KPMG

Kundu

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Foreword

In this month's edition we recap the 2020 supplementary budget and our summarised commentary. We also discuss the relevant updates in relation to tax revenue measures announced in this supplementary budget. Finally, we cover the impact of the new section 65A GST notices on taxpayers.

KPMG is a professional services firm in PNG with dedicated in-house specialists in all of the following areas: internal audit/risk, visa migration, corporate finance, management consulting, IT advisory, fraud investigation as well as tax and assurance. As such we are well placed to provide a truly multi-disciplined approach to business advisory.

Please enjoy this month's Kundu and reach out to us at +675 321 2022 if you would like to see KPMG cover specific topics in future editions.

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PNG 2020 supplementary budget review

by Wayne Osterberg, Director, Advisory

The PNG Treasurer, Hon, Ian Ling-Stuckey, recently presented the 2020 Supplementary Budget and accompanying Mid-Year Economic & Fiscal Outlook (MYFEO) to Parliament. The MYEFO reflects the very challenging environment in PNG faced by the Government. Government revenues are forecast to decline by K2.7bn due to the impact of COVID-19 and slower business activity. Tax revenues are well behind budget forecasts in keeping with the slowdown in business conditions but the implementation of certain of the tax revenue measures have been delayed, such as the Small and Medium Enterprise tax system. A rewrite of the Income Tax Act is underway and submissions are being considered – at this point implementation is however unlikely before 2021.

The bulk of the economic and budgetary headwinds that GoPNG are facing are COVID-19 related but the Porgera closure which will negatively impact GDP growth by 1.4% in real terms was self-inflicted.

It highlights one of the difficult challenges facing the Government – how to navigate through the tough decisions needed to shift the economic balance to 'Take Back PNG' and potentially destabilising the investment environment in the short term, when conditions have never been tougher. The Government needs some wins if it is to persuade investors and bilateral supporters that it is earnest in the proposed reforms, which may move them closer to their goals.

Overview

In introducing the supplementary budget, Prime Minister Marape noted that it comes at a time when PNG operates "in the toughest year since 1975". He made reference to a debt legacy of the previous government totalling K37bn and introduced a "Road to Recovery Plan" to reinvigorate PNG's economy, with four key pillars:

1. Optimise the absorptive capacity of the Public Investment Program (PIP) budget and direct it towards projects that can deliver economic and commercial outcomes for PNG;
2. Strengthen PIP budget utilisation rate from below 50% in 2018 towards 80%;
3. Pay out the portion of K4bn cumulative unfunded arrears in respect of unfunded contracts and retirements incurred in the last 8 years, which totalled K581m for 2019 and just under K1.1bn for 2020; and
4. Reforming our State Owned Enterprises and addressing a K6bn legacy debt.

In the MYEFO the Treasurer made the following key points:

- The PNG economy will contract from K92bn to K81bn in nominal terms and over 85% of the reduction is due to the impacts of COVID-19.
- PNG will experience a real growth of negative -3.0% in 2020, down from an estimate of positive 3% growth at the 2020 budget. This contraction cuts across all sectors of the economy.
- Lower export earnings and forex denominated tax and dividend payments means that the foreign exchange market will continue to be short of foreign currencies for the foreseeable future.

On the Economic Stimulus Package measures announced earlier in the year:

- Early access to superannuation funds will come into effect after initial legislative delays and will provide access to around K600m to support superannuation members who have lost their jobs.
- Monetary policy actions such as lowering interest rates and the cash reserve requirements are expected to support a further K600m in loan and repayment support for the private sector and those holding an estimated K1.8bn in loans are expected to benefit from the repayment moratorium.
- After an initial K45m focused on health programs, a further K600m was allocated, split into two main programs - Health and Security containment (K280m) and Economy Support programs (K320m).

Risks to the Outlook

The Treasurer identified a number of risks to his outlook and acknowledged that there is no prospect for "any quick LNG investment fixes" in the current global climate. He emphasised that the Government must continue with its balanced focus of also growing the non-resource economy. The specific risks identified were:

- Ongoing COVID-19 responses and trade tensions between US and China will continue to have implications on global trade, commodity prices, investment and financial flows, and thus impact PNG.
- Planned revenue reform for 2020 to widen the tax base and to increase compliance have been delayed due to COVID-19 with knock on effects for revenue collection. Income tax receipts may lag behind projections if the corporate sector has tax losses to recover.
- If spending is not carefully managed, debt concerns may derail the fiscal program. Additionally, the debt to GDP FRA limit needs to be lifted above the current 45% level.
- The forex imbalance continues to impede economic activity and, unless reduced, could slow investment flows.

For our full analysis including fiscal and economic outlook please see the KPMG PNG 2020 Supplementary Budget Review at www.kpmg.com.pg or our LinkedIn page.

