

Papua New Guinea 2016 National Budget



PwC Budget Commentary

*A budget promising to be
“responsible, affordable and yet
responsive to the needs of the
country”*

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The Minister for Treasury, the Honourable Patrick Prauitch, MP handed down the 2016 National Budget on 3 November 2015.

Executive summary

The theme of the 2016 National Budget is “*Supporting Economic Growth through Fiscal Discipline*” and is set at K14,762.6 million against projected revenue of K12,650.1 million.

The 2016 Budget is expected to result in a net borrowing position of 3.8 per cent of GDP and a debt-to-GDP ratio of 35.8 per cent in 2016. The level of net borrowing is projected to gradually reduce, to reach a surplus in 2020.

The Budget is set within the Government’s overarching development frameworks, including the Vision 2050, the Development Strategic Plan 2030, Medium Term Fiscal Strategy (MTFS) and Medium Term Development Plan II. It has been framed amidst a weak global economy and slower economic growth that has been constrained by the current El Nino drought and low commodity prices.

Key components of the 2016 Budget include:

- A reduction in spending of K613.4 million from the 2015 revised budget, however key Government priorities (eg. education and health) will not be affected.
- The PNG economy is projected to grow at 4.3 per cent in 2016 driven by a rebound in the mining and non-mining sectors.
- Inflation is expected to increase to around 5.7 per cent, reflective of the expected improvement in the global economy and the pickup in commodity prices.
- PNG’s current account balance has recorded a significant surplus of K7,154 million in the first half of 2015 compared to a deficit of K518.0 million recorded over the same period in 2014.
- In 2016, Total Revenue is projected at K12,650.1 million, K12.2 million above the 2015 Supplementary Budget estimate.
- Total expenditure in 2016 is estimated to be K14,762.6 million, a reduction of K367.2 million, or 2.4 per cent from the 2015 Supplementary Budget of K15,129.7 million.
- In 2016, the current account balance is expected to be a surplus of K15,955 million or 28.9 per cent of GDP compared to an estimated surplus of K14,665.7 million or 28.7 per cent of GDP in 2015.
- The 2016 Budget includes a potentially significant amendment from a taxation viewpoint – the introduction of a facility for an Import GST deferral scheme – a measure PwC has been suggesting for several years. There are also a number of technical amendments to the tax legislation.

2015 Budget Update

The 2015 Budget has been significantly impacted by a sharp fall in commodity prices. Downward revisions to tax and non-tax revenue receipts, particularly from the Mining and Petroleum sector, have required a firm policy response. The focus has been on reducing expenditure and finding additional revenues to maintain net lending close to the 2015 Budget forecast.

Total revenue for 2015 is estimated to be K12,637.9 million, a decrease of K1,455.6 million (or 10.3 per cent) from the 2015 Budget projection of K14,093.5 million. Total expenditure (expenses plus the gross investment in non-financial assets) in 2015 is anticipated to be K15,129.7 million, K1,377.1 million lower than the 2015 Budget estimate.

The fall in revenue and expenditure has led to a slight increase in the level of net borrowing and the debt level in 2015. These result in an expected net borrowing of K2,491.8 million (or 4.9 per cent of GDP) in 2015. The debt-to-GDP ratio is expected to be 34.7 per cent of GDP in 2015, which is below the ceiling of 35 per cent as set out in the Fiscal Responsibility Act.

These figures reflect that Total Government expenditure and revenue projections for the 2015 Budget are now based on the Government Finance Statistics (GFS) 2014 classification. It also reflects the 2015 Supplementary Budget, which includes reductions in appropriations of K1,376.9 million, and additional Revenue Measures of K1,101.6 million.

2016 Budget – 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	2014 actual	2015 est.	2016 proj	2017 proj	2018 proj	2019 proj	2020 proj
Real GDP Growth (%)	13.3	9.9	4.3	2.4	2.0	2.7	2.6
Non-mining GDP Growth (%)	1.2	2.4	3.4	3.6	3.6	3.6	3.3
Inflation (year average) (%)	5.2	5.1	5.7	5.0	5.0	5.0	5.0
Exchange Rate (Real Exchange Rate Index 2007=100)	153.2	140.9	140.2	143.6	147.0	150.6	154.4
Interest rate (Kina Rate Facility)	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Gold price (US\$ per ounce)	1,266	1,176	1,157	1,194	1,200	1,225	1,249
Copper price (US\$ per tonne)	6,864	5,676	5,149	5,184	5,218	5,249	5,286
Oil price (US\$ per barrel)	93	52	54	60	65	68	70
Nickel (US\$ per tonne)	16,847	12,507	10,302	10,404	10,439	10,439	10,439
Cobalt (US\$ per tonne)	30,724	29,500	30,000	30,000	30,000	30,000	30,000

Source: Department of Treasury

The Economy

Global

The global economy has weakened in 2015. According to the 2015 October World Economic Outlook (WEO) report published by the International Monetary Fund (IMF), the global economy is projected to grow by 3.1 per cent in 2015. This is a downward revision of 0.2 percentage points from the July WEO projection of 3.3 per cent and a downward revision of 0.4 percentage points from the April WEO of 3.5 per cent. The downward revision to the global economic outlook from the July WEO is driven by a further slowdown in emerging market economies and a weaker recovery in advanced economies.

