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Tax reform consultation

In line with the on-going efforts of the Government to pursue the Medium Term Fiscal Strategy, Treasury recently announced a round of public consultation on the introduction of legislation on two themes:

- Capital Gains Tax (**CGT**) regime and;
- Small to Medium Enterprise (**SME**) Taxation regime.

The consultation is supported by planned regional meetings in May and June and the release of background commentary papers and proposed draft legislative changes. Although the commentary is limited and the papers do not contain any revenue estimates this still represents a step forward in consultation and the creation of a more transparent tax reform process.

Capital Gains Tax

The CGT proposal is to amend the *Income Tax Act 1959* to include a 15% tax on capital gains (after the application of any capital losses) arising on the disposal of certain assets.

Type of Assets Subject to CGT

It is proposed the CGT would apply to either a PNG tax resident or non-resident's disposal of:

- PNG real property interests, which broadly includes:
 - Land or improvements on land; and
 - Interests in mining and petroleum resources, including information and the underlying licenses;
- Shares in a company where more than 50% of the company's value is derived from PNG real property interests;
- Shares in a company listed on the Port Moresby Stock Exchange; and
- Options or rights to acquire the above assets.

Assets that are specifically excluded from CGT include:

- Items of trading stock and depreciable assets;
- An individual's principal place of residence; and
- An asset owned by a tax exempt entity.

Importantly, the proposed legislation does not exclude assets acquired prior to the CGT regime's planned commencement, and would therefore capture assets already owned by taxpayers. Pre-CGT assets would be taken to have been acquired at "fair market value" at the commencement date. Selecting this transitional

treatment for the introduction of a CGT regime is not universal. Other transitional mechanisms have been used in other jurisdictions as part of the implementation of a CGT regime - e.g. Australia.

Calculation of Gain or Loss

Broadly, any capital gain or loss would be calculated by working out the proceeds received for the disposal (including the market value of any property received in kind) less the CGT asset's cost.

Where a capital loss arises, it is proposed to be carried forward indefinitely, but can only be applied against future capital gains (i.e. it is not deductible against ordinary assessable income) subject to "substantiation" to the satisfaction of the Commissioner General.

The proposed CGT regime includes a number of reductions, roll-overs and deferrals of capital gains in certain corporate reorganisation and replacement asset scenarios.

Curiously, it is proposed that a separate CGT Return would be lodged with the IRC within 28 days of the disposal of the asset, with payment of any liability also due on the same date.

New Non-resident CGT Withholding Tax

The proposed legislation would further require purchasers of a taxable asset to withhold 10% of the purchase price where the vendor is a non-resident. The vendor and purchaser could apply to the Commissioner General to vary the withholding tax rate to a lower rate (e.g. where 10% of the gross proceeds do not reflect the tax liability of the capital gain, or the asset is not PNG real property).

The legislation proposes any withholding tax suffered would be creditable against the vendors ultimate CGT tax liability (including refundable as the case may be).

SME Taxation

The consultation process also proposes to consider how tax rules should be simplified to make it easier for SMEs to satisfy their tax obligations and encourage greater participation in the tax system. The Consultation documentation canvasses a number of alternative options however is recommending that businesses with a turnover of less than PGK 250,000 be subject to a simpler SME taxation regime.

Reflecting the complexity and challenge of identifying and applying appropriate concessional regimes to SMEs, the paper covers a wide range of options and presents a number of thresholds, scenarios and measurements. However, ultimately, the Consultation proposes to apply a turnover based tax to SMEs. The rates applicable are yet to be determined and will be subject to further consultation, however it is recommended that different rates apply to trade and non-trade (e.g. services) businesses.

Additionally it is proposed that, for SMEs which are individual traders with an annual turnover of less than PGK 60,000 (i.e. micro businesses), further simplification of their tax affairs should be undertaken by adopting a "patent" system. This would provide that such an SME would pay a fixed tax amount of PGK250 per year.

Final thoughts

The CGT regime, as drafted, raises a number of challenging topics that need to be considered further, and ideally these would be the subject of detailed consultation prior to enactment of any legislation. Particular issues that should be considered further by relevant stakeholders include:

- Whether the transitional arrangements of deemed acquisition at market value is a more appropriate choice than simply grandfathering of CGT assets acquired prior to the regime. Given the consultation paper does not provide forward estimates it is difficult to assess the balance between the administrative burden placed on taxpayers and the IRC and anticipated collections;
- Ensuring adverse consequences do not arise in relation to farm in and farm out arrangements in the energy and resources sectors;
- Whether the requirements to lodge CGT returns and pay CGT liabilities immediately after a transaction, as distinct to returning net income on an annual basis is appropriate; and
- Whether rollover and deferral provisions are broad enough to ensure that no adverse CGT consequences arise in circumstances where there is no underlying change in economic ownership of CGT assets.

In relation to the SME proposals, any effort to simplify the tax regime and encourage taxpayers participation therein should be encouraged. Support should be provided to Treasury as needed to ensure the relevant turnover rates and patent amounts are appropriately set.

If you would like to know more about these recent developments or have any other questions, please get in touch with your usual PwC contact.

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