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2011

COMMISSIONER GENERAL
INTERNAL REVENUE COMMISSION

Annual Report



"We collect taxes to help build PNG"

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Revenue Accounting System II (RAS II)

In 2009, a Canadian Company, successfully tendered and was awarded the RAS II contract to redevelop the IRC's Revenue Accounting System (RAS) by installing their Standard Integrated Government Tax Administration System (SIGTAS). The RAS II Project is much more than a hardware and software solution. The project represents a multi-faceted, organisation-wide change that is fundamentally changing the IRC's business processes. The modifications to tax administration and the implementation of SIGTAS under the RAS II project are having an enormous impact on the organisation. The RAS II system will provide the IRC with enhanced capability in its registration, client accounting, forms processing and audit functions. In turn, this will allow the IRC to improve its service delivery to tax payers, as well as move to a compliance program that is based on robust data and intelligence to better manage risks to revenue and encourage greater levels of voluntary compliance. It is through the implementation of RAS II that IRC intends to fulfil its aspirations under the *2010-12 IRC Corporate Plan*.

IRC made significant progress with the RAS II project in 2011. A group of officers were appointed as super users to design the IRC's business processes in SIGTAS and provide SIGTAS training to the IRC officers upon completion. IRC also appointed a business change coordinator to manage the impact that SIGTAS will have on tax operations. The suppliers made several visits to the IRC in 2011. The consultants collected information needed to configure SIGTAS, provided SIGTAS training to the super users, assisted the IRC to prepare change management plans, and helped the IRC to prepare its internal and external communication plans.

IRC and the supplier will continue working together on the project in 2012 and SIGTAS is expected to be implemented in the second half of 2012. Successful implementation of SIGTAS under the RAS II Project is one of the IRC's highest priorities in 2012.

Key Client Management

A Key Client Unit was set up and developed to better serve particular taxpayers, including those engaged in LNG project activity consistent with the National Government's emphasis on developing PNG's LNG resources. Building on the existing Large Business Co-ordination Unit, it provides a single point of entry for early resolution of issues and fosters voluntary compliance. On the same token, business processes have been improved to ensure performance against a turnaround time of 30 days for GST refunds for these LNG related taxpayers. Further improvements to this unit are expected in 2012.

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Donor Support

The Internal Revenue Commission (IRC) is supported by key partners in development. This ongoing support is pivotal in enabling IRC to achieve its corporate objectives and is deeply appreciated by the IRC's Senior Management Team.

During 2011, AusAID's Economic and Public Service Program (EPSP) provided four advisers to support IRC to meet its changing role and responsibilities; a Strategic Management Adviser, an Information and Communication Technology Adviser (ICT Adviser), an Integrity and Investigation Adviser and a Human Resources Adviser (HR Adviser). The four Advisers were responsible to the Commissioner General IRC and the Director EPSP for the provision of expert advisory support to their nominated counterparts and for the planning and management of their placement and the delivery of the agreed outputs within agreed time-frames. During the year, the ICT Adviser and the HR Adviser completed their contracts and departed from PNG.

EPSP also completed a Capacity Diagnostic for the IRC. This report recognised IRC as being one of the best performing agencies within the PNG public service in terms of productivity. The report also identified that IRC faces emerging challenges stemming from an increasing complexity in the business environment. The amount of workload has increased with an expanding PNG modern economy along with complexity in transfer pricing techniques engendered by globalisation. The need to better understand the market through market segmentation and the development of key account relationships have exerted pressure on existing systems and procedures as well as resources. Based on the analysis undertaken by the EPSP Diagnostics Team, a number of key recommendations were derived for IRC to be considered by EPSP for its Capacity Development Agreement with the Agency. The resulting Capacity Development Agreement (CDA), signed between IRC and EPSP in December 2011, has defined the ongoing EPSP support arrangements for the next three years. This support will be combination of technical advisers and project related grants and will be progressively reviewed to ensure its continued validity.

The IRC also had three Strongim Gavman Program (SGP) Advisers out-posted from the Australian Tax Office working in various parts of the organisation providing specialist advice on taxation and revenue collection issues. Also in place is an Overseas Development Institute Economist who sits in a line position within the Office of the Commissioners.

The World Bank has an Adviser working with IRC's Tax Audit Division with the aim of building audit capacity within the Large Business and International Branch. This work is particularly aimed at the capacity to audit companies within the mineral and resources sector. Two more World Bank consultants are currently being recruited to build this team up to full strength.

During May 2011, the US Treasury conducted a review with regard to the steps and risks involved in transitioning to a full self-assessment system in Papua New Guinea.



With the introduction of the external email IRC has seen a marked improvement in communication with taxpayers and external stakeholders and this is a major milestone for IRC. Information Technology has enabled IRC to effectively communicate in ensuring that external stakeholders and taxpayers are responded to in a timely manner and also assisted with revenue collections to a greater degree because of the improved communications.

The WAN project will allow IRC regional and provincial offices to have access to the services provided at the Head Office in Port Moresby and this will enable effective use of IT resources to improve services to taxpayers in the provinces.

The replacement of the current tax administration system (RAS) is a major ongoing IRC project and this will be discussed in the next section.

Having an ICT strategic plan has ensured that ICT infrastructure and systems are consistently reliable and efficient to support IRC's strategies and ultimately enable IRC to achieve its corporate objectives. A clear ICT strategy is a key governance mechanism for effective use of IT resources.

Cash Economy Project

In 2011, a twinning arrangement between the Australian Tax Office and Internal Revenue Commission was entered into. This enabled IRC to commence scrutiny of the Real Estate Industry, an area of business where a number of players are deliberately not reporting their cash income from rentals. Our compliance activities for dealing with the Real Estate Industry in 2011 included:

- Record keeping and data matching
- Visitation with Real Estate Agents,
- Developing understanding of real estate operations and providing advise on their clients of their tax obligations, and
- Adoption of more intensive approaches and audit for non-compliers who evade their tax obligations and avoid paying taxes.

In 2011, three cases were audited raising revenue of K 2.6 million. Apart from the audit cases, the project caused a ripple effect with improved lodgement compliance that resulted in the raising of K 19.8 million and K 3.3 million in late lodgement penalties.

IRC is looking into other cash businesses and industries in view of the deliberate evasion of income tax obligations by those involved in the Cash Economy Sector. Additional outside assistance to look into these areas would be welcomed in view of the current scarce human resource capabilities.

About Us

The IRC is responsible for the collection of taxes which are used by the Government to fund its programs to develop the nation. The IRC's Vision, Mission and Values form the basis of why we exist and what we believe in:

Vision

To ensure Papua New Guinea's Tax System favours voluntary compliance.

We will make it easier for the taxpaying community to comply by offering improved services and education products, including encouraging greater reliance on our website: www.irc.gov.pg

Mission

We collect taxes to help build Papua New Guinea.

We will develop balanced awareness and enforcement strategies to address key risks for different market segments. Together with the provision of quality and timely advice through a new public rulings system, these strategies will ensure that we collect the right amount of tax.

Values

We foster fairness, respect, professionalism, honesty and openness.

Our values are illustrated by a traditional Trobriand Islands yam house. The values written across each beam supporting the house indicate that these values are the foundation of the IRC.

The "Haus" represents the way in which we want our organisation to be seen by the community as well as how we relate to each other at work in the IRC. We will continue to contribute to the tax system in ways that see us respected as much for the way we go about this as for what we deliver.





Role and Function

The Internal Revenue Commission (IRC) collects nearly all of PNG's taxes and, in particular, Income Tax, Salary and Wage Tax and GST. We inform taxpayers about their tax obligations; assess their tax returns and we take action against those who choose to avoid tax. We also assist Treasury on the development of tax policy.

The IRC has 368 staff in 19 provinces. The IRC was newly restructured in 2010, the first year of the Corporate Plan. This is the second year of our three year Corporate Plan. The IRC is mandated by Parliament to administer the following laws:

- *Income Tax Act 1959 (as amended)*
- *Income Tax, Dividend (Withholding) Tax and Interest (Withholding) Tax Rates Act Chapter 111*
- *Income Tax (Rates) Act (Consolidated) 1976*
- *Income Tax (rates) Act 1975*
- *Income Tax (Specific Gains Tax) (Rates) Act 1982*
- *Stamp Duties Act chapter 117*
- *Goods and Service Tax Act 2003*
- *Goods and Service Revenue Distribution Act*
- *Gaming Control Act 2007(Part V.7 relating to Betting Tax)*
- *Departure Tax Act Chapter 387*
- *Income Tax (International Agreements) Act 1987*
- *Income Tax (Salary or Wages Tax) (Rates) Act 1979*

In terms of managing staff and funds of the IRC, this means we are bound by the Public Service General Orders, the *Public Service (Management) Act* on staff and employment matters and the *Public Finance (Management) Act* on how we budget and spend our funds.

Information Technology

Information Technology has become a key strategic enabler of many modern tax administrations and IRC is no exception. IRC has been an active user of Information Technology (IT) and IT has played a major role in IRC's transformation efforts to realign the entire organisation towards the achievements of its strategic objectives. Information Technology will continue to play an even bigger role to collect taxes for the Government and in providing effective taxpayer services.

The Information and Communication Technology Strategic Plan (ICTSP) 2009 – 2012 has provided the roadmap for the implementation and application of Information Technology in developing the infrastructure and systems that will support IRC in achieving its goals and objectives.

There are three major projects that were identified in the ICTSP 2009 - 2012 as enablers to the operations of IRC. The first is the upgrade of the Infrastructure, which included replacing the old servers, Internet connectivity and integrated email to enable external email. The second major project is replacing the current tax administration system known as Revenue Accounting System (RAS). The third is the Wide Area Network (WAN) to connect the IRC regional and provincial offices.

The replacement of the Servers, the Internet connectivity and Integrated Email have been implemented, while the RAS replacement project and the WAN project are still in progress.

The replacement of the Servers introduced IRC to the Virtualisation environment. Virtualisation is already becoming the standard of modern infrastructures and is an enabling technology that not only may be used to help lower costs and simplify the IT infrastructure, but may also be used to extend business continuity planning to services that previously may not have justified the expense.

By aggregating servers and attached network storage into unified resource pools, virtualization can help lower the cost of redundant equipment by hosting multiple back-up virtual machines on fewer physical machines.

