Rehabilitation costs

The majority of rehabilitation costs are incurred towards the end of the project life and after production from the project ceases. Under the existing law this means the tax deduction for these costs may be lost for the following reasons:

- There is no income from production against which to claim the deduction and the ring fencing rules prohibit the deduction being claimed against other income.
- The taxpayer or a related corporation may not have an interest in another project and there is in practice no deduction available under Division 10 in respect of the completed project.

The conclusion of the Bogan Review in 2000 in relation to this issue was contained in recommendation 64 which provided *"Abandonment and restoration expenses should be accumulated in a tax deductible provisioning system for new projects; current projects should remain subject to existing rules."*

The Government has recognised this is a major exception to providing an internationally competitive taxation regime for resource projects. Accordingly, the 2012 Budget will introduce provisions to allow deductions for costs incurred on project site rehabilitation and environmental clean-up costs allowing companies to utilise deductions by transferring them outside the project ring-fence. The Government considers that allowing mining and petroleum companies to carry forward losses arising from site restoration and to use them against other projects treats resource projects on a similar basis to non-resource projects. The amendment will operate on a prospective basis and will thus only apply to new projects.

Highlands Highway -Infrastructure Tax Credits

The special Highlands Highway infrastructure tax credit scheme of up to 1.25% of assessable income has been reinstated to the extent the expenditure on the Highlands Highway is an emergency repair. An emergency repair means " *an activity carried out to restore traffic flow following an event that has resulted in the closure or partial closure of the highway, including bypass or replacement of a section of the highway, replacement of culverts, construction of temporary bridges and removal and repair of major landslips".*

GST Amendments

Thresholds

There has been no change to the tax thresholds for GST since the introduction of GST in 1999. As a result more small businesses are required to lodge monthly GST returns than is considered necessary. To address this and restore the real value of GST collections the following tax thresholds have been amended:

- The GST compulsory registration threshold is increased from K100,000 to K250,000.
- The taxable period threshold has been increased from K250,000 to K625,000.
- The accounting basis threshold has been increased from K500,000 to K1,250,000

Distribution

Under the original GST law provinces retained the right to impose their own sales and services taxes. However, any province that did this would forfeit its right to their share of the GST revenue. As a result of a review of the distribution to the provinces the GST Revenue Distribution Act was repealed and this provision no longer applies. Consequently, the provinces are currently able to introduce their own sales taxes without foregoing GST revenue.

As the introduction of such taxes would be administratively complex, a burden for business and inflationary, the 2012 National Budget introduces an amendment to the Intergovernmental (Functions and Funding) Act to restore the provision under which provinces will forfeit their GST if they impose a sales or service tax.

Customs and excise amendments

The 2012 Budget contains a number of customs and excise amendments that will be effective from 1 January 2012. These may be summarised as follows:

- In the 2011 Budget the Government announced a modest Tariff Reduction Programme to commence on 1 January 2012 which is to be phased in over seven years. To further combat inflation the 2012 Budget extends the tariff reduction programme to include intermediate goods. The tariff rate on intermediate goods will fall from 15% to 10% in two intervals commencing on 1 January 2012. The tariff on items in the protective category will be reduced from 15% to 10% in 2018. Goods which will benefit from the reduced rates include meat, flour, pasta and other food, shoes fabric, carpet, cement plastic, glues, paper, books and bridges, reservoirs, tanks, barbed wire, iron and steel, other metals and metal products.

- The Government considers the real value of excise rates on alcohol and tobacco products has been eroded by inflation as the indexation of excise rates is capped at 5% per annum. In addition the Government considers manufactures have benefited from lower input costs due to the appreciation of the Kina against the US dollar. As a result of these factors the excise rates on alcohol and tobacco products will be increased by 15% from 1 January 2012.

- In accordance with PNG's obligations to the World Customs Organisation the schedules to the Customs Tariff Act and the Excise Tariff Act have been updated to reflect the 2012 harmonised classification system. The Government considers this will also facilitate the efficient movement of goods through PNG Customs.

Administrative amendments

The Internal Revenue Commission is introducing measures to improve the efficiency and modernisation of tax administration. This includes a new information technology system, the Standard Integrated Government Taxation System (SIGTAS). The 2012 Budget contains a number of administrative amendments to support the introduction of the new technology and improve service. These include allowing taxpayers to lodge returns and pay taxes at approved regional centres, permitting the Commissioner General to accept electronic payments, and administrative penalties for taxpayers who lodge incomplete returns.

The 2012 Budget also provides a substantial increase in funding for the Internal Revenue Commission. In particular, the 2012 Budget provides for recurrent funding of K44.3 million (an increase of K6.0 million or 16%) plus contributions from the Development Budget for further development of SIGTAS. The number of funded positions has also been increased from 365 in 2011 to 581 in 2012. Nevertheless the funding remains below levels provided by other countries in the region for tax administration and the Government will consider further increases once the benefits of additional resourcing are realised.

One of the measures foreshadowed in the 2011 Budget was a change to the payment of taxation refunds. The 2012 Budget papers note the existing law provides for the payment of tax refunds when taxes have been overpaid. The Internal Revenue Commission will introduce an administrative solution in 2012 to pay income tax refunds, using similar practices to the existing payment of GST refunds. Consequently, no change in the law is required.

Areas of policy development

The 2012 Budget papers foreshadow the intention of the Government to direct tax policy into a number of key reform areas. These may be summarised as follows:

- The Government will consider amendments to the Goods and Services Tax Act to provide a GST deferral scheme for taxpayers with a strong record of compliance. This recognises the fact that GST paid on import of goods is refundable on lodgement of the taxpayer's next GST return. The GST paid in these circumstances results in no net revenue, imposes an administrative burden on all parties and delays in issuing refunds represents an additional cost to business.

- The Government may consider a technical amendment to recognise a nil assessment as an assessment. This will put to rest any lingering uncertainty about the commencement of the limitation period and the consequent ability of the Internal Revenue Commission to issue an amended assessment. It is foreshadowed that returns which give rise to a nil assessment are likely to have a longer period of amendment.

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