The slowdown in emerging market economies is reflective of a combination of weaker growth in oil exporting economies, the easing Chinese economy and a weaker outlook for exporters of other commodities, including those in Latin America.

In 2016, the global economy is projected to improve, growing by 3.6 per cent with advanced economies in particular the United States, Japan and the Euro area expected to strengthen further. Emerging and developing economies such as Brazil, Russia, India and some other economies in Latin America and the Middle East are expected to improve. China's growth is projected to continue to ease.

Domestic

The PNG economy is expected to grow at 9.9 per cent in 2015, a downward revision from the MYEFO estimate of 11.0 per cent and the 2015 Budget estimate of 15.5 per cent. This is due to the contraction in the mining sector and lower than anticipated growth in other sectors of the economy – a result of low commodity prices, the adverse effects of the drought, and the shut-down of the Ok Tedi mine in July 2015.

Despite these setbacks, the ramp up of a full year of LNG production in 2015 has been the main driver of growth in 2015. The oil and gas sector is estimated to grow at 67.9 per cent in 2015 after historic growth of 1,101.5 per cent in 2014 with the commencement of first LNG production in May 2014, several months ahead of schedule.

The agriculture, forestry and fisheries sectors continue to be impacted by low commodity prices, old-aged trees, crop diseases, unfavourable weather conditions and poor market infrastructure. The sector is expected to grow at 2.1 per cent in 2015, a downgrade from the MYEFO estimate of 3.2 per cent and the 2015 Budget estimate of 3.6 per cent. The downgrade is due to low commodity prices and the prolonged drought, forcing the government to provide relief assistance.

The manufacturing sector is expected to grow at 2.5 per cent in 2015, a downward revision from the 4.5 per cent growth estimated at MYEFO and the Budget. The downgrade is due to the temporary closure of a major oil refinery in Port Moresby for a period of around six months in 2015. In addition, the depreciating Kina exchange rate and the lack of foreign exchange at the Bank of PNG to facilitate import demand are affecting businesses.

The electricity, gas and water sector is expected to grow at 6.0 per cent in 2015, an upward revision from the 5.0 per cent growth estimated at MYEFO. The upward revision is due to the government's ongoing investment in PNG Power Limited. Some of these investments include the purchase of two 26 Megawatts (MW) power generators in 2014.

Exchange Rate Developments

PNG's Trade Weighted Index (TWI) remains subdued with a rise in the index in the second half of the year partially offsetting a sharp decline in the first half of the year. The decline in the TWI was driven by the depreciation of the Kina against the US dollar. The Kina depreciated by 10.2 per cent against the US dollar over the year to October.

The PNG Kina also depreciated against other key trading currencies including: the Singapore Dollar (-2.7 per cent), Chinese Renminbi (-8.8 per cent), Hong Kong Dollar (-10.2 per cent), and Philippines Peso (-8.6 per cent), while it appreciated against the Australian Dollar (7.9 per cent), Japanese Yen (5.4 per cent), New Zealand Dollar (7.1 per cent), Malaysian Ringgit (4.5 per cent), and the Euro (9.2 per cent).

The depreciation of the Kina against most of PNG's major trading currencies is due to ongoing strengthening of the US dollar over the first ten months of 2015 as well as the persistent mismatch in supply and demand for foreign currency within the PNG Foreign Exchange Market. According to the BPNG September Monetary Policy Statement (MPS), less LNG related inflows including lower receipts from LNG exports and accelerated asset depreciation also explains this depreciation. The appreciation of the Kina against the Australian dollar was attributed to cross currency movements as the Australian dollar weakened against a stronger US dollar on the back of weaker iron ore prices and reduced interest rate differentials between the US and Australia.

Any further depreciation in the Kina against the currencies of major trading partners is likely to flow through to higher import prices.

The 2016 Budget

The 2016 Budget has been framed against a relatively weak world economic environment still adjusting to a lower commodity prices outlook and lower than anticipated growth within the domestic economy due in part to the effects of drought in many parts of the country.

Total revenue in 2016 is projected to be K12,650.1 million, K12.2 million higher than the 2015 Supplementary Budget estimate. This slight increase, which is attributed to tax revenue and grants, more than offsets the decrease in other revenue.

