



2012

COMMISSIONER GENERAL
INTERNAL REVENUE COMMISSION

Annual Report



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“We collect taxes to help build PNG”



Revenue Accounting System II (RAS II)

2012 was an exciting year for the IRC, as the RAS II project kicked off in full swing. The year began with our team of 'Super Users' – IRC staff members across many operational business lines, with extra representation from our IT section; travelling to Montreal in Canada for an intensive training session with the company providing the RAS II software. This month-long experience laid much of the ground work for the final design of the application, and prepared the team for the challenges they will be facing with implementation. Returning to PNG, the team embarked on training with the PNG Institute of Public Administration, to certify under the National Qualifications Framework as trainers. The intention being that not only will the Super Users be managing the testing and implementation of the application, but also delivering the end-user training to all IRC personnel on the use of the application.

The IRC realised that the scope of the RAS II project cross-cuts through every aspect of their business, and this project is the most ambitious change undertaken by the organization to date. As such, the IRC sourced a team of experts to support the intensive project work of the Super Users. This team was mobilized by late 2012, and the IRC has been working with this team to further the project along several major work streams including User Acceptance Testing, Process Mapping and Redesign, and End-User Training.

By the end of 2012, the RAS II Project team had produced a revised project plan which showed a phased-in approach to implementation of the new software tool. This plan encapsulated the work achieved throughout 2012 and mapped out the course of action for 2013-14 of the Super Users and the IRC as a whole. We anticipate beginning to rollout RAS II in mid-late 2013 in the first of three phases, with implementation carrying on throughout 2014.

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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.



The ICT Division will continue to strive for excellence to support transformation of the IRC as it partners with its stakeholders both internal and external in fulfilling the aspirations of IRC being the best government agency and leading tax administration in the Pacific.

Donor Support

The Internal Revenue Commission (IRC) has continued to benefit from the support of key partners in development. This has contributed significantly to our performance across many areas of our operations and also helped position us to take on some of the very large challenges associated with implementing our corporate plan objectives.

In particular, AusAID provided funding for four Economic and Public Sector Program (EPSP) advisors and a number of project related grants, three Strongim Gavman Program (SGP) advisors deployed from the Australian Taxation Office (ATO) and a range of twinning activities under the PNG-ATO Twinning Scheme (PATOTS).

The EPSP advisors supported four key areas of need in the IRC being (1) governance and strategic change management, (2) internal investigations and integrity, (3) recruitment, and (4) development of a training capability and training curriculum. An ICT advisor was also provided to provide support on a short term basis during the year.

The Strongim Gavman Program (SGP) advisors provided specialist advice and capacity building across the organisation and particularly in relation to our critical tax technical and taxpayer compliance responsibilities. This was complemented by PATOTS twinning activities and other support from the ATO including for internal audit, development of Tax Circulars, audit case selection and transfer pricing.

We will continue to need the support of advisors in these areas in 2013 given the magnitude of the challenges and transformation task faced by the IRC in meeting our vision as outlined in our new IRC Corporate Plan 2013-2017.

We also had an advisor in place working on a World Bank sponsored project aimed at building audit capacity within the mining and energy sector. A further advisor joined this project late in 2012 and the third advisor has since joined us after the end of the year.

The IRC also has an Economist provided by the Overseas Development Institute and received assistance from the US Treasury Office of Technical Assistance who provided advice on staff recruitment and retention and also on setting up a large taxpayer office within the IRC to better support IRC administration of and support for large taxpayers.



Achievements

- **Server Upgrade** Fully Functional and Operational with backup Process complete which includes offsite storage of backup tapes.
- **Wide Area Network** Work on connecting the Lae office has commenced after some delays due to external problems.
- **Office Software Deployment (W7 and Off2010)** All PC's installed with Windows 7 and Office 2010 except for some provincial offices.
- **Upgrade Core Network** Partly done as part of IGIS project where 5 switches are already installed. Additional switches have been purchased and now waiting to be installed by the selected Service Provider.
- **Expectation Statements** Rolled out Expectation Statements to all staff, a new management tool that was introduced this year to monitor and assess the performance of staff.
- **Business Continuity Planning (BCP)** Stimulated interest for the executive management to consider BCP training, the training was well attended and received by the executive management team.
- **Service Desk** Service Desk installed but not fully implemented due to limited system administration knowledge and resources because recruiting people with the appropriate skills and knowledge is an on-going struggle.
- **SIGTAS Support** Team heavily involved in the installing and setup of SIGTAS User Acceptance Test and Training environments and configuration of the system.
- **Disaster Recovery (DR)** Equipment Setup DR Equipment has been purchased and a Service Provider has been engaged to integrate existing and new equipment as part of the BCP process in the first half of 2013.

