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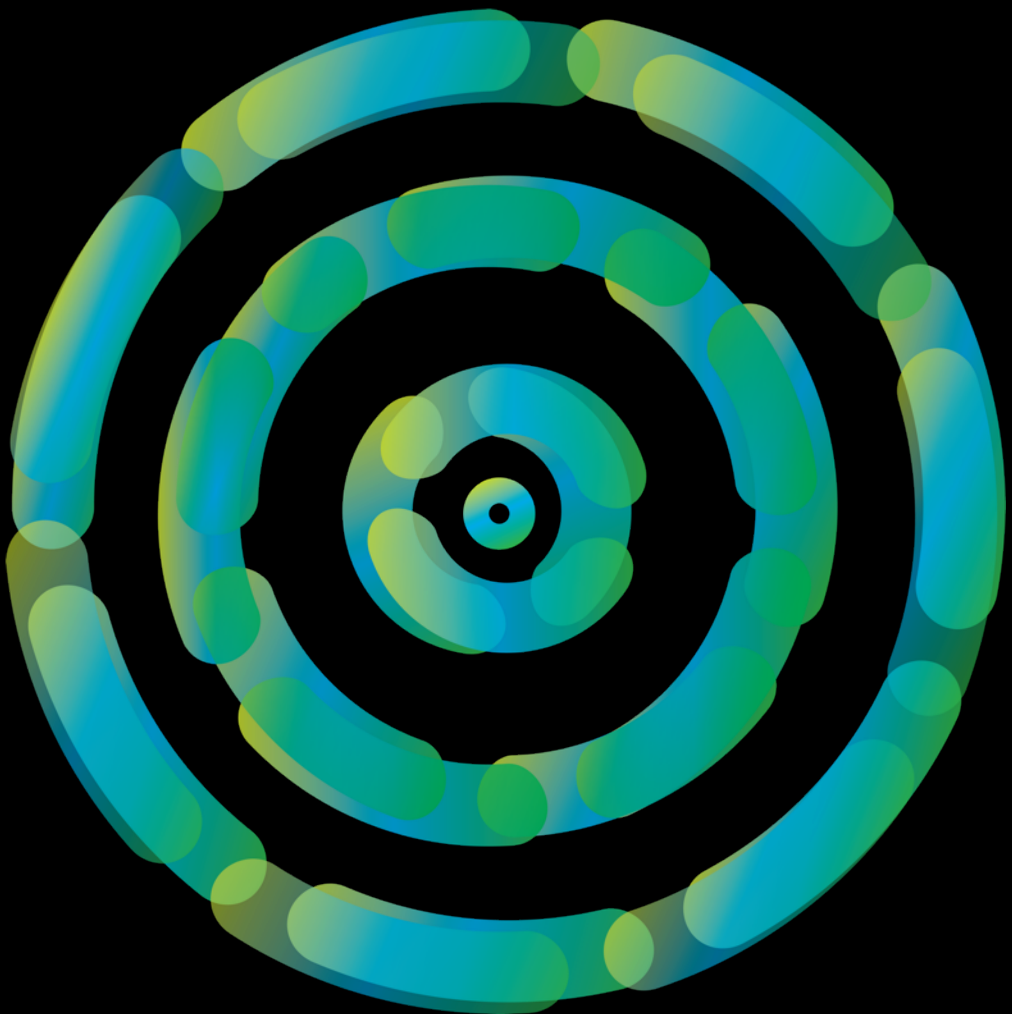

Papua New Guinea Budget 2021

Consolidation for Growth

Budget Alert

Earning the right to grow again

"A sensible and responsible budget designed for difficult times."

– Hon. Ian Ling-Stuckey, CMG. MP.
Minister for Treasury

Executive summary

Earning the right to grow again

With a theme of “Consolidation for Growth”, the focus of the 2021 Budget is to consolidate the country’s economic and budget position and move back to a growth path with a view of rebuilding living standards for Papua New Guineans.

It is intended this will be achieved through:

- borrowing to meet the budget deficit of PGK6.6 billion;
- growing the non-resource sector;
- gaining a larger share of resource projects; and
- reforming State-owned enterprises and the public sector.