In 2016, total expenditure is projected to be K14,762.6 million, which is K367.2 million lower than the 2015 Supplementary Budget estimate of K15,129.7 million. The 2016 Budget strikes a balance between the need to maintain broad-based economic growth through funding key priority expenditures, such as the 2018 APEC summit and the 2017 National Elections, against a fairly weak revenue profile.

Overall, all this is expected to result in net borrowing of K2,112.5 million or 3.8 per cent of GDP in 2016 (see Table 1), a reduction from 4.9 per cent for 2015.

The budget (Kina millions)	2014 Actual	2015 Budget	2015 Revised	2016 Budget
Revenue	11,874.9	14,093.5	12,637.9	12,650.1
Expenditure	15,453.9	16,506.8	15,129.7	14,762.6
Net Borrowing (-)	-3,579.0	-2,413.3	-2,491.8	-2,112.5
% of GDP	-8.3%	-4.7%	-4.9%	-3.8%
Debt to GDP (%)	35.5%	27.8%	34.7%	35.8%

Source: Department of Treasury

The estimated 3.8 per cent deficit results in a Debt to GDP ratio of 35.8 per cent (a debt stock of K14,762.6 million in 2016).

Financing the Budget

Central Government debt continued to increase in 2015 as the Government accessed the domestic and international markets to fund its National Budget. Interest rates were largely unchanged over 2015, despite a noticeable reduction in the demand for inscribed stock over the latter half of the year. Demand remained strong for the Government's Treasury Bills and Central Bank Bills throughout the year.

Set out below are the Budget forecasts to 2020, showing a deficit of 3.8 per cent in 2016 and then moving to a balanced budget in 2020.

Budget Balance 2015 – 2020 (Kina millions)	2014	2015	2016	2017	2018	2019	2020
2016 Budget Net Borrowing (-) / Net Lending (+)	-3,579.0	-2,491.8	-2,112.5	-1,346.2	-898.7	-133.6	582.7
Net Borrowing (-) as % of GDP	-8.3%	-4.9%	-3.8%	-2.3%	-1.5%	-0.2%	0.8%
Debt as % of GDP	35.5%	34.7%	35.8%	35.9%	35.6%	33.7%	30.9%
MTFS 2013–2017 Budget Balance (per cent of GDP)	-5.9%	-1.6%	-0.6%	0.1%	0	0	0
MTFS 2013–2017 implied debt to GDP	34.6%	28.9%	27.5%	25.4%			

Source: Department of Treasury

Sovereign Bond

Towards the end of 2015 and early 2016 the Government will consider undertaking an offshore debt raising (i.e. sovereign bond) that will be used to buy back stock from investors with the purpose of restructuring the domestic debt portfolio. Restructuring of the portfolio, which is expected to occur over the next five years, will reduce the current high level of Treasury Bills to more prudent levels. The Government will engage market participants in the coming months to determine the best way to achieve this task in a systematic and efficient manner, using a combination of buybacks, switches and reverse auctions.

Such a move by the Government will provide the following benefits:

- a reduction in the Government's heavy reliance on the use of short term debt (Treasury Bills) to finance the Budget deficit. This will lead to a decrease in the refinancing risk and increase in the average term to maturity;
- a consolidation of the current twenty-three Inscribed Stock (Treasury Bonds) lines into larger and more liquid lines of bonds. Larger lines would potentially increase the number of investors in each individual line, and promote secondary market transactions;
- rejuvenate the primary domestic debt market by freeing up funds ready for reinvestment back into government securities; and
- a reduction in domestic interest expenses that will partially offset the interest costs associated with a Sovereign Bond.

During 2016 the Government will examine ways of broadening the range of financing tools. It will also introduce measures and improvements that will lead to greater efficiencies and functionality in the primary and secondary securities markets.

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

2016 Central Government Financing (Kina millions)	2015 Balance (estimated)	2016 Repayment (estimated)	2016 Borrowing (estimated)	2016 Balance (estimated)	2016 Net Change
Domestic Debt	13,863.4	9,652.0	8,150.0	12,361.4	-1,502.0
Treasury Bills	6,667.2	9,188.0	7,250.0	4,729.2	-1,938.0
Inscribed Stock	7,196.3	464.0	900.0	7,632.3	436.0
External Debt	3,852.2	198.5	3,730.1	7,383.8	3,531.6
International Agencies	3,852.2	198.5	930.1	4,583.8	731.6
Foreign Bonds (a)	0	0	2,800.0	2,800.0	2,800.0
Total	17,715.6	9,850.5	11,880.1	19,745.2	2,029.6
% of Nominal GSP				35.8%	

Source: Department of Treasury

Revenue and grants

In 2016, Total Revenue is projected at K12,650.1 million, K12.2 million above the 2015 Supplementary Budget estimate. The increase is attributable to Tax Revenue and Grants, which more than offset a decrease in Other Revenue. Project Grants support from Donors are expected to be lower in 2016.

