



Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Foreign Contractors

This is the series of Alerts summarising the proposed major changes arising from the Income Tax Act rewrite. This Alert is based on the 9th redraft of the legislation. We understand that the legislation will be introduced to Parliament in late November 2022 and have a commencement date of 1 January 2024.

Foreign Contractors - A New Regime

The 9th draft of the Income Tax Act contains many important implications to consider for non-resident contractors, and for those that engage non-resident contractors. Essentially, the foreign contractor withholding tax (FCWT) regime will be removed. This will be replaced as follows:

1. A "non-resident tax" is imposed on non-residents deriving PNG sourced income including, amongst other things, technical fees, dividends, interest and royalties. Under the 7th draft, technical fees and management fees were split into two withholding taxes. In the 9th draft Act these two concepts have now been merged.

The definition of technical fees has been amended to include administrative, management, technical, professional and consultancy services. Fees of this nature will now be subject to 15% technical fee and Management Fee Withholding Tax (currently 17%) will no longer apply.

2. Only foreign contractors with no permanent establishment in PNG will be taxed through the non-resident withholding tax:
 - A. As stated above for technical service providers this is through a 15% non-resident withholding tax.
 - B. For lessors of equipment (that is not substantial equipment), this will be through a 10% (or 30% where the lessor is associated) royalty withholding tax
 - C. Non-resident persons who derive other types of income such as dividends, interest, insurance premiums, annuities, natural resource amounts are also subject to withholding tax.
3. A withholding agent responsible for withholding the taxes is required to furnish the recipient of the withholding income with a withholding tax certificate.
 - A. Where the withholding tax is not withheld by the withholding agent, the IRC may now recover that withholding tax from the foreign contractor.
 - B. Where the tax is withheld but not paid to IRC, then IRC can still recover that from the recipient, where the recipient is a party to an arrangement under which the tax withheld is not paid.
4. Importantly, the provisions of PNG's tax treaties will continue to impact the application of these withholding taxes.
5. Foreign contractors that have a permanent establishment will be required to lodge annual income tax returns and be assessed on 30% of their net (taxable) income. Some important features to this:

- A. The definition of permanent establishment is broadly the same framework to that found in PNG's tax treaties.
- B. Unless otherwise determined by the Commissioner, the permanent establishment will be treated as a separate and distinct person (who is an associate) from the offshore headquarters. This can have important implications for the permanent establishment on cross-border intra-company charges; including the application of transfer pricing, thin-capitalisation and withholding tax rules to such charges.
- C. The restriction of the deductibility of technical fees to the higher of 2% of assessable income or 2% of allowable deductions applies to permanent establishments.
- D. Permanent establishments are also taxed at 15% on their deemed repatriated profit, which is calculated as a function of the movement in net assets and net profit. See Tax Alert X for further details. We note that the proposed calculation of repatriated profits contained in the 9th draft still appears to be imperfect.
- E. All finance leases follow IFRS accounting treatment. Therefore, the lessee claims depreciation and interest. Interest may be subject to withholding tax at 15%. Further, the 9th draft now provides clarity on the leases of real estate. It is clarified that a lease of real property is not a finance lease.
6. The definition of who is a tax resident individual has also been broadened.
7. There are now treaty shopping anti-avoidance rules aimed to prevent the insertion of intermediary entities to obtain the benefit of a tax treaty. For instance, this may unwind treaty benefits for leasing arrangements routed via treaty countries such as Singapore.
8. Finally, there remains the anti-avoidance rules which make it difficult for an independent contractor who is an individual to be anything but an employee of their customer.

The abovementioned changes to the taxation of foreign contractors are significant and taxpayers should take time to ensure they understand the implications for their business. There are a number of transitional issues to consider. This includes the timing of the payment of contract payments which may impact the applicable tax around transition date.

The draft legislation provides for regulations to deal with many of the transitional rules. Treasury has advised that draft regulations will be issued during the calendar year 2023. These will need to be carefully considered before the proposed implementation date of 1 January 2024.

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