Some particular benefits include:

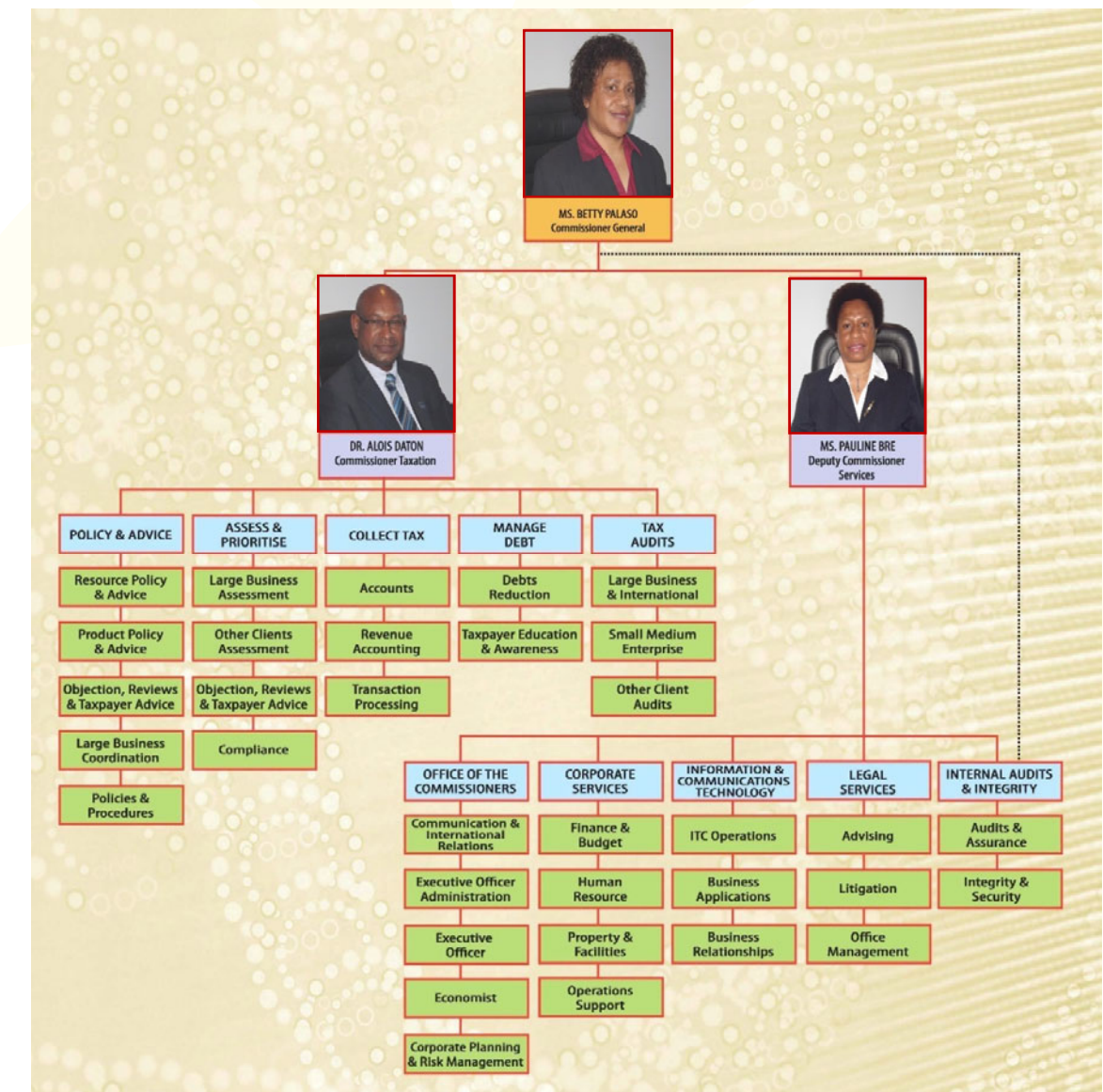
- Much greater uptime for critical servers;
- Significant reduction in the number of physical servers to support;
- Much more efficient use of existing resources;
- Very rapid recovery from individual server failures;
- Enables easier disaster recovery;
- Better support for legacy applications and servers (e.g. RAS);
- Reduced power consumption and air-conditioning load.

Payments from Appropriation - Warrants - Allocation

| ITEM | PAYMENTS | 2010 K,000 | 2011 K,000 |
|------|------------------------------------|-----------------|-----------------|
| 111 | Salaries and Allowances | 13,688.3 | 11,155.3 |
| 112 | Wages | 62.7 | 335.5 |
| 113 | Overtime | 54.9 | 66.5 |
| 114 | Leave Fares | 551.4 | 533.9 |
| 116 | Education Subsidies | | |
| 141 | Gratuities | 1,255.0 | 761.0 |
| | SUB TOTAL | 15,612.3 | 12,852.2 |
| | GOODS & SERVICES | | |
| 121 | Travel & Subsistence | 1,825.0 | 1,872.8 |
| 122 | Utilities | 3,554.4 | 4,784.9 |
| 123 | Office Material and Supplies | 988.9 | 987.4 |
| 124 | Operational Materials and Supplies | 429.7 | 343.5 |
| 125 | Transport & Fuel | 518.7 | 472.1 |
| 126 | Consultancy Fees | 207.1 | 230.2 |
| 127 | Rentals | 530.5 | 962.6 |
| 128 | Routine Maintenance | 1,540.1 | 1,805.3 |
| 135 | Other Operational Expenses | 5,242.3 | 7,305.1 |
| 136 | Training | 742.0 | 450.4 |
| 142 | Membership Fees | 156.3 | 45.7 |
| | SUB TOTAL | 15,735.0 | 19,260.0 |
| | CAPITAL | | |
| 221 | Furniture & Equipment | 3,888.2 | 1,126.0 |
| 222 | Purchase of Vehicles | | 188.4 |
| 223 | Plant & Equipment | | |
| 225 | Construction & Improvements | 140 | |
| | Renovation of Houses | | |
| | SUB TOTAL | 4,028.2 | 1,314.4 |
| | OTHERS | | |
| | Unutilised Funds | 2952.8 | 4,884.8 |
| | TOTAL PAYMENTS | 38,328.3 | 38,311.4 |

The IRC Structure

The chart below outlines our organisational and management structure. The IRC is headed by the Commissioner General, Ms Betty Palaso and has two core functions – the Tax Wing headed by the Commissioner Taxation, Dr Alois Daton and the Services Wing, headed by Commissioner Services, Ms Pauline Bre.





The Year in Review



It is with pleasure that I present the Internal Revenue Commission 2011 Annual Report. The Annual Report is our principal report to our Minister, the Minister for Treasury. This document also meets the IRC's reporting requirements as specified in the Income Tax Act, Part II, Section 8 for presentation to Parliament by our Minister. As an open and accountable administration, we publish these documents to assure the government and community that the tax system is being effectively and efficiently managed and administered.

Revenue Performance

In 2011, IRC collected a total net tax amount of 6,704.7 million Kina transferred to the Waigani Public Account (of which 6,144.2 million Kina was direct tax and 560.5 million Kina was GST). This is an increase from both the budget forecast of

6,230.6 million Kina and from 2010 actual collections of 5,534.3 million Kina.

In 2011, the cost of collection of revenue, i.e. IRC's operating costs, as a percentage of total revenue collected stood at 0.5%. This is down from 1% in 2009 and 0.64% in 2010. This falling trend in operating costs as a percentage of revenue is driven by both an increase in absolute revenue collections as well as a decrease in IRC's actual operating costs. The fall in actual operating costs represents a lack of spending on sufficient resources in the case of IRC. IRC's operating costs includes expenditure on salaries as well as goods and services required for tax administration. This implies that revenue collection, although increasing, may currently be constrained and below potential levels due to insufficient staff numbers and scale of operations.

The redevelopment of our dated revenue accounting computer system through our RASII project and the introduction of associated technology has progressed through 2012 albeit at a pace less than we planned. This was largely due to problems encountered in adapting the new system to accommodate PNG's complex revenue environment. Nevertheless, RAS II will produce significant improvements to our ability to deliver effective service to taxpayers. New work practices and procedures are being developed along with new skills for our people.

Understanding this, we introduced a change management program which has supported the introduction of RASII this year and potentially over the next two years. The IRC will continue, also, to receive technical

Government Appropriation - Allocation

| ITEM | RECIEPTS - WARRANTS | 2010 | 2011 |
|------|------------------------------------|-----------------|-----------------|
| | | K,000 | K,000 |
| 111 | Salaries and Allowances | 13,758.2 | 13,376.1 |
| 112 | Wages | 91.5 | 335.5 |
| 113 | Overtime | 74.3 | 146.7 |
| 114 | Leave Fares | 672.0 | 577.5 |
| 116 | Education Subsidies | | |
| 141 | Gratuities | 1,293.4 | 794.9 |
| | SUB TOTAL | 15,889.4 | 15,230.7 |
| | GOODS & SERVICES | | |
| 121 | Travel & Subsistence | 1,833.2 | 1,928.1 |
| 122 | Utilities | 3,554.4 | 4,940.0 |
| 123 | Office Material and Supplies | 990.8 | 997.2 |
| 124 | Operational Materials and Supplies | 441.4 | 344.0 |
| 125 | Transport & Fuel | 543.7 | 482.2 |
| 126 | Consultancy Fees | 1,048.0 | 1,080.0 |
| 127 | Rentals | 546.7 | 1,002.0 |
| 128 | Routine Maintenance | 2,270.0 | 1,793.8 |
| 135 | Other Operational Expenses | 5,312.9 | 8,129.7 |
| 136 | Training | 810.2 | 538.7 |
| 142 | Membership Fees | 163.3 | 152.0 |
| | SUB TOTAL | 17,514.6 | 21,387.7 |
| | CAPITAL | | |
| 221 | Furniture & Equipment | 4,424.3 | 1,504.0 |
| 222 | Purchase of Vehicles | | 189.0 |
| 223 | Plant & Equipment | | |
| 225 | Construction & Improvements | 500.0 | |
| | Renovation of Houses | | |
| | SUB TOTAL | 4,924.3 | 1,693.0 |
| | TOTAL APPROPRIATION | 38,328.3 | 38,311.4 |



- **Item 126 Consultancy** K799,800 was not spent under Information & Communication Technology (I&CT) due to delays with the State Solicitor and CSTB in clearing the contract for these planned activities. This money was earmarked for the consulting work on the Server Upgrade, setting up the Disaster Recovery (DR) site and the Wide Area Network (WAN) projects. The K50,000 unspent under Legal Services was for payment of consultancy fees for the Chairperson of the Income Tax Review Tribunal. Although advertisements had gone out during the year 2011, an appropriate Income Tax Review Tribunal chairperson could not be secured; therefore, no tribunal hearing was conducted and the funds remained unused.
- **Item 135 Other Operational Expenses** An underspend of K766,700 allocated under this vote was also related to costs associated with the Wide Area Network project rollout; however, as stated above, State Solicitors and CSTB delays in clearing the contracts delayed work on these projects.
- **Item 221 Furniture and Equipment** K374,000 was earmarked for purchase of equipment for Wide Area Network project, but due to contract clearance delays from external parties like State Solicitors and CSTB, IRC was unable to spend the funds as intended.

It should be noted that external stakeholders have been a major factor for IRC not spending as planned. IRC continued to have an issue concerning expenditure report variations between TMS / IFMS Reports and PGAS Reports for year 2011. Appropriate steps are being undertaken to compare and reconcile the two expenditure reports. This will involve the comparison of reports on a month by month basis. The outcome of this exercise will make the two reports agree with respect to expenditure balances for the production of the 2011 Public Accounts.

assistance and capacity building support from a range of institutions through this challenging period

At the Midyear Planning Review, we made a commitment to reduce the amount of work on hand in preparation for the implementation of RAS II. Improvements to our internal processes and the dedication of many Officers, who expended significant effort, including extensive overtime, produced exceptional results. This effort not only cleared the backlog of assessments but has improved service delivery turnaround times and resulted in improved revenue collection.

The IRC also has commenced a program to provide Tax Payers with clarity and certainty in the operation of the Tax laws through a Public Rulings Program. Public Rulings, to be known as Taxation Circulars, will provide advice and direction to the public and to IRC staff. Two Tax Circulars have been published; one setting out the framework for the development of Tax Circulars and another relating to Transfer Pricing. The provision of such advice by way of Taxation Circular is an overt demonstration of the IRC living its corporate values of being transparent and accountable in its administration of the Revenue System.

Governance

Over the past year, we have further developed our systems and processes for ensuring proper accountability, probity and openness in the conduct of IRC'S business. For example, 2011 saw the establishment of the Executive Governance Committee. This committee has efficiently replaced four other committees and provides me with advice from my executive management team to

ensure that all compliance and strategic level performance and reporting decisions are made only after thorough consideration and due consultation. The Charter for this committee has been formalised, alongside other policies that have been developed, and is contained within the new IRC Policy Framework.

Consistent with our endeavours to be one of the most highly performing PNG Public Sector Agencies, IRC has received favourable review from both the Auditor General and the IRC Audit Committee. The Auditor General commended the IRC for quickly implementing its audit recommendations.