The Marape Government has indicated its intent to continue supporting key capital programs such as Connect PNG, Micro Productivity Improvement Programs (PIP) for rural infrastructure and Special Intervention Programs that aim to reduce the cost of doing business, and to connect and expand the economic corridors to stimulate economic growth while boosting income generating opportunities in rural areas.

The 2021 Budget will also see increased expenditure to stimulate sectors, including agriculture, tourism and SMEs – those most affected by the COVID-19 pandemic. We see this as important given these sectors support 85% of the PNG population. Other expenditure priorities will be allocated to the health, education, and law and justice sectors, together with a focus on payment of arrears to business, and the retirement of public servants.

Challenges and risks

This Budget is being delivered during a period of heightened uncertainty – both from domestic parliamentary instability and the global pandemic. Assumptions are based around anticipated growth at both the global and domestic level, which may not materialise to the forecast extent or timeframes, thereby resulting in lower than anticipated revenues, private sector demand, and budget financing limits.

The Budget has also been prepared with the assumption that public sector agencies and SOEs will spend within their allocated budgets – which the Treasurer has stated is difficult to manage. Whilst there will be further controls put in place in 2021 to curb Personnel Emolument (PE) overruns, given the historical year-on-year increases in this space, it remains to be seen whether these limits and controls will sufficiently curb this expenditure. However, as the Treasurer calls out, the proposed capital programs remain at risk if recurrent expenditure cannot be sufficiently reined in - as can be seen from past supplementary budgets.

There is a notable budget deficit of around PGK6.6 billion, primarily on recurrent expenditure, which will be funded on borrowings. This reflects a significant expansion of debt, albeit at record low interest rates. A medium term outlook has been taken in this Budget to achieve a progressive decline in the budget deficit as a share of GDP between 2020 and 2023, moving from a high of 9% in 2020 through to a forecast of 3.2% in 2023. It will remain to be seen as to whether this is realistically achievable: not all economies can grow their way out of debt, nor have the discipline to do so even if growth is present .

Final thoughts…

We highlight the fact that the Government will expand borrowings to meet recurrent expenditure, with a plan to grow out of the debt challenge.

Whilst we are supportive of specific stimulus through deficits to drive economic expansion, particularly during COVID-19, we are concerned that the deficit is potentially unbalanced, comprising more recurrent expenditure than capital projects, reform and/or investment in human capital that would drive sustainable growth.

Our hope is that PNG can continue to harness all its natural advantages (renewable and non-renewable), drive connectivity (to water, electricity and the internet), which will result in enhanced health, education and economic outcomes for the people of Papua New Guinea.

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In early 2020 (pre-COVID times), business conditions in PNG remained subdued as a result of lower company tax collections, tight cash flow conditions and poor employment outcomes, despite a moderate growth recovery in 2019 at 6%, following the 2018 earthquake-related disruption. The onset of the pandemic exacerbated the already subdued economic conditions and further impacted the economy, alongside the closure of the Porgera mine and low output from the Lihir gold mine (despite the rise in gold prices in 2020). As a result of this, economic growth in 2020 is estimated to contract by -3.8%. Of this, the closure of Porgera Mine accounted for -1.3%.

Growth in the non-resource sector is forecast at 3.3% in 2021, reflecting an overall expected recovery of business conditions from the impact of COVID-19. The Mining and Quarrying sector is projected to grow by 9.5%.

Resurging growth

In 2021 economic growth is forecast to rebound at 3.5%, driven by a recovery across most sectors and improved global demand and consumption off the back of the COVID-19 pandemic in 2020. This will see growth rise to an estimated 10.6% in nominal terms (which is an increase from an initial 7.4% forecast in the 2021 Budget Strategy Paper) totalling at PGK90.3 billion and is expected to increase in 2022 to reach an estimated growth at PGK99.4 billion. The forecast increase of 10% per annum in both 2021 and 2022 is the highest in PNG's history, and is larger than the growth from 2013 to 2015 when the PNG LNG Project commenced production.

Economic growth is projected to grow at a steady annual growth rate of 3.1% over the medium term, in line with an estimated 3.7% growth in the non-mining sector.

