Resetting expectations?

Budget 2020

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Introduction

A Budget provides an opportunity for a new Government to reset expectations, and take decisions that may be harder to undertake later in the electoral cycle.

This is generally what we see in the Treasurer's handing down of the Supplementary 2019 Budget in October and the current PNG 2020 Budget, but with a few notable exceptions.

Specifically, the new Treasurer has sought to reset the public narrative in:

- the 2019 Supplementary Budget to call out:
  - unachievable expenditure forecasts, particularly in respect of wages
  - poor cash flow management
  - higher real debt levels and increased interest costs.
- the 2020 Budget itself, which includes:
  - economic growth forecasts (i.e.gross domestic product (GDP) that are far more modest and are now aligned with third party forecasts
  - estimates for revenue and expenditure in the 2020 Budget that show higher expenditures and lower revenues than the 2019 Budget. Given the inability of the previous Government to restrain spending to forecasts or collect the estimated revenues, this resetting of expectations is welcomed.

The Budget sets out the National Government's 2020 Budget and Reform priorities as being based on ten principles:

- spend the money we have more wisely
- raise the revenues more fairly
- finance the debt more cheaply
- leverage friendly international support more intelligently
- focus on growth in the agriculture, forestry and fishing sector, SMEs and the informal economy
- distribute resource benefits more equitably
- stimulate non-resource growth back to at least 5% annually
- comprehensive Government state owned enterprise (SOE) reform program for cheaper energy, internet and water
- getting foreign exchange flowing more freely
- create at least 10,000 jobs annually.

These are worthy principles, but the challenge continues to be in the execution of the policies put forward to address them. While this Budget provides pointers to future reforms more evidence of execution is required to give comfort that the resetting of expectations is sustainable.

This paper addresses three particular areas which are addressed in Budget 2020:

- the future prospects for the PNG economy (chapter 1)
- the PNG Government's fiscal position (chapter 2)
- specific tax changes (chapter 3).

1 The PNG Economy

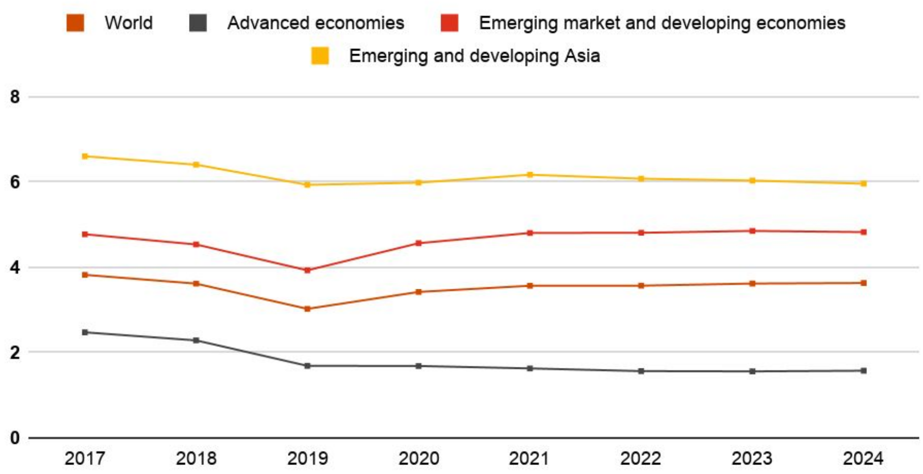
1.1 The global economic environment

Global growth

As a small export reliant economy, the strength of the global economy has an important role to play in determining PNG's domestic outcomes.

Global economic conditions have noticeably dampened this year, as ongoing downside risks act as a drag on economic activity. The IMF is expecting global growth of 3.0% this year. This is 0.3 percentage points lower than forecast in April 2019 and the lowest levels seen since 2008-09. Trade and geopolitical tensions between major global economies are a main driver of this sluggish growth. In particular, ongoing trade tensions between the US and China have exacerbated existing issues from weak global demand.

Figure 1: IMF real GDP growth forecasts (%)



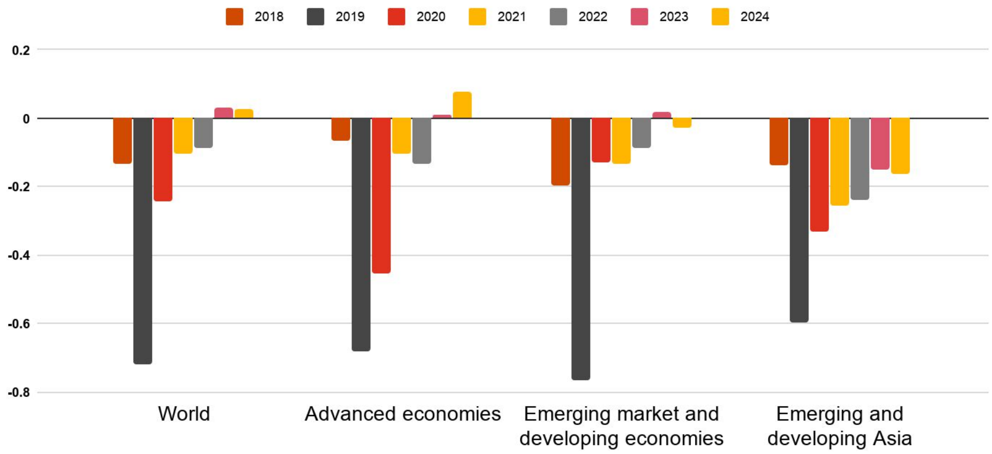
Source: IMF

This dampening of growth is expected to continue into 2020. Global growth is forecast to be 0.25 percentage points lower than forecast 12 months previous (3.41 from 3.66%). This reflects the appreciable slowdown in global conditions since the 2019 Budget and suggests that growth and revenue estimates presented in last year's Budget may have been overstated.

Risks with the largest potential impacts on the economy of PNG include:

- decreasing commodity prices impacting exports and foreign direct investment
- global inflation through PNG imports borne by business and consumers
- a weak kina exchange rate impacting valuations for PNG's outstanding loans and the cost of future borrowing.

