CHAPTER 3. 2007 BUDGET REVENUE MEASURES

3.1 OVERVIEW

The Government continues to draw from the benefits of strong economic leadership and improved macroeconomic environment. In the 2007 Budget, there will be no new taxes. Rather, the 2007 Budget introduces measures to improve on the existing taxation regime and continue with planned tax reductions. The mining levy will be phased out altogether in 2007. Meanwhile the seven-year Tariff Reduction Program came to an end in January 2006 and will be reviewed in early 2007.

Reform of the income tax scales will continue as announced in the 2006 Budget. A lower excise rate will apply on pre-mixed “Zoom” at the refinery gate (or at the point of import) for a trial period of one year. This will provide tax relief to coastal people reliant on “Zoom” to access markets and basic services. The Government will address impediments in the forestry sector by simplifying the current log export tax system.

3.2 TOURISM INCENTIVES

In the 2006 Budget the Government initiated a range of tax incentives to apply from 1 January 2006 designed to promote tourism in PNG, both by encouraging advertising of PNG tourist venues in countries that should be the prime markets for PNG tourism and by encouraging investment in tourist facilities. These incentives included a double income tax deduction for the costs of tourism operators promoting their services in overseas markets and accelerated depreciation for capital investment in hotels, restaurants and facilities such as sports fishing.

Earlier this year the Government requested the Independent Consumer and Competition Commission (ICCC) and the Tourism Promotion Authority (TPA) to undertake a comprehensive review of the tourism industry in PNG and to develop proposals to foster its development. The final report on the Tourism Master Plan was provided to the Government on 20 September 2006.

The report acknowledges that the initiatives provided in the 2006 Budget provided significant assistance to the industry. However the report considers that a number of further tax concessions to assist with the development of the tourism sector of the economy are necessary to ensure the industry is fully developed.

The report notes that the potential gains from tourism can be significant for the country. It also notes that countries with which PNG competes for large tourist hotel projects offer significant tax concessions for these projects. It concludes that PNG needs to increase the level of tax incentives it provides in this area if it is to be effective in competing for such investments. It considers such investments an important part of the future development of the tourism sector in PNG. The following tax concessions will apply from 1 January 2007:

- exempt from GST the purchase by foreign tourists, prior to arrival in PNG, of travel and accommodation within PNG;

for all investors in the tourism sector:

- increase accelerated depreciation to a maximum of 55 per cent , and
- make expenditure on staff training qualify for double deductions;

provide two additional incentives for new investments in tourist accommodation facilities, where expenditure exceeds US$10 million and the facility has at least 150 guest rooms, and the new investments are made within 5 years from 1 January 2007:

- a concessional tax rate of 20 per cent for ten years from the date of completion of the project; and
- availability of infrastructure tax credits, for an indefinite period but limited in amount to 1.5 per cent of gross income in each year and to the income tax liability.

3.4 FORESTRY TAX REFORMS

The forestry industry makes an important contribution to the economic development and social wellbeing of Papua New Guinea. Within the constraints of the medium term fiscal framework, the 2007 Budget provides for forestry tax reforms.

3.4.1 Development Levy for Forestry Resource Owners

The royalty of K10 per cubic metre that landowners currently receive for the logs harvested from their land and exported has remained unchanged since its introduction in 1996. As such, there is a compelling case to increase the benefits that landowners receive from log export revenue.

In this Budget the Government will significantly increase the benefits to communities from the logging of their resources. From 1 January 2007, timber permit, timber authority and timber licence holders will be required to pay a new levy called “premium levy” of K8 per cubic metre in respect of the exports of natural unprocessed logs and flitches. This levy will be administered using similar arrangements as currently apply for development levies paid in relation to petroleum projects. The Government will offset the cost to the industry of paying this levy by reducing the log export tax.

It is intended that this will provide real benefits to the development and well being of rural communities by funding agricultural or infrastructure development projects in logging areas.

3.4.2 Changes to the Log Export Tax System

The existing log export duty operates on a progressive scale based on the log export price per cubic metre. To simplify the system and to address concerns that the current progressive scale discourages production and investment, the log export tax will be changed to a flat rate so that the same rate of tax applies across the price range.

The new flat rate of log export tax will be set at 28.5 per cent, offsetting both the “premium levy” and the impact of the increase in the average rate of tax since the scales were last reviewed.

3.5 GREEN REVOLUTION

The Government is committed to providing effective assistance to agriculture to maximise the contribution this sector can make to the PNG economy. To this end, the Government

announced in the 2004 Budget a range of direct tax concessions, including a 150 per cent tax deduction for approved expenditure on research and development, a similar concession for approved expenditure on agricultural extension services and a special concessional income tax rate of 20 per cent to apply for 10 years to new agricultural investments projects with investments of more than K5 million where construction commenced between 1 January 2004 and 31 December 2006.