I am also pleased to report that three of our staff members were awarded commendations for taking a personal stance against corruption in that they refused bribes.

Our Resources

IRC is currently severely under staffed relative to other tax administrations, taking into account total population. IRC has, for a number of years, been attempting to recruit staff to cover shortfalls but building IRC'S workforce has proved to be complex and problematic. Despite enormous recruitment effort, IRC has failed to grow at the desired rate and instead has basically just managed to cover its attrition rate.

The modifications to tax administration and the implementation of RAS II will have an enormous impact on the organisation and, to a lesser extent, its stakeholders. It will also force further structural redevelopment on an organisation that is still recovering from its last restructure.



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In response to this situation, IRC is developing a HR Strategy for 2012 and beyond to progressively grow and reconfigure the organisation commensurate with IRC's capacity to absorb and train the new workforce.

Information Technology has become a key strategic enabler of many modern tax administrations and IRC is no exception. IT has played a major role in IRC's transformation efforts. The connection of IRC staff to the internet and an integrated email system has significantly improved our service delivery.

Our final full year operating expenditure budget for 2011 was K38.3 million and our operating expenditure for the year was K33.4 million. The key factors influencing the under spend were our inability to attract full staffing, some delays in the RAS II Project and a deployment delay of a wide area network to our Provincial offices due to delays in approval of procurement by external government agencies.

The Year Ahead

Looking to the future, 2012 will be a year of change and growth for IRC. We are coming into the final year of the *2010-12 IRC Corporate Plan* and we are in the second year of our transition to the new Revenue Accounting System (RAS II). Coincidentally, we are also significantly understaffed. This means that we will be progressively recruiting, training and reorganising throughout the year in addition to achieving the Government's revenue requirements. Each of these commitments will draw heavily on IRC's resources and all activities will need to be carefully planned and managed. IRC is certainly facing a demanding year. To that end, we have been developing strategies for balancing the supporting activities with improvements to revenue collection.

2012 will also see the IRC contemplating its future as we develop the *2013-17 Corporate Plan* in order to rise up and meet the increasing expectations of our stakeholders and a growing Nation.

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Finances

IRC was given an appropriation of K38.3 million for recurrent expenditure for its operations and K5 million for development expenditure for enhancement of the aging Revenue Accounting System (RAS I). The details below shows the figures for the warrants issued to IRC and the amounts spent and unspent as of year ending 31st December 2011

| Warrants issued to IRC | Amount spent | Amount not Spent |
|------------------------|------------------------|-----------------------|
| K,000 | K,000 | K,000 |
| PE: 15,230.7 | PE: 12,852.2 | PE: 2,378.5 |
| G/S: 23,080.7 | G/S: 20,574.4 | G/S: 2,506.3 |
| Total: 38,311.4 | Total: 33,426.6 | Total: 4,884.8 |

Of the total warrants issued of K38,311,400 under the recurrent budget, IRC spent K33,426,600 and the balance of K4,884,800 remained unspent at the end of the year as of 31st December 2012.

With regards to the development budget, the K5.0 million appropriated and released for the year was fully expended for implementation of the RASII Project, with part payment made to the suppliers for work done.

The justification below against each item explains why funds could not be fully utilized in the recurrent budget by the end of the year as of 31st December 2011, comprising of personal emoluments, and goods and services. These items relate to the recurrent expenditure budget as separate from the K5 million development budget appropriated and allocated for enhancement of the aging RAS I system.

1) Personal Emoluments The total amount of funds unspent under personal emolument was K2,378,500. This was mainly Item 111 (Salaries and Allowances) amounting to K2,220,800. This under expenditure was mainly due to delays in recruitment of funded vacant positions. For example, of the 158 vacant positions advertised in 2011, only 40 positions have been filled as follows; 25 recruited externally, 11 through internal promotions and 4 for which conditional offers were issued and awaiting appointment processes to be finalized. The remaining difference comprises smaller savings from the other items all across IRC divisions.

2) Goods and Services The total unspent funds reported for goods and services at the end of the year as of 31st December 2011 was K2,506,300. The reasons for this underspend are explained below. Some are amounts considered substantial and material in nature whilst the remaining difference comprises smaller savings from other activities and items.

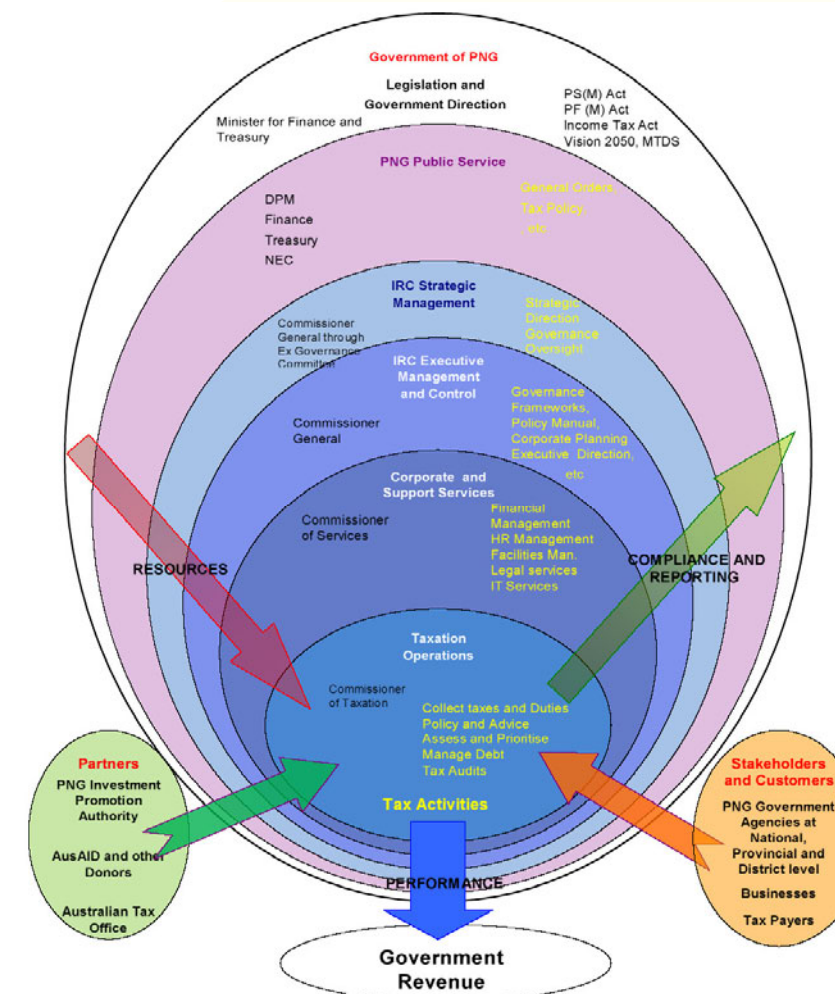
Learning and Development

| Number of Training Programs Conducted | Number of Participants | Remarks |
|--|------------------------|-----------------------------|
| Recruitment & Selection Workshop | 15 | Ongoing |
| Performance Management | 12 | In progress |
| Public Service Induction | 14 | Ongoing |
| Attendance Awareness | All IRC Staff | Compulsory |
| Tax Debt Recovery Workshop | All Manage Debt Staff | In progress |
| Public Service Procedures and Ethics | All IRC Staff | Compulsory |
| Report Writing Skills | 13 | In progress |
| Audits Introductory | SME Officers | Conducted by SME |
| Accounting for non-accountants | 15 | In progress |
| IRC Senior Executive Change Management Workshop | 35 | Conducted by EPSP |
| PITAA Managers Development Program (MDP) | 26 | Organised by ATO & IRC |
| Leadership and Team Building for Service Wing Managers | 28 | Conducted by EPSP |
| Change Management / Leadership / Governance Workshops | 216 | Conducted by EPSP |
| Routine Workplace Communication & Time Management | 12 | In progress |
| MS Excel 2007 (intermediate) | 11 | In progress |
| Presentation Skills | 12 | In progress |
| MS Excel 2007 (intermediate) | 12 | In progress |
| Public Service Induction | 13 | Ongoing |
| Expectation Statements | 15 | In progress |
| National Certificate 2 in Training and Assessment (Instructor) | 16 | Conducted by PNGIPA |
| Legal and Advocacy Training | 18 | Conducted by Legal Services |

Corporate Governance

Governance Framework

IRC has placed a high priority on further developing its Governance Framework during 2011. This considerable effort can be reflected in the overview of the multifaceted regulatory and policy environment in which IRC operates, shown diagrammatically below.



The diagram shows the relationship between essential elements that shape IRC governance arrangements. The various accountabilities for each of the functional areas within the IRC can be readily derived. The diagram also demonstrates the flow of resources, the broad compliance and reporting requirements and core business performance measurement in terms of revenue outcomes. IRC intends to exceed performance expectations placed upon it by stakeholders and, in a timely fashion, to meet all expected compliance and reporting requirements.



Policy Framework

To underpin the IRC's Governance framework, IRC has developed a policy framework that controls and facilitates the flow of executive direction, guiding principles, policy and procedural information for the administration of IRC. The IRC Policy Manual has been developed as the means to promulgate IRC instructions as well as procedures and policy statements. They are intended as long-term, high level and enforceable policies. The policy manual has been arranged in sections corresponding to functional, operational and administrative areas. The IRC Policy Manual is laid out as follows:

- Section 1 – Governance Policy
- Section 2 – Taxation Policy
- Section 3 – Management and Administrative Policy
- Section 4 – Financial Management Policy
- Section 5 – Human Resources Policy
- Section 6 – Information, Communication and Technology Management Policy
- Section 7 – Taxation Circulars

Considerable effort across the whole organisation has been expended in refreshing existing IRC policy and in developing new policy documents. This work will proceed with a high priority into the future. It is anticipated that all the new tax administration procedures developed under RAS II will be captured and promulgated in the new policy framework. All IRC staff will have desktop access to the policy manual via the IRC Intranet.

Committee Structure

During the 2011 Midyear Review, the Senior Management Team reviewed the IRC's governance arrangements and agreed to streamline and simplify the then current arrangements, in particular the committee structures, to improve the reporting and oversight functions. The principal finding was that there was considerable overlap of responsibilities and duplicated effort when working within the existing committee structure. This has been resolved by the Executive Governance Committee taking prime carriage of IRC's governance considerations; reviewing and endorsing strategies, overseeing corporate planning and reporting requirements and policy approval. The Executive Governance Committee has a formal charter that is captured in the IRC's Policy Manual. This Committee is supported by the various stand alone committees that focus on mandated functions such as audit and discipline. A Project Board has been set up to provide strategic direction and oversight for RAS II personnel and project activities.

The IRC is also developing a system of management that includes a weekly Executive Management Committee run by the Commissioner General that supports day-to-day activities and the general running of the IRC. The Tax and Service Wings have each refined their meeting structures to improve information flow and reduce management overheads.

have the requisite skills are most often seduced by the better employment packages offered by companies in the private and mining sector leaving IRC with either no candidates or candidates that are not sufficiently qualified. As a result, IRC has failed to grow at the desired rate and instead has basically just managed to cover its attrition rate, despite enormous recruitment effort.

| As at December | 2010 | 2011 |
|-------------------------------|------|------|
| HUMAN RESOURCES | | |
| Total establishment | 581 | 581 |
| Permanent staff | 335 | 321 |
| Non citizen contract officers | 5 | 4 |
| Probationary officers | 9 | 25 |
| Unattached officers | 5 | 18 |
| Casual officers | 0 | 0 |
| Funded vacancies | 229 | 213 |
| Staff on Strength | 354 | 368 |
| Understaffed by | 227 | 213 |

The emphasis on recruitment was further hampered with demands placed on the IRC to collect additional revenue and improve our processes brought about by the RAS II project. In 2011, with DPM concurrence 54 casual employees were engaged to assist with administrative tasks whilst IRC staff concentrated on revenue collection efforts. This was unfortunately reviewed by DPM in 2012.