Key facts and figures

Table 1: Key macroeconomic indicators (Source: Department of Treasury)

	2014 Actual	2015 Actual	2016 Actual	2017 Actual	2018 Actual	2019 Est	2020 Proj	2021 Proj	2022 Proj	2023 Proj	2024 Proj
Economic Growth											
Total real GDP (%)	13.5	9.5	4.1	2.2	-0.3	5.9	-3.8	3.5	4.2	2.4	2.6
Non-Mining Real GDP (%)	4.1	-4.1	1.5	1.5	4.0	2.4	-1.1	3.3	3.7	3.5	3.7
Inflation											
Average on Average (%)	5.2	6.0	6.7	5.4	4.7	3.6	4.0	4.8	4.2	4.3	4.5
Dec on Dec (%)	6.6	6.4	6.6	4.7	4.9	2.8	3.5	5.8	3.8	4.6	3.7
Real Exchange Rate Index											
(2007 = 100)	153.2	141.0	131.0	132.9	131.6	130.7	133.1	136.1	139.9	143.6	143.6
Interest rate											
Kina Rate Facility (KFR)	6.25	6.25	6.25	6.25	6.25	5.50	3.00	3.00	3.00	3.00	3.00
Inscribed Stock (3-year yield)	8.0	9.7	9.7	9.7	9.0	10.5	9.0	9.8	9.8	9.8	9.8
Mineral Prices											
Gold (US$/oz)	1,266	1,160	1,248	1,258	1,270	1,392	1,783	1,961	1,985	2,006	2,024
Copper (US$/tonne)	6,864	5,502	4,865	6,166	6,517	6,006	6,004	6,584	6,584	6,598	6,629

Economic snapshot

Table 2: Overall Budget balance (Source: Department of Treasury)

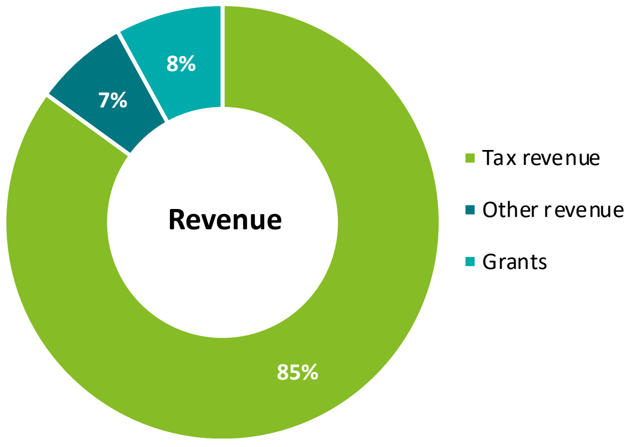
	2019 Actual	2020 Budget	2020 Supp. Budget	2021 Budget
Revenue	13,680.5	14,095.4	11,359.1	12,995.0
Expenditure	17,852.4	18,726.5	17,989.3	19,607.8
Net deficit	-4,171.9	-4,631.1	-6,630.2	-6,612.8
% of GDP	-5.0%	-5.0%	-8.1	-7.3%
Government debt (% GDP)	39.8%	40.3%	48.9%	51.5%

Revenue, expenditure and Net deficit figures are in PGK million

Of the PGK6.6 billion net deficit, PGK4.6 billion is expected to be financed through external borrowing. Of this, PGK2.4 billion has been identified on concessional terms, while PGK2.2 billion is yet to be identified. The remainder of the net PGK2 billion will be financed by domestic borrowing through the issuing of Government Securities.

In 2021, total revenue and grants are forecast to increase by 14.4% (higher than estimated in the 2020 Supplementary Budget).

Chart 1: Where does PNG's revenue come from? (Source: Department of Treasury)



2021 revenue is projected to be PGK12,995 million, arising from economic recovery supported by increased government spending, public injections to private sector credit growth, improved export commodity prices and higher anticipated growth in the Agriculture, Fisheries and Forestry sector.

The Government plans to rapidly reduce budget deficit over four years from a record high of 9% in April 2020 to a forecast 3.2% in 2023.