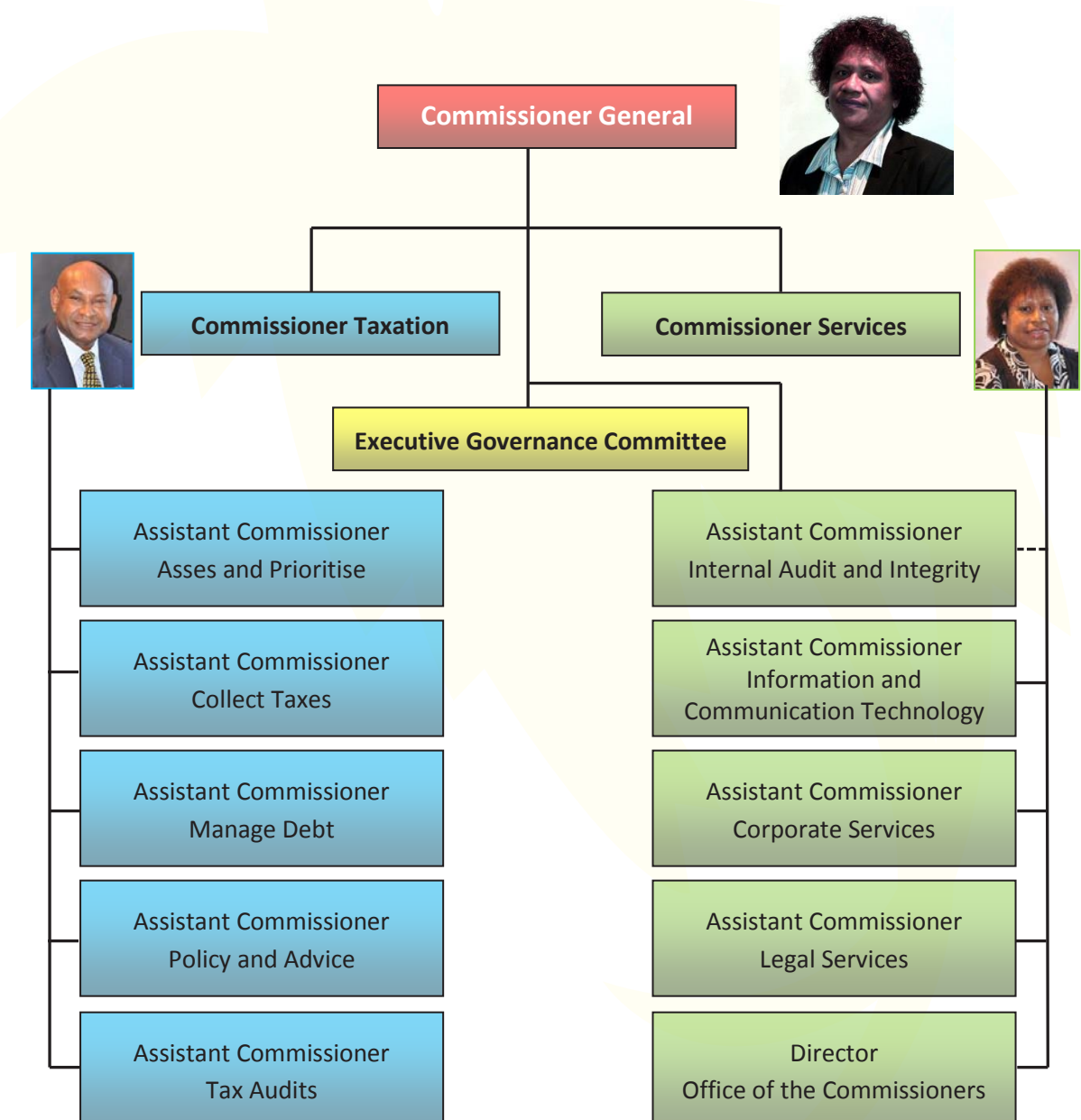
Challenges

Apart from the common HR issues experienced by all divisions of the IRC the following challenges are specific to the operations of the ICT division in its endeavors to satisfy the requirements and needs of the organization as a whole.

- Senior managers are diverted from strategic and governance activities to doing day to day operations.
- Unplanned but high priority projects taking up much needed resources.
- Greater demand on ICT Operations staff due to conflicting priorities which causes some capacity and capability issues.
- No clear reporting lines for the RAS II Project team. This highlights the need to build permanent business change capabilities within the ICT Division and the IRC as a whole.
- Dependencies on other stakeholders (Internal/External) causing delays in achieving desired outcomes.

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 2012 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.

2012 Revenue Performance

In 2012, the IRC was set a revenue target of K7.1 billion. However, given the falling world commodity prices and expected reduction in mine operations for a number of mining companies, the revenue target for the resource sector was revised in Treasury Department's Mid-Year Economic and Fiscal Outlook (MYEFO) to K6.8 billion. The IRC committed all its resources to ensure the projections were reached.

The IRC performance in revenue collections was shy of the original budget projection by K227 million but surpassed the MYEFO projection by K46 million. The IRC is pleased with this performance given the very significant shortfall of about K900 million compared with revenue projections from the resource sector and that this shortfall was almost made up for by increases in other revenue streams. The collection outcome in part reflects the dedication of IRC officers to achieving the best revenue outcome possible, as many senior and other staff of the IRC, for example, worked over the Christmas Public Service Shutdown period to maximise the revenue outcome for 2012.

There is room for IRC to improve on this performance and we have the opportunity to do so in 2013, if we overcome some, if not all of the constraints placed on us internally and by factors in the external environment. These constraints and challenges include:

- Staffing levels
- Staff skills levels
- IRC's ability to attract, recruit and retain staff
- Cross-agency support and institutional inflexibilities
- Staff welfare issues
- Office accommodation deficiencies
- Communications infrastructure between Head Office and Provinces
- Legislation complexity
- Maintaining revenue outcomes during rollout of a new core system, RAS II

Advance Acquittal Register Control

IRC has installed the Travel Advance Register system in the PGAS system in 2012, and will also create an Advance Acquittal Register book to facilitate review and monitoring of travel advances for IRC officers on domestic and international official travels to ensure compliance with advance management requirements stipulated in the Finance Management Manual. The register will contain all the columns as prescribed in the Financial Management Manual. This was one of the findings of the 2011 audit of IRC by the Auditor General office and reported in the Auditor General's Management letter for implementation.

Information and Communications Technology

The 2012 end of year review highlighted another satisfactory year for the ICT Division in terms of its overall performance in meeting its desired outcomes identified at the beginning of the year.

2012 was also the end of the three year (2009-2012) strategic plan and a reflection of the plan makes ICT Division proud of its achievements and at the same its readiness to take up any new challenges that may be introduced in the new plan.

The three major projects (Infrastructure Upgrade, Wide Area Network (WAN) connection and replacement of the Revenue Accounting System (RAS II)) identified in the 2009-2012 Strategic Plan and reported in the 2011 annual report were carried forward into 2012. The major components of the Infrastructure Upgrade (Server Upgrades, External Email and Internet Access) are in full operation and only require on-going maintenance and support, however the WAN and the implementation of the new tax accounting system – SIGTAS – are still in progress due to external constraints and will be carried forward in the new plan which is a five year plan aligned with the IRC 2013-2017 Corporate Plan.

The WAN project has progressed to a stage of commencing work on connecting the Lae regional office, however due to external factors the connection is likely to be completed in the first half of 2013. This will be another milestone for the Internal Revenue Commission.

ICT's involvement in the RAS II project is providing the infrastructure and support for the implementation of SIGTAS which is the new tax accounting system and has done exceptionally well in ensuring that the environment is ready for the implementation of the new system. ICT also provided a good number of super users who are responsible for the business process mapping, developing flow charts and instruction sheets and user acceptance testing as part of the development and implementation of SIGTAS.