Figure 2: Change in real GDP growth forecasts between October 2018 and 2019 (percentage points)

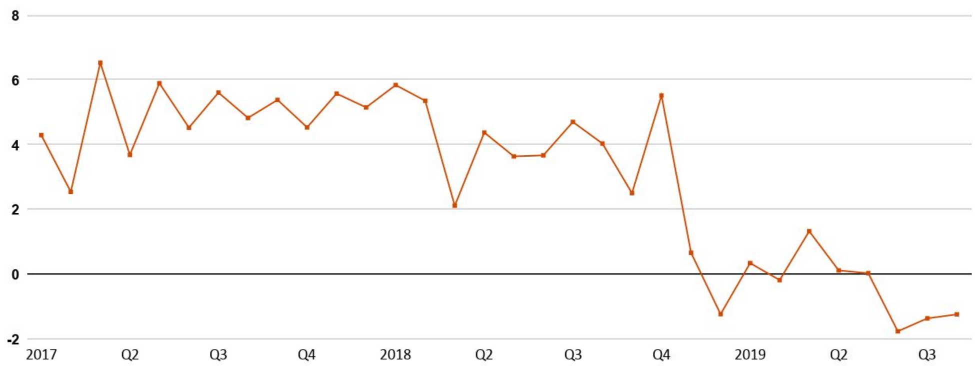


Source: IMF, PwC

Global trade

A notable feature of the sluggish GDP growth in 2019 is the sharp and geographically broad-based slowdown in manufacturing and global trade. While this decline is driven by a range of factors, ongoing trade tensions are at the heart of it. Specifically, higher tariffs and prolonged uncertainty means that global trade volumes declined by more than 1 percentage point in the past year. This has resulted in the weakest levels of trade growth since the aftermath of the Global Financial Crisis (GFC) in 2009.

Figure 3: Annual growth in world trade (% change by volume, seasonally adjusted)



Source: Netherlands Bureau of Economic Policy Analysis

PNG's economy remains heavily reliant on commodities exports. For example, the IMF reports that over the period 2016-18 PNG was the tenth largest country producer of gold. As a result, assumptions about future commodity prices have a material impact on Budget outcomes.

As shown in Figure 4, commodity price trends for PNG's key mineral and petroleum exports have softened in line with developments in the global economy over the first half of 2019. A notable exception is the price of gold which has strengthened, playing its role as an alternative 'safe haven' investment option in the face of lower US interest rates and international uncertainty.

Figure 4: Commodity forecasts

Year	2017	2018		2019		2020
Time of estimate	Actual	Estimate	2019 Budget	2019 MYEFO	2020 Budget	2020 Budget
Gold price (US$ per ounce)	1,258	1,269	1,217	1,302	1,380	1,510
Copper price (US$ per tonne)	6,166	6,517	6,200	6,070	5,989	5,849
Oil price (US$ per barrel)	51.00	64.50	67.70	63.00	58.00	54.00
Nickel (US$ per tonne)	10,415	13,109	9,555	9,072	10,782	11,034
Cobalt (US$ per tonne)	55,988	72,819	45,682	22,606	22,258	23,180

Source: 2019 Budget, MYEFO & 2020 Budget

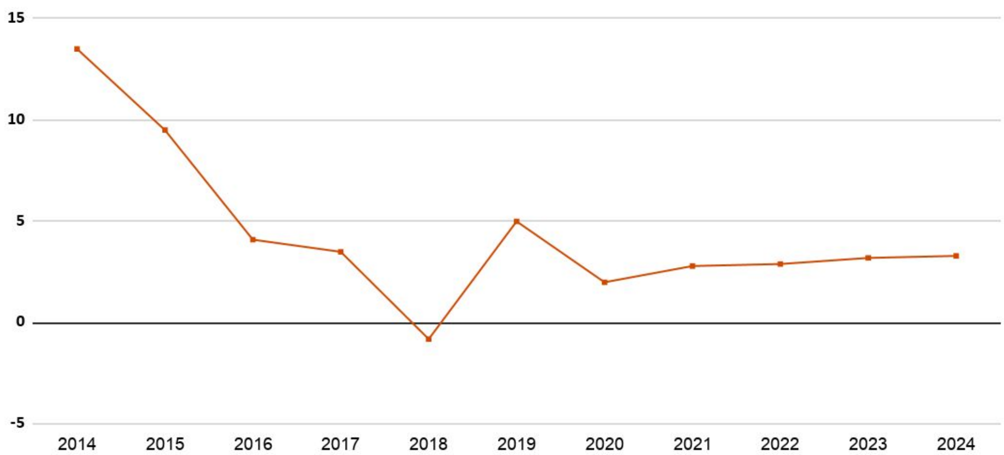
The Bank of Papua New Guinea's (BPNG) All Price Commodity Index, which tracks movements in the price of PNG's key commodity exports, increased by 2% in the first half of 2019. This compares to a 10% increase in the same period in 2018. These lower commodity forecasts suggest that tax revenue growth will be constrained in the medium term.

1.2 The domestic economy

Economic growth

Despite the slowdown in global growth, the PNG economy is expected to perform above the forecast in the previous Budget. Specifically, in 2019, the domestic economy is projected to grow, in real terms, by 5%, 1 percentage point higher than the 2019 Budget and, somewhat remarkably, 0.6 percentage points higher than the MYEFO forecast in October.

