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2015 National Budget

PwC Budget Commentary

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Cover photo: Reconstruction of Sir Hubert Murray Stadium, Port Moresby for the 2015 Pacific Games

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The Minister for Treasury, the Honourable Patrick Pruaitch, MP handed down the 2015 National Budget on 18 November 2014.

Executive summary

The theme of the 2015 Budget is "*Building our Nation and Providing Opportunities for our People*" and at K16.2 billion, represents Papua New Guinea's largest ever budget. The budget's aim is to support continued economic growth by focusing on high impact priority infrastructures, not only at the national level, but also at the provincial and district levels. The budget is designed to give each Papua New Guinean a fair opportunity to participate in the development of the nation.

Key components of the 2015 Budget include:

- The budget will be PNG's biggest ever at K16.2 billion and is in deficit of 4.4 cent of GDP, lower than the deficit of 5.9 per cent of GDP for 2014.
- Economic growth for 2014 is expected to be 8.4 per cent, increasing to 15.5 per cent in 2015, supported by the first full year of LNG production.
- Growth in the non-mining sector is expected to increase from 1.4 per cent in 2014 to 4 per cent in 2015.
- Inflation is expected to decrease to 5.5 per cent from 5.9 per cent in 2014 and ease over the medium term.
- The Budget's debt to GDP ratio for 2015 has fallen from the revised 2014 35.5 per cent to 27.8 per cent.
- Inflation is forecast to be 5.5 per cent in 2015, down from the 2014 estimate of 5.9 per cent.
- The 2015 Budget includes five major taxation policy measures as well as a number of minor taxation policy measures including technical amendments, designed to enhance compliance and strengthen the revenue base.

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	2013 actual	2014 est.	2015 proj	2016 proj	2017 proj	2018 proj	2019 proj
Real GDP Growth (%)	4.6	8.4	15.5	5.0	3.0	3.2	3.5
Non-mining GDP Growth (%)	4.9	1.4	4.0	4.0	3.8	3.9	4.0
Inflation (year average) (%)	5.0	5.9	5.5	5.0	5.0	5.0	5.0
Gold price (US$ per ounce)	1,411	1,273	1,277	1,298	1,311	1,330	1,370
Copper price (US$ per tonne)	7,331	6,904	6,947	7,038	7,144	7,163	7,198
Oil price (US$ per barrel)	104	95	90	93	94	93	92
Nickel (US$ per tonne)	15,030	17,255	18,000	18,000	18,000	18,000	18,000

Source: Department of Treasury

The Economy

Global

In 2015, the IMF expects the world economy to grow to 3.8 per cent, up from 3.4 per cent in 2014. This is mainly driven by the recovery in advanced economies supported by highly accommodative policy settings in the major advanced economies.

Domestic

In 2015 the economy is projected to grow sharply at 15.5 per cent driven by a full calendar year of gas production and supported by a rebound in the non-mining sectors. While this marks a record growth for PNG, it is a downward revision from the 2014 Budget forecast of 21.2 per cent due to the impact of increased PNG LNG production in 2014 and the delaying of peak production to 2016, which is expected to result in lower production in 2015.

The oil & gas sector is expected to grow at 156.3 per cent during the year as gas production steadies after increasing sharply in the previous year. Total non-mining GDP is expected to grow at 4 per cent rebounding from the slower 1.4 per cent in 2014. The pick-up in the non-mining sector is due to the rebound in the construction sector and expectations of renewed confidence in the growing environment of key cash crops. This is also supported by gradual improvements in global demand. Other factors also considered to boost activity in the non-mining sectors include the 2015 Pacific Games and the preparations for the 2018 Asia Pacific Economic Cooperation (APEC) meetings.

The post Liquefied Natural Gas (LNG) construction slowdown (with the exception of a contraction in construction sector) of activity in 2014 and rebound in 2015, is expected to be the trend depicted in the non-mining sectors including finance, real estate and business services and community social and personal services.

However, other sectors such as manufacturing, wholesale, retail trade, transport, storage and communication continued to grow in 2014, and are expected to do the same in 2015 while electricity, gas and water are expected to slow down.

Over the medium term (2016 to 2019) the PNG economy is expected to adjust to traditional drivers of the economy in the non-mining sectors, an aftermath of the boom and bust periods of the construction and production phase of the LNG project. This adjustment is expected to set in after the economy absorbs peak levels of LNG production in 2016.

The 2015 Budget

The 2015 Budget has been framed against a backdrop of moderate, albeit strengthening global economic growth and continued domestic growth underpinned by the commencement of LNG exports.

The 2015 Budget will seek to establish an appropriate balance between the continued need to encourage broad-based economic growth and the on-going need to support key Medium Term Development Plan (MTDP) enablers, such as education, health, infrastructure, and law & order, against a fairly weak revenue profile and the critical need for continued macroeconomic stability.

Total revenue in 2015 is projected to be K13,927.3 million, K1,252.5 million higher than the 2014 Budget estimate of K12,674.8 million. Total Expenditure and Net Lending is projected to be K16,199.1 million which is K1,095.7 million higher than the 2014 Budget estimate.