The following highlights some of the success stories for 2012 and challenges faced by the division:

**PAYMENTS FROM APPROPRIATION - WARRANTS ALLOCATION**

PAYMENTS	2011	2012
PERSONAL EMOLUMENTS		
111 Salaries and Allowances	11,155,300.00	15,454,639.00
112 Wages	335,500.00	30,194.99
113 Overtime	66,500.00	65,168.00
114 Leave fares	533,900.00	458,930.76
116 Education Subsidy		
141 Gratuities	761,000.00	450,677.00
SUB TOTAL	12,852,200.00	16,459,609.75
GOODS and SERVICES		
121 Travel and Subsistence	1,872,800.00	2,249,929.55
122 Utilities	4,784,900.00	3,808,675.86
123 Office materials and Supplies	987,400.00	700,049.50
124 Operational Material and Supplies	343,500.00	240,074.98
125 Transport and Fuel	472,100.00	358,409.58
126 Consultancy Fees	230,200.00	2,036,476.00
127 Rental of Property	962,600.00	764,659.55
128 Routine Maintenance	1,805,300.00	1,880,955.48
135 Other Operational Expenses	7,305,100.00	7,137,492.06
136 Training	450,400.00	805,779.45
142 Membership Fees	45,700.00	25,606.62
SUB TOTAL	19,260,000.00	20,008,108.63
CAPITAL		
221 Furniture and Equipment	1,126,000.00	2,067,214.81
222 Purchase of Vehicles	188,400.00	555,877.58
223 Plant and Equipment's		
Construction and Improvements and		
225 Renovation of Houses		2,144,916.10
SUB TOTALS	1,314,400.00	4,768,008.49
OTHERS		
Unutilized Funds	4,884,800.00	6,689,273.13
Unutilized warrants		1,550,000.00
TOTAL PAYMENT	38,311,400.00	49,475,000.00

IRC continued to have an issue concerning expenditure report variations between TMS / IFMS Reports and PGAS Reports for year 2012. IRC has implemented an interim process to compare and reconcile the two expenditure reports on a month by month basis while awaiting a permanent solution. This exercise was to ensure the two reports agree with respect to expenditure balances for the production of the 2012 Public Accounts.

Performance against the IRC Corporate Plan 2010-12

Over the past three years, IRC has been guided by our Corporate Plan 2010-12. It is appropriate that I take this opportunity to report against the Key Performance Indicators that we set ourselves. We aimed to reduce our turnaround times for the various tax returns and GST refunds. While we still have room for improvement, we have significantly improved our turnaround times for processing returns and refunds for our key clients while still making measurable improvements across all types. Although we are proud of this achievement, we were unable to do as well as we aspired due to our inability to attract and retain staff in key tax administration areas.

We were also able to keep our taxpayers better informed through improved and targeted tax awareness sessions across the country but by far the best achievement in this respect was the commissioning of the IRC email system allowing us to better communicate both internally and with taxpayers and stakeholders. IRC was for the first time able to respond promptly to taxpayer queries and correspondence via the internet. The IRC website has been commissioned and now hosts a variety of information for taxpayers including forms, policy documents Tax Circulars and Tax Agent Circulars.

We also recognised the need to upgrade IRC's Revenue Accounting System (RAS) and initiated the RAS II project to install the Canadian-developed *Standard Integrated Tax Administration System* (SIGTAS). 2012 saw the commencement of "Super User" training in Montreal that has led to developing a solid core of staff members to test the system as it is released to us and to develop and conduct the training packages for the RAS II end users through 2013. SIGTAS represents a major investment by the IRC in developing its ability to effectively administer the revenue system in PNG - with a view to modernising and streamlining how we process taxpayer information. It is anticipated for Phase 1 of the implementation of SIGTAS to "go live" in July 2013.

IRC Corporate Plan 2013-17 Development

A significant amount of time was spent during 2012 investing in our future in developing the IRC Corporate Plan 2013-17. A very important aspect of this plan was that the planning process is owned by the staff. Each Division made a contribution by conducting their own Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis that was then combined with an analysis of IRC's strategic environment. This means that the new IRC Plan is not only directly connected to PNG's strategic planning framework and its outcomes, but also reflects Divisional needs and aspirations. Another first for IRC will be the direct connection between the Annual Work Plan and the Corporate Plan. The connection will eventually find its way through to individual work plans thereby making the delivery of its outcomes readily monitored and achievable. The improvements that we have made to the planning and reporting framework will lead to better business decision making in the future. Of paramount importance is that the new corporate plan has set the blueprint for the transformation of IRC into a modern tax



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administration. I thank all the staff who have assisted in setting the course for IRC to steer into the future.

Over the last three years (2010-2012) IRC's Actual Collections have generally exceeded Budget Projections by over 21% despite being hit this year by a fall in world commodity prices and other factors beyond our control. IRC has also seen the revenue base strengthen from year to year over this period. However, we now have a greater challenge ahead, in that by 2016 IRC is expected by the Government to collect 50% more than current collections. This basically means that we need to be smarter in strategizing now more than ever, and ensuring that these strategies are properly and effectively implemented. In saying so, I am confident we are on track to transform the IRC into a modern tax administration and a model public sector agency by focussing on cascading our IRC 2013-2017 Corporate Plan into the Divisional Strategic Plans and even into individual staff expectation statements. We are making headway but we are not underestimating the magnitude of the reforms being undertaken.

What was Pleasing in 2012

IRC made much improvement in its recruitment process including rolling out its Graduate/Cadetship Development Programs, and implementing Expectation Statements for individual staff which proved to be an effective tool in monitoring and evaluating staff performance. In terms of staff welfare, year 2012 has been the stepping stone: IRC introduced a staff transportation program for staff in NCD, (i.e. pick-up and drop-off to and from work) and in addition acquired two more 15-seater buses for this purpose; acquired four houses for manager accommodation in the regions; and has loaded new Special Domestic Market Allowance (SDMA) rates and additional SDMA positions onto the structure.

IRC's performance was recognised during 2012 by several of our external stakeholders for achievements that we should be proud of as an organisation. We received international recognition by the International Monetary Fund at the Pacific Island Tax Administration Association conference for preparing its draft Charter and Constitution. IRC was recognised by the Auditor General's Office, Finance Department and the Audit Committee, as being one of the better performing government agencies and was awarded a prize for the "best Audit Committee" in the Public Service. IRC was one of only four Departments that were awarded a Four Star rating by the Department of Finance for continuing to maintain high standards of performance in terms of timeliness and quality of the bank reconciliations of the National Drawing Accounts. While I commend IRC Budget and Finance staff for this great work, I also challenge them to take us to the next level; a Five Star rating in 2013. Finally we orchestrated the signing of the Double Tax Treaty between the Governments of PNG and New Zealand.