Figure 5: Real GDP growth (%)

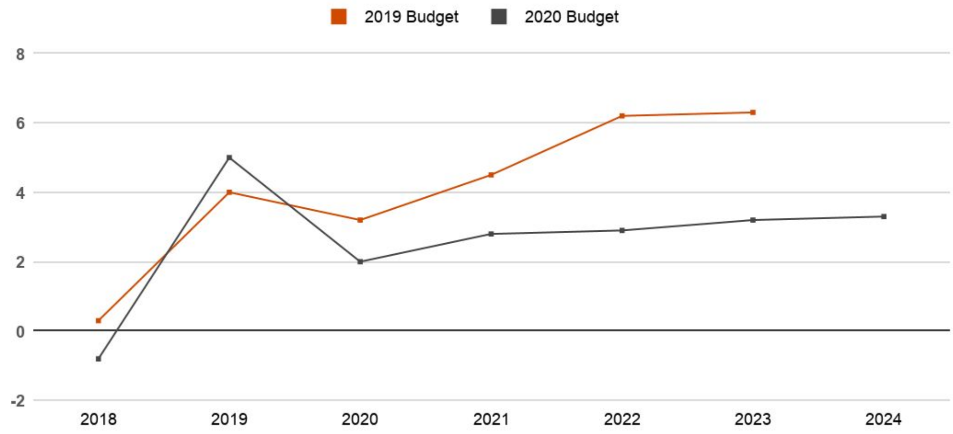


Source: Budget 2020

This upward revision over the past year is driven largely by the rebound in output in the oil and gas sector following the abnormal developments observed in 2018 (e.g earthquake), with an estimated 13% increase driven by a 14.9% increase in LNG volumes and an 11.1% increase in condensate production.

While 2019 is expected to be significantly better than forecast, the forward projections are not so rosy in comparison to previous forecasts. As shown in Figure 6, the growth forecasts in this Budget are significantly below the forecasts provided in the previous Budget.

Figure 6: Real GDP growth (%)



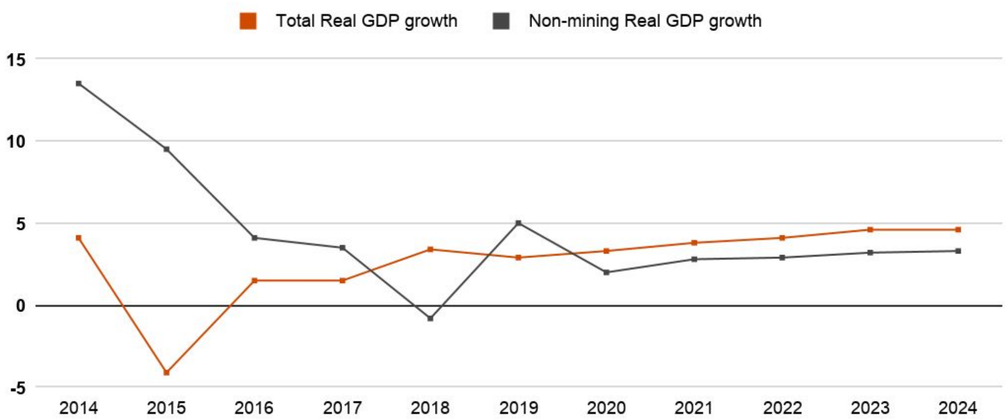
Source: Budget 2019, Budget 2020

This broad trend of revised growth expectations continues through to non-mining growth expectations.

Non-resource GDP is the best measure for economic activity in which most Papua New Guineans are involved, excluding output from the foreign-owned extractive sector.

In the coming year the Government is forecasting a slightly lower than expected contribution from the non-mining sector, with growth revised down slightly from 3.1% in the 2019 Budget to 2.9%, (as shown in Figure 7). It needs to be remembered, however, that this growth is off a relatively modest base.

Figure 7: Real GDP growth in the non-mining sector (%)



Source: Budget 2020

Owing to weak economic diversification and issues such as the overvalued kina, economic growth will be relatively muted in PNG until there is additional investment into the country's liquefied natural gas (LNG) sector. There is a proposal to add LNG production in the country; if the relevant investment decisions are made in 2019, the Oil and Gas Extraction sector's forecast growth shown in Figure 8 should pick up and GDP could be expected to increase as a whole.

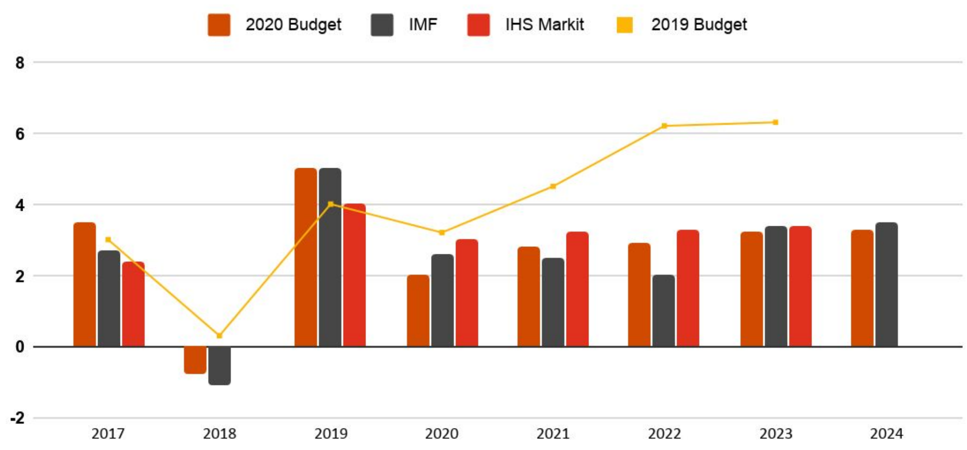
Figure 8: Real GDP growth by sector (%)

	2018	2019	2020	2021	2022	2023	2024
Agriculture, Forestry & Fishing	0.5	0.4	0.5	0.8	0.8	1.1	1.1
Oil and Gas Extraction	-3.5	2.7	-1	0	0	0	0
Mining and Quarrying	0.4	0.3	0.7	0.2	0.1	0	0
Manufacturing	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Electricity, Gas & Air-conditioning	0	0	0	0.1	0.1	0.1	0.1
Water Supply & Waste Management	0	0	0	0	0	0	0
Construction	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Wholesale & Retail Trade	0.3	0.3	0.3	0.4	0.4	0.5	0.6
Transport & Storage	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Accommodation & Food Services	0.1	0	0	0.1	0.1	0.1	0.1
Information & Communication	0.1	0.1	0.2	0.2	0.2	0.2	0.2
Financial and Insurance Activities	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Real Estate Activities	0	0.1	0.1	0.1	0.1	0.2	0.2
Professional & Scientific	0	0	0	0	0	0	0
Administrative & Support Services	0.4	0.1	0.1	0.1	0.1	0.2	0.2
Public Administration & Defence	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Health & Social Work Activities	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other Services Activities	0	0	0	0	0	0	0
Total GDP	**-0.8**	**5**	**2**	**2.8**	**2.9**	**3.2**	**3.3**
Total - Non-mining GDP	**3.4**	**2.9**	**3.3**	**3.8**	**4.1**	**4.6**	**4.6**