The expenditure versus projected revenue is expected to result in a budget deficit of K2,271.9 million or 4.4 per cent of GDP in 2015, down from 5.9 per cent for 2014.

The following table summarises the financing requirements arising as a result of the 2015 Budget and also includes historic information for reference purposes.

The budget (K millions)	2013 Actual	2014 Budget	2014 Revised	2015 Proj
Total revenue and grants	9,833.0	12,688.5	12,674.8	13,927.3
Total expenditure and net lending	12,505.0	15,041.5	15, 103.8	16,199.1
Budget balance	(2,672.4)	(2,353.0)	(2,429.0)	(2,271.9)
Budget Balance (% of GDP)	(7.8)	(5.9)	(5.9)	**(4.4)**
Debt to GDP (%)	**34.6**	**35.2**	**35.5**	**27.8**

Source: Department of Treasury

The estimated 4.4 per cent deficit results in a Debt to GDP ratio of 27.8 per cent (a debt stock of K14,260.6 million in 2015).

Financing the Budget

Financing of the 2015 Budget is to be achieved through a mixture of development partner loans, asset sales, and domestic financing through the issuance of Kina denominated securities. The foreign capital markets may also be tapped to support expenditure levels.

The 2015 Budget focuses on the following key principles:

- additional funding to the Education, Health and Infrastructure sectors and further devolution of funding and responsibilities to the lower levels of Government;
- understanding the need to balance increased expenditure with the need to retire debt to maintain the level of general government debt below 30 per cent of GDP by 2016 in line with the Fiscal Responsibility Act 2006;
- establishment of the Sovereign Wealth Fund and consolidation of mineral and petroleum assets; and
- maintaining the integrity of the tax system; as well as promoting a competitive, dynamic and diverse economy, through developing an environment that is conducive to strengthening the private sector.

The 2015 Budget has been framed under the Medium Term Fiscal Strategy 2013 – 2017. The strategy provides for a shift over time from non-priority expenditures, towards the MTDP enablers of infrastructure, health, education, and law and order. This shift is expected to see expenditure on these areas increase from their present 61.9 per cent share of the Budget (excluding the Provincial sector) to at least two thirds by 2017.

Set out below are the Budget forecasts to 2019, showing a deficit of 4.4 per cent in 2015 and then moving to a balanced budget in 2017. This drives a reduction in the debt to GDP to well under 30 per cent by 2017.

Budget Balance 2014-2019 (Kina million)	2014	2015	2016	2017	2018	2019
2015 Budget – estimated deficit	2,429.0	2,272.2	1,398.2	0	0	0
2015 Budget – deficit to GDP ratio	5.95	4.44	2.5	0	0	0
2015 Budget – debt to GDP ratio	35.5	27.8	28	26.6	25.2	23.6
MTFS 2013–2017 Budget Balance (per cent of GDP)	(5.9)	(1.6)	-0.6	0.1	0	0
MTFS 2013–2017 implied debt to GDP	34.6	28.9	27.5	25.4	23.1	23.1

Revenue and grants

Total revenue and grants is projected to be K13,927.3 million in 2015. This is an increase of K1,252.5 million or 9.9 per cent from the 2014 revised estimate of K12,674.8 million. The increase in total revenue and grants in 2015 is expected from tax revenues whilst non tax revenues are projected to decline.

A breakdown of the total budgeted revenue and grants for 2015 is set out below.

Revenue Summary (K millions)	2013 Actual	2014 Budget	2014 Revised	2014 Var Budget	2015 Budget	2015 Var. 20154 Revised
Total Revenue	**8,862.4**	**11,003.5**	**10,958.2**	**(45.3)**	**12,323.4**	**1,366.4**
Per cent of GDP	25.8%	27.8%	26.9%	**(0.1%)**	24.1%	2.7%
Taxation revenue*	**8,588.5**	**9,743.5**	**9,762.8**	**19.3**	**11,257.8**	**1,495.0**
Per cent of GDP	2.5%	24.6%	23.9%	**0.04%**	22.0%	2.9%
Non-taxation revenue	**273.9**	**1,260.0**	**1,195.5**	**(64.5)**	**1,065.6**	**(128.7)**
Per cent of GDP	0.8%	3.2%	2.9%	(0.1%)	2.1%	(0.3%)
Grants & ITC	**970.3**	**1,685.0**	**1,716.6**	**31.6**	**1,603.9**	**(112.7)**
Total revenue and grants	**9,832.7**	**12,688.5**	**12,674.8**	**(13.7)**	**13,927.3**	**1,252.5**

Source: Department of Treasury

* Comprises of taxes on income and profits (K8,352.3m), domestic taxes on goods and services (K2,043.4m) as well as taxes on international trade (K862.2m)

Tax Revenue

The composition of the tax revenue is as follows:

Taxation revenue 2013-2015 (K million)	2013 (Actual)	2014 (Budget)	2014 (Revised)	2014 Var Budget	2015 Budget	2015 Var. 2014 Revised
Personal income tax	2,808.4	2,852.0	3,076.5	224.5	3,303.1	226.6
Company tax	2,060.5	2,647.4	2,692.7	45.3	2,746.1	53.4
Dividend withholding tax	244.5	261.3	204.8	(56.5)	238.7	33.9
Mining and petroleum tax	666.7	1,001.8	766.5	(235.3)	1,749.2	982.7
Interest withholding tax	38.5	49.0	38.9	(10.1)	38.9	0
Other direct tax	118.1	125.0	162.5	37.5	128.3	(34.2)
Gaming tax	144.6	180.8	137.8	(43.0)	148.1	10.3
Taxes on income and profits	**6,081.30**	**7,117.20**	**7,079.60**	**(37.6)**	**8,352,3**	**1,272.70**

Source: Department of Treasury

Tax Revenue is projected at K11,257.8 million in 2015, an increase of K1,495.0 million or 15.3 per cent from the 2014 revised estimate of K9,762.8 million. The increase in Tax Revenue is expected from Taxes on Income and Profits, Domestic Taxes on Goods and Services and Taxes on International Trade.

Taxes on Income and Profits are projected at K8,352.3 million in 2015. This is an increase of K1,272.7 million or 18.0 per cent from the 2014 revised estimate of K7,079.6 million and is driven by a projected increase of K982.7 million in Mining and Petroleum Taxes (MPT). The bulk of the increase in MPT is expected from the gas exports, meanwhile non gas MPT is insignificant due to the projected decline in productions from the existing oil fields, as well as increased claims for Infrastructure Tax Credits (ITC) by companies operating in the mining and petroleum sector.

The 2014 revised estimate of K7,079.6 million for Taxes on Income Profits is a reduction of K37.6 million or 0.5 per cent from the 2014 Budget forecast of K7,117.2 million. The reduction is due to anticipated decline in Mining and Petroleum Tax, Dividend Withholding Tax, Interest Withholding Tax and Gaming Tax totalling K344.9 million. This will be offset by increases in Personal Income Tax, Company Tax and Other Direct Tax totalling K307.3 million. Mining and Petroleum Tax is anticipated to decline by K235.3 million and is reflective of weaker commodity prices, lower production expected from most major mines and expected increase in Infrastructure Tax Credits claims. A total ITC of K161.6 million is factored in the 2014 revised estimate.

Compared to the 2013 actual outcome of K6,081.3 million, the 2014 revised estimate is anticipated to be higher by K998.3 million or 16.4 per cent.

Expenditure

Total expenditure in 2015 is estimated to be K16,199.1 million, representing a K1,095.3 million or 7.2 per cent increase over the 2014 Revised Budget of K15,103.8 million. This level of expenditure will result in an estimated deficit of K2,272 million or 4.4 per cent of GDP.

The total expenditure and net lending for the years 2014 to 2018 are set out below.

Total Expenditure and Net Lending 2015 (K millions)	2014	2015	2016	2017	2018
Administration **	3,066.50	2,536.10	2,412.00	2,269.30	1,880.40
Debt Servicing (Administration)	751	1,130.00	1,130.00	1,130.00	
Economic	690	730.8	460.8	438.4	
Education	1,509.90	1,909.30	1,648.40	1,575.30	
Health	1,303.80	1,771.50	1,372.60	1,320.90	
Infrastructure	2,798.90	2,732.90	2,086.30	1,580.30	
Law and Order	1,181.40	1,578.40	1,326.80	1,595.70	
Provinces	3,582.90	3,670.50	3,437.20	3,318.90	
Social	219.6	139.5	57.3	54	56.7
Total	**15,104.00**	**16,199.10**	**15,707.80**	**16,101.90**	

Source: Department of Treasury

** Funding provided to Admininstration Sector agencies (such as Department of National Planning) for projects related to other sectors has, where appropriate, been reallocated to that sector. Accordingly the sector totals in this section may vary from other sector totals elsewhere in these Budget papers. Also, the untied Support Improvement Program (SIP) funding is included in Provinces.

The slower rate of growth in spending and the reduced deficit as a proportion of GDP are key elements of the Government's strategy for an orderly, graduated return to a balanced Budget by 2017.

The Government's broad spending priorities for the 2015 Budget are to:

- enhance opportunities for Papua New Guineans by building the foundation of the country in 2015 whilst recognising the need for macroeconomic stability by progressively returning to a balanced budget in 2017;

- further promote the efficient and effective implementation of major projects through improving designing, scoping, and implementation processes;
- increase direct funding to Provinces and Districts with more emphasis on monitoring, evaluation and compliance so as to achieve improved development outcomes;
- continue to support policy priorities in the Education, Health, Infrastructure, Agriculture and SME sectors; and
- continue to strengthen the Justice sector, resource Corrections Services, modernise Police and rebuild the Defence Force.

The 2015 total estimated expenditure of K16,199.1 million includes operational spending of K9,213.5 million (2014 Revised Budget K7,594 million) and capital expenditure is K6,985.5 million (2014 Revised Budget K7,510.0 million).