Total Supplementary Budget Revenue is expected to be lower by K1,504.7 million compared to the original 2015 Budget projection and this reflects a lower Tax Revenue in spite of the additional Supplementary Budget revenue measures of K1,106.6.0 million. A breakdown of the total budgeted revenue and grants for 2016 is set out below.

Total Revenue and Grants (Kina million)	2014 Actual	2015 Budget	2015 Supp. Budget	2016 Budget	Variation
Tax Revenue	10,232.1	11,681.9	10,093.3	10,525.6	432.4
% of GDP	24	23	21	20.3	0.0
Grants	867.5	1,396.1	1,396.1	1,513.2	117.1
% of GDP	2.0	2.7	2.9	2.9	0.0
Other Revenue	775.3	1,064.6	1,148.5	611.3	-537.2
% of GDP	1.8	2.1	2.4	1.2	0.0
Total Revenue	11,874.9	14,142.6	12,637.9	12,650.1	12.2
% of GDP	27	28	27	24.3	0.0

Source: Department of Treasury

Tax Revenue

Tax Revenue is projected at K10,525.6 million in 2016, an increase of K432.4 million from the 2015 Supplementary Budget estimate. The increase is from Taxes on Income Profits and Capital Gain and Taxes on Goods and Services, which are projected to increase by K239.9 million and K196.3 million respectively and offset a decrease in Taxes on International Trade.

Total Supplementary Budget Tax Revenue is estimated to be lower by K1,588.5 million than the 2015 Budget projection. This is a result of lower Taxes on Income, Profits and Capital Gain and to a lesser extent Taxes on Goods and Services. These are expected to offset a small increase in Taxes on International Trade and Taxes on Payroll and Workforce. The composition of the tax revenue is as follows:

Taxation revenue 2014-2016 (Kina millions)	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
Taxes on Income, Profit & Capital Gain	6,778.9	8,110.6	6,524.5	6,764.4	239.9
Taxes on Payroll & Workforce	14.6	7.5	15.6	17.0	1.4
Taxes on Property	0.0	0.0	0.0	0.0	0.0
Taxes on Goods & Services	2,883.6	2,998.9	2,941.1	3,137.4	196.3
Taxes on International Trade & Transactions	555.0	564.8	612.1	606.8	-5.3
Other Taxes	0.0	0.0	0.0	0.0	0.0
Total Tax Revenue	10,232.1	11,681.8	10,093.3	10,525.6	432.4

Source: Department of Treasury

Taxes on Income, Profits and Capital Gains

The increase in Taxes on Income, Profits and Capital Gain in 2016 is expected to be primarily driven by higher Personal Income Tax and Company Tax and to a lesser extent Dividend Withholding Tax.

Personal Income Tax and Company Tax receipts are projected to increase by K233.3 million and K170.6 million respectively in 2016. The increases are expected from a positive growth in the domestic economy and supported by additional revenue raising efforts expected from Internal Revenue Commission (IRC) and Customs. The IRC is expected to collect additional K350.0 million and Customs to collect additional K50.0 million in 2016.

Mining and Petroleum Tax (MPT) projection is significantly lower at K259.8 million in 2016, reflective of the low commodity prices. This has significantly reduced MPT in 2015, resulting in an estimate of K300.0 million in the 2015 Supplementary Budget compared to the K1,749.6 million projected in the 2015 Budget.

Of the K259.8 million forecast for 2016, 50 per cent will be transferred to SWF Stabilisation Fund.

Taxation revenue 2014-2016 (Kina millions)	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
Taxes on Income, Profits and Capital Gains	6,778.9	8,110.6	6,524.5	6,764.4	239.9
Personal income tax	3,195.1	3,303.1	3,278.4	3,511.7	233.3
Company tax	2,522.4	2,746.1	2,622.5	2,793.2	170.6
Mining and petroleum tax	794.2	1749.2	300.0	129.9*	-170.1
Royalties Tax	22.4	21.9	24.0	26.0	2.0
Management Tax	14.9	10.8	30.2	17.4	-12.9
Dividend Withholding Tax	186.1	238.7	216.0	232.7	16.8
Interest Withholding Tax	43.1	38.9	52.7	52.7	0.0
Tax Related Court Fines	0.0	0.0	0.0	0.0	0.0
Sundry IRC Taxes & Income	0.7	2.0	0.7	0.8	0.1

Source: Department of Treasury

* 50 per cent of MPT is shown under Tax Revenue and 50 per cent is shown in SWF receipts under Grants from Other General Government Units.

