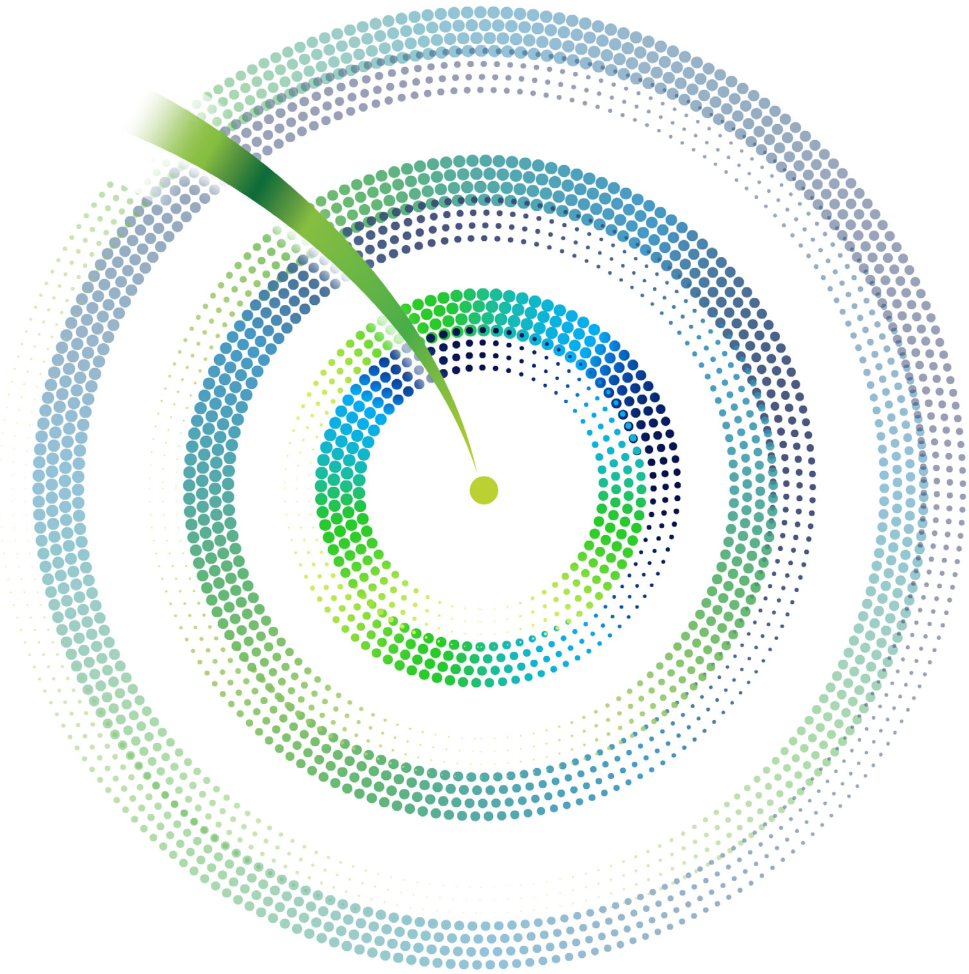
Deloitte.



Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Taxation of Employment Income

Changes to the Taxation of Employment Income

This is the series of Alerts summarising the proposed major changes arising from the Income Tax Act rewrite. This 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.

In this article we summarise the implications for salary and wages withholding tax on employment income.

Salary and Wages

The definition of what constitutes employment income remains broadly the same as per the old Act, with some specific extensions referred to below.

In the initial draft the definition of employment included an individual engaged "to perform services under the direction and control of another person". However, this has now been replaced by reference to situations where the contract is "to perform services under a contract where the payments are substantially for the labour of the individual".

The new Act also retains anti-avoidance rules which make it difficult in practice for individuals who are independent contractors to be anything other than an employee. The Act therefore gives wide powers to the Commissioner General to treat an individual as an independent contractor.

Employee Share Scheme Benefit

Unlike the old Act, the new Act specifically provides for the tax treatment of shares or options under an Employee Share Scheme (ESS). The new Act provides for the taxing point (timing) and the valuation of the income derived by an employee from an ESS.

Redundancy Payments

The concessional component of a redundancy payments under an "approved redundancy scheme" will be subject to a 15% tax rate if the employee is made redundant before reaching the age of 65 or meets certain other criteria as set out in the new Act. Full details of the concessional components and qualifying years of service are now provided in the new Act. The definition of approved redundancy scheme is similar to the current Act.

Allowances

The new Act contemplates that the assessable value of allowances, including cost of living, subsistence, rent, utilities, education, entertainment, meeting, or travel allowance may be reduced to the extent it is expended by the employee in the performance of their duties. This principle covers reimbursements for work related expenditure as well. Details of supporting documentation requirements, or prescribed reasonable limits, have not yet been released.

Employee Deductions

Expenses incurred by an employee in deriving employment income are still not an allowable deduction to the employee.