The Government recognises that while capital spending remains at historically high levels, the unprecedented growth achieved in 2014 cannot, and should not, be expected to be sustained on an ongoing basis. It is critical that, over time, major investment in capital infrastructure are accompanied by growth in operational budgets to ensure those investments are sustained and the expanded capacity is fully utilised to deliver improved services.

Financing & Debt Strategy

Total public debt is estimated to decrease from K14,488.4 million in 2014 to K14,260.4 million at the end of 2015. This decrease is attributed to the expected proceeds from the sale of equity in the PNG LNG project exceeding the projected 2015 budget deficit. In terms of the debt targets outlined in the Fiscal Responsibility Act, debt as a share of nominal GDP is projected to fall from 35.5 per cent in 2014 to 27.8 per cent in 2015. Going forward the debt to GDP ratio is expected to rise slightly in 2016 before falling again over the forward years. The ratio is projected to fall to 23.6 per cent in 2019.

The sources of the Central Government's financing is set out below.

2015 Central Government Financing (K millions)	2014 Balance (estimated)	2015 Repayment (estimated)	2015 Borrowing (estimated)	2015 Balance (estimated)	2015 Net Change
Domestic Debt	**10,768.1**	**8,618.6**	**7,579.8**	**9,729.3**	**(1,038.8)**
Treasury Bills	4,564.3	8,127.5	6,379.8	2,816.5	(1,747.8)
Inscribed Stock	6,203.8	491.1	1,200.0	6,912.8	709.0
External Debt	**3,720.3**	**75.8**	**986.8**	**4,531.3**	**811.0**
International Agencies	3,720.3	175.8	986.8	4,531.3	811.0
Commercial loans	0	0	0	0	0
Total	**14,488.40**	**8,794.40**	**8,566.60**	**14,260.60**	**(227.8)**
% of Nominal GSP	35.5%			27.8%	

Source: Department of Treasury

Changes to the Sovereign Wealth Fund

The Papua New Guinea Sovereign Wealth Fund (PNG SWF), to be established by the National Government, is designed to improve the effectiveness of Government spending and prudent management of public finances, especially the volatility of revenue flows from the mining and petroleum sector including the PNG LNG project.

In late 2013, the Government directed for the removal of the Development Fund and for the incorporation of a Savings Fund for the purpose of saving mineral and petroleum revenues. As a result, there will be a single governance framework for the PNG SWF, but this incorporates two funds – a Stabilisation Fund and a Savings Fund. The Stabilisation Fund will manage the impact of fluctuating mineral and petroleum revenues on the PNG Economy and on the Budget, while the Savings Fund is to provide a means of preserving the real value of extracted mineral and petroleum resources through long-term investment for the benefit of current and future generations of PNG citizens.

In August 2014, the Government approved the revised operational and institutional framework of the PNG SWF. The draft Bill to establish the PNG SWF under a new Organic Law was also endorsed by the Cabinet for gazettal. The primary aim is for this Organic Law to be introduced in the Parliament during earliest possible Parliament session, which is the session following 2015 National Budget session.

The overall objectives of the PNG SWF are to:

- support macroeconomic stabilisation;
- promote intergenerational equity; and
- support asset management in relation to financial assets accrued from natural resource revenue.

The PNG SWF will be integrated into the budget and fiscal policy framework. This will ensure effective government spending of mineral and petroleum revenues and facilitate fiscal transparency and oversight of public finance management by Parliament. The National Budget will be accorded priority funding and will be linked by the deposit and withdrawal rules of the PNG SWF. The policy is intended to help achieve macroeconomic and financial system stability.

From 2016 onwards, all mining and petroleum tax will be deposited into the Sovereign Wealth Fund instead of flowing directly to Waigani Public Accounts.

National Reform Agenda

The Government recognises the importance of on-going reform to enhancing outcomes for Papua New Guineans and has commenced two reviews fundamental to these objectives: the Competition Review and the Financial Sector Services Review.

These reviews, combined with the significant transparency and governance reforms currently being implemented, will arm the Government with a program for reform that will improve the environment for PNG businesses both private and public into the future.

The Government is also committed to public sector reform that will enhance the sector's efficiency and effectiveness. One of the planned reforms is that the Government is to undertake an amalgamation of Government Agencies with duplicate functions in 2015. In addition, efforts will be needed to implement the 'one position, one salary' principle, so as to eliminate an estimated several thousand 'ghost' employees in the public sector.

Public sector reform

Consultations with the various Departments, Agencies and Provinces regarding the alignment of their Plans to the PNG Vision 2050 continued to take place in 2014. Most of the work in relation to alignment of Plans by the various Agencies has been completed. The challenge now is to ensure that appropriate frameworks are put in place to monitor the outcomes of these strategies. The key elements for monitoring performance will include Agencies' planned outcomes, indicators, baseline data and targets.

Key elements of the Public Sector Reform program include the Service Improvement Program, Manpower & Payroll Audits, Rightsizing Initiative, Capacity Building and Institutional Strengthening Program, Equitable

Resource Allocations to Provincial Governments, District Treasury Roll-Out Program, Public Service Pay Fixation Agreement 2014 to 2016 and Superannuation Liabilities.