Taxes on Payroll and Workforce

Taxes on Payroll and Workforce are projected to be K17.0 million in 2016, from the Training Levy, an increase of K1.4 million from the 2015 Supplementary Budget estimate of K15.6 million.

Taxes on Payroll & Workforce (Kina millions)	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
Training Levy	14.6	6.9	15.6	17.0	1.4
Total	14.6	6.9	15.6	17.0	1.4

Source: Department of Treasury

Taxes on Goods and Services

Taxes on Goods and Services are projected at K3,137.4 million in 2016, an increase of K196.3 million from the 2015 Supplementary Budget estimate of K2,941.1 million. The increase is expected from Excise Duty and Good and Services Tax (GST) and to a lesser extent Import Excise and other Taxes on Goods and Services.

Excise Duty is projected to increase by K78.6 million from the 2015 Supplementary Budget estimate. The increase in Excise Duty is reflective of a return to normal production from a domestic refinery and additional collection efforts by Customs of K50 million.

GST includes all collections from ports and provinces and net of refunds. In 2016, GST is projected to increase by K94.2 million from the 2015 Supplementary Budget estimate. The increase is due to positive growth in the domestic economy. GST transfers to provinces would result in net GST to the Waigani Public Account projected for 2016 at K1,218.0 million. Import Excise is projected to increase by K13.4 million from the 2015 Supplementary Budget estimate. The increase is due to positive growth in the domestic economy.

Taxes on Goods & Services	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
Taxes on Goods & Services	2,883.8	2,998.8	2,941.1	3,137.5	196.4
GST(1)	1,668.8	1,789.8	1,664.8	1,759.0	94.2
Stamp Duties	137.3	68.8	110.0	117.8	7.8
Excise Duty	638.6	663.8	656.2	734.8	78.6
Import Excise	250.6	297.3	303.3	316.7	13.4
Bookmakers' Turnover Tax	12.8	10.3	13.6	14.9	1.3
Gaming Machine Turnover Tax	158.1	148.1	169.9	176.5	6.6
Departure Tax	5.8	6.9	6.2	6.8	0.6
Motor Vehicle Registration	7.1	-	7.1	6.2	-0.9
Commercial Vehicle Licences	1.2	1.0	1.2	1.0	-0.2
Other taxes on use of goods and on permission to use goods or perform activities	1.0	-	1.0	0.9	-0.1
Other taxes on goods and services	2.5	12.8	7.8	2.9	-4.9

Grants

Grants for 2016 are projected at K1,513.2 million, an increase of K117.1 million from the 2015 Supplementary Budget estimate of K1,396.1 million. While donor grants are projected to be K1,134.1 million, which is slightly lower than the 2015 Supplementary Budget estimate, an increase in overall grants is expected from the category Grant from Other General Government Units, and reflects the contribution from SWF receipts of K379.1 million.

Of the donor projection of K1,134.1 million, K998.8 million or 88 per cent are grants from Foreign Governments and K135.3 million or 12 per cent are grants from International Organisations.

Grants	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
GRANTS	867.5	1396.1	1396.1	1513.2	117.1
From Foreign Governments	767.3	1234.9	1234.9	998.8	-236.2
From International Organisations	100.2	161.2	161.2	135.3	-25.8
From Other General Government Units	0.0	0.0	0.0	379.1	379.1

Source: Department of Treasury

Other revenue

In 2016, Other Revenue is projected at K611.3 million, comprising of Property Income at K516.9 million, Sales of Goods and Services at K85.4 million, Fines, Penalties and Profits at K0.8 million and Transfers Not Elsewhere Classified at K8.2 million.

The projected K611.3 million for Other Revenue is a decrease of K537.2 million from the 2015 Supplementary Budget estimate. The decrease is reflective of a lower projection for Property Income, mainly mining and petroleum dividends, dividends from statutory authorities and dividends from state owned enterprises and other state entities. These have offset the slight increase in the projection for Rents, in particular land lease rentals.

Sales of Goods and Services, mainly Departmental Fees and Charges, are projected at K85.4 million, an increase of K15.9 million from the 2015 revised estimate of K69.5 million. The increase is mainly from higher projections for incidental sales by non-market establishment, specifically migration fees projected at K50.0 million. Other small increases are from Transfers not elsewhere classified, an increase of K5.7 million.

