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Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Capital Gains Tax

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This is the tenth of our series of Special Alerts summarising the major proposed changes under the Income Tax Act rewrite. This Alert is updated to the 9th draft of the draft ITA.

Capital Gains Tax

The rewrite of the Income Tax Act (new Act) contains many important implications to consider for taxpayers. In this article we summarise the proposed new Capital Gains Tax rules. This Alert is updated to the 9th draft of the new Act. It is expected that the new Act will be introduced to Parliament in late Nov 2022 and come into effect from 1 January 2024.Unlike other provisions in the new Act (which will apply from 1 January 2024), the CGT provisions will only apply from a date to be announced and Gazetted by the Treasurer.

Capital Gains Tax (CGT)

Early in 2019, Treasury issued a consultation paper and draft legislation regarding the introduction of CGT. In our April & May 2019 Tax Alert we highlighted the main features of the draft legislation. There has been further consultation as part of the

The new Act contains a division dealing with the draft CGT rules. At present, capital gains arising from the sale of capital assets such as real property or shares are generally untaxed in PNG. Accordingly, the intention behind the introduction of a CGT is to broaden the tax base.

We set out in this alert a summary of the draft CGT rules as contained in the new Act.

CGT is imposed on the gain arising from the disposal of a taxable asset where the consideration for the disposal of the asset exceeds the cost (or deemed cost) of the asset. If the cost exceeds the consideration, a capital loss arises. The capital loss is available to be offset against capital gains indefinitely until the loss has been fully offset. The capital loss can only be offset against a future capital gain (so capital losses are quarantined against capital gains) To claim a loss a CGT return must be filed in respect of that disposal. As CGT will operate on a transaction by transaction basis a loss within an income will not be available for offset against a gain in that unless the loss arises first and a CGT return has been filed in respect of that disposal.

Furthermore, the capital loss can only be offset where the amount of the capital loss is substantiated to the satisfaction of the Commissioner General. It is unclear what sufficient substantiation would require, and whether this is anything in addition to the IRC's usual assessment process.

The determination of what is a "taxable asset", when a disposal occurs and what would constitute consideration is critical to the scope of the proposed CGT regime. We discuss these elements briefly below.

"Taxable Asset"

The proposed CGT rules suggest that that the CGT will initially only apply to the following assets:

- PNG real property (there definition of "real property" includes a leasehold, structural improvements to land, and resource tenements and information relating thereto);
- a membership interest in an entity whose value (directly or indirectly – this would include non-PNG entities and also an entity that held the relevant property at any time in the period of 365 days prior to the disposal) is more than 50% derived from PNG real property; and
- an option or right to acquire the above.

Importantly, CGT will not apply to –

- an individual's principal private residence;
- an asset that is used by a person solely to derive exempt income;
- a gain or loss derived from the first commercialization of customary land is not subject to tax or recognised as a loss.

Note there is no exclusion for assets held prior to the introduction of the CGT regime.

Disposal

The term disposal is widely defined. In the case of-

- a right – cancellation, redemption, expiration or surrendering of a right. The time of disposal is the time when this occurs;
- any other asset – at the time it is sold, exchanged, or otherwise transferred ownership of the asset. Disposal can also occur when an asset is destroyed. It is not clear what destroy means. For instance, does it include a building gutted by fire and abandoned or rendered derelict?

When a person changes the application of an asset from a non-business asset to business asset (and vice versa), it is deemed to be a disposal and reacquisition of the asset at fair market value for CGT purposes. A disposal also includes a part disposal of an asset.

Cost

The proposed CGT rules have specific rules on what constitutes cost for each type of asset. Effectively it is the cost of acquisition (including installation, improvement and cost to dispose of the asset)/construction/production or development. Where the consideration is in kind, it is the fair market value of the asset acquired. There are specific rules that apply to specific types of assets.

The transitional provisions do not have an exclusion for pre-CGT assets, meaning CGT assets held at the time of CGT implementation will instantly fall into the CGT regime. As the rules are currently drafted, a taxpayer can elect that the cost of an asset acquired before the commencement date of the CGT rules is determined the same way as assets acquired after the CGT commencement date. This method does not account for any increases in value from the time of acquisition to the CGT commencement date and so is retrospective in effect. Alternatively, the taxpayer can elect to use the fair market value of the asset at the CGT commencement date. While fair market value is defined in the new ITA, some questions remain as to what evidence is considered acceptable to support the determination of fair market value.

Consideration

The general rule is that the consideration for the disposal of an asset is the total amount received or receivable. Some specific rules apply where an asset was destroyed, change of purpose of the asset etc. The proposed CGT rules do not cater for deferred consideration or earn-out arrangements so as to prevent unfunded CGT liabilities arising.

Reorganisations

For transfers between PNG resident group companies only, the draft capital allowance rules contain corporate reorganization relief in the form of roll-over relief (i.e. the acquiring company is deemed to acquire the asset at the written down value of the asset in the hands of the disposing company). These provisions also apply to CGT taxable assets, such that no CGT gain or loss will arise on the transfer of assets. Instead, the related entity will be treated as having acquired the CGT asset for the same value as held by the disposing entity at the time of transfer.