A Competitive and Dynamic Private Sector

The primary driver of growth is a competitive, dynamic and diverse private sector. The Government remains committed to developing an environment that is conducive to private sector development, through encouraging innovation and supporting competitive markets. As part of this ongoing effort and commitment, the Government has commenced two reviews fundamental to these objectives, the Consumer and Competition Framework Review and the Financial Sector Services Review. These reviews combined with the significant transparency and governance reforms currently being implemented will assist the Government to improve the environment for PNG businesses both private and public into the future.

The recently passed Public-Private Partnership (PPP) legislation will encourage a competitive bidding process for private sector participation in public infrastructure development. This will lead to more effective infrastructure development for boosting economic activity and alleviating poverty. In addition, the community service obligation and the on-lending policies which were approved recently by National Executive Council aims to apply competitive tension in the market dominated by public enterprises and create a level playing field for the private sector to enter the market.

Financial Services

The Government recognises that to start, consolidate or grow a business there is often a need for financial capital and that access to finance has not always been readily available for people in PNG, particularly for the SME sector. The Government remains committed to promoting the Financial Inclusion and Financial Literacy Strategy and facilitating access to finance through: promoting microfinance, facilitating secured lending through the Personal Properties Security Register (PPSR) and establishing the Centre for Excellence in Financial Inclusion (CEFI).

Key aspects of the Government's reform of the financial sector include a financial sector review, the implementation of the Personal Property Securities Act and the development of a national strategy improving the access to finance, including microfinance.

Improving Public Enterprise

The State has substantial interests in enterprises in PNG. Its interests consist of public enterprises and listed investments. Public enterprises are referred to as state owned enterprises (SOEs) and are engaged in the provision of essential services such as telecommunication, aviation, sea port, electricity, water, banking and postal services. The State owns majority stakes in SOEs and hence it is in a position to influence its management. State investments include commercial investments in private companies in the banking, mining, petroleum and agriculture sectors. The State owns minority stakes in these investments and is thus not in a position to influence the management to the same degree.

SOEs are critical in determining development outcomes by virtue of their central role in delivering utility and communication infrastructure. Only with disciplined, transparent governance frameworks and strong guiding policies can SOEs operate to efficiently deliver essential goods and services.

Public Enterprise and State Investment Performance

The State has twelve SOEs with the recent inclusion of the National Petroleum Company of PNG (NPCP), DataCo and Ok Tedi Mining Limited, however Ok Tedi's nationalisation is subject to legal challenge. These SOEs are vested with the Independent Public Business Corporation (IPBC) through its role as trustee and manager of the General Business Trust (GBT). The National Airport Corporation (NAC) was created after separating the policy, regulatory and commercial functions of the Department of Civil Aviation and the Government is currently considering whether the NAC should appropriately sit within the GBT.

The valuation of total General Business Trust Assets at 31 July 2014 was K7.7 billion. Of the total assets the value of investments in unlisted equities (predominantly state owned enterprises) was K5.7 billion and investment in listed equities was K749 million. This represents a total change in asset value of K1.45 billion largely due to the increase in asset value of NPCP and PNG Ports.

State Owned Enterprise Policy

The Government expects SOEs to operate as a successful business and to that end to be as profitable as comparable businesses not owned by the State. SOEs in PNG are caught in the dichotomy of aspiring to operate on commercial principles on the one hand and attempting to honour the State's primary responsibility of basic service delivery on the other.

The Government's SOE policy imperatives provide the broad guidance in managing and administering SOEs and enabling them to actively participate in the economy. The specific SOE policies include Community Services Obligation Policy (currently in the pilot stage), the Dividend Policy, the Guarantee and On-Lending Policy, and the Public Private Partnership Policy.

The on-lending, dividend and guarantee policies aim to ensure subsidies are not provided to SOEs through discounted equity finance, or cheap credit enhancement. Community service obligation is particularly important to ensure Papua New Guineans are able to access vital public infrastructure that they are unable to afford. It ensures that Parliament can transparently use tax payer money to provide services if appropriate.

Managing the Mining and Petroleum Assets

The Mining and Petroleum Sector plays an important role in the PNG economy and represents a significant portion of the State's asset holdings. The Government recognises the importance of effectively managing this sector in order to maximise benefits for the community and ensure resource revenues are optimally utilised to assist in meeting our Development objectives. Papua New Guinea is on the verge of transforming natural resources management and 2015 will see a culmination of policy reforms to enhance management and investment frameworks.

As is the case with SOEs, Mining and Petroleum Assets held by or on behalf of the State will be held within the Kumul structure ensuring consistent application of best practice governance arrangements and focussing management expertise on these valuable assets. The Government will influence the ongoing management of these assets through articulated policies carefully setting out the State's expectations.

A key element of managing the State's mining and petroleum assets is Papua New Guinea's participation in the Extractive Industries Transparency Initiative (EITI), a global initiative that promotes revenue transparency relating to extractive industries. The benefits derived from the EITI process include promoting good governance, fighting corruption, attracting investment and enhancing public debate and decision making through access to quality information.