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GOVERNMENT APPROPRIATION - ALLOCATION

RECEIPTS WARRANTS		2011	2012
PERSONAL EMOLUMENTS			
111	Salaries and Allowances	13,758,200.00	19,541,300.00
112	Wages	91,500.00	63,200.00
113	Overtime	74,300.00	100,300.00
114	Leave Fares	672,000.00	639,000.00
116	Education Subsidy		
141	Gratuities	1,293,400.00	483,800.00
SUB TOTAL		15,889,400.00	20,827,600.00
GOODS and SERVICES			
121	Travel and Subsistence	1,833,200.00	2,374,000.00
122	Utilities	3,554,400.00	3,850,000.00
123	Office Materials and Supplies	990,800.00	717,400.00
124	Operational Material and Supplies	441,400.00	242,000.00
125	Transport and Fuel	543,700.00	394,900.00
126	Consultancy Fees	1,048,000.00	2,090,000.00
127	Rental of Property	546,700.00	885,800.00
128	Routine Maintenance	2,270,000.00	2,021,000.00
135	Other Operational Expenses	5,312,900.00	8,643,000.00
136	Training	810,200.00	860,600.00
142	Membership Fees	163,300.00	40,500.00
SUB TOTAL		17,514,600.00	22,119,200.00
CAPITAL			
221	Furniture and Equipment's	4,424,300.00	2,118,200.00
222	Purchase of Vehicles		660,000.00
223	Plant and Equipment's		
225	Construction and Improvements and Renovation of Houses	500,000.00	2,200,000.00
SUB TOTALS		4,924,300.00	4,978,200.00
OTHERS			
	Unreleased Warrants		
	Personal Emoluments		25,000.00
	Goods and Services		25,000.00
	RASII Development		1,500,000.00
SUB TOTAL			1,550,000.00
TOTAL APPROPRIATION		38,328,300.00	49,475,000.00



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 2012, comprising of personal emoluments, and goods and services. These items relate to the recurrent expenditure budget as separate from the K5.2 million development budgets appropriated and allocated for the replacement of the aging RAS II system and Regional Manager Housing Project.

RECIEPTS	2011	2012
TREASURY APPROPRIATION		
Personal Emoluments	15,230,700.00	20,790,000.00
Goods and Services	21,387,700.00	19,896,000.00
Capital Expenditure	1,693,000.00	8,789,000.00
Total Receipts	38,311,400.00	49,475,000.0
PAYMENTS		
TREASURY APPROPRIATION		
Personal Emoluments	12,852,200.00	20,852,600.00
Goods and Services	19,260,000.00	23,634,200.00
Capital Expenditures	1,314,400.00	4,988,200.00
Unutilised Fund	4,884,800.00	
Total Payments	38,311,400.00	49,475,000.00

Personal Emoluments The total amount of funds unspent under personal emolument was K4,367,990.30. This was mainly from Item 111 (Salaries and Allowances) amounting to K4,086,661.00. This under expenditure was mainly due to staff departure and delays in recruitment of funded vacant positions. The remaining difference in funds comprised smaller unspent amounts from the other items all across IRC divisions like Item 112 Wages of K33,005.01, Item 113 Overtime of K47,573.00 and Item 114 leave fares of K180,069.24 and Item 141 gratuity of K20,682.00.

Goods and Services The total unspent funds reported for goods and service at the end of the year at 31st December 2012 was K1,859,599.50. The main item which recorded under expenditure was Item 135, Other Operational Expenses vote. This amount is considered very substantial and material in nature whilst the remaining difference comprised of smaller unspent amounts from other activities and items.

Item 135 Other Operational Expenses . An underspend of K1,480,011.61 under this vote related to costs associated with the Wide Area Network project rollout; mainly due to State Solicitors and CSTB delays in clearing the contracts which delayed work on these projects.

The Year Ahead

Whilst we are proud of these and other achievements over the course of the year, there have been and still are pressing challenges that we must address: the need for effective, targeted/strategized enforcement activities; the need for improved communication and dialogue both internally and with our external stakeholders; our reporting systems need to be re-looked at; staff constraints, attraction and retention measures need to be identified, and proper succession planning to be put in place; skill gaps, attendance and performance issues have to be better managed. Ultimately, better understanding of the issues, the business, and of their correlation in maximising output for the IRC as a whole would facilitate necessary adjustment to further push IRC in the right direction.

We are on the verge of an exciting era over the next five years with a new Corporate Plan (2013-2017) to lead us into achieving our new vision of being the best public sector agency and the leading Tax Administration in the Pacific. To refresh us, we have a new look with our new corporate uniforms and our new logo and a new slogan that testifies our significance in the development of this nation, Papua New Guinea; "IRC, Your Partner in Nation Building".

Last but not least; I would like to express my sincere gratitude to all staff for your support and efforts this past year. Please note that we all have a crucial part to play in IRC no matter how small you or anyone may think it is. On that point, I urge us all as individuals to step up in 2013 and in the years that follow. It is a combination of our individual contributions that amount to the organisation's successes that I know await us in 2013 and beyond.



Corporate Governance

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.

Internal Audit

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.

The Internal Audit Unit initially planned to complete eight audits in 2012 across IRC. As a result of ad-hoc audits, the number planned grew to 14. By the end of 2012, 12 Internal Audits were completed and tabled at the IRC Audit Committee Meeting and two audit activities were carried forward to 2013.

The audit reports received positive responses from IRC Management and the Executive. Recommendations were issued to the Divisions concerned for implementation. IRC Executive Management supported the recommendations and actively supports their implementation. Post audits will be conducted in 2013 to test the implementation of the recommendations endorsed.

On the job audit training was provided by Australian Tax Office (ATO) and incorporated three separate Twinning Training Programmes of two weeks duration. Training from Deloitte, sponsored by the Governments of PNG and Australia was coordinated by the Department of Finance.

Recruitment and retention of suitable candidates to fill in the vacant Internal Audit positions was one of the major challenges for the Internal Audit Unit. Consequently a number of the senior Internal Audit positions remain vacant.

Internal Investigation

The 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 ensures, where appropriate, successful convictions of people arrested and charged both disciplinarily and criminally.

The Internal Investigation Unit provides a deterrent effect which is targeted towards minimising the level of corruption in the IRC. The Unit facilitates Fraud Awareness and Education presentations to staff of all levels throughout the Organisation. During 2012, the Internal

Finances

IRC was given an appropriation of K44.2 million for recurrent expenditure for its operations and K5.2 million for development expenditure; K3 million for enhancement of the aging Revenue Accounting System (RASI) called RASII project and K2.2 million for IRC Regional Managers Institutional Housing Project. The details below shows the figures for the warrants issued to IRC and the amounts spent and unspent at year ending 31st December 2012 under the recurrent budget and the development budget

Recurrent Expenditure Budget

Warrants to IRC K,000	Amount spent K,000	Amount not Spent K,000
PE: 20,827.6	PE: 16,459.6	PE: 4,368.0
G/S: 23,397.4	G/S: 21,537.8	G/S: 1,859.6
Total: 44,225.0	Total: 37,997.4	Total: 6,227.6

Development Budget

Warrants to IRC K,000	Amount spent K,000	Amount not Spent K,000
RAS II: 1,500.0	1,400.0	0.1
IRC RMIH: 2,200.0	2,144.9	55.1
Total: 3,700.0	Total: 3,544.9	Total: 55.2

Of the total warrants issued of K44,225 million under the recurrent budget, IRC spent K37,997.4 million and the balance of K6,227.6 million remained unspent at the end of the year as of 31st December 2012.

