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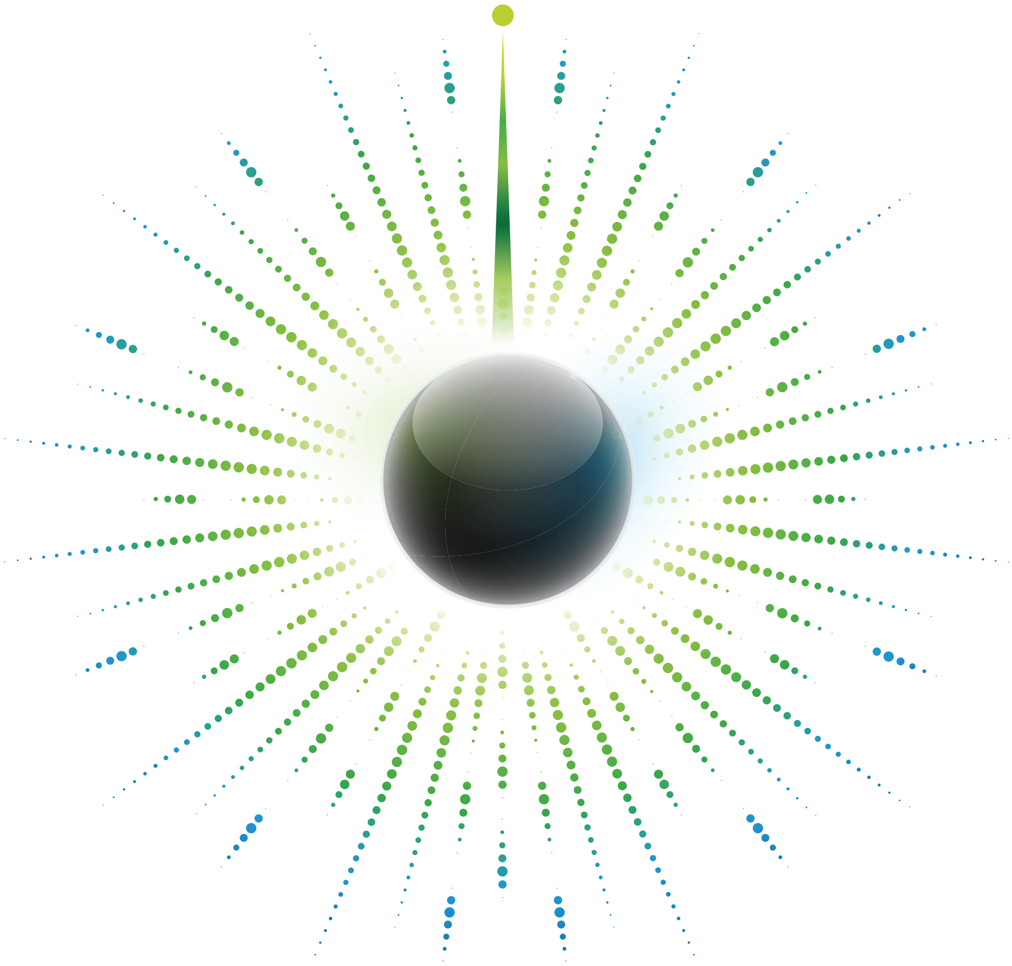

Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Assessable Income

The draft rewrite of the Income Tax Act (referred to as the new Act) contains many important implications to consider for taxpayers, including changes to what constitutes assessable income. In this article, we summarise how the new Act has broadened the definition of assessable income. 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.

Assessable Income

Under the new Act, assessable income includes employment, business and property income, as well as income provided under statute, ordinary concepts and interestingly, amounts derived by a person from an illegal act. Assessable income is generally gross income whereas taxable income is assessable income net of allowable deductions. Assessable income is particularly relevant for determining the level of management fees deductible or infrastructure tax credits.

Employment Income

The concept of employment income under the new Act has broadly not changed. However, it now specifically has rules regarding amounts from an Employer Share Benefit Scheme.

Employer Share Benefit Scheme

The value of the benefit is to be included in employment income at the earlier of:

- The date that the employee is able to freely transfer the shares; or
- The date the employee disposes of the shares.

In either case, the amount of the employee's contribution reduces the amount included in employment income. Our tax alert on employment income (Topic 4) provides further detail on Employer Share Benefit Schemes.

Property Income & Business Income

The new Act makes a distinction between property and business income. The latest draft Act clarifies that income (including dividends and interest) of a business are included in business income and not property income.

Property Income

Property income under the new Act includes amounts (other than business income or employment income) derived by a person from dividends, interest, royalty, rent, pensions or annuities or any other amount derived by the person from the provision, use, or exploitation of property. There are specific rules on the treatment of purchased annuities.

Business Income

Business income is defined under the new Act as the gross revenue derived by a person from the conduct of business, including, but not limited to, consideration for the disposal of trading stock and fees derived from the provision of services.

Business income also includes:

- Income derived by the person from the investment of the capital of a business, including dividends, interest, royalties, and rents
- Net foreign exchange gains; and
- The net gain derived from:
  - The conduct of a venture or concern in the nature of trade
  - The conduct of a profit-making undertaking, scheme; or
  - The disposal of a business asset, being an asset held by the person on revenue account, other than trading stock.

Finally, business income includes any other income according to ordinary concepts derived by the person from the conduct of a business.

Note special rules apply for individuals carrying on small businesses. See our Alert #6 for further details on the small business tax regime.

Exempt Income

Schedule 3 to the new Act lists all amounts that are exempt from income tax. The schedule covers a wide range of income that is currently exempt. However, we suggest entities that currently have exempt income review the schedule to ensure that income is still covered.

There is a broad exemption for non-profit bodies, which is defined to mean a trust and now also a company approved by the Commissioner General. The new Act provides the conditions under which approval is required to be given. It also allows for exemption to be provided in other cases in accordance with Regulations (not yet available).

Statutory Income

Recaptured Deductions

The new Act provides that where a person is allowed a deduction for expenditure or loss incurred, or a bad debt written off, in a tax year and later receives in cash or kind an amount as reimbursement or recovery of the amount of the allowable deduction, the amount received is included in the assessable income of the person for the tax year, in which it is received or remitted and treated as income of the same character as the income to which the deduction relates.

Depreciable Assets

Depreciable assets under the new Act are classified into 5 classes, certain classes can be pooled together and depreciated at a rate specified by the Act. If a depreciable asset, not in a pool, is sold,

any gain (balancing charge) on sale is assessable income, up to the level of depreciation previously claimed. Our Alert #2 on Fixed Assets and Depreciation Changes provides further details on this.

Foreign currency exchange gain or loss

The net foreign currency exchange (forex) gain of a resident taxpayer (and non-resident taxpayer conducting business through a PE in PNG) is included in assessable business income. The net forex gain is the total realised forex gains less the total realised forex losses (for a PE it is the forex gains and losses attributable to the PE).

Permanent Establishments

The new Act also includes "force of attraction" rules for income of a similar kind to that of a permanent establishment of the non-resident. This deems such income of the foreign resident to be assessable in PNG. Refer to our tax alert on international taxes Alert #7 for further details.

Long Term Contracts

Under the new Act long term contracts must now be included in assessable income for each tax year of the contract in accordance with the percentage of completion method under financial reporting standards. There are currently no transitional rules, so this could give rise to issues and represent a significant change for those undertaking long term contracts. These may be covered by transitional rules in the Regulations (yet to be released).

Outcomes

The changes to the taxation of assessable income are significant and taxpayers should take time to ensure they understand the implications of the changes for their business.

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