Source: Budget 2020

In comparison to the 2019 Budget's growth forecasts, the revised growth forecasts in the 2020 Budget appear far more realistic, particularly as they now align with estimates provided by independent commentators (see Figure 9)

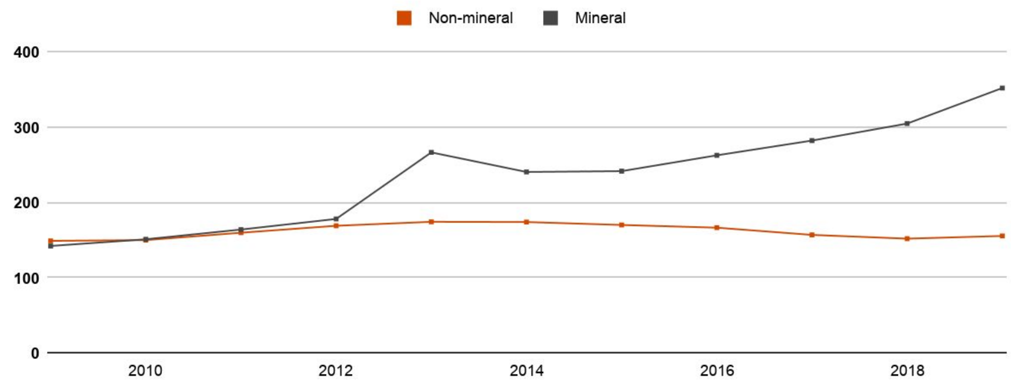
Figure 9: Comparison of real GDP growth forecasts



Source: Budget 2020, Budget 2019, IMF, IHS Markit

Also, it is important to note that growth in GDP masks poor non-mining employment growth, with total formal non-mineral employment lower than in 2011 (see Figure 10).This is particularly a challenge given the Government's principle to 'create at least 10,000 jobs annually' and that 'with the Government's new reform agenda, employment in 2020 and beyond will be driven by the non-mining sector'.

Figure 10: Formal employment in minerals and mon-minerals sectors (index March 2002=100)



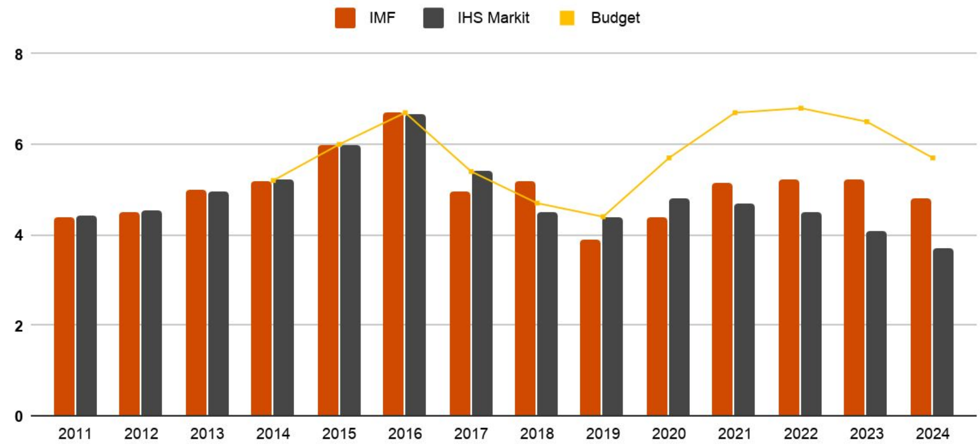
Source: Bank of Papua New Guinea

The public focus on growing employment is welcomed.

Inflation

Interestingly, the Budget inflation forecasts are above those of third part commentators (see Figure 11). This may reflect that any depreciation of the kina will likely increase shipping costs and imported inflation, which will be added to with inflationary pockets of improved domestic demand (e.g. as the extractives sector recovers and new investments come on line).

Figure 11: PNG inflation



Source: Budget 2020, IMF, IHS Markit

Foreign exchange availability

Currency availability has been one of the ongoing challenges for the PNG business community and ‘getting foreign exchange flowing more freely’ is one of the Government’s stated principles underpinning the Budget and its reform agenda.

This lack of currency availability has in large part been triggered by the need for LNG project partners to repay their debts on the project, there have been massive capital account outflows on the order of 25–28% of GDP recorded in recent years. The result was a plunge in foreign-exchange reserves from a record high of USD4.2 billion in mid-2012 — the peak of LNG construction — down to a low of USD1.6 billion in mid-2016. Reserves have since hovered between USD1.6 billion and USD1.8 billion.

To cope with the shortages of foreign reserves, there has been rationing of reserves being made available to the broader PNG economy. The rationing policy has focused on supporting priority imports such as food and has created significant backlogs in import funding and arrears on foreign payments by firms. Profit repatriation by any firms outside the extractive sectors is also banned, frustrating established foreign investors and deterring new potential investors.

It is reported that funds from the PNG Government's first-ever international bond issuance — which was completed in September 2018 — as well as borrowings from both the Asian Development Bank (ADB) and the World Bank have been utilised to help slowly reduce the backlog of foreign-exchange orders in the country. The IMF in late 2018 cited commercial bank figures estimating the backlogs at USD1 billion.

It was expected that in 2019, the foreign-exchange backlog would narrow further, as the BPNG is understood to be injecting into the system proceeds of its 2018 sovereign borrowings as well as new borrowing of up to USD450 million planned for 2019.