In terms of RASII development budget appropriation of K3 million, only K1.5 million was released to IRC. Of that only K1.4 million was spent. The delay has been due to the technical nature of the work being developed to adapt to the PNG IRC environment and took longer than planned. The K1.4 million was paid for the provision of project management services to assist in the implementation of the RAS II SIGTAS project.

The K2,200 million appropriated and released for Regional Managers' Housing Project, was not fully expended, only K2.1 million was spent to purchase (4) four residential institutional houses for the IRC Regional / Port Provincial Managers stationed in Alotau, Madang, Kimbe and Buka. The balance of K55,100 was unspent because it was not possible to purchase any residential accommodation with that amount of money.



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Number of Training Programs Conducted	Number of Participants	Remarks
Service Wing Expectation Statement Workshop	118	Compulsory
Public Service Induction Training for IRC Recruits	75	Compulsory
Routine Workplace Communication & Time Management	10	Ongoing
Performance Management	32	Ongoing
Pacific Manager Development Program (Vanuatu)	27	Ongoing
Requisition Forms Training	25	Ongoing/Finance & Budget
National Cert II in Training & Assessment	14	Conducted by PNG IPA
SIGTAS Training (Basic Tax Roll – 2012 1 st Run)	13	In Progress

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Investigation Unit commenced presentations on Fraud Awareness and Corruption Prevention to external stakeholders and business people.

Originally, a target of 96 completed Internal Investigations was set for 2012. The Internal Investigation Unit experiences similar issues to the Internal Audit Unit in relation to attracting, recruiting and retaining suitable staff. As such, the target was revised to 24 completed Internal Investigations.

At the end of 2012, the total number of completed Internal Investigations was 12. Staff numbers within the Internal Investigation Unit continued to have a negative effect on the completion rates of matters.

During 2012, IAID received 78 reports of incidents and information suggesting possible improper or corrupt behaviour by IRC employees and the taxpayers. The number of complaints received increased compared to the previous year as a result of the Fraud Awareness and Education Campaigns.

Throughout 2012 four IRC officers were charged and dismissed, five IRC officers were demoted and two taxpayers and an IRC officer were convicted by the National Court.

Four matters are still at the Committal Court for hearing.

Recruitment and retention of suitable candidates to fill in the vacant Internal Investigation positions was one of the major challenges for the Internal Investigation Unit. Consequently a number of the senior Internal Investigation positions remain vacant.

The number of complaints received compared to the staff on strength to address the matters was another of the challenges faced by the Internal Audit and Integrity Division.

External Audit Activities

The Auditor General's Office (AGO) conducted an audit in August on the internal control systems and accounts of the IRC relating to both recurrent and development budget expenditure for the 2011 financial year.

The AGO Management Letter was received by the Commissioner General on 1st November 2012. The audit report detailed seven 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.

The majority 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 2013 to address any outstanding issues.

Of the recommendations contained within the AGO 2009/2010 Management Letter, 97% were implemented by the end of 2011. A large number of the recommendations contained within the AGO 2011 Management Letter were also implemented during 2012.



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 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.

The current Chair of the IRC Audit Committee is Mr Rueben Aila (Principal Manager for Community Affairs, Business Development and Permitting, Wafi Golpu Services Limited). Overseen by the Audit Committee, the IRC has implemented other recommendations made by the AGO for the 2009, 2010 and 2011 financial years. Very positive comments from the Chair of IRC Audit Committee were made during 2012.

On 9th July 2012 it was announced by a representative from the Department of Finance Audit Committee that IRC was ranked the best performing GoPNG agency for 2011.

During the final IRC Audit Committee Meeting of 2012, IRC was recognised for outstanding audit performance by the Public Service Audit Program (PSAP) through the Department of Finance and the Australian Government.

The award of a K50, 000.00 cheque to be used for the training of Internal Auditors and the purchasing of equipment for the Internal Audit section was presented to the Commissioner General.

The cadetship is aimed at school leavers from grade 12 and diploma holders whilst the graduate program is aimed at university graduates of degree programmes in disciplines suitable to the IRC's business.

Overall, there were three rounds of recruitment and alternative options such as cadetship and graduate programmes were explored to assist the IRC meet our staffing challenges.

Additionally, increased SDMA rates were successfully negotiated with DPM for technical positions and an initial attempt at IRC becoming a statutory body was also instigated.

Further, for the first time in the history of IRC a HR Strategy was in place to guide the IRC in terms of how it intends to approach its staff and HR issues over the next 5 years.

Learning and Development

2012 has seen the training unit commence a transitional shift from traditional tax administration and soft skill training programs to a competency based learning model that will be implemented across the organisation and reflect the outcomes of the HR strategy and corporate planning process. The competency standards are being developed to link in with existing PNG public sector standards and qualifications, and will reflect our organisational training needs for 2013 – 2017.

The year has seen a substantial effort by the training unit and HR to maintain and complete induction training for new and existing IRC officers as part of the PNG Public Services New Basics Program; this will transition to the Certificates Two and Three in Government in 2013.

In addition to core training activities, the training unit has worked closely with the SIGTAS implementation team, and the SUG (Super User Group) in assisting with preparation for the training rollout of the SIGTAS learning modules, this program will run for much of 2013. This has included the up-skilling of the SUG as trainers. The IRC has worked closely with one of our training partners, PNG IPA's School of Government who have facilitated the delivery of the Certificate 2 in Instruction to all members of the SUG.

2012 has also seen the reconnection of the IRC with many of its external training providers and stakeholders including the PNG Training and Development Society. Engagement with our national and regional learning and development stakeholders will be key to our long term goal of establishing the IRC as a leader in tax administration learning and professional development for the Pacific region.



Using Resources Effectively

Staffing

In 2012 the IRC approached recruitment through a phased approach given lesson learnt in 2011 where a bulk recruitment process used for 158 positions advertised placed a lot of strain on our capacity due to competing priorities.

The IRC, with the assistance of AusAID's Economic and Public Sector Program (EPSP), engaged a private recruitment company to assist with the initial recruitment using the grant funding made available to the IRC. This greatly assisted the process because of the staffing constraints in the IRC's HR recruitment area.