Economic snapshot

2021 Highlights

Table 3: Tax revenue by source (Source: Department of Treasury)

Tax Revenue (PGK million)	2019 Actuals	2020 Budget	2020 Supp. Budget	2021 Budget
Personal Income Tax (PIT)	3,211.6	3,215.0	3,308.0	3,455.7
Company Tax (CIT)	1,696.9	2,085.4	1,648.6	1,724.0
Mining and Petroleum Taxes (MPT)	760.7	561.2	161.1	313.6
Withholding and Other Income Taxes	401.2	367.8	352.8	452.1
GST	2,252.5	2,341.9	2,002.9	2,494.8
Stamp Duties	46.6	55.5	35.3	96.2
Excise Duty	1,061.0	1,215.0	964.2	1,175.1
Import Excise	299.7	292.0	273.7	294.5
Bookmakers' and Gaming Machine Turnover Tax	244.4	264.9	150.4	276.3
Other Taxes on Goods and Services	32.3	25.8	11.5	14.3
Import Duty & Import Taxes	511.2	427.8	347.3	417.7
Export Tax	398.1	455.4	390.0	395.6
Grand Total	**10,916.2**	**11,307.7**	**9,645.8**	**11,109.9**

Corporate income tax was significantly down on the original 2020 Budget estimate. It was also lower compared to the prior year. This downturn was a result of the adverse implications of the pandemic on business profitability, which will extend into 2021, given 2020 income will be reported in that year. However, the IRC is predicting an increase in 2021 by focusing on audits and compliance checks.

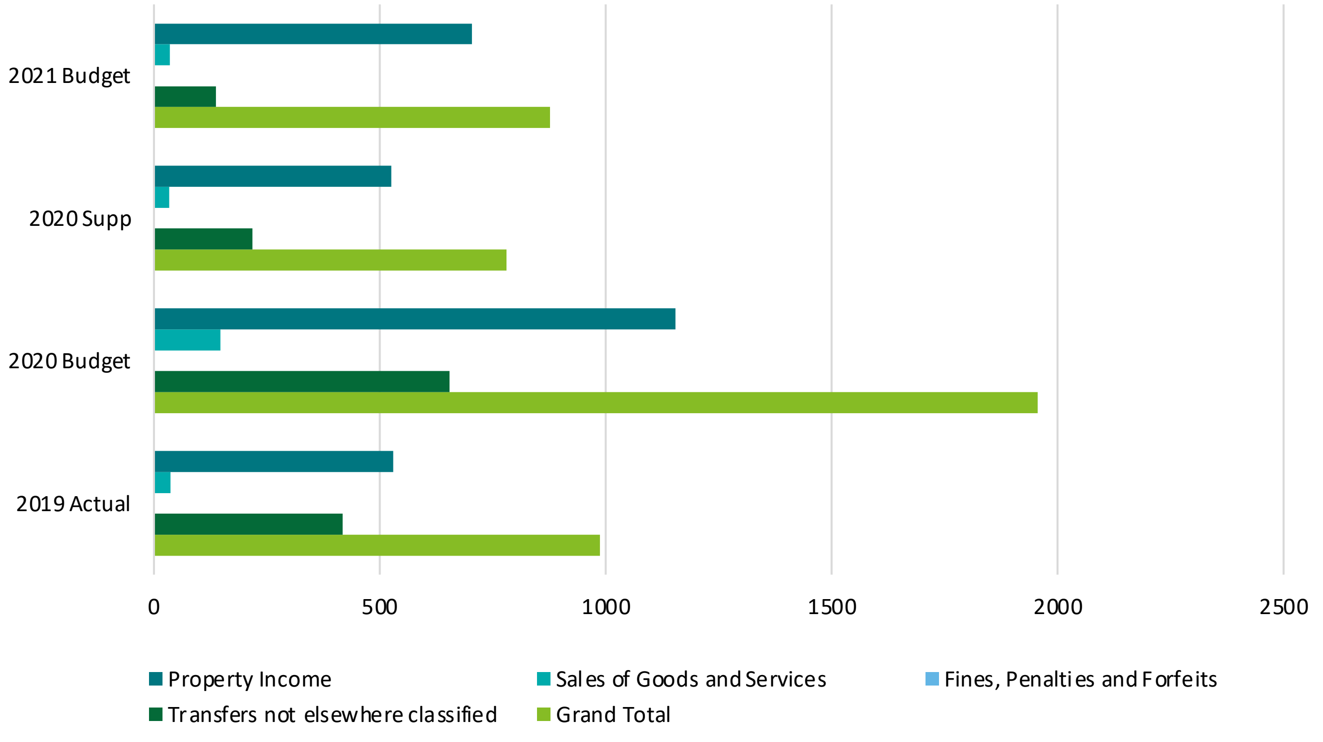
The decline in oil and gas prices, closure of Porgera Mine and temporary closure of Ok Tedi due to the pandemic has significantly impacted collections from the mining and petroleum sectors. Forecasts are based on Porgera resuming production around July 2021.