As a candidate country, PNG will now move to produce its first report throughout 2015. In order to support the work of the Multi-Stakeholder Group in producing the first PNG EITI report the Government is establishing an EITI National Secretariat. The recruitment exercise to identify quality staff for this important function is progressing well. An announcement of the Head of the National secretariat is expected prior to the end of 2014.

State Equity Participation

The Mining Act, 1992 Review and the Tax Review will consider the fiscal regimes applying to the mining and petroleum sector in PNG. The findings of these reviews are expected to include recommendations around the level and terms on which the State should seek to participate in resource projects. The Government looks forward to considering these findings and distilling them into principles to guide state equity participation.

These principles will form the basis of a State Equity Participation policy allowing the state to consistently assess the risks and benefits of state equity participation against a robust framework. The Government will develop this policy throughout 2015.

Taxation developments and amendments

The 2015 Budget includes five major taxation policy measures, as well as a number of minor taxation policy measures including technical amendments, as part of the Government's ongoing effort to enhance compliance and strengthen the revenue base. These include:

- liabilities on directors in relation to Goods and Services Tax;
- a major compliance measure in relation to rental income;
- changes to the excise on tobacco;
- an update on non-tax fees and charges; and
- measures to enhance compliance for legally issued court orders.

In September 2013 the Government established a Tax Review Committee (TRC) to undertake a National Tax Review. The TRC is made up primarily of former Commissioner Generals and it is expected the TRC will hand down its report in 2015 in time for changes to be implemented in the 2016 National Budget.

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 also been no change to the personal tax rates that have applied from 1 July 2012.

From 1 January 2015 the rates for residents will continue to be as follows:

Taxable income (K)	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 2015 the rates for non- residents will continue to be as follows:

Taxable income (K)	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

Thin Capitalisation

In the 2013 Budget, the Government introduced thin capitalisation rules into the income tax law which applied to non-resource companies. These measures included the introduction of definitions including

"Debt", "Equity" and "Interest" to remove uncertainty to the definition of these terms for the purpose of calculating a debt to equity ratio for the thin capitalisation rules.

As the definitions were inserted into the general definition section they apply for all purposes of the Income Tax Act (the Act). One of the consequences of the new definitions is that a transaction can be characterised as both interest and as a dividend for income tax purposes.

To limit the unintended consequences of the definition of debt, the definition of interest will be repealed and the definitions of "debt" and "equity" will be included for the purposes of the thin capitalisation rules. The amendment will be consistent with the original intent of the introduction of these definitions in the 2013 Budget.

Research and Development

The Government provided an update on the status of research and development claims made prior to the repeal of the research and development concession in the 2014 Budget. The Government acknowledged there remains a need to address existing claims relating to research and development. Treasury and IRC have progressed the establishment of a working group to evaluate the legislation governing this incentive and to form the R&D Committee to evaluate outstanding claims. Part of this ongoing work is in conjunction with the National Tax Review.

Goods and Services Tax- Director Liability

There are no provisions in the Goods and Services Tax Act to hold company directors liable for failing to ensure their company complies with the GST obligations. The Goods and Services Tax Act is to be amended to extend the current director penalty regime for Salaries and Wages Tax obligations of a company to the GST obligations of the company.

The director penalty regime will make directors of companies, which fail to comply with GST obligations, personally liable for a penalty equal to the amount that the company ought to have remitted to the IRC.

The Budget papers noted the measure is set to 'level the playing field' in terms of sole traders, partners and company directors who use collected GST to fund their business or private activities rather than remitting the amounts as required.

Salary or Wages Tax- Director Liability

The current law holds directors of companies personally liable for failing to ensure their companies comply with its obligations under the SWT provisions. The income tax law is to be amended to enhance the implementation of the current director penalty regime by requiring that company directors are proactive in ensuring that amounts due by their company are reported by the due date. It will cause the directors who fail to ensure their company complies with salary or wages tax reporting obligation are, after 3 months, unable to obtain a remission of their director penalty by winding up the company except by causing the company to pay the amount due to the IRC.

Royalty Withholding Tax

Under the current practice the individual recipients of prescribed royalty payments are required to lodge tax returns declaring income in the nature of the royalty and any other income they may derive in a year of tax. The individual taxpayer is assessed on that income and the royalty withholding tax (RWT) withheld would be allowed as a credit against the tax liability established. The law is to be amended so that from 1 January 2015 the RWT will be a final tax.

The Budget papers noted the need to identify all recipients of the royalty payments and to break up the RWT to allow a credit to the individual recipients is not easy and the cost of administering this outweighs the benefits. The IRC does not have the capacity to require recipients of the royalties to lodge tax returns, and be assessed on that income to be eligible for a credit or refund on the RWT withheld. In addition, most individual recipients of prescribed royalty payments may require assistance to lodge their tax returns which may also be costly for them.

Under this amendment the recipients of prescribed royalty income will no longer need to lodge income tax returns. This will reduce the administrative burden on IRC and will free up resources for other critical revenue raising activities.

Stamp Duty – increased compliance for reporting rental income

The Stamp Duties Act is to be amended to implement a rental income compliance system. The amendment will effectively make it compulsory for landlords to provide their Taxation Identification Number (TIN) on lease documents as lease documents will not otherwise be stamped.