There were three rounds of recruitment with the first round in June to September of 48 priority positions which resulted in 38 positions being filled from a total of 861 applications received. However, most of the applications were for lower level positions and the technical positions requiring skills were very few with as low as 1 or nil applicants. The next round of recruitment was in December 2012 to April 2013 for 46 manager/senior officer positions the selection and recruitment of which is currently in the final stages. The same scenario as the first round was observed with a total of 414 applications; resulting in only 12 positions being filled with the rest to be finalised during the first half of 2013.

HUMAN RESOURCES	December 2012	December 2011
National Permanent Officers	293	321
Non-Citizen Officers	4	4
Probationary Officers	76	25
Unattached Officers	11	18
Staff on Strength	384	368
Staff Ceiling	581	581
Understaffed by	197	213

Simultaneously in 2012 IRC launched, for the first time ever, its graduate and cadetship programs targeting 43 positions to undertake internship for 12 months with the option of permanent recruitment. There was enormous interest displayed with 337 applications received. The Cadets and Graduates are intended to commence on 29th April 2013.

Report on Revenue Performance

Summary

This chapter provides an overview and analysis of the performance of IRC's revenue collections in 2012. The IRC and its operations provide the main source of revenue for financing government expenditure in PNG (approximately 70% of government financing in 2012 was sourced from IRC). To meet the country's spending needs and to minimise the government of PNG's budget deficit planned for the next four fiscal years, it is important for IRC to meet or exceed its revenue performance targets. This chapter provides a detailed analysis of revenue performance data for the different direct and indirect taxes for 2012, and draws comparisons to budget forecasts and previous years' revenues.

In 2012, IRC collected a total net tax amount of K6,863.1 million¹ and transferred to the Waigani Public Account (of which K5,853.1 million was direct tax and K1,010 million was GST). This total is below the original 2012 budget revenue projection of K7,089.9 million, but is however, above the Mid-Year Economic and Fiscal Outlook (MYEFO) revised projection of K6,816.9 million.

Tax Type	2008	2009	2010	2011	2012
Individual Income Tax	1,097.9	1,254.5	1,553.1	2,158.8	2,645.1
Corporate Income Tax	839.7	1,085.9	1,201.1	1,373.1	1,740.5
Dividend Withholding Tax	190.6	246.6	278.8	290.7	176.5
Mining & Petroleum Tax	1,991.4	749.1	1,476.1	2,073.5	981.1
Stamp Duty	74.5	57.7	65.4	63.6	70.2
Gaming Machine Tax	84.3	89.2	93.1	111.3	133.9
Other Direct Taxes	46.6	54.4	68.6	73.2	105.9
Total Direct Taxes	4,325.0	3,537.5	4,736.1	6,144.2	5,853.1
GST to WPA	647.1	693.0	788.2	560.5	1,010.0
Total Revenue	4,972.1	4,230.5	5,524.3	6,704.7	6,863.1

Table 1: IRC Total Tax Collections, 2008-2012 (Million Kina)

Table 1 displays the trend of total tax revenue collections by IRC² over the last five years, and Figure 1 over the past decade. In Figure 1, the revenue trend has been overall in an upward direction during this period. 2009 experienced a decrease in revenue following the global

¹ Note net collections are defined as total direct tax revenue plus GST revenue transferred to the Waigani Public Account (WPA). Hence net collections exclude the K272 million of GST transfers to provinces in 2012.

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.



financial crisis, which saw a drop in world commodity prices and demand, leading to a significant fall in mining and petroleum tax revenue. Since 2009, collections have again been following an upward trend, although revenue growth has experienced a slowdown in 2012, which the Department of Treasury has predicted will continue in 2013. Reasons for this slowdown in total revenue growth in 2012 will be discussed in this chapter.

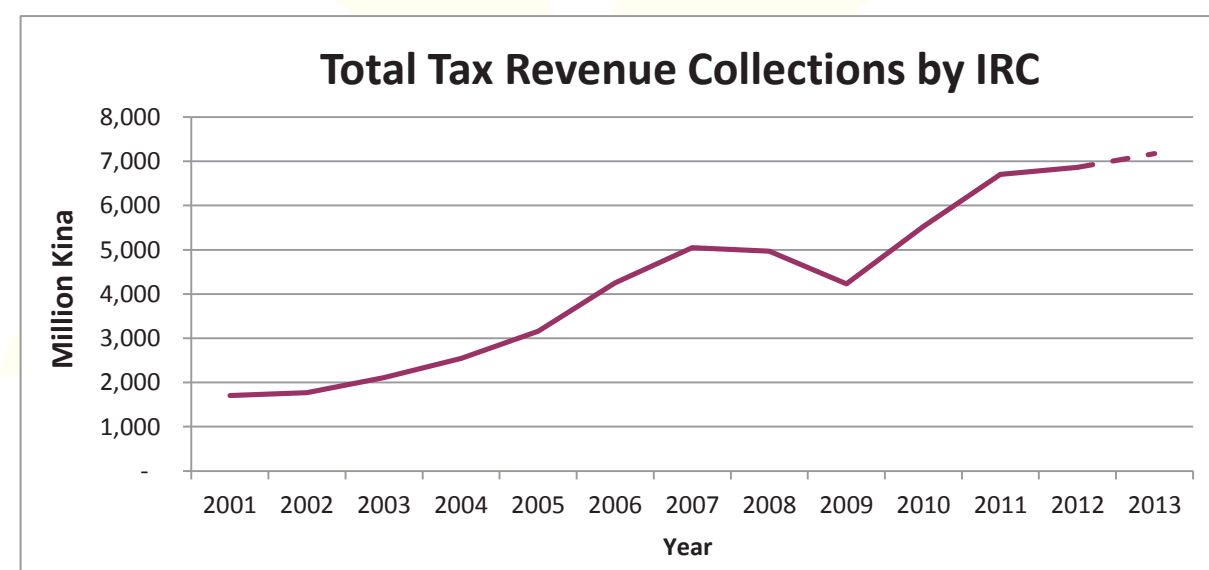


Figure 1: Total Tax Revenue Collections by IRC, 2001 – 2012
(Note: 2013 figure is budget projection)

Tax revenue as a percentage of gross domestic product (GDP) is one indicator used to determine if tax revenue is rising in line with a country's gross annual income generated. Figure 2 plots total tax revenue and nominal GDP³ over time from 2005 to 2012 (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. Revenue as a percentage of GDP is estimated at 20% in 2012. GDP has increased more sharply than tax revenue between 2011 and 2012, leading to a fall in the revenue as a percentage of GDP measure from 22% to 20%.