In response to this situation, IRC is developing a HR Strategy for 2012 and beyond to progressively grow and reconfigure the organisation commensurate with IRC's capacity to absorb and train the new workforce. The strategy will recognise the need to carefully balance these activities to ensure that revenue collection remains the priority. We will also develop and nurture our relationship with DPM as our strategic partner in HR issues.

Rewards and Recognition

A key corporate focus area within the IRC Corporate Plan (2010-2012) is for IRC to have 'Capable Staff'. The Corporate Plan states that "We will ensure our staffs is engaged, equipped and appropriately rewarded to contribute to the IRC's responsibilities in fairly and professionally collecting taxes for the welfare of the people of PNG." In 2010, IRC created a policy that provides an overall framework for the recognition of exceptional performance and achievement by staff, on an individual or team basis, to be acknowledged and encouraged through formal and informal reward mechanisms because we are restricted to the public service general orders in terms of what we can offer our staff. At the end of year, fourteen IRC staff members were formally and publically rewarded commendations letters from the Commissioner General of the IRC for their performance and dedication.

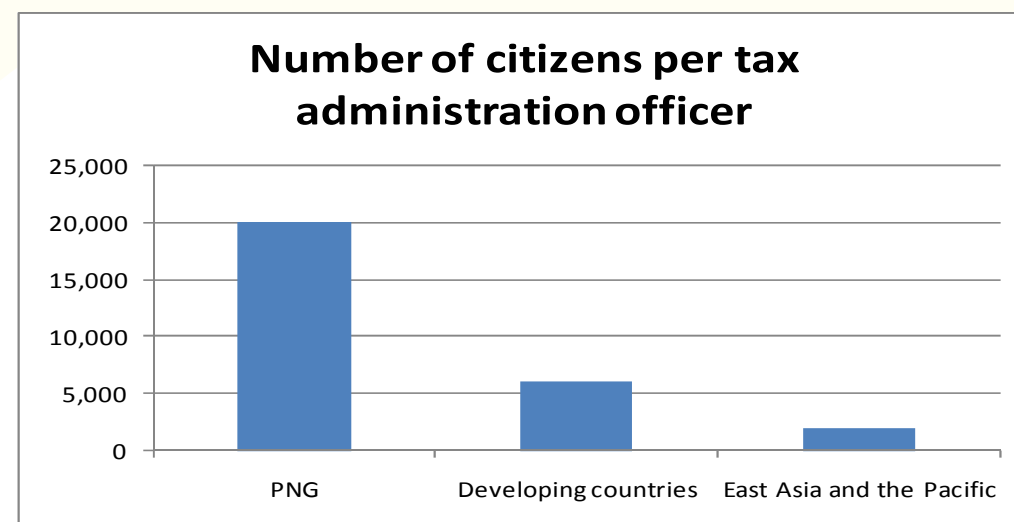


Using Resources Effectively

Staffing

Related to the relatively low operation cost of IRC is the number of permanent tax administration staff employed by IRC. At the end of 2011, IRC had 368 staff on strength, with an approved staff ceiling of 581. IRC was short staffed by 213 positions, or 37%, which is contributing to the under spend of IRC on its annual operating costs.

IRC is currently severely under staffed relative to other tax administrations, taking into account total population. This is illustrated by the following figure which plots 2011 data for number of citizens per tax administration officer for PNG, the developing country average, and the East Asia and Pacific average. From this data, PNG has four times as many citizens per one tax administration officer compared to the developing country average, and eight times as many citizens for each tax administration officer compared with the average for East Asia and Pacific.



Number of Citizens per Tax Administration Officer, 2011

IRC has undergone significant organisational turmoil over the past couple of years, mostly as a result of the separation of Customs from the IRC by the government's decision in 2009. IRC employees have therefore experienced major upheavals with organisational restructuring, and are still coming to terms with the changes this has entailed. The modifications to tax administration and the implementation of the RAS II project will have an enormous impact on the organisation and, to a lesser extent, its stakeholders. It will also force further structural redevelopment on an organisation that is still recovering from its last restructure. IRC has, for a number of years, been attempting to recruit staff to cover shortfalls but building IRC's workforce has proved to be complex and problematic. 158 positions were advertised in May 2011 with applications closing in June 2011. By December 2011, only 25 positions could be filled with new recruits from outside IRC with about 15 internal promotions and the balance of carried over into 2012. The number of potential recruits with the skill sets appropriate for tax administration is small and the market very competitive. Those that do

Since the introduction of the new committee structure, decision making processes have been simplified and duplication of effort has been significantly reduced. More work will be conducted in the coming years to further refine the IRC's Committee structure as it develops and matures.

Planning and Reporting

2011 saw IRC complete the second year of its Corporate Plan 2010-12. The Corporate Plan aspires to develop IRC with respect to four key focus areas; Effective Service Delivery, Managing Risk, Measurement and Capable Staff. During the 2011 Midyear Review, it was realised that the implementation of the RAS II Project will enable IRC to deliver against the Corporate Plan's four focus areas. By focussing attention on implementing RAS II outcomes, the IRC could also satisfy its corporate aspirations. Therefore, for the second half of 2011 (and into 2012), IRC will concentrate on activities that will enable and implement RAS II. As a result, significant effort was expended in actively managing tax processes to clear workload backlogs in preparation for RAS II implementation. These efforts have enabled Tax Wing in particular to further define the type and amount of data collection and to refine the reporting and analysis processes. This has resulted in a significant reduction in the backlog.

This management effort has led to a greater understanding of internal tax work flow processes and their control within the IRC. It has greatly improved the quality and timeliness of data collected for the purposes of managing IRC business activities and for providing relevant information to our stakeholders.

2012 will see the development of the Corporate Plan 2013-17 and a further refinement in IRC's internal management reporting processes.

Stance against Corruption

IRC has a zero tolerance of corruption to fulfil its mission of collecting taxes to help build Papua New Guinea. IRC's challenge is to combat unethical and corrupt behaviour within IRC. We work tirelessly to stop these types of behaviours because it is not only bad for PNG but also tarnishes the reputation of all the good and honest people working in the IRC.

During 2011, IRC developed and approved its policy on Recognition and Reward. By recognising employees who have exceeded performance expectations, contributed new ideas and innovations, or who have gone "above and beyond", helps to build a positive, strong and ethical organisation. It was through this process that IRC was for the first time able to officially recognise exceptional performance and achievement by staff. Notably, three staff members were recognised for their individual stance against corruption. In 2011, Ms Gwen Lewa, Mr Kila Pou and Ms Rose Luke were each awarded a Commissioner General's Commendation for not accepting bribes and for reporting the incidents to their supervisors.



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All IRC Officers must perform their duties legally, impartially, effectively and responsibly and must display personal integrity, honesty and truthfulness that cannot be regulated by legislation. To this end, IRC released its own Code of Conduct and Ethics policy at the end of the year and all staff members were issued with the IRC Code of Conduct and Ethics Handbook as a guide to correct unethical behaviour.

Internal Audit and Integrity

The key role of the Internal Audit and Integrity Division (IAID) is to address directly the professionalism and accountability of the IRC: *“To win the fight against corruption”*. Our key objective is to foster public confidence in IRC’s management and operations and to analyse corporate risks and identify opportunities for improved performance.

The Internal Audit Unit deals with issues of corporate behaviour and accountability. It focuses on promoting and ensuring IRC’s compliance with legislative requirements and the identification of measures to improve our operational efficiency and effectiveness. In 2011, the Internal Audit Unit planned to complete nine audits across IRC. By the end of 2011 two Internal Audits were fully completed and tabled at the IRC Audit Committee Meeting. The audit reports received positive responses from Management and the Executive. A list of recommendations were issued to the Divisions concerned for implementation. Post audits will be conducted in 2012 to test the implementation of the recommendations endorsed. At the time of tabling the Internal Audit Reports to the IRC Audit Committee, three Internal Audits were in progress and four Internal Audits had been carried forward for inclusion in the 2012 work plan.

Internal Investigation Unit focuses on issues of individual behaviour and accountability and the minimisation of fraud and corruption risks within the IRC. The Unit investigates fraud and corruption allegations within the IRC and to ensure, where appropriate, successful convictions of people arrested and charged both disciplinarily and criminally. The Unit provides a deterrent effect which is targeted towards minimising the level of corruption in the IRC. In 2011, the Internal Investigation Unit planned to complete 20 Internal Investigations and by the end of the year had completed 11 Internal Investigations and issued 11 investigation reports outlining the findings and recommendations of each investigation. The difference between the planned and completed audits was due to lack of staff.

During 2011, IAID received 21 reports of incidents and information suggesting possible improper or corrupt behaviour by IRC employees. Sixteen of the reports received were allocated for investigation with five being completed. The remaining six reports completed in 2011 were in relation to the complaints received in prior years. During 2011, IRC charged and dismissed five officers. We currently have nine matters pending Court relating to IRC staff being criminally charged by Police during 2011.

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New Registrations

The Table below indicates a total of 7152 new registrations for the payment of Income Tax, GST, Salary & Wages Tax (Group Tax).

| 2011 New Taxpayer Registration Report | | | | | | | | | | | | | |
|---------------------------------------|-------|-----|-----|------------|-----|-----|------|-----|-----|------|-----|-----|-------|
| Tax Type Registration | MONTH | | | | | | | | | | | | Total |
| | JAN | FEB | MAR | APR | MAY | JUN | JUL | AUG | SEP | OCT | NOV | DEC | |
| Individual | 51 | 210 | 193 | 96 | 141 | 234 | 126 | 146 | 137 | 164 | 152 | 132 | 1782 |
| Company | 54 | 60 | 194 | 103 | 178 | 141 | 124 | 195 | 168 | 119 | 176 | 74 | 1586 |
| T/Levy | 6 | 3 | 10 | 7 | 9 | 6 | 7 | 46 | 28 | 10 | 11 | 5 | 148 |
| T/Partnership | 0 | 0 | 3 | 4 | 1 | 1 | 0 | 3 | 2 | 1 | 6 | 0 | 21 |
| Group Tax | 110 | 179 | 189 | 213 | 143 | 186 | 197 | 228 | 176 | 154 | 132 | 150 | 2057 |
| GST | 35 | 50 | 146 | 134 | 124 | 169 | 137 | 146 | 142 | 167 | 198 | 110 | 1558 |
| Total Registrations | | | | | | | | | | | | | |
| Income Tax: | 3537 | | | Group Tax: | | | 2057 | | | GST: | | | 1558 |



Public Rulings

The IRC has commenced a program to provide taxpayers with clarity and certainty in the operation of the Tax laws through a public rulings program. Public rulings, to be known as Taxation Circulars, will provide advice and direction to the public and to IRC staff on:

- Interpretation of the various laws administered by the IRC;
- How the Commissioner General will exercise discretions in particular situations; and
- Practical administration of tax laws.

Tax Circulars will be developed in consultation with external stakeholders. Two Tax Circulars have been published; one setting out the framework for the development of Tax Circulars and another relating to Transfer Pricing. The basic administrative policy of the IRC is to stand by what is said in a Taxation Circular and to depart from a Taxation Circular only where there are good and substantial reasons to do so.

The provision of such advice by way of Taxation Circular is an overt demonstration of the IRC living its corporate values of being transparent and accountable in its administration of the Revenue System.