This amendment is intended to capture landlords who are currently leasing out their commercial and residential properties but are not declaring rental income derived to the IRC.

Excise Duties

The Government will increase excise indexation by a set 5 per cent biannually (10 per cent annually) from 1 December 2014.

The current excise regime on tobacco excise is adjusted six monthly in line with the Consumer Price Index (CPI). The increase in the excise is capped at 2.5 per cent. This means that if the CPI is above 2.5 per cent then a maximum of 2.5 per cent is applied. However, if the CPI is less than 2.5 per cent, then excise is adjusted to the CPI inflation rate.

The Government considers the change to the indexation arrangements applying to tobacco excise, to a set 5 per cent biannually, is necessary given the high health risks tobacco poses on people and the cost of treating tobacco related common diseases such as cancers, heart diseases, asthma and lung cancers is around K9.0 million per year. As such, the Government has chosen to recover part of the health cost through the increase of the excise duty on tobacco.

This measure to index excise by 5 per cent every six months will raise about K6.8 million in 2015 and K145.0 million over the next five years after accounting for the behavioural effects related to a reduction in smoking and substitution to illicit tobacco usage driven by this tax increase.

New Tariff Items

The Government will introduce new tariff items for other meats and edible offal that do not fall in the mechanically deboned meat (MDM) description from 1st January 2015. This amendment will avoid potential confusion in the identification of appropriate items and rates. The import duty rate of this tariff item will be consistent with other tariff items under heading 0207 except for MDM.

The Government will also introduce new tariff item for the misclassified cigarettes from 1st January 2015. Currently there are no descriptions in the PNG Customs Harmonised system to cater for cigarettes with filter containing tobacco other than dark fired tobacco (Pall Mall and other manufactured cigarettes), or cigarettes without filter containing tobacco and or other tobacco substitutes containing dark fired tobacco (spear or equivalent).

Currently these cigarettes are classified under tariff item 2402.20.10, attracting an excise duty of K249.06 per 1000 sticks (excise rate as at 1st June 2014). The item code 2402.20.10 caters for cigarettes of dark fired tobacco without filter such as “spear or mutrus”.

The amendment introduces new tariff items which will ensure that cigarettes are correctly classified under the new tariff item 2402.20.40 and 2402.20.50 reflecting their descriptions. The excise rate of these tariff items will be consistent with the current practice and from 1 January 2015, the excise rate of cigarettes will be

K249.06 per 1000 sticks indexed to change in consumer price index (CPI) over the previous 6 months between March 2014 and September 2014, which will be further indexed to the newly introduced 5 per cent nominal increase biannually for tobacco.

Enhancement of Compliance measures for convicted taxpayers

The Government will introduce tougher measures from 1 January 2015 to deal with convicted tax offenders who fail to comply with legally issued court orders. The current penalty for non-compliance with a court order ranges from K500 to K5000 which is the same as the penalty applying to the tax offence committed at the time of offence. This does not provide a stronger enforcement action to IRC if taxpayers refuse to comply with the court orders served on them and refuse to pay the court fines levied. This results in a significant number of disobedient taxpayers who continue to operate business without complying with their tax obligations.

The amendment will introduce a jail term penalty to a convicted tax offender who fails to comply with a court order and increase the monetary fines to provide different levels of fines for an individual and corporate taxpayer.

The imposition of a jail term is considered to be a greater deterrent than the same range of monetary fine in the event that a person fails to comply with a court order. The increase in the amount of court order fines and the different levels of fines for natural and corporate persons is to range from K1,000-K10,000 for a natural person and K5,000-K50,000 for a company.

Information Sharing

The secrecy provision of the income tax law does not allow for information to be transferred to Treasury for the purpose of forecasting and policy formulation or to the National Statistics Office (NSO) for the production of the National Accounts and other statistics. In order to undertake their roles, Treasury requires tax aggregate data on a certain sector or sub-sector basis to enable it to undertake forecasting work. Where the data relates to a sector or sub-sector with few entities then the information may have the tendency to identify the affairs of a specific taxpayer and its disclosure is prevented by the secrecy provisions.

The amendments to the secrecy provisions allow the IRC to provide relevant information to Treasury for the purposes of estimating or analysing taxation revenue or estimating the cost of policy proposals. Likewise, the NSO is expected to use information provided by the IRC in its production of the National Accounts and other statistics going forward.

Given the issue that the amendment is trying to address, and the importance of maintaining secrecy more generally, the amendment expressly excludes information that includes the name, contact details or tax identification number of the taxpayer. However, the provisions ensure that information if made available for the entities to effectively perform their functions, including both where there is a risk that aggregate information may identify particular taxpayers or where taxpayer specific information is required (for example when costing a proposal to provide a particular taxpayer or project with a special tax treatment).

Global Forum on Transparency and Exchange of Information on Tax Matters

The Government has announced its support for PNG's membership to the Global Forum on Transparency and Exchange of Information on Tax Matters.