The fall in consumption due to COVID-19 restrictions has negatively impacted GST, excise and import duties.

The gradual easing of COVID-19 restrictions and subsequent increased business activity is expected to improve the revenue collected from consumption taxes in 2021, with growth also supported by increased IRC compliance measures.

Economic snapshot

Chart 2: Other revenue by source (Source: Department of Treasury)



	2019 Actual	2020 Budget	2020 Supp	2021 Budget
Grand Total	986.7	1,955.5	779.7	877.1
Transfers not elsewhere classified	418.2	654.3	218.3	136.6
Fines, Penalties and Forfeits	1.8	0.8	1.8	1.8
Sales of Goods and Services	37.2	146.7	34.2	35.0
Property Income	529.5	1153.7	525.4	703.7

Figures in PGK million

Property income predominantly consists of dividend revenues. In 2020, dividends from Kumul Petroleum and Ok Tedi are expected to be PGK350 million, increasing to PGK500 million in 2021.

Dividends from statutory authorities is expected to be PGK150 million in both 2020 and 2021.

Economic snapshot

2021 Capital Budget

Table 4: Development Partner Contributions

Development Partner (PGK million)	Grants	Loans	GoPNG Counterpart
ADB	20.0	714.7	70.0
CESKA		256.9	3.00
DFAT	890.5	16.0	5.0
EIB		76.0	5.0
European Union	135.6		13.0
IFAD		31.5	2.0
Indian Exim Bank		15.0	2.0
JICA	12.6	330.4	22.0
NZAID	29.3		
PRC	27.0	410.0	43.0
UN	167.7		
USAID			
World Bank		187.40	35.0
Total	**1,282.70**	**2,037.9**	**200.0**

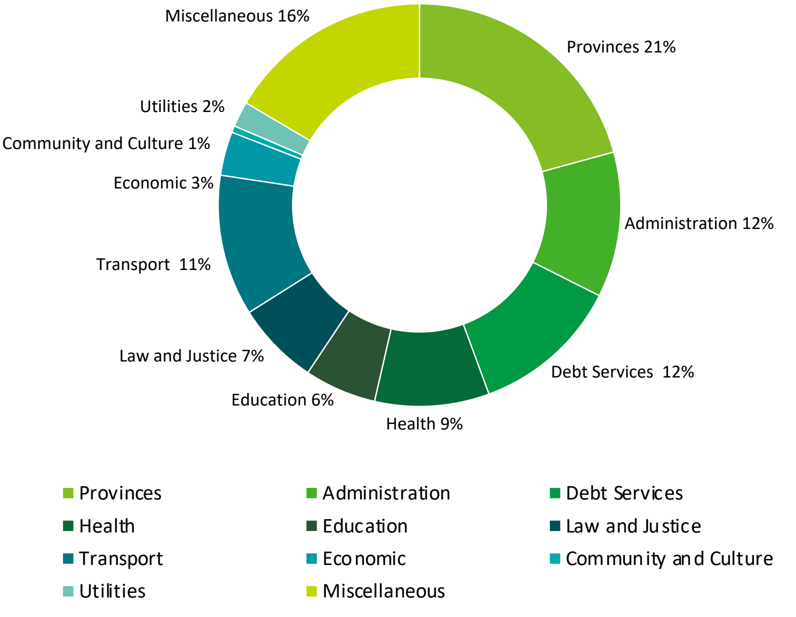
Grants and loans continue to provide key support to transport infrastructure, health, education, law and justice, technical support, capacity building, climate change and environmental support, and addressing cost cutting measures.