However, in the short term, PNG's foreign exchange difficulties have worsened, as documented in the recent MYEFO report because of:

- a lack of supply of US dollars into the PNG market, due to an unanticipated decline in external borrowing by the Government over the first half of 2019 (p.16)
- the halting of the foreign exchange backlog program with the consequence that 'the FX backlog has widened further in recent months' (p.16).

The rationing of foreign reserves has artificially suppressed import demand for nearly four years now. Owing to PNG's high level of dependence on imports for capital and consumer goods, there has been a significant suppression of investment and consumption activity in the economy. Therefore, there is significant upside potential for the economy from pent-up demand in the near term as those backlogs are cleared.

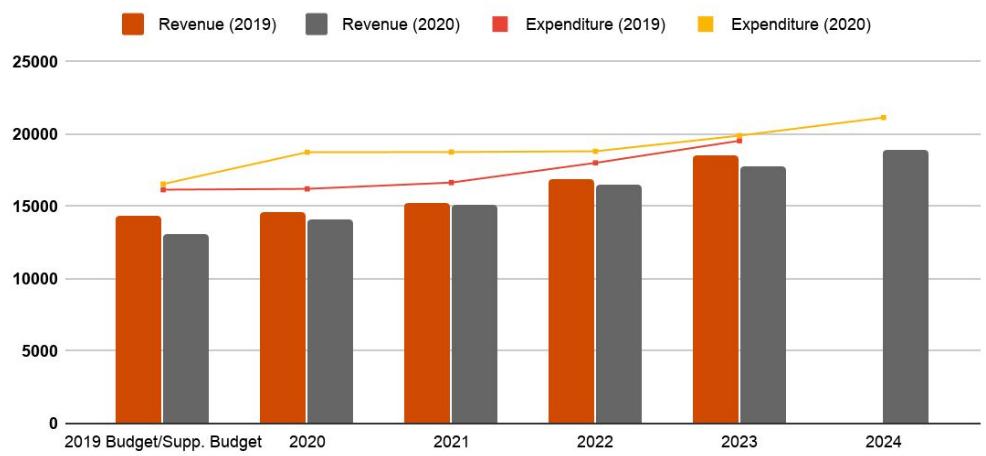
2 The Government's Fiscal Position

The new Government has sought to reframe the its fiscal position.

According to Treasurer Ling-Stuckey, a 'due diligence' check by his staff and external advisers prior to the Supplementary Budget showed that the fiscal deficit for the year was 5.8% of GDP, significantly higher than the former Government's claim of a deficit of 1.5% of GDP.

Figure 12 shows the 2019 Budget estimates for revenue and expenditure juxtaposed against the 2020 estimates. What is clear is that every year the new Government is projecting higher expenditures and lower revenues. Given the inability of the previous Government to restrain spending to forecasts or collect the estimated revenues, this resetting of expectations is welcomed.

Figure 12: Estimates of revenue and expenditure from the 2019 and 2020 Budgets (kina, million)



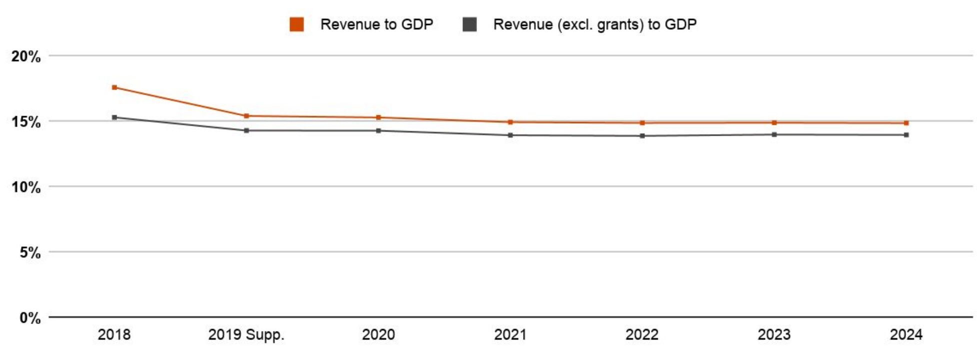
Source: Budget 2020, Budget 2019

Further details about revenue, expenditure and debt is provided in the following sections.

2.1 Revenue

The new Government has again recognised the challenges faced in collecting taxation. This Budget references expected changes from the new Government to improve tax collection systems through proper funding and monitoring. With these policy frameworks and development mechanisms, the Government expects to boost revenues from K14,905 million in 2020 to around K18,834 million in 2024.

Figure 13: Revenue as a percentage of GDP



Source: Budget 2020

Low GDP growth last year, largely due to the February 2018 earthquake, lifted the revenue to GDP ratio (excluding grants) above the then Government's target of 14% to 17.8%. Although it no longer appears that the 14% is an explicit target for the new Government, nevertheless Treasury expects to continue to generate revenues above 14% of GDP; total revenue (including grants) of K13,022 and K14,095 million in 2019 and 2020 are equivalent to 15.4% and 15.3% of GDP respectively.

2.2 Expenditure

Total expenditure in 2020 is budgeted to be K18,726.5m. This is significantly higher than the 2019 Budget projections; total expenditure is higher by K2,593.0 million, or 16.1% from the 2019 Budget.

An ongoing challenge identified in previous Budgets has been the issue of staff salaries, brought to a head by the need for the 2018 and 2019 Supplementary Budgets to provide for an extra funds for unfunded staff compensation. Funding for public sector staff takes up the largest portion of public expenditure with K5,672.8 million or 44.5% of the Operational Budget or 30.2% of the total 2020 Budget. This includes salaries and allowances but does not capture a range of other expenditures (e.g retirement, retrenchment, gratuities and superannuation).Such public sector costs grew by 5.5% over the 2019 Budget.

A significant driver of the increased spending (in the order of 40%) in the 2020 Budget is arrears payments, amounting to an estimated K1,050.0 million in 2020. This will include:

- arrears under personnel emoluments of K430.0 million for exit payments (i.e. redundancies)
- K120.0 million for the 3.0% pay increase for 2019
- K200.0 million will be set aside to reduce the Goods and Services arrears.