Objections

During 2011, the IRC has made a concerted effort to address the backlog of the number of objections to tax assessments. This year over 210 objections were finalised. All objections are work-shopped with the Objections Team as a whole and specific direction is given to case officers to assist them in dealing with their cases. Each subsequent workshop consists of two parts:

- A call-over of cases previously work-shopped to confirm that they have been completed or to address any “blockers”; and
- A technical discussion of other allocated cases to resolve the issue in the objections.

Tax Payer Education & Awareness Activities

During the year, we have successfully conducted 52 general tax awareness sessions and conducted 2,344 inspections with the aim of encouraging voluntary compliance to discharge our corporate vision.

- Conducted 860 “One to One Tax Education” sessions.
- Conducted 52 General Tax Awareness sessions across all provinces.
- Conducted 2,344 inspections.
- Total collections in the provinces: K598,353,925.

The output for 2011 was negatively affected by the low staffing levels. The recruitment of a number of Internal Investigators during the year will ensure that completion rates and outputs will be increased during 2012.

External Audit Activities

The Auditor General's Office (AGO) conducted an audit of activities in IRC for 2010 financial year, on the 18th of April, 2011. The AGO Management Letter relating to the audit of the IRC on the year 2009 accounts and 2010 control environment and final year audit of 2010 was received by the Commissioner General on 5th October 2011. The audit report detailed 15 findings and recommended actions. The Commissioner General accepted these findings and recommendations and responded to the Auditor General within the statutory one month time frame. Most of the findings related to minor anomalies that have since been addressed by IRC. In conjunction with the IRC Audit Committee, work will continue into 2012 to address any outstanding issues. The AGO commended the IRC for taking immediate corrective actions and for implementing audit recommendations.

IRC Audit Committee

The IRC Audit Committee was formed in 2007 and since then it has met every quarter. The role of the Audit Committee is to assist the Commissioner General and the senior executive management team in fulfilling their responsibilities for achieving good corporate governance within IRC. The Committee consists of five members:

- Secretary - Department of Finance;
- Commissioner General – IRC;
- Auditor General of PNG; and
- Two independent members.

Positive comments to IRC from the Audit Committee were in relation to registration of IRC's assets and an audit conducted on procurement and management of assets. The Chairman commended IRC stating that it was a fine example of why he considered IRC as being the most accountable and well run organisation in the PNG Public Service. IRC also implemented other recommendations made by the AG's Office and overseen by the Audit Committee.



Report on Revenue Performance

Summary

This section provides an overview and analysis of the performance of IRC's revenue collection in 2011. The IRC and its operations provide the main source of revenue for financing government expenditure in PNG. To meet the country's spending needs and to keep the country on a balanced budget, it is critical for IRC to meet its revenue performance targets. This chapter provides a detailed look at revenue performance data for the different direct and indirect taxes for 2011, and draws comparisons to budget forecasts and previous years' revenue.

In 2011, IRC collected a total net tax amount of 6,704.7 million Kina¹ transferred to the Waigani Public Account (of which 6,144.2 million Kina was direct tax and 560.5 million Kina was GST). This is an increase from both the budget forecast of 6,230.6 million Kina and from 2010 actual collections of 5,534.3 million Kina.

Figure 1 below displays the trend of total tax revenue collections by IRC² over the last ten years. Since the drop in revenue during 2009, which was driven by a significant fall in mining and petroleum tax revenue, breaking the previous trend of increasing revenue, collections have again been following an upward trend since 2009. Furthermore, the revenue growth over 2010 and 2011 has been greater than that experienced in the early 2000s.

¹ Note total net collections are defined as total direct tax revenue plus GST revenue transferred to the Waigani Public Account (WPA). Hence net collections exclude GST transfers to provinces.

² Note that IRC collections include tax on income and profits (direct taxes) and GST (inland GST and import GST) only. Revenue from import duty, export duty and excise are recorded as Customs revenue, and is not a component of IRC's revenue.

Audit Results

During 2011, income tax audits were completed on Small & Medium Enterprises in the logging and retailing industries, with total revenue of K 90.4 million raised.

An additional K 73 million was raised through the completion of 233 comprehensive non – deduct and non-remit audits completed on Group Tax and Business Payment taxpayers including government agencies, private enterprises and sole traders. A further 670 desk audits were completed on Group Tax non-remitters resulting in the collection of K 545 million.

Three audits were completed on High Net Worth Individuals resulting in revenue raised of K 1.7 million.

GST Audits were also completed on forty-nine Small & Medium Enterprise Clients resulting in K 10 million in revenue raised.

A total of 3,704 comprehensive GST Refund audits were completed on GST payers submitting claims for refunds. These GST taxpayers included:

- Schools
- Religious and aid organisations
- NGOs/Charities
- LNG Project Contractors and other mining and exploration companies
- Exporters
- Aid workers and diplomats

This audit activity reviewed a total claim submitted of K 935 million that resulted in the approval of K 908 million for refund whilst K 27 million worth of GST refund claims were disallowed.

During the year the Tax Audits Division commenced a Cash Economy Project focusing on income generated from real estate rental, which will continue through 2012. As of 31st December 2011, the project has raised revenue of K 2.6 million and produced additional voluntary lodgements totalling K 16,472,673 in taxes and associated K 3.3 million in penalties

Whilst resourcing remains an issue for the Tax Audits Division, improvements have been made in our case management processes including the introduction of case call-over and case workshopping, and improved targeting of audit work based on industry profiling and risk analysis. This work has been supported by assistance from the Australian Tax Office through the commencement of new projects to improve capacity in transfer pricing and audit management. Initiatives to improve audit operations and staff capacity will continue into 2012.



Legal Services prepared eight tax legislative change proposals and one tax policy change with the Department of Treasury which were incorporated in the 2012 Tax Budget Amendments:

- General computer service provisions in Income Tax Act, Goods & Services Tax Act and Stamp Duties Act
- New penalty for furnishing incomplete tax returns for GST and ITA
- Increased threshold for accounting on payment basis (GST) to K1,250,000.00
- Increase registration threshold (GST) to K250,000.00
- Phasing out of export sales incentive in line with WTO requirements.
- Clarifying law on project basis assessment of resource projects
- Amendment of Regulations to permit the Commissioner General to establish provincial tax centres.
- Administration of income tax refunds

The Department of Treasury was supported by providing legal and tax advice on eight tax legislative and tax policy change submissions from external stakeholders:

- Income tax exemption for 2015 Pacific Games
- Zero-rating for goods imported for 2015 Pacific Games
- Concessional treatment of approved redundancy payments
- Deduction for site rehabilitation expenditure
- Deduction for allowable capital expenditure for environmental initiatives
- Salary and Wages Tax concessions
- Tax Credit for emergency repairs on the Highlands Highway
- Tax Credit in respect of Bank community service obligations – Extension of time.

Total Tax Revenue Collections by IRC

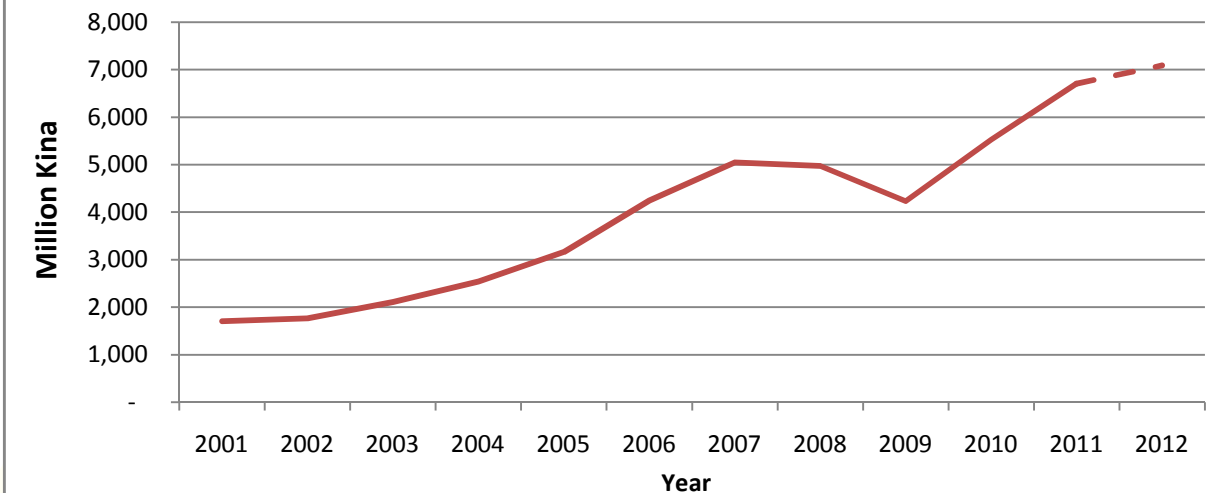


Figure 1: Total Tax Revenue Collections by IRC, 2001 – 2011

Tax revenue as a percentage of GDP is one indicator used to determine if tax revenue is rising in line with a country's gross annual income generated. The figure below plots total tax revenue and nominal GDP over time from 2005 to 2011 (left hand axis). The dashed line plots tax revenue as a percentage of GDP (right hand axis), which has varied over time from a peak of 27% in 2007 to a low of 19% in 2009, when revenues fell, and is estimated at 22% in 2011. Nominal GDP has increased more sharply than tax revenue during 2010 and 2011, which has led to a limited improvement in the revenue as a percentage of GDP measure since 2009.

Total Tax Revenue vs Nominal GDP

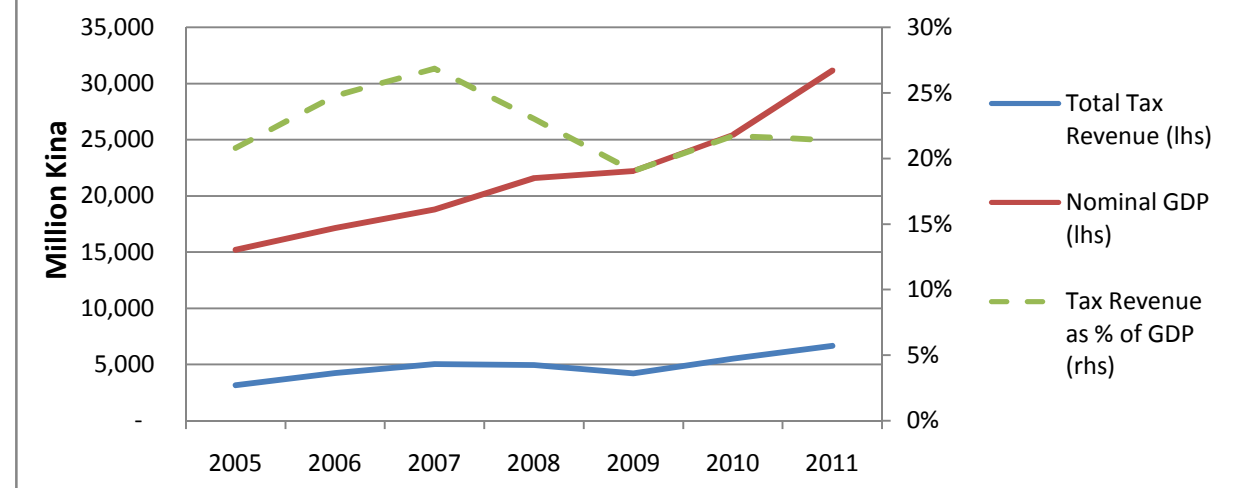


Figure 2: Total Tax Revenue vs. Nominal GDP, 2005 to 2011



Note: lhs = left hand side, rhs = right hand side

In 2011, total tax collection was 8% above expected tax revenue for the year as forecast in the 2011 budget. Over the past few years, actual collections have been consistently greater than budget forecasts, indicating that revenue performance has been better than expected for each year, and projections conservative relative to actual revenue performance. Since 2005, the difference between actual revenue and forecast revenue has narrowed from 50% greater in 2006, to 8% in 2011 (as shown by the figure below), which may indicate an improvement in forecasting accuracy.