In 2012, total tax revenue collections were 3% below the initial budget projections (as shown in Figure 3). Over the past few years, actual collections have been consistently greater than budget forecasts (e.g. 8% greater in 2011), indicating that revenue performance has been better than expected for each year, and projections conservative relative to actual revenue performance. However, this position changed in 2012, when budget projections for the year

³ Nominal GDP gives figures for GDP that have not been adjusted for inflation (Real GDP figures include the adjustment for inflation over time). Nominal GDP is used in the comparison to tax revenue which is also not adjusted for inflation

New Registrations

Table 14 indicates a total of 7,973 new registrations for the payment of Income Tax, GST, Salary and Wages Tax (Group Tax) for 2012.

2011 New Taxpayer Registration Report	
Tax Type	Number
Individual	2,389
Company	1,760
T/levy	82
T/Partnership	17
Group Tax	2,110
GST	1,632
Grand Total:	7,973

Table 14: Number of New Registrations in 2012

Report on Breaches of the Tax Laws in 2012

Table 15 outlines the breaches or evasion of the Income Tax Act 1959 (as amended) and the compliance action taken.

Breaches or evasion of Income Tax Act	Compliance action taken	
	Number of cases	Value (Kina) (If applicable)
Section 313 - Failure to lodge income tax returns	11,434 Taxpayers	17,019 Final Notices Issued
Section 313 – Court fines	99	K257,000
Section 316 (1) - Late lodgement penalties for income tax returns lodged late	45	K21,654,651
Section 316 (2) - Omitted income penalty	31	K75,633,140
Legal costs	99	K4,550
Section 275(O) - Underestimation of provisional tax	6	K1,193,979
Section 272 - Garnishee on bank accounts	825	K26,535,634
Section 262 - Penalty for unpaid tax (late payment penalty)	1,835	K7,320,102

Table 15: Breaches of the Tax Laws in 2012



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 Taxation Office through the commencement of new projects to improve capability in transfer pricing and case selection and risk management. Initiatives to improve audit operations and staff capability will continue into the year 2013.

Achievements

- Corporate Income Tax – K51m over projections
- Cash economy project – K15m above projections
- GST refunds – K4m in additional revenue raised
- Aggregate revenue target set for the division exceeded for all tax types by K55m

Challenges

- Conflicting Priorities
- Case Selection approach
- Transfer Pricing work
- Staff communication and discipline
- Improve GST audits
- Work within limited Resources
- Technical skill gap (basic assessing/audit)

Tax Payer Education and Awareness Activities

The Tax Payer Education and Awareness area have adopted and implemented a Risk Management Approach by carrying out the Nationwide Tax Awareness sessions concentrating on GST, Salary or Wages Tax, Business Payment Tax, Company Tax, Individual Income Tax, etc. and encouraging the public and taxpaying community to voluntarily comply with the tax requirements. During the Tax Awareness sessions, participants were also given an overview of the RASII (SIGTAS) that is expected to go live in mid-2013.

The Provincial Tax Payer Education and Awareness officers including the telephone unit officers conducted 2,344 inspections during the year (2012) and collected approximately K812 million. The inspections were focussed on the non-lodgers, non-payers and non-registrations.

- Conducted 59 General Tax Awareness sessions.
- Conducted 18 RAS II Awareness sessions
- Conducted 2,344 inspections.
- Revenue Collections in the provinces: K812 million.

were strong relative to actual collections. This was largely due to a high projection for mining and petroleum tax revenue.

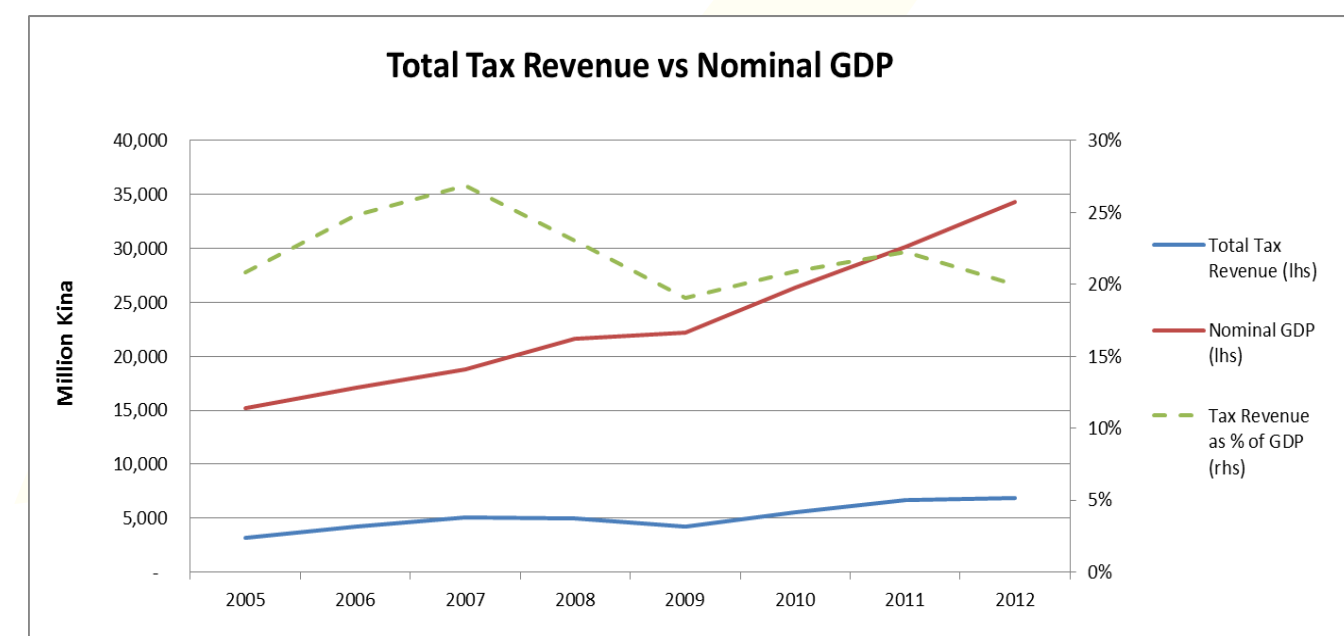


Figure 2: Total Tax Revenue vs. Nominal GDP, 2005 to 2012
(Note: lhs = left hand side, rhs = right hand side)

