Foreword

As KPMG is the only 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 as well as tax and assurance, we are well placed to provide a truly multi-disciplined approach to business advisory. We hope you enjoy our regular KPMG Kundu.

IRC notice – diverting personal revenue through interposed entity

by Karen McEntee, Head of Tax and Rachael Sindigaim, Manager

The IRC issued a notice in the national newspapers in relation to ‘income splitting’ arrangements discovered as part of their ongoing IRC audit activity, which in their view are null and void and contrary to the anti-avoidance tax provisions. In their view the arrangements appear to be aimed at reducing the amount of overall salary or wages tax payable. Under the arrangements:

- An individual sets up a company with the individual and other associated members as shareholders and directors (InterposedCo).
- InterposedCo enters into an agreement for the provision of personal services with another paying company (EmployerCo) which are to be provided by the individual.
- The individual tends to be acting in an official capacity in both EmployerCo and InterposedCo or otherwise acting on a non-arm’s length basis.
- The individual becomes an employee of InterposedCo.
- The amount of income that would otherwise have been paid to the individual as salary or wages will instead to be paid by EmployerCo to the InterposedCo.
- InterposedCo may then distribute the income to the individual and other related parties via salaries or directors fees, taxable at lower threshold amounts than would otherwise have applied if the individual had received the entire income directly from EmployerCo.
- In addition the IRC state that it is often a feature that the InterposedCo would claim a range of tax deductions that would not otherwise have been allowable if the individual engaged directly with EmployerCo.

The IRC’s position is that such arrangements are void and the individual should be subject to salary or wages tax on the income paid by EmployerCo. In addition EmployerCo will be subject to the tax due plus penalties of up to 20% flat tax plus 20% interest per annum for any retrospective shortfalls. The IRC have stated that a reduction in penalties may apply where a voluntary disclosure is made.

Given the IRC's published notice we recommend that a review is carried out of any such or similar arrangements for personal services. Please contact us for more information.

Cyber security – the fear factor, or taking a positive approach

by Anton van Tonder, IT Manager and Larson Pyakalyia, IT Graduate

In the last couple of years we have seen a rapid emergence of new technology and greater connectivity as well as a social media and mobile use explosion in Papua New Guinea. However, many organisations are struggling to achieve their online aspirations without feeling exposed to cyber and information security risks. It is not surprising that managing cyber security has moved up the corporate agenda.

There is no organisation in Papua New Guinea that is not impacted by information technology.

A recent spate of cyber breaches in developing countries has again highlighted that all organisations in PNG need to implement protections against such possible attacks. There is also an increasing sophistication and persistence as these could be the work of nations, organised crime, hacktivists or even from within the organisation itself.

A recent example of such an unusual attack is that of an equipment manufacturer with a long track record of strong sales and premium pricing that noticed that they were losing market share. Their analysis revealed that their products were having a much higher fail rate than expected.

After further investigation, the company identified that this was due to a cyberattack. However, this was not a typical breach whereby customer or company information was stolen. Instead, the hackers deliberately changed the parameters in the company's quality control programs so that even components with significant flaws or defects would pass quality control testing. They were sending sub-par products into the marketplace because a cyberattack.

One major blind spot for executives is viewing cyber and information security as an IT risk only, when it should be viewed as part of the holistic business strategy and overall management of strategic risks.

A high-quality cyber readiness program will not only focus on keeping the data safe and secure. It will also help to increase and improve the integrity of that data to make sure that you have the right and complete data upon which to base your business decisions.

We are living in a world in which technological change is taking place at lightning speed, companies are transforming and everything is connected. The bottom line for CEOs of transforming companies is that they and their leadership teams need to act now to implement a strategic, holistic approach to cyber readiness that will not only protect their valuable data, but also enhance the company's agility and better position it for growth down the road.

What is the role of the audit committee in organisational culture?