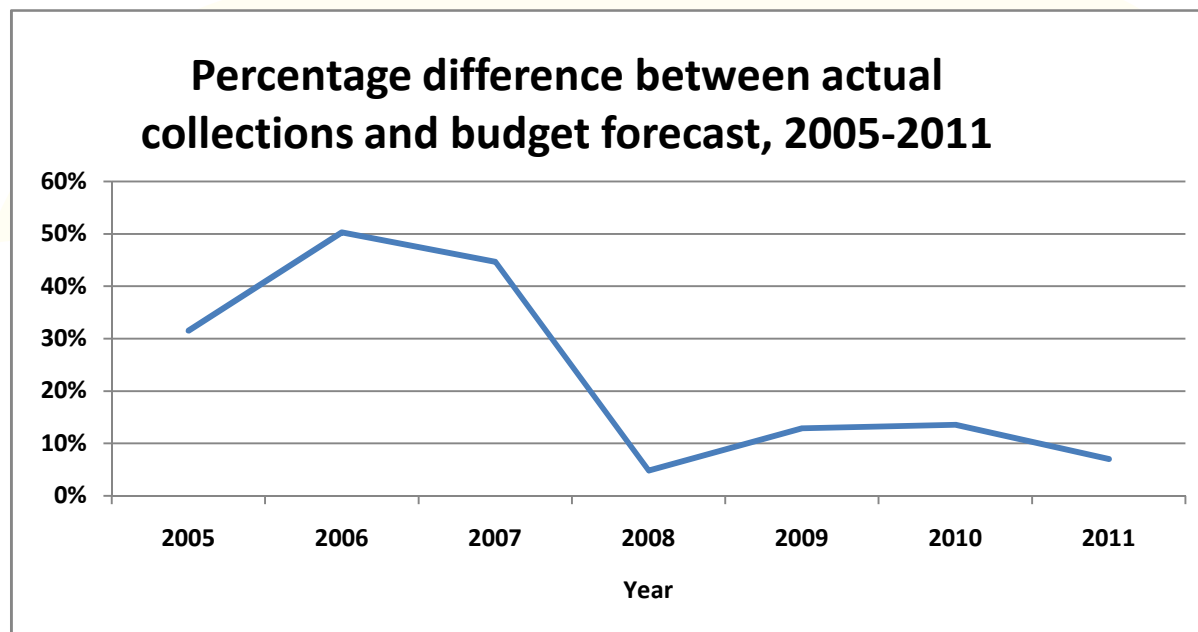


Figure 3: Percentage Difference between Actual Annual Revenue Collections and Budget Forecasts, 2005 to 2011

Note: The graph indicates the percentage by which actual collections have exceeded budget forecasts.

Supporting Tax Operations

Legal Services

The Legal Services Division assists the IRC by ensuring that the IRC has access to high quality legal and related services that would enhance collection of revenue and promote effective administration of the national tax system for the Government and the people of Papua New Guinea. The Legal Services Division comprises of an Advising and Litigation section providing legal advice on 10 pieces of legislation that are administered by the Commissioner General. The main focus for the provision of legal services is directed to the administration of the *Income Tax Act*, *Stamp Duties Act*, *Goods and Services Tax Act*, and other Revenue Laws and from a broader perspective the application of the *Public Finances (Management) Act* and the *Public Services (Management) Act*.

Our services include delivering legal advice and representation, conducting litigation and providing advice not only to the IRC but also to external stakeholders, international development partners, the business community and the community in general. The Legal Services Division also plays a vital role in assisting key government departments and agencies by providing legal drafting services for tax technical legislative proposals. The key outcomes for 2011 were:

- Of the several tax appeals on foot, one Stamp Duty appeal case was concluded in favour of the CGIRC and the State. The appeal by the duty payer against a stamp duty assessment of K 155, 732.88 was dismissed by the National Court and the assessment upheld.
- 71 out of 90 tax debt recovery cases were summarily determined and closed.
- Six Charitable Bodies were approved out of 21 applications received in 2011 pursuant to Section 25A of the Income Tax Act and gazetted.
- The Draft PNG Model Tax Treaty Agreement 2002 was reviewed and updated.
- Successful conclusion of the Double Tax Treaty negotiations between Papua New Guinea and New Zealand.
- Supported the PNG State negotiation which led to the successful conclusion and execution of the PNG/JAPAN- Investment Promotion and Protection Agreement (IPPA).
- Basic Legal and Advocacy Training was conducted for the IRC Manage Debt and Non-Compliance Prosecution teams.
- Improved and regular liaison with Department of Treasury.
- Supported Department of Treasury by providing legal expertise on drafting of tax technical legislative bills for the 2012 Budget Session.
- Provision of legal advice on a number of important internal policies and procedures in particular the IRC Code of Conduct.
- Support in terms of provision of timely legal advice and related services for the RAS II project.



A cross country comparison shows that PNG has internationally relatively very low costs of collection as a percentage of revenue collection.

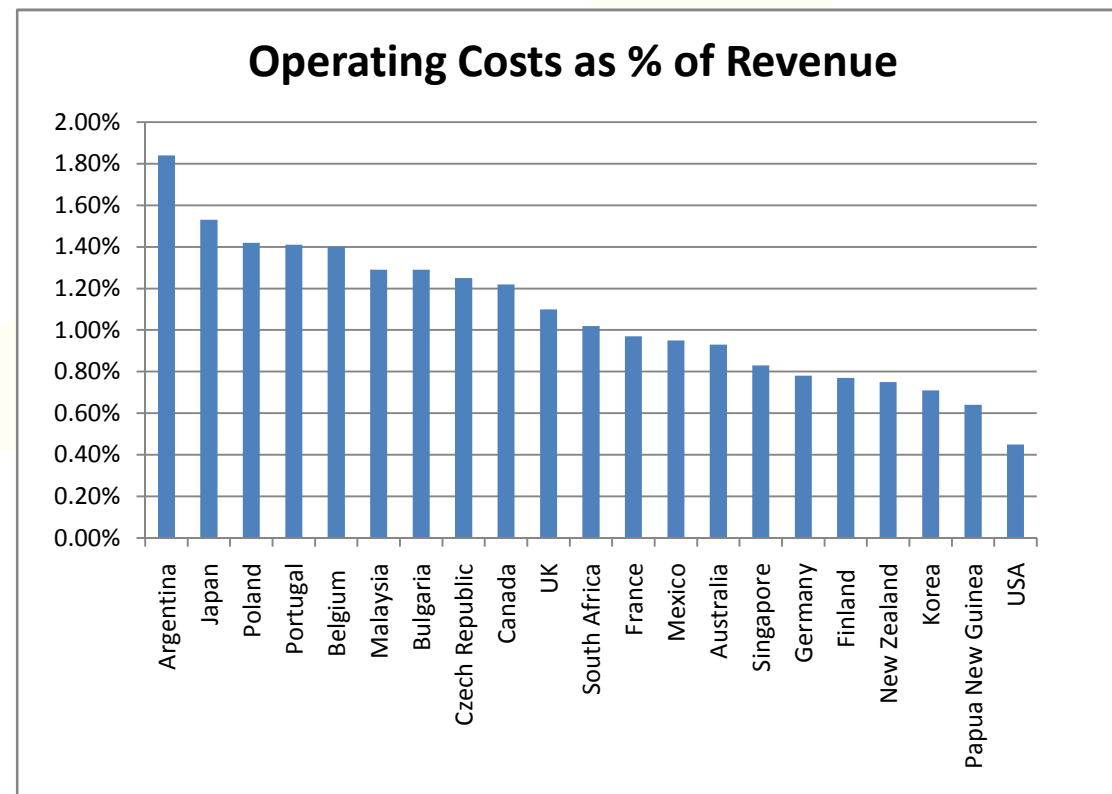


Figure 9: Cross Country Comparison: Operating Costs as Percentage of Revenue

Note: Data extracted from OECD (2009) "Tax Administration in OECD and Selected Non-OECD Countries: Comparative Information Series"

Direct Taxes

The table below gives the breakdown of actual revenue collected in 2011 for the different direct tax types, and draws comparison to the original 2011 budget estimates. Mining and petroleum tax (MPT) showed the largest increase above the budget estimates with a change of plus 30%. Individual income tax was 25% above the budget forecast, whereas corporate income tax was 2% under 2011 budget forecasts. Overall, direct tax was 16% greater than the budget forecast.

| Direct Tax | 2011 Total Actual Collection (K '000) | 2011 Total Budget Forecast (K '000) | % Change |
|---------------------------------|---------------------------------------|-------------------------------------|------------|
| Individual Income Tax | 2,158,794 | 1,727,100 | 25% |
| of which: PAYE Tax | 2,081,996 | | |
| of which: Business Payments Tax | 60,490 | | |
| of which: Income Tax Assessed | 16,308 | | |
| Corporate Income Tax | 1,373,092 | 1,401,900 | -2% |
| Dividend Withholding Tax | 290,708 | 298,000 | -2% |
| Mining & Petroleum Tax | 2,073,533 | 1,594,700 | 30% |
| Bookmakers Turnover Tax | 8,058 | 9,250 | -13% |
| Stamp Duty | 63,557 | 88,010 | -28% |
| Royalty/Management Fees | 15,625 | 14,200 | 10% |
| Court Fines | 7 | 40 | -83% |
| Departure Tax | 4,661 | 4,450 | 5% |
| Training Levy | 3,598 | 2,250 | 60% |
| Gaming Machine Tax | 111,264 | 108,600 | 2% |
| Interest Withholding Tax | 40,482 | 42,400 | -5% |
| Sundry Receipts | 793 | 1,380 | -43% |
| Total Direct Tax | 6,144,174 | 5,292,280 | 16% |

Table 1: Total Direct Tax Revenue, 2011

Table 2 and Figure 4 below illustrate the breakdown of 2011 direct tax revenue collection by tax type. The largest portion of tax revenue was derived from individual income tax (35%), followed by mining and petroleum tax (34%), corporate income tax (22%), and dividend withholding tax (5%).



| Taxes Types | 2011 Actual Collection (K'000) | Percent (%) |
|--|--------------------------------|----------------|
| Direct Tax | | |
| Individual Income Tax | 2,158,794 | 35.14% |
| <i>of which: PAYE Tax</i> | 2,081,996 | |
| <i>of which: Business Payments Tax</i> | 60,490 | |
| <i>of which: Income Tax Assessed</i> | 16,308 | |
| Corporate Income Tax | 1,373,092 | 22.35% |
| Dividend Withholding Tax | 290,708 | 4.73% |
| Mining & Petroleum Tax | 2,073,533 | 33.75% |
| Bookmakers Turnover Tax | 8,058 | 0.13% |
| Stamp Duty | 63,557 | 1.03% |
| Royalty/Management Fees | 15,625 | 0.25% |
| Court Fines | 7 | 0.00% |
| Departure Tax | 4,661 | 0.08% |
| Training Levy | 3,598 | 0.06% |
| Gaming Machine Tax | 111,264 | 1.81% |
| Interest Withholding Tax | 40,482 | 0.66% |
| Sundry Receipts | 793 | 0.01% |
| Total Direct Tax | 6,144,174 | 100.00% |