The Government enhanced these concessions in the 2006 Budget. In particular the Government relaxed the eligibility criteria for the concessional tax rate in any new agricultural investment. The concession is now available for projects with an investment of at least K1 million commencing any time between 1 January 2004 and 31 December 2011.

Industry has responded positively to these concessions. The Government has received 13 applications for approval of research and development expenditure to qualify for the concessional tax deduction. These applications involve the expenditure of more than US$10 million (K30 million) in agricultural research and development.

The initiatives announced by the Government in recent Budgets to assist agriculture are set out in Table 46 below.

In addition to these tax measures the Government has also provided support to the agricultural sector through increased expenditure on infrastructure, increased funding to the Rural Development Bank and its extensive liberalisation of foreign exchange controls in 2006.

The Government considers these initiatives as essential elements of its strategy to enhance the level of agricultural production in the country. The Government will continue to take pro-active approach to ensure these incentives are as effective as possible. To this end the Government will be launching a promotion program to ensure all sectors of agriculture are aware of the concessions available and how to access them.

Table 46: Relief provided to the Agriculture Sector by Government

Green Revolution Government Policies	Government Action/Implemented
1. Tax Relief for Agricultural Research and Development.	150 per cent deduction in Agriculture Research and Development from 1 January 2004 onwards.
Tax Relief for Agricultural Extension services.	150 per cent deduction for Agriculture Extension services from 1 January 2004 onwards.
2. Concessional tax rate on income from new investment in agriculture.	20 per cent income tax rate for new agricultural projects from 1 January 2004 to 31 December 2011.
3. Reduction of the tariff rate on agricultural equipment.	Tariff free import of tractors from 1 January 2004 onwards.
4. Increased Infrastructure Tax Credit (ITC) for agriculture sector.	1.0 per cent of assessable income introduced in 2005 and increased to 1.5 per cent in 2006.
5. Reduction for Excise on diesel.	Absorbed National Road Authority levy on diesel Excise introduced in 2006.
6. Made dividends tax free.	Dividend Withholding Tax now a final tax on dividends; no income tax on dividends since 2006.

Source: Department of Treasury

3.6 EXCISE RELIEF FOR PRE-MIXED GASOLINE-OIL FUEL (EG 'ZOOM') AND AVIATION GASOLINE

The Government has made significant investments in roads and land transport infrastructure. This has improved the ability of people to move from one place to another and has benefited the agriculture sector significantly by enhancing the access of agricultural goods to relevant markets.

Furthermore, for many of our people living in towns and rural areas, the main forms of land transport are powered by diesel - PMVs for passenger transport and larger trucks for agricultural produce and trade store goods. The rate of excise on diesel is currently only 6 toea per litre.

On the other hand, the 'banana boats' used by many people in coastal areas to access essential services and markets for their produce are fuelled by a gasoline-oil fuel (for example, 'Zoom'). This is a mixture of mainly gasoline with a small amount of oil. Gasoline is taxed at 61 toea per litre, a much higher rate than applies to diesel.

High world oil prices have pushed up the price of fuels used by the coastal population to access basic essential services and get their produce to markets. It is not feasible to stop prices moving in line with world oil prices. However, there is clearly a case on equity grounds for targeted tax relief for users of gasoline-oil fuel.

A special excise rate of 30 toea per litre for pre-mixed gasoline-oil fuel will be introduced from 1 January 2007.

There is concern, however, that it is possible some other fuel users will try to substitute pre-mixed gasoline-oil fuel for gasoline in their vehicles to take advantage of the lower rate of excise. The extent of possible revenue loss, and of air pollution, from this cannot be known in advance. Therefore, this measure will initially apply only for a trial period of one year.

In addition, because aviation gasoline for light planes is needed for vital services in remote regions, in much the same way as diesel for road vehicles or "Zoom" for banana boats, the 2 toea per litre excise on that fuel is being removed from 1 January 2007.

3.7 DISTRIBUTION OF GOODS AND SERVICES TAX (GST)

The current system of distribution of financial assistance to the Provinces and the National Capital District (NCD) is unsustainable. Accordingly, the Government through the National Economic and Fiscal Commission is developing a new framework for the provision of financial assistance to Provincial Governments. This new system is discussed in more detail in section 4.3.2 below.

The new system is designed to provide a stable source of funding that will grow in proportion to the National Government's revenue that will equalize over time the capacity of provinces to provide the services mandated to them.