Including recoveries of fees and charges and asset sales, the overall projection for Departmental Fees and Charges is K205.3 million for 2016

Other Revenue	2014 (Actual)	2015 (Budget)	2015 Supp. Budget	2016 Budget	Variation
OTHER REVENUE	775.3	1064.6	1148.5	611.3	-537.2
Property Income	696.0	803.5	1074.7	516.9	-557.7
Interest	0.0	4.0	4.0	4.0	0.0
Dividends	665.8	778.5	1045.0	480.0	-565.0
Mining, Petroleum and Gas Dividends	507.2	698.5	0.0	0.0	0.0
Dividends from Statutory Authorities	152.0	55.0	220	70	-150
Shares in Private Enterprises	6.6	0.0	0.0	0.0	0.0
Dividends from State Owned Enterprises	0.0	0.0	370.0	110.0	-260.0
Other Dividends	0.0	25.0	450	300	-150
Rent	30.2	21.0	25.7	32.9	7.3
Sales of goods and services	75.0	47.8	69.5	85.4	15.9
Sales by market establishments	0.0	0.0	0.0	0.0	0.0
Administrative fees	31.0	38.9	25.5	31.1	5.7
Incidental sales by nonmarket establishments	44.1	8.9	44.1	54.3	10.2
Imputed sales of goods and services	0.0	0.0	0.0	0.0	0.0
Fines, penalties, and forfeits	1.9	2.2	1.9	0.8	-1.1
Transfers not elsewhere classified	2.5	211.1	2.5	8.2	5.7

Source: Department of Treasury

Expenditure

Total expenditure in 2016 is estimated to be K14,762.6 million, of which K12,698.3 million is Government funded, K922.0 million is loans and the remainder is donor funded. The total expenditure represents a K367.2 million, or 2.4 per cent reduction over the 2015 Revised Budget of K15,129.7 million.

The 2016 expenditure is lower than previous years and a clear prioritisation of expenditures guided the formulation of the 2016 Budget. The following are the main Budget priorities:

- hosting the African, Caribbean and Pacific (ACP) Group of States meeting in 2016, facilitating the 2017 National Elections and hosting the APEC Summit in 2018;
- placing more emphasis on monitoring, evaluation and compliance so as to achieve improved development outcomes;
- assisting our large rural population through adequate and targeted drought assistance;
- continuing to support policy priorities in the education, health, infrastructure, agriculture and Small and Medium-sized Enterprise (SME) sectors; and
- further promoting the efficient and effective implementation of major projects through improving design, scoping and implementation processes.

The Government will take further steps in 2016 to address inefficiencies in the public sector. This includes measures to be taken on freezing staffing structures, unattached officers to be redeployed or made redundant, efficiencies between agencies and others.

Expenditure by Sectors	2015 (Revised)	2016	2017	2018	2019
Administration	3,085.6	2,548.8	2,473.7	2,526.3	2,618.1
Community & Culture	145.6	156.4	90.9	93.2	96.3
Economic	485.8	610.6	263.3	270.4	277.4
Education	1,554.0	1,312.5	1,066.4	1,097.2	1,150.9
Health	1,492.3	1,565.9	993.4	1,132.3	1,090.3
Law & Justice	1,244.1	1,240.9	1,058.0	1,107.4	1,173.3
Provinces	4,137.9	4,215.8	4,550.3	4,667.9	4,805.0
Transport	1,586.3	1,254.1	915.9	687.4	612.9
Utilities	267.9	378	299.7	208.3	612.9
Debt Services	1,130.1	1,479.6	1,393.2	1,461.7	1,553.6
Unallocated			908.4	917.6	761.2
Total	15,129.7	14,762.5	14,013.4	14,169.7	14,752.0

Source: Department of Treasury

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 2020.

Implementation of the Sovereign Wealth Fund

The Papua New Guinea Sovereign Wealth Fund (SWF) is an important mechanism to manage external shocks to the economy, to support the Budget to fund priority areas such as education, health and infrastructure, and to invest for the benefit of future generations.

Tax revenues received from mining and petroleum projects, including the PNG LNG project, will be directed to the Stabilisation Fund, and be available to be drawn down into the Budget to fund expenditure needs. When revenue flows are large, the excess will be deposited into the Savings Fund, according to the SWF Organic Law.

The SWF Board will invest these funds offshore. Given that, in the short term, most of the revenue streams flowing into the SWF will be drawn back into the Budget, under the SWF withdrawal rules, investments are likely to be short term and highly liquid.

In June 2015, Parliament passed legislation to establish Kumul Petroleum Holdings Limited, Kumul Minerals Holdings Limited and Kumul Consolidated Holdings Limited. These entities will pay dividends directly into the SWF, after deducting operational funding to meet the requirements of their approved annual plans.

The fall in oil prices in 2015 significantly affected revenue flows from the mining and petroleum sector, including the PNG LNG project. As a result, inflows into the Stabilisation Fund are expected to be substantially lower than projected in the 2015 Budget. Mining and petroleum receipts into the Stabilisation Fund are projected to be below K400 million in 2016 and increase slowly until the late 2020s, when tax revenues peak at around K1.7 billion, based on current commodity price assumptions.