At our most recent PNG Audit Committee we discussed with Directors the role if any, the Audit Committee should play with respect to organisational culture. The overwhelming consensus was that there is a role for the Audit Committee and some of the key considerations coming out of the discussion included:

- Poor culture makes the implementation of strategy difficult or even impossible.
- A key consideration for Audit Committees is to understand how your management are measured and remunerated. There is an old adage that what gets measured gets done and therefore this is a key driver of behaviours. Are your KPIs driving the right behaviour?
- What is the visibility of the Audit Committee to management – do you have regular attendance on a rotational basis for divisional managers to report on their risks? This contributes to culture.
- The view that the Audit Committee has a role in enforcing actions (such as implementing recommendations) and that a measure for management could be the implementation of recommendations on a timely basis (as opposed to a KPI around the number of recommendations raised during audits).
- Is there a level of tension between the Committee and management? While the relationship should not be antagonistic, there should be a clear separation between the Committee and management.
- The fraud triangle demonstrating the three elements contributing to instances of fraud – opportunity, incentive / motivation and rationalisation. Does your audit committee have oversight of these three elements? There is empirical evidence to suggest that a high level of satisfied employees tends to minimise the risk of fraud, as does ensuring there is visible surveillance and monitoring of the business.

Our next Audit Committee Institute will be held early in 2019. If you would like to attend please do not hesitate to contact us for further details.

Geopolitics and tax - why it matters?

It has been said often – we live in uncertain times, and this can impact our business. Of course, political risk itself is not new. Many companies have been dealing with it for a long time. But today, change is coming faster, harder, and from more directions than ever. This means that navigating tax systems today is becoming far more complex than many of us have been used to.

What is geopolitics? And how does it relate to tax?

Geopolitics is, at its heart, the study of the impact of geography on politics. Geography is not just mountains and rivers, although these physical elements are part of the picture. Geopolitics refers more to the impact of human geography: people, culture, communities, religion, access to resources, demography, and political systems are all critical components.

All of these factors create the political environment in which government policy – including tax policy – is made and enacted. Tax systems don't just exist. They are constructed and operationalised according to the political context. They can, and do, change, as politics changes. While the basic function of tax remains to raise revenue, the design of tax policy are all political decisions. How much tax is collected, how and from whom, as well as how it is then spent, are all designed to achieve certain political outcomes. What constitutes a 'public good' depends on the political preferences of those in power.

And, as geopolitical circumstances change this will have impacts on how tax systems look and function. This includes today, as well as the operations of the tax functions of the future.

A good example is the recent reforms to China's tax laws. Taxation is a sensitive issue in China. So why now? And why these particular changes? What geopolitical trends in China do they reflect, and what could they augur for the future? Another country to watch is Indonesia, which has recently increased its import tax rates. More uncertainty lies ahead, as identity politics and an apparent authoritarianism are characterising the political environment in the lead-up to elections scheduled for early next year. In what ways might incumbent President Jokowi reshape the tax system to garner support from certain critical interest groups? Looking at Latin America, recent protests in Argentina against austerity measures may push the government into changing how tax is designed there.

Geopolitical currents have resulted in seismic shifts across Europe. In response, EU Commission President Juncker has outlined five possible scenarios for the future of the EU, every one of which will have very different results for the tax systems in European countries. A combination of numerous geopolitical factors in the United States has had profound impacts around the world. Denuclearisation on the Korean Peninsula, and the US' trade relationship with China will ultimately have an effect on tax systems.

In the current unpredictable global environment, tracking geopolitical trends and events means being able to better understand and navigate the changes, and make the most of new opportunities. It is more important than ever to understand the shifting sands of geopolitics and the implications of geopolitics for tax.

The KPMG Geopolitics and Tax Unit has been established to support businesses as they negotiate these complex challenges. It will examine the broader geopolitical context around changes to tax regimes. Its work helps clients figure out the 'now what' of geopolitics for their business by joining the dots between the macro political trends and pressing challenges in different sectors.

It's a cliché because it's true. Uncertain times complicates planning, so we must plan for uncertainty.

This is a revised version of an article produced as part of the KPMG Geopolitics and Tax Unit which first appeared in Tax Now.
