



Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Taxation of Trusts

Changes to the Taxation of Trusts

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 implication for Trusts and Trust beneficiaries.

Principles for the Taxation of Trust income

The new rules seek to formalise “flow through” rules for trusts. Where a beneficiary is entitled to income, the beneficiary becomes taxable on that income at their marginal tax rate and not the trustee. Expenses incurred by the trustee in respect of that income are treated as incurred by the beneficiary.

Losses incurred by a trust pass through to the beneficiary where they are entitled to the assessable income. For these purposes the word entitled is defined to mean “a vested and indefeasible interest.” An amount also retains its character and geographic source in the hands of the beneficiary and is treated as derived or incurred by the beneficiary at the time it was derived or incurred by the trustee.

Where the income does not vest in the beneficiary, the trustee is taxable at the rate of 42%. Consequently, there are good reasons to pass through the income to beneficiaries on a lower tax rate.

Where income has been taxed on a trustee that income will not be taxed again in the hands of the beneficiary.

Tax Residence of Trusts

A trust is resident in PNG for tax purposes when the trust:

1. Was settled or established in PNG.
2. Is the estate of a deceased resident individual; or
3. Is administered in PNG at any time during the year.

Potential issues are likely to arise in particular for expatriates who become resident in PNG. The implications of Double Tax Treaties (DTA) may also impact the foregoing and therefore require consideration. A non-resident trust is taxable on PNG source income but only to the extent the income (and allowable deductions) has not flown through to a beneficiary.

Where the income of a resident trust in the form of dividends or interest is paid to a non-resident beneficiary the trustee must account for withholding tax at the time the beneficiary becomes entitled to such income.

Implications for PNG Resident Beneficiaries of Foreign Trusts

If a PNG beneficiary is entitled to income of a non-resident trust, the beneficiary is taxable on that income and will be assessed at the time the distribution from the non-resident trust is received. A distribution is widely defined and includes a loan, payment for goods, use of assets or anything which in substance would be regarded as a distribution of accumulated income.

Where the trustee pays non-resident tax or international transportation tax on that income, the PNG resident beneficiary would be entitled to a tax credit in respect of that amount to the extent that the amount is included in the assessable income of the beneficiary.

These provisions may lead to a need to rethink the use of offshore family trusts or how the income in such trusts are dealt with.

For example, Australian discretionary trusts often contain a provision for the vesting of income in family beneficiaries. Such a provision could result in tax payable in PNG for the beneficiary. We would recommend that such structures are revisited before the legislation comes into effect to ensure the implications are understood. We would be happy to assist, should you require.

Unit Trusts and Collective Investment Fund.

Unit Trusts and Collective Investments vehicles are often used for investment purposes. Investors subscribe for units, can buy and sell such units, redeem the units and receive distributions. They are generally (but not always) structured as trusts.

The definition of a company specifically includes:

- A prescribed unit trust,
- A landowner resource trust, and
- A superannuation fund,

but not other collective vehicles. The definition of a company also includes an “unincorporated body or association of persons formed in PNG...”. It is not clear if this is intended to cover collective vehicles. The term “prescribed unit trust” will be defined in the Regulations.

As the unit holders can often sell or redeem units, the trust would generally not vest the income in unit holders. The new rules would therefore tax the Trustee at 42% on income not distributed unless it is deemed a company. This could be a major impediment to the use of such vehicles for funds management. Clarification will be required on this matter.

Landowner Resource Trusts

The latest draft of the Income Tax Act now includes specific provision for Landowner Resource Trusts.

The definitions of a company and dividend have been extended to include Landowner Resource Trusts.

The income that the landowner resource trust derives from a resources project, either as an equity participant in the project or through any other derivation of assessable income from the project, and whether the project is carried on by the trust or any other person, is subject to the extractive industries provisions of the Act (see extractive industries tax alert for further details)

Where a dividend is paid out of profits derived from a resource project such income is exempt income of the trust.

Where a company has derived assessable income from such income and other assessable income, a dividend paid by the company is treated as paid first out of profits derived from income.

A dividend paid by a landowner resource trust to a beneficiary of the trust is exempt income of the beneficiary.

Tax Payable

Under the new Act the payment dates for provisional tax for all taxpayers are aligned, being the last day of the month following the end of the 3rd, 6th and 9th month of the year. Any residual tax is due on the date that the income tax return is due to be filed.

The draft legislation is due to be introduced to Parliament in November 2022 and is due to commence from 1 January 2024, subject to enactment by Parliament. If you would like to discuss the draft changes please contact us.

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