National Reform Agenda

The Government recognises the importance of ongoing reforms to enhancing outcomes for Papua New Guineans. Accordingly, the Government will continue its ambitious reform agenda throughout 2016.

As part of this ongoing effort and commitment, the Government 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 reforms that will enhance the efficiency and effectiveness of the public sector. In addition, the Government will monitor existing reforms to ensure they achieve their objectives and explore areas for further reform.

Improving Public Enterprises

The State has substantial interests in enterprises in PNG, consisting of public enterprises and listed investments, referred to as State Owned Enterprises (SOEs). SOEs are engaged in the provision of essential services such as telecommunication, aviation, sea ports, electricity, water, banking and postal services.

SOEs are critical in determining development outcomes by virtue of their central role in delivering utility and communication infrastructure. The Government's Kumul Consolidation framework seeks to address some of the deficiencies of the past and ensure that resources are utilised effectively for the benefit of the country.

Taxation developments and amendments

In the 2016 Budget the Government is introducing several taxation policy measures and a number of minor technical and administrative amendments as part of the Government's ongoing effort to refine the tax system and improve its efficiency and fairness.

The Government is introducing two Goods and Services Tax (GST) measures. The first is a GST deferral scheme for imports to improve cash flow for importers and to reduce the administrative burden on the Internal Revenue Commission (IRC) and PNG Customs. The second is the removal of the discretionary power of the head of State, acting on advice of the NEC, to exempt goods from GST or reduce the rate of GST to zero.

To improve the exchange of taxpayer information the Government will continue to support PNG's membership of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. This will be done while the Government suspends negotiations of any new Double Tax Agreements until the Base Erosion Profit Shifting (BEPS) report by the OECD has been fully considered by PNG.

The Government has received the report from the Taxation Review Committee following two years of work by the Committee and will be considering the recommendations in the report, and carrying out consultation with stakeholders, during 2016.

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 2016 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 2016 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

GST Deferral

In this Budget the Government is introducing the opportunity for a GST deferral scheme to improve the operation of the GST refund system.

The current GST Act provides for GST to be imposed on the importation of goods at the time they are imported. The GST paid by importers is refunded to the taxpayer on lodgement of the next GST return by input tax credit. Hence the GST imposed on the importation results in no net revenue being collected by the State.

The requirement for taxpayers to pay GST on importation and then seek to have the same GST refunded by the IRC reduces cash flow for business and creates unnecessary administration for the IRC and PNG Customs.

Under a GST deferral scheme the payment of the GST on importation is deferred until the time the taxpayer lodges its next GST return, and an input tax credit for the same amount is allowed in the same return, so there is no cash tax payable.

The measure will come into effect from 1 January 2016.

At this stage there is no detail as to how the scheme will be operated and administered in PNG. The proposed legislative amendment simply provides that “*The Commissioner may operate a deferral scheme ... for the payment of goods and services tax on imported goods*”. In other jurisdictions where a GST deferral scheme operates taxpayers are required to apply for approval to participate in the scheme, and approval is granted (and can be withdrawn) based on the compliance record of the taxpayer.

No information has been provided at this stage on who will be eligible to participate in the scheme, or the procedures for any approvals by the IRC. It is also not clear whether these procedures will ultimately be governed by legislation or practical administration by the IRC.

Removal of discretionary GST exemptions

The Head of State, acting on advice from the NEC, is currently able to exempt from GST the supply of any good or service attracting GST and substitute a lower rate.

In this Budget the Government is repealing the discretionary powers of the Head of State to exempt goods from GST or reduce the GST rate to zero. This is to ensure that the application of GST remains efficient, non-distortionary and prevents revenue leakage.

This measure will come into effect on 1 January 2016.

Suspension of Negotiation of Double Tax Agreements

The OECD has been undertaking a review of practices referred to as “Base Erosion and Profit Shifting” (BEPS). Such practices may be used by taxpayers to reduce tax liabilities and move tax liabilities to lower tax jurisdictions, and used by governing authorities in some jurisdictions to attract taxpayers through non-transparent and low tax regimes. The OECD has expressed some concern that Double Tax Agreements (DTAs) can result in the unintended outcome of not taxing income in any jurisdiction.

In light of the OECD review the Government will postpone entering into new DTA negotiations until after the BEPS report can be fully considered by PNG. Once the BEPS report has been considered the Government believes it may be appropriate to renegotiate existing DTAs to ensure PNG gets its fair share from treaties.

PNG currently has DTAs with Australia, Canada, China, Fiji, Malaysia, Singapore, Korea, the United Kingdom, New Zealand and Indonesia. While it is of course not desirable (and not the intention) for DTAs to result in income not being taxed anywhere, DTAs do facilitate foreign investment by preventing the double taxation of income. The expansion of PNG’s DTA network can have the effect of opening new markets to foreign investment into (and out of) PNG.