The first step in the implementation of this new funding arrangement will occur in 2007. It will involve changing the basis for determining the GST revenue to be distributed to the provinces and NCD. The current method is based on an estimate of GST to be received in the forthcoming year. The new system will be based on actual GST received in the most recent year adjusted for inflation.

This change is necessary to address the instability experienced in the current system which has hindered the ability of both the national and provincial governments to prepare their budgets.

For 2007 a comparison will be made between the GST collections in each province in 2005 and their actual amount of GST distribution received by the province in 2006. The amount the province will receive will be the greater of these amounts indexed by the expected level of inflation for 2007.

This system will ensure no province is worse off in 2007 compared to 2006 as well as producing more certainty in revenue flows for provincial governments which should assist in the development of provincial budgets.

3.8 TEMPORARY INCREASE IN SELECTED IMPORT TARIFFS

Because of unexpected pressure through imports on the domestic industries processing and canning some foods and drinks, temporary increases will be made with effect from 1 January 2007 in import tariffs on a small set of products — canned dark-meat tuna from 15 per cent to 20 per cent and canned carbonated soft drinks from 15 per cent to 25 per cent. In addition, the import tariff on beans used as inputs for making canned baked beans is being reduced from 25 per cent to zero and the import tariff on canned baked beans is being increased from zero to 25 per cent.

These tariff increases are temporary because they will need to be reassessed in a wider and longer-term context, when the planned review of tariff policy takes place early in 2007.

In addition, the Government's undertaking to maintain an import tariff of 20 per cent on canned mackerel will be extended to 31 December 2011.

3.9 OTHER MINOR AND TECHNICAL AMENDMENTS

As in previous years, a number of minor (non-policy) changes to the taxation laws have become necessary for various reasons — to improve the clarity of the tax laws, overcome interpretational issues, bring them into line with international agreements, streamline them and reduce compliance costs. In brief, the measures are to:

- Amend the *Goods and Services Tax Act* to clarify the scope of the exemption from GST for crude oil supplied by the Kumul Terminal to Napa Napa Oil Refinery.
- Amend the *Goods and Services Tax Act* to ensure that aid providers which set up trusts to administer aid funds are not disadvantaged.
- Amend section 155L of the *Income Tax Act* to clarify that credit for exploration expenditure can be transferred to the new owner when an exploration licence is transferred.
- Amend regulation 10G of the *Income Tax Act* Regulations to clarify what licences are subject to the regulation.
- Amend the *Income Tax Act* to implement NEC Decision 135/2005 which approved double income tax deductions for donors to the 30th Independence Day celebrations and the Pacific Islands Forum held in 2005.

- Amend section 20 of the *Income Tax Act* to extend the exemption from income tax available for non resident Commissioners of Inquiry appointed under the Commissions of Inquiry Act to non resident expert staff appointed under the Commissions of Inquiry Act.

- Amend section 275AA of the *Income Tax Act* to make Bougainville Copper Limited subject to the requirement to pay company tax in advance as intended.

- Amend the relevant legislation to implement NEC Decision 139/2006 to provide Ramu Nickel with an exemption from income tax for the period of the 'tax holiday' agreed to by the NEC, exemption of certain transfers from stamp duty and exemption of certain imports from customs duty.

- Amend the *Bookmaking Act* to facilitate electronic betting by providing for the purchase of betting tickets from persons approved by the Commissioner General of Taxation.

- Amend the Excise Regulation and Excise (Beer) Regulation to remove redundant references to pre-Independence descriptions of Papua New Guinea in respect of labelling of excisable products, and to increase penalties.

- Amend the *Stamp Duties Act* to close a loophole which currently allows agreements for the sale of shares to escape duty on the transfer of the shares subject to the agreement.

- Amend the *Stamp Duties Act* to remove the exemption for long-term bonds to bring the treatment into line with the treatment under the *Income Tax Act*.

- Amend the *Stamp Duties Act* to clarify the application of section 68A in respect of company amalgamations.

- Amend the *Stamp Duties Act* to ensure the "land rich" provisions apply to land held in subsidiaries of the acquired company.

- Amend the *Customs Act* and Regulations to facilitate PNG's adherence to its international obligations arising from its accession to the Revised Kyoto Convention.

- Introduce cyber crime legislation as a measure to protect the Customs electronic entry processing system known as ASYCUDA ++.

- Amend the *Customs Act* to introduce more stringent reporting requirements for travellers and goods entering and leaving PNG.

- Amend the *Excise Tariff Act* to correct the description of the new tobacco competing product to enable utilisation of the lower excise rate.

- Amend the *Customs Act* to rectify certain drafting errors and anomalies identified in the 2006 Budget Customs legislation.