This is a sensible and welcome acknowledgement that past projections were unrealistic in not accounting for these obligations.

The forecast pattern of government expenditure is shown in Figure 14, with the largest three areas of expenditure being:

- Administration/Miscellaneous (21.5%)
- Provinces (23.7%)
- Debt Services (12.5%).

Notably, some changes projected in the coming year reflect reversals of movements in the previous years. For example:

- relative to GDP, debt servicing decreased from 12.7% in 2017 to 12.3% in 2018, and is now projected to increase to 12.5%
- expenditure directed at the Provinces declined significantly from 26.7% in 2017 to 19.0% in 2018, but is now projected to increase to 23.7%.

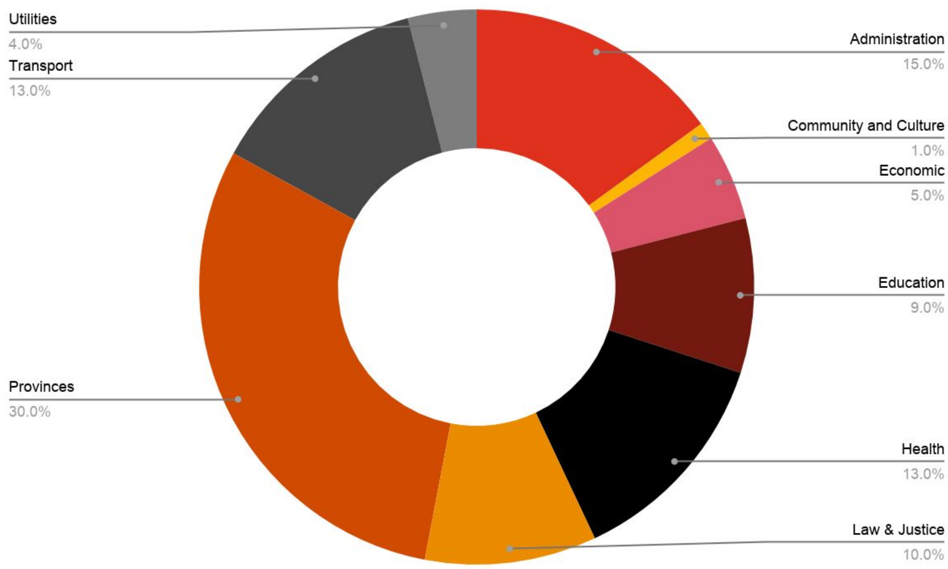
Figure 14: Expenditure by sector as a % of the total budget

	2019	2020
Administration/Miscellaneous	25.2	21.5
Community and Culture	0.9	0.7
Debt Services	12.3	12.5
Economic	4.6	4.8
Education	8.5	9.0
Health	9.6	10.4
Law & Justice	8	9.7
Provinces	19	23.7
Transport	8	6.4
Utilities	3.8	1.2

Source: Budget 2019 and Budget 2020

Drawing on the data from Figure 14, the Government reports a more down-to-earth perspective of the relative focus of spending by excluding Debt Servicing and Miscellaneous categories. The result is shown in Figure 15.

Figure 15: Expenditure in 2020 by sector as a % of the total Budget

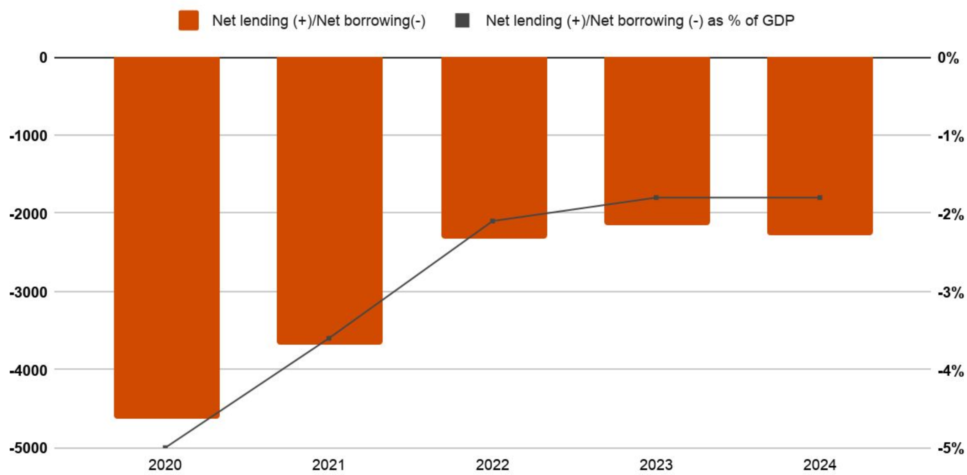


Source: Budget 2020

2.3 Debt

Getting the Budget back to surplus is not an explicit goal of the Government. However the Budget does project an improvement in the net position - from the recently revised estimate of -5% to -1.8% by 2023 (Figure 16).