Tax reform and measures update from MYEFO 2020
by Karen McEntee, Partner, Tax, Transactions and Accounting

The MYEFO 2020 report provided some updates in relation to tax revenue measures announced in Budget 2020 as follows:

Updates on the Rewritten Income Tax Act

As we have previously reported the Income Tax Act is being re-written. The stated aim of rewriting the Income Tax Act was to simplify and modernise the tax legislation to improve tax administration and compliance. However, there are a number of issues with the draft legislation presented in February 2020 and KPMG made a submission to Treasury and IRC earlier in the year in this regard. The MYEFO report refers to a final consultation with stakeholders on specific issues on a case by case basis.

It also states that, to ensure a smooth transition and to avoid unintended policy consequences, the Act is now more likely to be tabled in 2021.

We look forward to seeing a further draft of the Rewritten Income Tax Act for consultation given the potential wide ranging implications for all taxpayers.

Implementation of Tax Administration Act 2017

The 2018 Budget saw the introduction of the *Tax Administration Act (TAA) 2017* although it awaits the release of a Gazettal Notice for implementation. The TAA sets out clear procedures for main tax heads, administrative rules and taxpayer obligations and rights. It is intended to improve tax administration and compliance and consequently revenue generation.

The IRC need to make a number of administrative reforms to prepare for the implementation of the TAA and these have been delayed due to Covid 19. As a result, MYEFO 2020 suggests changes may be implemented in stages with the initial changes expected to commence on 1 January 2021.

Enhancing Land Lease Rental Payments

The Government estimate the outstanding land lease rentals with the Department of Lands and Physical Planning to be c. K300m covering the period 2014 to 2020 inclusive. The Department was behind schedule on the implementation of a new online electronic payment system named goLands and eLands. The system allows lessees as registered users to pay land rental online using visa or master card. The first half of 2020 saw no additional revenue collections but additional revenue is expected to be collected towards the end of 2020.

Increase Excise on Alcohol and Tobacco

The *Excise Tariff (2020 Budget) (Amendment) Bill 2019* was certified by Parliament and the excise measures were implemented seeing an increase in six monthly excise adjustment rates from 2.5 per cent to 5.0 per cent, one-off 10.0 per cent increase to excise on alcohol and tobacco, and specific additional increases to anti-social drinks (drinks with higher alcohol content). Although this measure was expected to generate additional revenue actual excise revenue from alcohol and tobacco dropped 33% compared to the same period in the previous year, mainly due to reduced spend as a result of Covid 19 lockdowns.

Reduce Excise on Imported Vehicles

Budget 2020 introduced substantial reductions in the import excise rates for imported vehicles. While these were expected to reduce Government revenue the reform saw excise revenue collection drop by 4.4% compared to same period in 2019 but an 14% increase in demand for imported vehicles resulting in increased import GST and import duty.

Log Export Duty

The average progressive export duty rate increased from 32 per cent to 50% in 2020. The first half of 2020 saw revenue from the export of unprocessed round logs increase by 40% compared to the same period in 2019 due to an increase in the export of tropical wood in round form and the imposition of the higher export duty rate on unprocessed logs.

Introduction of Small Medium Enterprise (SME) Taxation Regime

The legislation to give effect to the SME taxation regime was passed and certified by Parliament and is pending Gazettal Notice for implementation. The delay in implementation is due to some changes required to reflect the true intent of the policy before the SME tax regime is implemented. These changes are expected to be introduced as part of the 2021 Budget.

The SME taxation regime is intended to simplify record keeping system, accounting and tax rules, and compliance costs for SMEs with the aim of bringing those in the informal into the formal sector.

Tightening the Thin-Capitalisation Rule for Resource Sector

The Government tightened the thin capitalisation rule by reducing the debt to equity ratio for the extractive sector from 3:1 to 2:1 to aliat of the non-extractive sector. *Although the Income Tax (2020 Budget) (Amendment) Bill 2019* was passed and certified by Parliament the amendment is yet to come into force as these taxpayers need a lead time to adjust their existing financing arrangement before the new rules come into effect. The changes are expected to come into force from 1 January 2021.

Section 65A and its impacts on taxpayers

As previously reported the IRC are requiring certain specified government departments and state owned entities to remit GST payable to suppliers directly to the IRC rather than to the supplier. Suppliers should therefore consider how they will record these transactions for accounting purposes in their system. Suppliers should complete their GST return as normal but also complete line 16 of the form stating the Section 65A credit available. Suppliers should also lodge a suppliers listing with their GST return. It remains to be seen how Section 65A will work in practice - we hope that IRC's reconciliation process will be fast and effective so taxpayers are not left with tax shortfalls and automatic penalties on their GST accounts.

Our social media presence

Please follow us on our KPMG PNG LinkedIn page to see our regular thought leadership pieces, newsletters and updates.

Contact us

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