In 2021, the development partner assistance would amount to 46.6% of the total 2021 capital expenditure. The Government of Australia, through DFAT, provides the largest share of the grants.

Economic snapshot

Chart 3: Where does PNG's expenditure go? (Source: Department of Treasury)

Expenditure	2021 (PGK million)
Provinces	3,939.0
Administration	2,215.1
Debt Services	2,270.8
Health	1,745.0
Education	1,094.8
Law and Justice	1,270.8
Transport	2,149.4
Economic	666.5
Community and Culture	102.2
Utilities	387.4
Miscellaneous	3,135.8



2021 expenditure is expected to reach PGK19,607.8 million, split into the above sectors

Detailed tax measures

Corporate Tax Losses

- The 2020 Budget changes shortened the loss carry forward period from 20 years to 7 years (and from unlimited to 20 years for resource operations). However, the legislative amendments created some confusion as to whether the shortened year count was to be applied prospectively (from 1 January 2019) or retrospectively (from the year the loss was incurred).
- While it has been understood that the policy was for the change to be prospective, and this is how the changes have been interpreted by the IRC, the legislation had not been amended to reflect this.
- The 7 year tax loss carry forward period is now clarified to apply from 1 January 2019, such that losses available at that date may be carried forward up to 7 years from 1 January 2019. Losses can continue to expire under the old 20 year rule during that period.
- This change remains unhelpful for resource operations, given it does not specify that such losses may be carried forward 20 years from 1 January 2019.

Clarification of Tax Loss Carry Forward Rules

Provisional Tax Payments

- Provisional tax payment dates were previously set regardless of the accounting year end for taxpayers. This complicated matters for taxpayers who had a substituted accounting period (SAP) year end different to the default 31 December.
- In the 2020 Budget provisional tax payment dates were amended to change the dates to 90 days, 180 days and 270 days from the year end. However, these dates were not comparable to existing 31 December year end payment dates (being a month earlier) and have not been enforced in 2020.
- The payment dates have now been amended to:
  - First instalment - 120 days after the end of the preceding year
  - Second instalment - 210 days after the end of the preceding year
  - Third instalment - 300 days after the end of the preceding year.
- The changes do not take account of long or short months so the payment date may not correspond with the month end.
- Changes are effective from 1 January 2020, meaning the IRC will be required to clarify that penalties will not be imposed for dates already passed, should it be earlier for a taxpayer with a SAP.

Provisional Tax Payment Due Dates Adjusted

Detailed tax measures

Anti-Avoidance Measures

- The 2021 Budget introduces anti-avoidances measures to discourage employees and employers from converting employment relationships into independent contractor arrangements and thereby falling within the Small Business Tax regime (rather than Salary and Wages Tax).
- The new rules outline conditions that must be met before an independent contractor will be treated as such. Where one of these tests is not met the contractor must be treated like an employee, subject to salary and wages tax.
- In a positive step, the tests pull back from the initial anti-avoidance proposals circulated earlier in the year which were almost impossible to satisfy. The measures codify what had essentially been the common law tests with respect to distinguishing between an employee and independent contractor.
- This is effective from the date to be specified in the National Gazette.

Anti-avoidance Rules for Independent Contractors acting as Employees

Small Business Tax

- The 2020 Budget announced the introduction of a simpler tax regime for individuals conducting business as sole traders. The intention is to encourage them to enter the formal tax regime.
- While the small business tax still only applies to individuals, there have been some changes to the thresholds and tax amounts:
  - Sole traders with turnover less than PGK60,000 will now pay a fixed annual amount of PGK250.
  - A sole trader with annual turnover of PGK60,000 or more will now pay a small business tax of PGK62.50 plus 2% of turnover above PGK15,000 per quarter (March, June, September and December).
- Exclusions for who can be a sole trader subject to small business tax remain. For instance, they cannot provide professional services or be registered or required to be registered for GST (with the GST registration threshold being an annual turnover or PGK250,000).
- These changes will come into effect from a date to be specified in the National Gazette.