Figure 16: Net borrowing



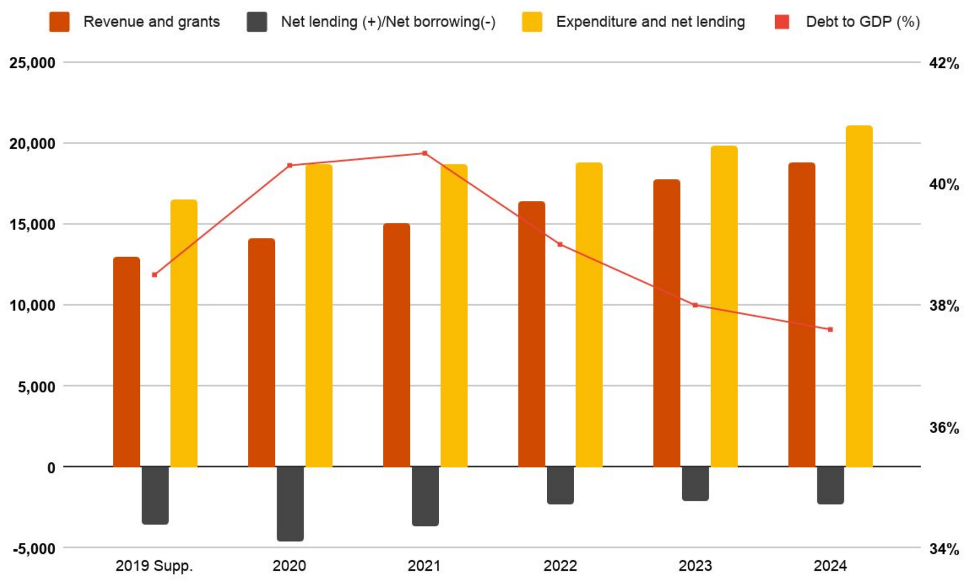
Source: Budget 2020

The fiscal deficit is more than K3.5 billion and higher than last forecast, where a deficit of almost K2.4 billion was anticipated. Additional debt will be required to finance the additional K1.5 billion difference.

The *Fiscal Responsibility Act* put a fiscal constraint on government in that it limited debt levels to 35% of GDP. To manage the obligations under the *Fiscal Responsibility Act* Parliament agreed to raise the debt limit from 35% of GDP to 45% of GDP given that the 35% cap would otherwise have been breached (see Figure 17).

Total debt is projected to decline as a percentage of the economy, but this relies on closing the gap between spending and revenue, with continued steady economic growth continues. These are the challenges for the Government.

Figure 17: Revenue, expenditure, net lending and debt as a percentage of GDP



Source: Budget 2020

3 Taxation Developments and Amendments

The 2020 Budget introduces a number of new revenue measures with particular emphasis on increasing excise to enable the Government to meet its spending commitments. While the focus of more recent Budgets has been more closely aligned to vision contained in the Medium Term Revenue Strategy (MTRS), this Budget appears to have adjusted the MTRS to more closely address the policy priorities of the Marape-Steven Government. This revision of the areas of focus has to a degree been reflected in some of the announced measures, but it is also likely to directly impact more generally on tax developments in the near term. The priorities of the new Government that have been referenced as inspiration for the Budget include:

- raising revenue in a 'fair' manner which is 'investor friendly'
- focussing on sustainable development investment options, and industries such as agriculture, tourism, small to medium enterprise and downstream processing.

Despite the measures proposed and discussed further below, this Budget may be notable for the number of measures which were mooted but ultimately not announced or even mentioned, including no:

- announcement regarding the commencement of the *Tax Administration Act*
- introduction of the proposed capital gains tax regime which had undergone consultation with stakeholders during the year, including the preparation of draft legislation.

Further, the Treasurer has announced a number of measures that appear to have aligned his vision of revenue generation to that alluded to the Prime Minister's 'Manifesto' released on PNG Independence Day (16 September 2019), with a focus on providing tax relief for small to medium enterprises, whilst reversing prior Government's moratorium on excise increases.

The Budget does not contain any commentary on the potential introduction of policy reform agenda in relation to matters beyond 31 December 2021, which is another departure from the prior Budget. The Prime Minister's Manifesto did contain some elements of policy intent regarding revenue generation, particularly around substantive changes to the taxation of resource projects (moving from license, royalties and income tax to a production sharing model) however no further guidance was provided in the Budget regarding the consultation and implementation of these potential changes.

3.1 Efforts continue to strengthen revenue administration

Consistent with recent years, the Government's focus for 2020 is to improve revenue policy and institute effectiveness of revenue administration in a coordinated manner with an objective of collecting more tax revenue collections on a sustainable basis. The Government acknowledges that there are significant institutional and capacity issues within the revenue administration agencies and therefore it is crucial that revenue administration agencies are strengthened with the adoption of the principles of an effective tax administration system. The MTRS aims to achieve this by increasing awareness, compliance and enforcement.

Key reforms for the IRC in 2020 include:

- a near 500% increase in salary costs allocated to its Debt and Lodgment Enforcement Division indicating a significant capacity build in audit activity is likely to arise
- increased spending on regional compliance
- provision of funding to commence the implementation of a new Integrated Tax Administration System (ITAS) to replace SIGTAS. However the expenditure forecasts appear to indicate the earliest the system will be able to commence operation will likely be 2022.

Any changes that increase the capability and capacity within the IRC and Customs is a step in the right direction, as well as enforcement activity for those who are not compliant with PNG taxation laws. The key will be in implementation, especially the introduction of the ITAS. We encourage the IRC to continue to seek feedback from stakeholders in its design before implementation.

Additionally, this appears to be the first Budget which has quantified and utilised reliable estimates over tax expenditures. It is unclear whether the data has been utilised to inform policy decisions or will be used in the future, but does align with global trends in developed economies and indicates a growing sophistication of the revenue administration and potential in data analytics.

3.2 Reduction in thin capitalisation ratio for resources companies

Resource companies are currently entitled to claim interest deductions up to debt to equity ratio of 3:1. The Budget implements a change to align the thin capitalisation ratio for resource companies to that applicable to all other PNG taxpayers being 2:1. The key driver for the change is to create a 'level playing field' for companies in PNG.

The change is scheduled to become effective immediately. As the thin capitalisation test is continuous during the year of income, presumably this will therefore take effect for the income year ended 31 December 2019. This will have the impact of reducing the available interest deductions for all resource projects. The impact of fiscal stabilisation agreements on this legislative change will need to be considered.

The differential in the thin capitalisation ratio has historically been understood to be a result of the higher risk and higher cost of funding resource projects as compared with other non-resource industries. The immediate adjustment also has retrospective application to resource projects that have already made an investment decision and effectively requires taxpayers to make immediate adjustments to avoid the risk of losing deductions for interest.

3.3 Amendments to the tax dispute process

The Budget amends the Income Tax Act to reduce the amount of disputed tax that must be paid in order to progress an appeal against a decision by the Commissioner General to 50%.

