

# ***PNG Pulse***

## ***Keeping you informed***



### ***November 2016 Part 2***

#### ***2017 Budget handed down***

This year's budget was launched with the theme of Responsible Fiscal Consolidation, and saw a number of potentially significant changes to the tax landscape for the country. In this series of PNG Pulse Special Editions, we will present some additional explanation and commentary on a number of areas – focussing on some of the groups of taxpayers that may particularly benefit from reviewing their current operations in light of fiscal changes.

#### ***Standardisation and simplification of dividend withholding tax***

One of the headline changes in this year's budget which impacts a wide range of taxpayers was the announcement of the amendments designed to standardise and simplify dividend withholding tax (DWT).

##### ***Background***

DWT currently applies to dividends paid by domestic companies, except for those whose dividends arise from petroleum or gas operations (which are currently exempt from dividend withholding tax) and a number of other limited exceptions. DWT is currently

applied at a standard rate of 17%, although mining company dividends are taxed at 10% and some double tax agreements may provide for a lower rate.

This has had the implication of imposing dividends on domestic intra group dividends as profits pass through domestic groups and DWT being applied as the profits are passed to ultimate shareholders. However, rather than applying multiple levels of DWT as the dividends pass through a chain of companies, the current system allows a refund of DWT to be claimed by a company paying a dividend in cases where it has a balance in its "refundable dividend withholding tax account" generated from receiving a dividend that was subject to DWT. Effectively, this enables DWT to be levelled only once on profits passed through a chain of companies to ultimate shareholders.

The current system also provides that dividends are not part of the assessable income of non-residents, resident individuals or resident trust estates. This has the effect that no further action with respect to tax compliance is required for these recipients of dividends that have been subject to DWT.

##### ***What's new?***

The rate of DWT has been now established at 15% for all resident company dividends (including for mining companies). This is still potentially subject to a lower rate if provided by a double tax agreement.

DWT is applicable when dividends are paid to non-resident shareholders, resident shareholders and resident trust estates. In other words, DWT no longer applies to dividends paid between any resident companies. Therefore, the concept of the “refundable dividend withholding tax account” is repealed as dividends are now subject to DWT only at payment to non-residents, resident individual shareholders or resident trust estates.

The exemption from DWT for income from petroleum and gas operations is eliminated.

Another critical change is the repeal of the provision that dividends do not form part of the assessable income of resident individuals, non-residents and resident trusts. We believe that this change is possibly an unintended result of the amendments. We have raised this with Treasury and the position is potentially subject to change.

### ***Implications***

For mining, petroleum and gas companies these changes will mean an increase in the effective tax rate on income from operations in PNG. The changes are proposed to come into effect from 1 January 2017 and there are no transitional rules proposed. Only those existing projects that are subject to fiscal stability will be protected from these changes. These changes, coupled with the elimination of the exemption from interest withholding tax for financing of resource projects will require resource project owners to review their project structures and financing arrangements.

Resident companies (whether as part of a group or as a holding company) will effectively forfeit the benefit of the current balances in

their refundable dividend withholding tax accounts. Therefore, dividends paid after 1 January 2017 from existing retained earnings of companies that lose their balances will effectively be subject to DWT twice. Any company with a balance in their refundable dividend withholding tax account should urgently review their position in this regard before 31 December 2016.

Dividends after 1 January 2017 will be subject to a potentially lower rate of DWT (17% vs 15%). For companies without a DWT credit balance, this should form part of the consideration of their dividend policy and position – subject to the impact on shareholders (see below).

For non-resident, resident individual and resident trust shareholders, there may be significant impacts from the removal of the provision stating the dividends are not part of assessable income. Taking the example of a resident individual shareholder:

- The dividend received is now part of assessable income
- Assessable income should be returned in a tax return and is subject to tax at normal marginal rates
- A credit is available for DWT against the tax payable on the return

For a shareholder on the top marginal rate of 42%, this will mean a “top up” tax payment in the shareholder’s hands. It will also mean an effective tax rate on distributed company profits in the hands of shareholders of up to 59.4% for dividends paid after 1 January 2017. As noted above, we believe that this may be an unintended consequence of the way in which the amendments have been drafted as it would reflect a substantial backward step in the established tax policy with respect to the treatment of dividend income.

The position of non-resident shareholders is similarly changed. Whereas previously the DWT was a final tax on dividends, this conclusion appears at risk. Should the amendments come into effect as drafted, non-

resident shareholders will be in receipt of PNG source assessable income. In turn they should file a tax return in PNG and claim a credit for the DWT while paying the additional tax that may be required. Double tax agreements may limit the ultimate tax payable, but arguably not eliminate the requirement to complete a return.

If you would like to know more about the changes to FCWT or any other matters that arose from the budget, please get in touch with your usual PwC contact.

## ***Contacts***

If you would like further advice or information in relation to the issues outlined in this bulletin, please call your usual PwC contact or any of the individuals listed below:

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