Small Business Tax Tweaks

Detailed tax measures

Prescribed Royalty Withholding Tax (PRWT)

- Prescribed royalty payments are specified payments to or on behalf of customary landowners. At present payments are directly paid by the developer to the relevant regulator, who then makes the payments to landowners and the PRWT to the IRC.
- Given this chain can prolong the payment to IRC, the 2021 Budget now amends the legislation to mandate developers to directly pay the 5% PRWT to IRC.
- Problematically this is stated to be effective from 1 January 2020.

Payment of PRWT to be made direct to IRC

Customs

- Current penalty fees and imprisonment terms of importers, exporters, brokers, and travelling passengers for offences under the Customs Act are increased to enhance compliance.
- There are new specific penalty provisions for the smuggling of tobacco products introduced.
- The increases in penalties are stated to be designed to increase compliance with Customs Act requirements.
- Changes are effective from 1 January 2021.
- The Customs Counter Clearance threshold is also to be increased from PGK1,000 to PGK5,000 to encourage SMEs and individuals to declare goods.

Increase in penalties for offences

Excise

- 20% excise duty has been introduced on hybrid vehicles, including electric vehicles. Previously these vehicles had no tariff item.
- The rate of 20% is the same as that applied to combustion engine vehicles.
- Changes are effective from 1 January 2021.
- It was also confirmed UHT Milk should be duty free.

Introduction of Excise Duties on Hybrid Vehicles

Future tax measures

Bank Levy

- The Government has indicated that it will look to the imposition of a new tax on the banking sector with the intention of introducing it during 2021. This measure was previously announced but deferred due to COVID-19.
- The Government has stated there will be public consultations prior to the introduction of this new tax.

Banks still to get that special attention

Telecom Levy

- There are also still plans to introduce a new universal access levy on telecommunications.
- This levy is to be based on turnover with a rate set in line with international practices and PNG's needs, and in the range of 0.5 % to 4%.
- Again consultation is promised prior to introduction, with NICTA playing a key role.

Expensive call on the horizon?

Other Future Measures

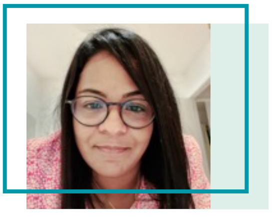
- New measures are being contemplated which would clearly differentiate fish species, packaging, and duty rates. This would come into effect retrospectively from 1 January 2015.
- A new heading would be created for margarine used for baking purposes by local manufacturers. This will come into effect from 1 January 2021.
- The Government has proposed to conduct a review of taxation arrangements around the fuel industry. This would also explore the possibility of examining options for waste oil and looking at excise tax on fuels.

Fish, margarine and fuel - a slippery topic?

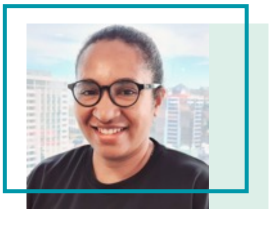
Contacts

Benjamin Lee
Managing Partner
benjlee@deloitte.com.pg

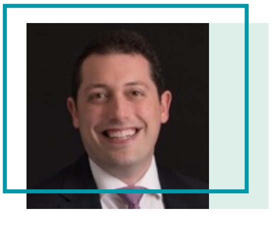
Andrew Harris
Partner - Tax and Business Services
andrewharris@deloitte.com.pg



Sanchika Sutharshan
Director - Tax and Business Services
ssutharshan@deloitte.com.pg



Maygen Turliu
Director - Tax and Business Services
mturliu@deloitte.com.pg



Gil Grinberg
Partner - Advisory
ggrinberg@deloitte.com.pg

Lyndel Melrose
Partner - Consulting
lymelrose@deloitte.com.pg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2,500
4,567
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7,325
Link One
Link Eight
Daily active users
Daily active users
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Top 5
Disbursement
Progress
Account Balance:
App Usage across versions
123k
53k
23k
3k
Marketing
30%
Media
10%
Engagement
20%
Awareness
15%

Deloitte.

Contact us
Deloitte Touche Tohmatsu

Level 9 Deloitte Haus,
MacGregor Street,
Port Moresby
Papua New Guinea

Phone: +675 308 7000
www.deloitte.com/pg