Table 2: Revenue Collection by Tax Type; Value and Percentage

Total Actual Collection (2011) by Tax Type

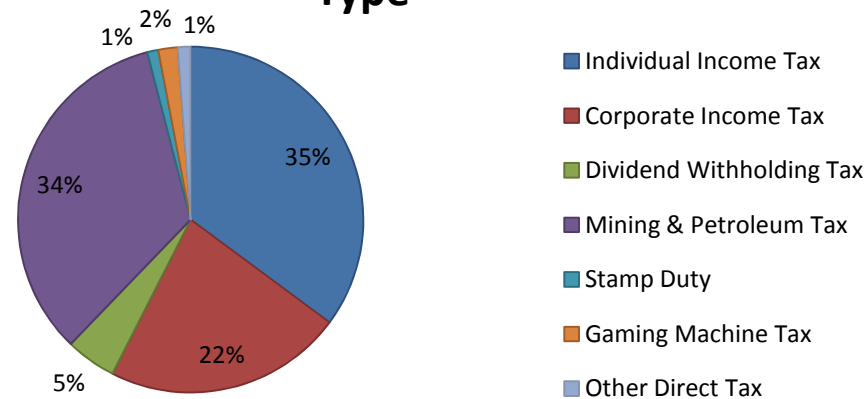


Figure 4: Total Actual Collection (2011) by Tax Type

Cost of Administrative and Revenue Collection

In 2011, the cost of collection of revenue, i.e. IRC's operating costs, as a percentage of total revenue collected stood at 0.5%. This indicator has been on a downward trend over the last three years, down from 1% in 2009 and 0.64% in 2010. This falling trend in operating costs as a percentage of revenue is driven by both an increase in absolute revenue collections as well as a decrease in IRC actual operating costs. Since operating costs should typically increase (or at least not decrease) with a corresponding increase in revenue, due to the additional manpower and resources required to collect more revenue, a fall in actual operating costs represents a lack of spending on sufficient resources in IRC. IRC's operating costs includes expenditure on salaries as well as goods and services required for tax administration. This implies that revenue collection, although increasing, may currently be constrained and below potential levels due to insufficient staff numbers and scale of operations.

Operating Costs as % of Revenue

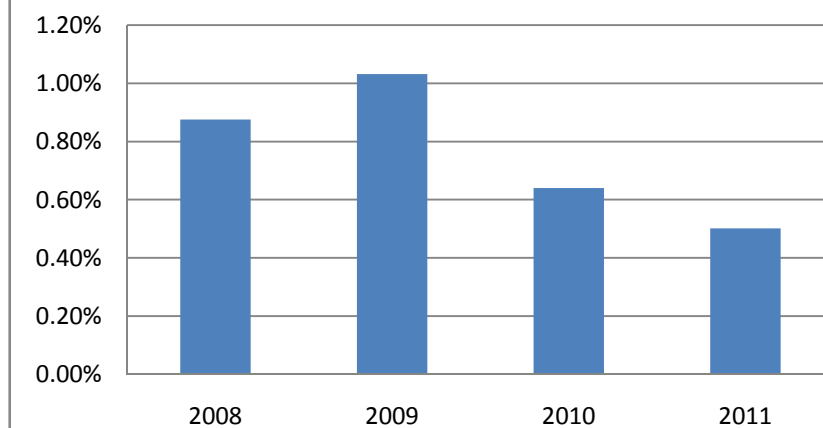


Figure 8: IRC Operating Costs as a Percentage of Total Revenue

Note: Operating costs prior to 2010 include operating costs of Customs before the separation of Customs from the IRC



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The IRC has continued strong efforts during 2011 to recover and reduce taxpayer debt by finalising as many outstanding cases as possible given the resource constraints. During 2011, 4,120 debt cases were finalised, although the additional new cases resulted in a net increase in overall debt of 389 million Kina.

Enforcement

The IRC pursues an active policy of enforcement of penalties, including late lodgement of tax return penalties, late payment penalties, and omitted income from tax return penalties. Penalties are used as an incentive for correct taxpayer compliance which helps to improve revenue performance. In 2011, IRC enacted a total of 5,605 penalty cases, an increase of 589 from 2010. As part of the process of clearing the backlog of tax assessments to be processed for the RASII Project, the number of omitted income penalties applied has been temporarily reduced. This has allowed for an acceleration in the rate of processing tax assessments, leading to a net increase in revenue collection.

| Penalty type | 2008 | 2009 | 2010 | 2011 |
|----------------------------|--------------|--------------|--------------|--------------|
| Late lodgement penalty | 1,315 | 1,310 | 1,003 | 1,768 |
| Late Payment Penalty | 2,366 | 1,628 | 3,945 | 3,763 |
| Omitted Income Penalty | 364 | 447 | 68 | 74 |
| Total Penalty Cases | 4,045 | 3,385 | 5,016 | 5,605 |

Table 10: Number of Penalty Cases by Penalty Type and Year

| Breaches or evasion of Income Tax Act | Compliance action taken |
|--|--|
| Section 313 - Failure to lodge income tax returns | 3,262 taxpayers 11,853 final notices issued |
| Section 313 - Court Fines | 80 fines imposed K206,300 |
| Section 316(1) - Late lodgement penalties for income tax returns lodged late | 1,768 late lodgement penalties imposed K5,606,329 |
| Section 316(2) - Omitted income penalty | 74 omitted income penalties imposed K18,009,749. |
| Section 275(O) - Underestimation of provisional tax | 7 cases for K41,473 |

Table 11: Breaches of the Tax Act in 2011

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Mining and Petroleum Tax (MPT) is company tax applied specifically to companies operating in the mining and petroleum sector, and corporate income tax is company tax revenue derived from all other economic sectors. Mining and petroleum is the sector with the greatest company tax revenue collection. The table below breaks down MPT revenue by sub sector and commodity, where mining accounts for 64% and petroleum 36% of MPT revenue.

| Sector/Commodity | Kina | % |
|-------------------------------|----------------------|-------------|
| <u>Mining sub sector</u> | | |
| Gold | 881,231,744 | 42% |
| Copper | 434,798,790 | 21% |
| Silver | 15,614,119 | 1% |
| Mining sub total | 1,331,644,653 | 64% |
| Petroleum sub total | 741,888,737 | 36% |
| Total MPT tax revenue: | 2,073,533,390 | 100% |

Table 3: Mining and Petroleum Tax; Disaggregated by Commodity, 2011

Note: Gold, copper and silver revenue breakdowns are based on estimates only.

Actual direct tax collection from 2011 and 2010 by tax type is compared in the table and figure below. Mining and petroleum tax had the largest percentage increase in 2011 with a 40% increase from 2010, followed by personal income tax (39%). Corporate income tax increased 14% compared to 2010, and the only main direct tax to fall was stamp duty (-3%).

Personal income and company taxes increased in 2011 due to continued strong domestic economic growth and the build up in the PNG Liquefied Natural Gas (LNG) Project activity. Rising formal employment has also boosted personal income tax this year. Increasing commodity prices during 2011, such as gold and copper, have contributed to the growth in mining and petroleum tax. Stamp duty revenue fell due to legislative changes in the 2011 budget which increased the stamp duty exemption threshold for first time home buyers.

| Taxes Types | 2011 Actual Collection (K '000) | 2010 Actual Collection (K '000) | Percentage (%) Change |
|--|---------------------------------|---------------------------------|-----------------------|
| Direct Tax | | | |
| Individual Income Tax | 2,158,794 | 1,553,071 | 39% |
| <i>of which: PAYE Tax</i> | 2,081,996 | 1,493,303 | 39% |
| <i>of which: Business Payments Tax</i> | 60,490 | 53,219 | 14% |
| <i>of which: Income Tax Assessed</i> | 16,308 | 6,549 | 149% |
| Corporate Income Tax | 1,373,092 | 1,201,051 | 14% |
| Dividend Withholding Tax | 290,708 | 278,831 | 4% |
| Mining & Petroleum Tax | 2,073,533 | 1,476,052 | 40% |
| Bookmakers Turnover Tax | 8,058 | 9,109 | -12% |
| Stamp Duty | 63,557 | 65,439 | -3% |
| Royalty/Management Fees | 15,625 | 10,393 | 50% |
| Court Fines | 7 | 9 | -23% |
| Departure Tax | 4,661 | 4,338 | 7% |
| Training Levy | 3,598 | 1,736 | 107% |
| Gaming Machine Tax | 111,264 | 93,063 | 20% |
| Interest Withholding Tax | 40,482 | 42,306 | -4% |
| Sundry Receipts | 793 | 686 | 16% |
| Total Direct Tax | 6,144,174 | 4,736,084 | 30% |

Table 4: Direct Tax 2011 Actual Collection and 2010 Actual Collection

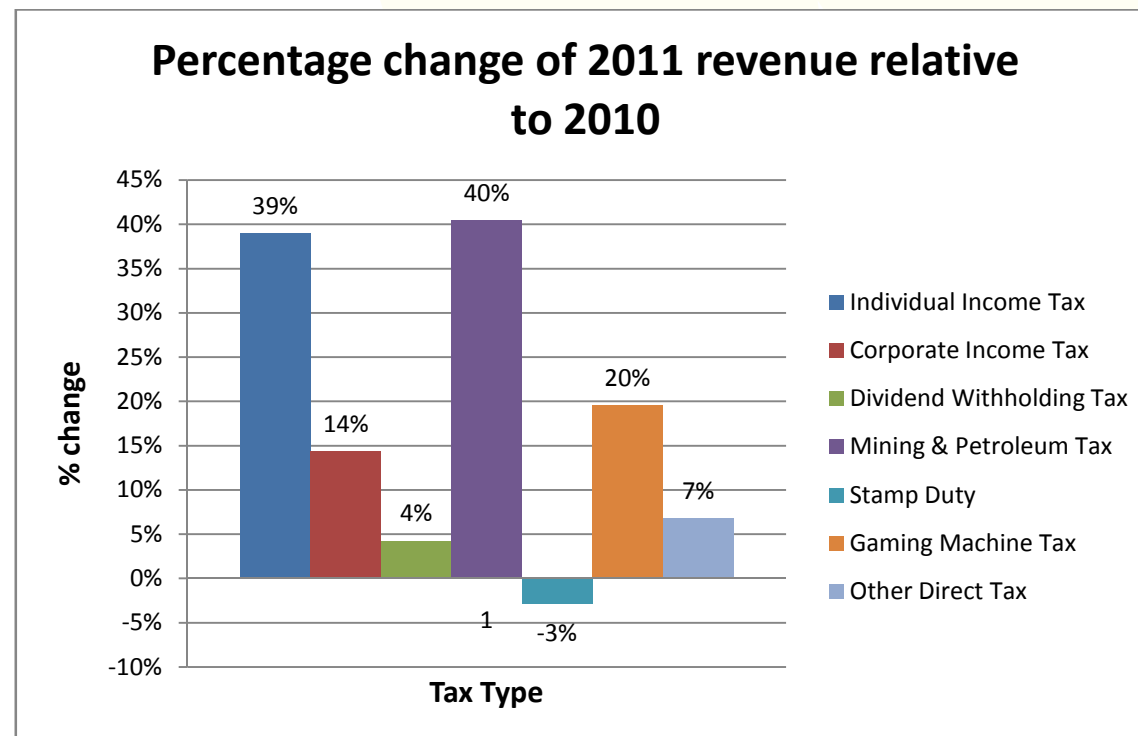


Figure 5: Percentage Change of 2011 Revenue Relative to 2010 Revenue by Direct Tax Type

stock is over 5 years old (as shown in the figure below). The majority of the debt this age becomes increasingly difficult to recover as the ability of the taxpayer to repay this debt becomes more diminished over time as their debts accumulate, until they are prohibitively high. Over this time period, companies may also have ceased trading (note company tax represents 70% of the outstanding debt). However a proportion of this older debt is recoverable, and the IRC's Manage Debt Division is taking steps to maximise debt recovery.