Previously, taxpayers were required to pay 100% of a disputed tax liability in order to be able to make an application to the IRC's Review Tribunal or filing an appeal in a National Court, making it prohibitive to dispute amounts, and disincentivizing the IRC from resolving matters on a timely basis.

Whilst the reduction in the tax payable for disputes to 50% should be welcomed, no additional measures, resources or policy announcements were made in relation to the timely constitution of the Review Tribunal to actually hear and resolve matters. We understand the Review Tribunal has recently been reconvened, although had not progressed any issues presented before it, some of which date back to the early 2000s.

3.4 Changes to tariffs, levies and license fees

The Budget revenue strategy for 2020 focuses heavily on a number of changes to various tariffs, levies and license fees. Perhaps the largest change is the reversal of the previous Government's freeze on indexation of excise on alcohol and tobacco products. These changes introduced include:

- **Increase in alcohol excise:** A one off 10% increase in the excise rate applicable to most alcohol categories to reverse the prior indexation suspension, as well as recommencing a 5% bi-annual increase. Certain categories of 'stimulant' alcoholic drinks, as well as alcoholic drinks manufactured from fruit grown in PNG (e.g. cassava drinks) have had much more substantial excise increases.
- **Increase in tobacco excise:** As with alcohol, the tobacco excise rate is having a one-off increase of 10%, with the recommencement of the 5% bi-annual increase. A '2nd tier' excise to address the problem of illicit tobacco has been announced and is intended to apply until November 2021.
- **Increases to export tariffs on unprocessed timber logs:** Marketed as a measure to move more processing of timber in PNG, the export tariffs applicable to the export of certain types

of unprocessed old growth timber logs, with a vision to cease the export of unprocessed timber logs by 2025.

- **Decrease in the import tariffs on new and used vehicles:** The Budget substantially reduces by up to 75% the import tariffs on the import of both used and new vehicles.

Most changes noted above will commence with effect from 1 December 2019. It should be noted that the previous freeze in indexation of excise on tobacco and alcohol products was a direct response to a dramatic reduction in consumption of those products and the impact that had on excise collection. It also pushed large portions of the economy into consumption of illicit and unregulated products. There is a significant risk that the material increase in excise will again give rise to similar impacts. To combat these risks the Budget proposes to impose significant penalties on the sale of home brew alcohol up to K50,000 although the Budget is silent on funding enforcement measures.

3.5 The implementation of a SME taxation regime

As foreshadowed in prior Budgets and the previous Government's MTRS, this Budget accelerates the implementation of an SME regime designed to provide certain tax concessions to encourage development in the SME sector. Whilst the policy measure indicates that the provisions should apply to privately owned corporations, partnerships and individuals, the amending legislation only applies to individuals, provided they are not performing professional service, as follows:

- a 2% tax on turnover where the SME's turnover is less than K250,000, payable on a quarterly basis or
- an annual fee of K400 for businesses with a turnover of less than K50,000.

Furthermore, measures designed to simplify the taxation of SMEs are intended to apply as follows:

- income will be taxed on a cash basis
- record keeping requirements are reduced to three years
- taxpayers may irrevocably opt out of the provisions.

Whilst the legislation's passage is welcomed to provide tax relief for SMEs, it is likely that amendments will be required to ensure that the provisions apply to more businesses other than individuals. It also reflects a concrete move to broaden the tax base which has been a policy goal for a number of years.

Nevertheless, given the challenges already faced by the IRC administering the existing taxation regimes, it is important that additional compliance burdens placed on the IRC by this regime do not disturb its ongoing revenue administration goals.

3.6 Tax Clearance Certificates

Flagged as a potential policy consideration during 2020, the Budget foreshadows a change in the administration of tax clearance certificates. The Budget suggests that the IRC will retain administration of TCCs, however it is suggested that the certificates will be 'system-generated' and that the TCCs will be issued directly to banks.

There already exist a number of procedural challenges in obtaining TCCs on a timely basis, and taxpayers are aware of general challenges with the IRC's SIGTAS system. It will be important any developments in relation to the administration of TCCs are carefully managed to ensure that it does not impact on taxpayers ability to maintain their normal business operations.

3.7 Other tax changes and corrections

Other policy measures are also being introduced to increase the efficiency of the tax system and enhance tax compliance through clarification of tax laws and simplification of tax administrative procedures and processes for the benefit of tax administration and taxpayers.

These include:

- Amending the provisional tax payment dates for taxpayers who have a substituted accounting period to correspond to periods ending three, six and nine months after their balance date. We note that this brings provisional tax payments forward a month for all taxpayers. Previously taxpayers had to make provisional tax payments according to a calendar year and in April, July and October, which led to misalignment between liabilities payment dates and financial reporting periods. We note however there is a technical error in the drafting which will need to be corrected.
- In the 2019 Budget the *Income Tax Act* was amended to limit the carry forward period for tax losses incurred after 1 January 2019 to seven years (for non-resources companies) and 20 years (for resources companies). The amending legislation created ambiguity as to the treatment of losses incurred in years prior to 1 January 2019, although we understood the old loss carry forward periods were intended to apply (being 20 years for non-resource companies).

The Budget contains provisions to reinforce the intention that losses prior to 31 December 2018 should be entitled to be carried forward in accordance with the prior provisions. However, again the legislative amendments to the Income Tax Act included in the Budget Bills do not quite adequately address the intention but we are advised that this is likely to be corrected in subsequent amendments.

3.8 Policy development areas for 2020

The Budget has indicated Treasury will look to review several elements of revenue collection with a view to commencing some measures in 2021, including:

- undertaking a review of the Infrastructure Tax Credit Scheme
- reviewing bank licensing fees and imposition of an additional profits tax on banks. No details were provided as to how either of these will be determined or calculated. The Budget papers make mention of targeting foreign exchange spreads
- reviewing telecommunication license fees and a universal access levy regime. The Budget papers make mention of changes based on turnover rather than profits
- continuing the rewrite of the *Income Tax Act 1959*
- further amending tariffs including implementation of tariffs on imported refined petroleum products.

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