Valuation of Non-cash Benefits

The prescribed rates for housing and motor vehicle benefits are to move to more market-based valuation rules, while specific valuation rules have been introduced for other benefits:

- Housing
  - The value of the housing benefits are not provided, however, reference is made to the Regulations on prescribed amounts. These are expected to be somewhat higher than the present prescribed amounts. There is also no specific provision at present for the housing allowance variation scheme.
- Motor Vehicle
  - The value of a motor vehicle benefit is calculated at 10% of the cost of the vehicle per annum, spread out over each fortnight. Where the vehicle is leased by the employer, the benefit value is based on the fair market value at the commencement of the lease.
  - Unlike the current Income Tax Act, the value of the motor vehicle benefit does not increase where the vehicle is also fuelled and consequently the value includes the value of such fuel. However, the value of the benefit may now be reduced by:
    - Any payment made by the employee for the use of the motor vehicle or for maintenance and running expenses;
    - The proportion of the use of the vehicle by the employee in the conduct of employment; and
    - The proportion of the fortnight that the vehicle was not provided to the employee for private use.
  - Where the vehicle is more than 10 years old then only two-thirds of the value of the benefit is taken into account to calculate the value of the benefit. As the legislation is currently drafted it appears for these older vehicles that only 2/3rds of the amounts outlined above are used to reduce the value of the benefit. We assume this is not intended.
- **Debt Waiver:** A waiver by the employer of an employee's obligation to pay or repay an amount owing to the employer by the employee is a taxable employee benefit to the value of the debt waived.
- **Discounted Interest Loan:** A loan provided by the employer to an employee at a rate less then market lending rates is a taxable benefit equal to the value of the interest discount.

- **Discounted Goods & Services:** The provision of discounted goods or services by an employer to an employee is a taxable benefit, equal to the cost to the employer. There are concessional valuation rules (75% of normal selling price) where the employer supplies such goods or services in its ordinary course of business.
- **Private Expenditure:** The payment of private expenditure by an employer for the private benefit of the employee, whose value is otherwise not specifically covered, is a taxable benefit equal to the amount of the expenditure.
- **Residual Benefit:** Other non-cash benefits provided to an employee by the employer which are not covered elsewhere is a residual taxable benefit whose value is its fair market value at the time it is provided, less any employee payments for the benefit.

We also note that employers should consider the GST implications of benefits (and amounts refunded) provided to employee.

Exempt Benefits

- Annual school fees for a child of the employee remains exempt but is now extended to an "approved tertiary institution". However, the benefit must be "..available to all non-casual employees on equal terms" . No details of an approved tertiary institution have been provided to date. This will be included in the Regulations to be issued.
- Medical Insurance Premiums: Payment on behalf or reimbursement to, an employee by the employer of medical insurance premiums is now exempt, but only if this benefit is available to all non-casual employees on equal terms.
- Annual Leave & Additional Leave Fares: The existing rules are preserved, including ability to apply for additional fares due to remoteness or hardship. What is important to note is the inclusion of the wording paid or reimbursed, suggesting the employee will be able to book the fares directly and recover the cost from the employee.
- A superannuation contribution made by an employer is not assessable to the employee. Employers may still contribute up to 15% of taxed employment income of the employee. Amounts in excess of this will not be allowed as a tax deduction to the employer.
- Meals or refreshments provided in a canteen, cafeteria or dining room by the employer solely for all employees is now proposed as exempt but only if this available to all non-casual employees on equal terms.
- Citizen first home ownership scheme: A subsidy provided by an employer to an employee towards the capital cost of purchasing a residential dwelling under a first home buyers scheme approved by the Commissioner General is exempt. This extends to cover repayable amounts advanced to the employees to pay for the cost of the property, which is equal to or less than K400,000 where this is taken out against leave entitlements, superannuation or gratuity entitlements.
- Non-deductible employer expenses: Where the employer has not been allowed a deduction for expenditure, on the basis that it is domestic or private in nature, that benefit is not assessable on the employee.

Formalising the Salary Sacrificing Arrangement

The new Act formalises the 60:40 rule and the practise remains the same with the excess to be taxed as salary or wages. Procedures for complying with salary sacrificing requirements are not yet stated, and we expect these will be covered by subsequent Regulations and IRC Tax Circulars.

Foreign employment income

Foreign employment income, including a pension related to foreign employment, derived by a resident individual will be exempt but only where the income is subject to tax in the country of employment.

Salary and Wages Tax Lodgement Date

Salary and wages withholding taxes due date has been moved from the 7th to the 15th day of the following month while other withholding taxes is by the 21st day of the following month.

The above-mentioned changes to the taxation of employment income are 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, their impact, please contact any of the following.

For more details please contact your key Deloitte contacts or any of the following:

Leadership Contacts

Andrew Harris
Partner
Tax & Business Services
Tel/Direct: +675 308 7010
andrewharris@deloitte.com.pg

Sanchika Sutharshan
Partner
Tax & Business Services
Tel/Direct: +675 308 7160
ssutharshan@deloitte.com.pg

Maygen Turliu
Director
Tax & Business Services
Tel/Direct: +675 308 7017
mturliu@deloitte.com.pg

Declan Mordaunt
Senior Counsel
Tax & Business Services
Tel/Direct: +675 308 7037
dmordaunt@deloitte.com.pg

Deloitte.

Designed by CoRe Creative Services. RITM1216092