Administration of CGT: Filing and payment obligation

The draft rules require a person to lodge a CGT return and pay the CGT within 21 days from the disposal of the asset. As noted above, this means that a capital gain occurring before a capital loss in the same tax year, cannot be reduced by that capital loss.

The CGT payable by a person will be 15% of the amount of the capital gain arising on the disposal of a taxable asset reduced by any capital loss carried forward.

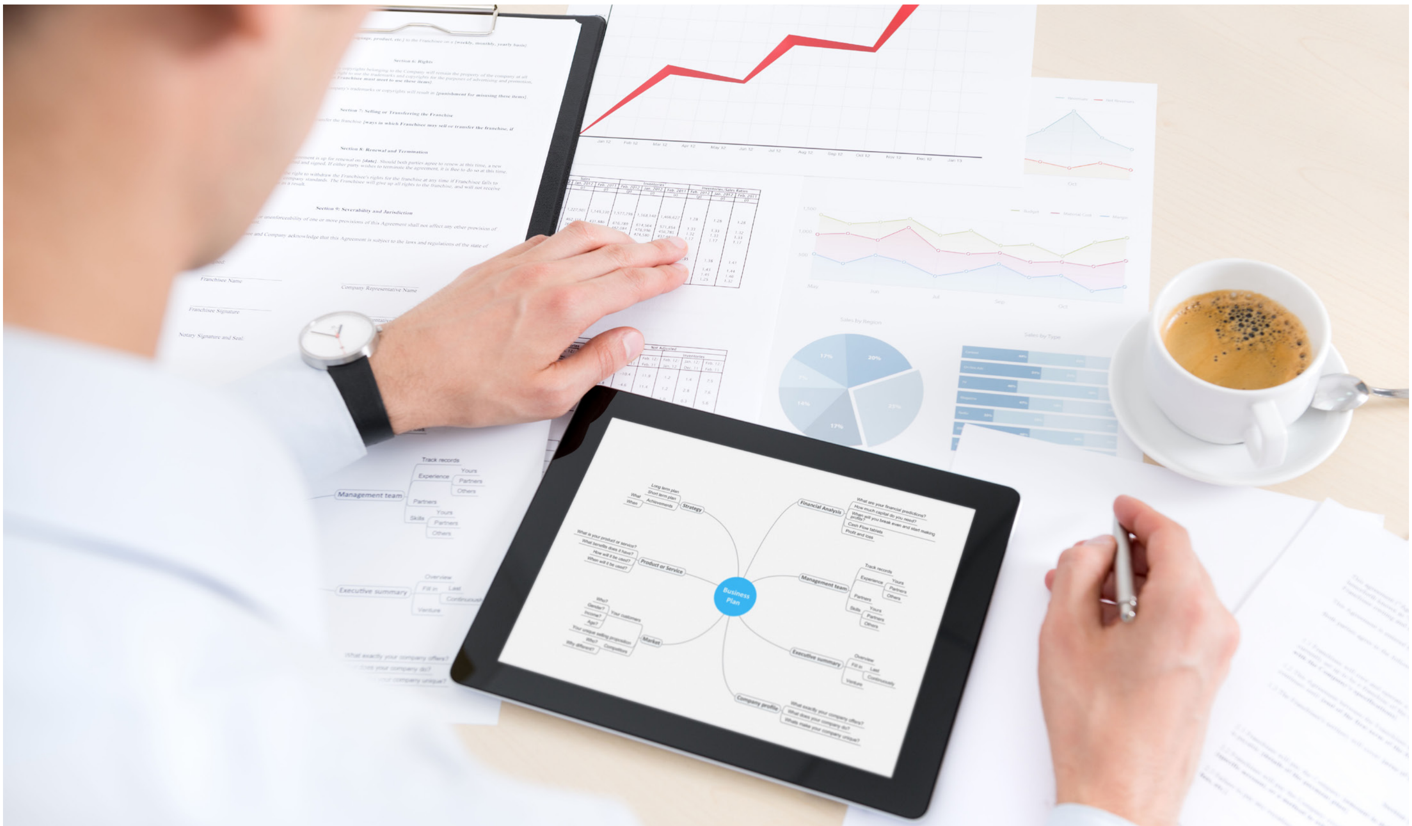
Where the taxable asset is acquired from a non-resident the transferee is required to withhold 10% of the gross consideration unless the Commissioner General has issued notice that the rate can be varied including at a zero rate.

The Register of Titles must not register a transfer of title unless a certificate is issued by the Commissioner General stating that the tax has been paid, a satisfactory arrangement has been made to pay the tax or that no tax is due.

Outcomes

The introduction of capital gains tax is significant and taxpayers should take time to ensure they understand the implications of the changes for their business.

If you would like to discuss the draft changes or their impact, please contact us.



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