In addition there was a large effort by IRC to clear existing backlogs of work, in particular assessing thousands of unassessed returns during the later part of 2011. This in turn had an impact on the change in the stock of taxpayer debt between 2010 and 2011.

A significant proportion of the stock of debt, 41%, is less than 12 months old and has a high probability of collection.

(Million Kina)

| Age of Debt | 2008 | 2009 | 2010 | 2011 |
|----------------------------|--------------|--------------|--------------|--------------|
| Current Debt (not yet due) | 71 | 35 | 36 | 236 |
| 1 - 12 months | 513 | 564 | 492 | 641 |
| 13 - 60 month | 653 | 759 | 826 | 805 |
| > 60 months | 238 | 322 | 377 | 439 |
| Total Debt Holdings | 1,474 | 1,680 | 1,732 | 2,121 |

Table 9: Total Debt by Age of Debt and Year

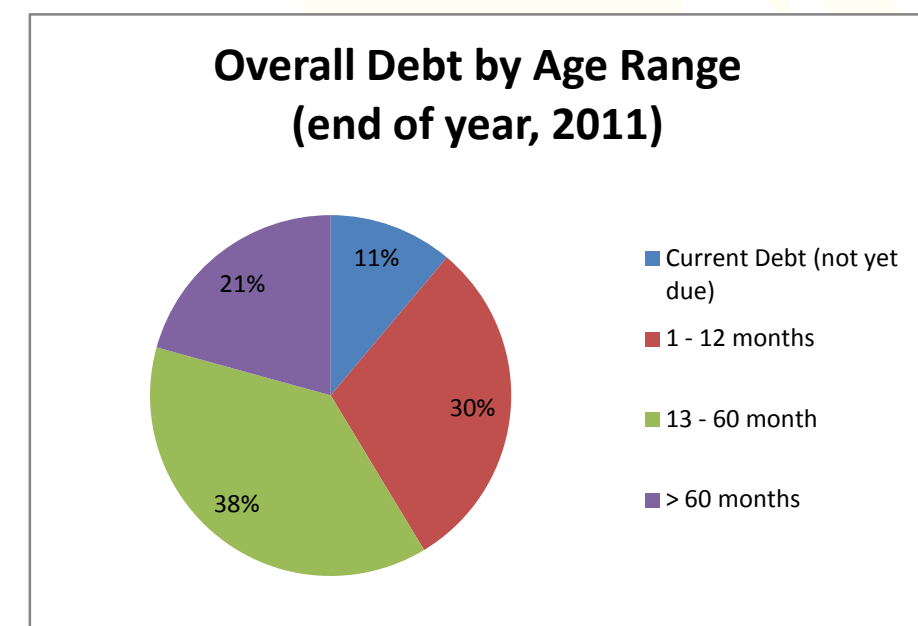


Figure 7: Proportion of the Total Debt on Hand by Age Range of Debt (2011)



2011 GST Disbursements

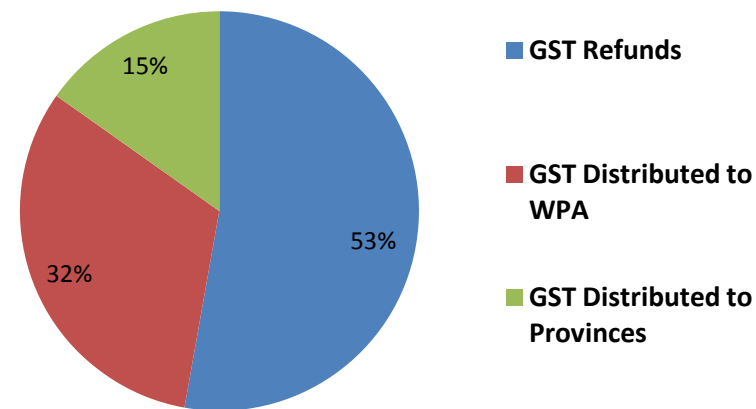


Figure 6: 2011 GST Disbursements by Destination (%)

Collecting Debt

At the end of 2011, taxpayer debt to IRC, aged between one and twelve months (the age of debt classified as most collectable), stood at 641 million Kina, or 10% of total tax revenue. Debt (1 -12 months old) as percentage of total collections saw a minor increase of one percentage point between 2010 and 2011.

(Million Kina)

| | 2008 | 2009 | 2010 | 2011 |
|--|-------|-------|-------|-------|
| End of year debt on hand (1-12 months old) | 513 | 564 | 492 | 641 |
| Total tax revenue | 4,972 | 4,230 | 5,524 | 6,705 |
| % | 10% | 13% | 9% | 10% |

Table 8: Debt aged 1-12 Months Compared to Total Tax Revenue

Total taxpayer debt on hand increased from 1,732 million Kina at the end of 2010 to 2,121 million Kina at the end of 2011. This value of total debt on hand appears relatively high as this amount includes the sum of taxpayer debts recorded from several years ago up to the present; 38% of the total debt stock is aged between 1 and 5 years old, and 21% of the debt

Goods and Service Tax (GST)

Total GST collections for 2011 stood at 1,947 million Kina and total GST disbursements equalled 1,760 million Kina, leaving a net balance of GST revenue equal to 187 million Kina. Goods and Services Tax experiences constant flows as GST registered taxpayers both remit GST revenue to IRC (import GST and inland GST) and receive GST refunds (depending on their commercial transactions and the circumstances). Besides flows of GST between taxpayers and IRC, there are also disbursement flows of GST to provincial government budgets and the central government [Waigani Public Account (WPA)]. Total tax revenue is calculated as total direct tax plus GST transfers to WPA for a given time period.

Total GST collections in 2011 were 8% above budget forecasts. For GST disbursements, GST refunds were made a priority during 2011, hence, actual GST refunds were greater than forecast. This was undertaken in order to honour IRC's commitments to taxpayers and to reduce the number of refund cases that have been building up over time. Lodgement of GST refund cases related to the LNG Project has also had a large impact on the total number of refund cases to process in 2011. As a result, transfers to WPA were lower than forecast. Total GST distributed to provinces is set at a pre determined amount based on net GST collections from provinces two years previous (i.e. in 2009) as provided by the GST Revenue Distribution Act. For 2011 this pre determined amount was 266.5 million Kina which equals actual disbursements to each province.

| | 2011 Actual Collection/ Disbursement (K '000) | 2011 Budget Forecast (K'000) | Percentage Change |
|--|---|------------------------------|-------------------|
| GST Collections | | | |
| Import GST Revenue (collection from ports) | 1,071,200 | 1,010,100 | 6% |
| Inland GST Revenue (collection from provinces) | 875,833 | 800,800 | 9% |
| Total Collection | 1,947,033 | 1,810,900 | 8% |
| GST Disbursements | | | |
| Total GST Refunds | 933,393 | 525,200 | 78% |
| GST Distributed to Provinces | 266,539 | 266,539 | 0% |
| GST Distributed to WPA | 560,500 | 938,300 | -40% |
| Total Disbursements | 1,760,432 | 1,730,039 | 2% |

Table 5: GST Collection and Disbursements; 2011 Actual and 2011 Budget Forecasts

The two tables below show the total GST collections from ports and provinces for 2011 and 2010, as well as the GST disbursements which includes GST refunds to taxpayers, GST distribution to provinces, and GST transferred to WPA. Compared to 2010 figures, GST collections increased 24% in 2011, which included a 16% increase in import GST and a 36% increase in inland GST (from all provinces), and GST disbursements increased 18%.



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The continuation of strong wages growth and employment in 2011 has resulted in higher disposable incomes for households, which has supported higher levels of consumption and therefore GST tax revenue.

| GST Collection Type | 2011 Actual Collection (K '000) | 2010 Actual Collection (K'000) | Percentage Change |
|---|---------------------------------|--------------------------------|-------------------|
| GST collections at Ports | 1,071,200 | 923,147 | 16% |
| GST collections in Provinces: | | | |
| Central | 5,503 | 4,674 | 18% |
| East New Britain | 26,906 | 22,461 | 20% |
| East Sepik | 10,625 | 10,367 | 2% |
| Eastern Highlands | 37,653 | 24,654 | 53% |
| Enga | 2,263 | 2,882 | -21% |
| Gulf | 748 | 583 | 28% |
| Madang | 18,265 | 11,092 | 65% |
| Manus | 1,759 | 441 | 299% |
| Milne Bay | 11,561 | 5,870 | 97% |
| Morobe | 141,716 | 133,537 | 6% |
| National Capital District | 496,020 | 349,713 | 42% |
| New Ireland | 11,613 | 8,743 | 33% |
| North Solomons | 9,700 | 7,419 | 31% |
| Oro | 5,588 | 2,919 | 91% |
| Sandaun | 3,515 | 2,636 | 33% |
| Simbu | 8,381 | 3,953 | 112% |
| Southern Highlands | 12,876 | 3,708 | 247% |
| West New Britain | 17,227 | 9,184 | 88% |
| Western Highlands | 40,843 | 30,823 | 33% |
| Western province | 13,074 | 7,517 | 74% |
| GST collections in Provinces Sub Total | 875,833 | 643,178 | 36% |
| Total GST Collection | 1,947,033 | 1,566,325 | 24% |

Table 6: GST collections; 2011 and 2010 Actual Collections

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| GST Disbursement Type | 2011 Actual Disbursement (K '000) | 2010 Actual Disbursement (K'000) | Percentage Change |
|--|-----------------------------------|----------------------------------|-------------------|
| GST Refunds | 925,539 | 453,928 | 104% |
| of which: allocated to Ports | 509,204 | 269,465 | |
| of which: allocated to Provinces | 416,335 | 184,463 | |
| GST Transferred to Waigani Public Account | 560,500 | 798,200 | -30% |
| GST Distributed to Provinces: | | | |
| Central | 963 | 751 | 28% |
| East New Britain | 10,923 | 8,516 | 28% |
| East Sepik | 3,140 | 2,036 | 54% |
| Eastern Highlands | 10,822 | 10,276 | 5% |
| Enga | 879 | 465 | 89% |
| Gulf | 51 | 197 | -74% |
| Madang | 5,971 | 4,036 | 48% |
| Manus | 206 | 224 | -8% |
| Milne Bay | 3,342 | 2,544 | 31% |
| Morobe | 46,763 | 31,186 | 50% |
| National Capital District | 155,826 | 149,030 | 5% |
| New Ireland | 2,542 | 2,247 | 13% |
| North Solomons | 1,923 | 1,314 | 46% |
| Oro | 1,442 | 1,237 | 16% |
| Sandaun | 657 | 317 | 107% |
| Simbu | 1,564 | 662 | 136% |
| Southern Highlands | 923 | 653 | 41% |
| West New Britain | 3,964 | 5,560 | -29% |
| Western Highlands | 11,991 | 11,966 | 0% |
| Western province | 2,648 | 2,898 | -9% |
| GST Distributed to Provinces Sub Total | 266,539 | 236,115 | 13% |
| Total GST Disbursement | 1,752,579 | 1,488,244 | 18% |

Table 7: GST Disbursements; 2011 and 2010 Actual Disbursements

Of the sum of GST revenue disbursed in 2011, the largest proportion was allocated to GST refunds (53% of total GST disbursements). The balance was then allocated between transfers to provincial government accounts³ which is a fixed amount, and WPA (see figure below). A priority was placed on paying GST refunds in 2011 in order to finance existing refunds and clear a backlog of refunds. This priority will continue throughout 2012 until the backlog of outstanding GST refunds are processed.

³ Note: GST distributed to each province in a given year is calculated as 60% of the net GST collections from each province (i.e. gross GST collected from the province minus GST refunds to that province) from two years earlier in accordance with the GST Revenue Distribution Act.