Multilateral Convention on Mutual Administrative Assistance on Tax Matters

The Government believes that as taxpayers are increasingly operating across borders it is important for there to be collaboration between tax administrators to address offshore tax evasion, and that PNG can obtain information more efficiently by becoming a member of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

PNG has recently become a member of the Global Forum on Transparency and Exchange of Information, which is a prerequisite to joining the Multilateral Convention on Mutual Administrative Assistance in Tax Matters.

Minor Technical and Administrative amendments

The 2016 Budget introduces minor technical and administrative amendments to correct drafting errors, remove doubt in the law and ease administration procedures.

- **Repeal of section 6A of the *Income Tax Act 1959* (ITA).** Section 6A of the ITA provides for the removal of the Commissioner General from office. This is now provided for in the Internal Revenue Commission Act (2014) (IRC Act) and should have been repealed when the IRC Act commenced.
- **Repeal of section 6B of the ITA.** Section 6B of the ITA provides for the appointment of the Commissioner General to office. This is now provided for in the IRC Act and should have been repealed when the IRC Act commenced.
- **Amend Section 196B of the ITA** to replace the reference to ‘section 196D(1)’ with the word ‘Division’. This is intended to make it clear that income derived from a prescribed contract defined in Division 14A is income sourced in PNG and is subject to PNG tax.
- **Amend the Income Tax Regulation (IT Regulation) by repealing Regulation 91A(2) and paragraph (b)** of the definition of ‘eligible payment’ in section 354K. When changes were made in 2013 to limit the industries that require a Certificate of Compliance, Regulation 91A(2) was inadvertently not removed. Contracts for the hire and leasing of equipment no longer require a Certificate of Compliance.
- **Amend the GST Act paragraphs 72(1)(a) and 72 (1)(b)** to clarify that the IRC has four years to amend a GST return from either then date the return is lodged or the date of the assessment, whichever is the earlier.

The amendment to section 196B of the ITA could have the effect of increasing the amount of income liable to tax in PNG for an investor that is resident in a country that does not have a Double Tax Agreement with PNG.

Taxation Review Report and Recommendations

The PNG Taxation Review Committee which was formally launched in September 2013 issued its Report to the Treasurer in October 2015. The report contained 91 recommendations and the Government is committed to acting on the reforms proposed in the report. However, imposing changes that have wide impacts requires consultation with those affected and a lead time for taxpayers to prepare for the changes. The Government will be working with stakeholders in 2016 on the first of these changes for the 2017 Budget.

The Tax Review applied five principles in guiding its consideration of reforms for a better tax system. The Government will apply these principles as it considers and implements recommendations from the report. These principles are that the tax system should:

- raise sufficient revenue to enable the Government to deliver services that meet the community’s expectations;
- promote economic growth creating more jobs, higher incomes, less poverty and more services;
- treat taxpayers fairly;
- be as simple as possible to understand and comply with; and
- build trust in the Government and support Government accountability.

The Review’s key findings are that PNG relies too heavily on salary or wages tax, which is borne by fewer than 400,000 taxpayers out of an estimated population of 7.5 million and that PNG’s corporate income tax rates are not regionally competitive. On the other hand, the GST rate of 10% is comparatively low, the tax base is not sufficiently broad, and tax incentives have been over-used.

In this context some of the key recommendations of the Review are:

- A reduction in the corporate income tax rate from 30% to 25%.
- A reduction in dividend withholding tax from 17% to 15%
- An increase in the tax free threshold for individual taxpayers from K10,000 to K15,000, and ultimately to K20,000, together with a reduction of the tax rate applying to income below K33,000.
- An increase in the GST rate from 10% to 15%
- Improvement of tax administration and the establishment of a Centralised Revenue Board to oversee the IRC and PNG Customs.
- The introduction of an additional profits tax to apply to mining in PNG.
- Alignment of income tax, dividend withholding tax and interest withholding tax rates applying to the extractive industries with the rates for corporate taxpayers generally.
- A reduction in tax incentives and transparent management and reporting of incentives granted.
- Abolition of the training levy and the double deduction for training.
- Introduction of a tax on capital gains, initially to apply only to some classes of real property (including interests in resource licences, but not the family home or customary land), but in the longer term extended to other assets.
- A simpler and less costly tax system for small business with a turnover up to K250,000. Payment and filing arrangements for the sector should also be streamlined.

The Taxation Review Committee has proposed a staged introduction of the reforms over the next few years and it is likely the first changes will be made in the 2017 National Budget in November 2016.

The PNG Budget commentary has been prepared to provide an overview of the general issues raised in the 2016 Budget. It does not cover exhaustively the subjects discussed. When specific issues occur in practice it is necessary to refer to the laws and regulations and to obtain appropriate professional advice.

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

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