The Global Forum on Transparency and Exchange of Information on Tax Matters is the largest such organisation with over 121 members countries including a number of developing countries. This global forum provides support to countries with limited administrative capacity, particularly in building their capacity to engage in exchange of information with other jurisdictions.

Membership to the Forum could be a precursor to signing up to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters which would provide the legal basis for PNG to exchange tax information with much broader range of jurisdictions and allow PNG to ask other jurisdictions to collect taxation debts on its behalf.

There will be no significant revenue implications as membership to the global forum only requires a nominal annual fee. Also, no legislative amendments would be required for the membership for the Forum.

Minor Technical and Administrative amendments

The 2015 Budget contains a number of minor technical amendments and these include the following:

- An amendment to correct wrong referencing in section 46CA(4).
- An amendment to correct inconsistencies in section 69K which deals with the 150% deduction for sponsorship of the 2015 Pacific Games.
- An amendment to update the definition of Central Bank to reflect the correct name as defined under the Central Banking Act 2000.
- An amendment to replace out dated references to the provisions of the Central Banking Act 2000 that do not exist anymore and update them with the correct legislative references.

Revenue Compliance Measures

In the 2014 Budget the Government announced that the Treasury and IRC had developed a strategy to improve compliance and collections based on the existing tax system. The main focus areas of additional revenue from improvements in compliance and IRC efficiencies in 2015 and 2016 are as listed below. To a large extent the themes remain similar to those of 2014.

- **Taxpayers Registration Compliance –** this will involve the IRC new registrations with the concurrent IRC and IPA registration and extra contemporary registrations. Part of this will also involve Anti Money Laundering (AML) Prudential Standard impacts and follow up for current non-compliant taxpayers.
- **Taxpayers Lodgement Compliance –** this measure will see firmer action on late lodgement with assigned penalties plus the identification and enforcement of currently registered taxpayers whom fail to submit lodgements.
- **Taxpayer Reporting Compliance** – the IRC will undertake substantially more verification and audit activities particular for GST Debit, Large and SME Business Income Tax, Foreign Contractors Withholding Tax rate and employee/contractor issues, Data Matching (including, provisional tax underestimation), Tax Identification Numbers (TIN) and rental contracts and GST credit verification.
- **Taxpayers Payment Compliance –** work to be undertaken within this measure will see IRC introducing approaches to deal with additional early collection and firmer action on debt and late payment penalties, GST Director Penalty Notices (new legislation to be enforced) and finalise objections and requests for amendment.
- **Efficiencies –** this involves other revenue improvement – including thorough improvements in case selection, improved data quality allowing earlier enforcement action, improved taxpayer awareness and knowledge/clarification of obligations etc.

The IRC strategy remains fairly constant and consistent with its 2013-2017 Corporate Plan Strategy and involves:

- the need to get its basic tax administration operations running smoothly and sustainably. An important part of this is to have sufficient staff in place to manage all core aspects of standard taxation administration;

- attraction and retention of the right calibre of staff required for the more classified professional and knowledge work roles and have the ability to deploy them to areas of greatest risk to revenue; and

- the need to modernise its antiquated core processing capability – IRC has taken the first steps towards this with the ongoing phased implementation of its new revenue accounting system (RASII) and other revenue raising initiative capital expenditures.

Future Development of taxation policy

Papua New Guinea Taxation Review

The Taxation Review Committee was formally launched in September 2013 and the Government is pleased with the progress of the work undertaken. Some of the major work undertaken since the Review was launched includes:

- **Blue Sky consultation** – Over 45 submissions were received in response to the Committee's general call for submissions in December 2013. This provided stakeholders with an opportunity to raise any issue of interest to be considered as part of the Review.

- **Diagnostic Reviews –** The Review has commissioned a number of diagnostic reviews. This has included a diagnostic review of PNG's direct taxation system, as well diagnostic reviews of PNG's two revenue collection agencies. These two tax administration reviews are expected to be concluded shortly.

- **Regional Consultations**–The Tax Review Committee has to date held open forums in Lae, Kokopo and Madang. These forums were well attended by over 100 people in each event. Further regional consultations will follow.

- **Tax Symposium** – In collaboration with the National Research Institute (NRI), a tax symposium was staged in Port Moresby at the end of May this year. The symposium provided an opportunity for local and international academics to present and seek feedback on draft papers on various tax issues. The NRI's engagement in the Review process has been ongoing.

- **Release of Issues Papers** – To date three Issues Papers have been released by the Committee for public consultation – these are on Mining and Petroleum Taxation, Corporate and International Taxation as well as a Broad Directions Issues Paper. Three additional Issues Papers will be released before 31 December 2014.

The Review will continue to consult and engage widely with stakeholders. It is anticipated that the Review will continue to release Issues Papers on various areas of taxation until the first quarter of 2015. This will include a further three Issues Papers released by the end of 2014. These Issues Papers are intended to promote targeted discussion and debate.

This will be followed by further consultation upon release of a single final draft report, which will put forward the Committee's proposed recommendations.

In recognition of the level of interest in the Review and the value of the consultation processes to date, the Government has agreed to extend the timeline for the Review by three months, until 31 July 2015.

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