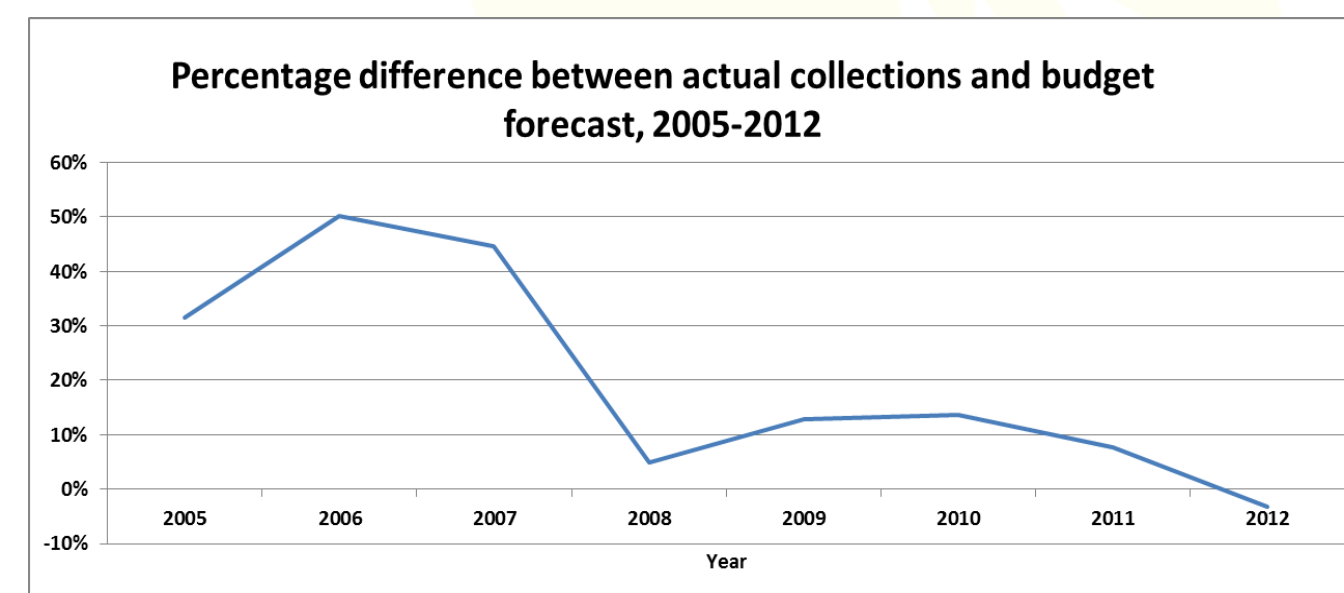


Figure 3: Percentage Difference between Actual Annual Revenue Collections and Budget Forecasts, 2005 to 2011
(Note: The graph indicates the percentage by which actual collections have exceeded budget forecasts.)



Direct Taxes

Table 2 gives the breakdown of actual revenue collected in 2012 for the different direct tax types, and draws comparisons to the original 2012 budget revenue projections, and the 2012 MYEFO projections. Mining and petroleum tax had the largest shortfall below budget projections (-48%). However, this was partially offset by individual income tax and corporate income tax, which exceeded the budget projections by 9% and 3% respectively. Overall, direct tax was 11% below the budget projection and 3% below the MYEFO projection.

Direct Tax	2012 Actual Collection (K '000)	2012 Budget Projection (K '000)	% Change	2012 MYEFO Projection (K '000)	% Change
Individual Income Tax	2,645,116	2,417,397	9%	2,471,378	7%
of which: PAYE Tax	2,570,037				
of which: Business Payments Tax	62,180				
of which: Income Tax Assessed	12,899				
Corporate Income Tax	1,740,503	1,692,094	3%	1,762,091	-1%
Dividend Withholding Tax	176,495	282,114	-37%	198,739	-11%
Mining & Petroleum Tax	981,087	1,872,104	-48%	1,326,270	-26%
Bookmakers Turnover Tax	9,459	0.11		344	
Stamp Duty	70,156	84,564	-17%	88,592	-21%
Royalty/Management Fees	17,843	18,978	-6%	17,919	0%
Bookmakers Licence Fees	43	0		0	
Court Fines	0	0		45	
Departure Tax	6,543	5,385	22%	5,612	17%
Training Levy	3,747	2,723	38%	2,837	32%
Gaming Machine Tax	133,878	122,123	10%	129,272	4%
Interest Withholding Tax	67,382	45,479	48%	49,200	37%
Sundry Receipts	871	1,695	-49%	1,770	-51%
Total Direct Tax	5,853,124	6,544,656	-11%	6,054,069	-3%

Table 2: Total Direct Tax Revenue, 2012

Table 3 and Figure 4 illustrate the breakdown of 2012 direct tax revenue collection by tax type. The largest portion of tax revenue was derived from individual income tax (45%), followed by corporate income tax (30%), and mining and petroleum tax (17%).

Legal Services assisted in the preparation of legislative change proposals and tax policy changes with the Department of Treasury which were incorporated in the 2013 Tax Budget Amendments. Legal supported the Department of Treasury by providing legal and tax advice on government tax initiatives. These included:

- Clarification of the law in regard to the definition of "Assessment" to include cases where no tax payable, this will have the effect of providing certainty and consistency to the Taxpayer; and
- Extension of the Thin Capitalisation interest deduction limit to all Taxpayers, other than financial institutions; and
- Technical amendments to clarify drafting errors in the Tax legislation.

Tax Audit Results

During 2012, income tax audits were completed on Small and Medium Enterprises in the logging and retailing industries, with total revenue of K 101 million raised.

An additional K 108 million was raised through the completion of 315 comprehensive non – deduct and non-remit audits completed on Group Tax and Business Payment Clients (taxpayers) including government agencies, private enterprises and sole traders.

There were thirty-one audits completed in both High Net Worth Individuals and Cash Economy projects resulting in revenue raised of K 40 million.

GST Audits were also completed on sixty-one Small and Medium Enterprise Clients resulting in K 7 million in revenue raised.

A total of 2,317 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
- Coffee/cocoa
- Aid workers and diplomats

This audit activity included reviewing a return that found in excess of K22 million worth of GST claims to be not allowable.

During the year the Tax Audits Division continued its enforcement in the Cash Economy Project focusing on income generated from real estate rental. As of 31st December 2012, the project has raised revenue totalling K40,457,577.



Supporting Tax Operations

Legal Services

In 2012, the Legal Services Division played an essential part in supporting the IRC's role in administering the national tax system and facilitating the collection of taxes/State revenue by providing timely legal advisory and litigation services.

The Legal Services Division comprised of an Advising and a Litigation section, which provided legal advice on 10 pieces of legislation that are administered by the Commissioner General. The main focus in the provision of legal services was directed to the administration of the Income Tax Act, Stamp Duties Act, Goods and Services Tax Act, and other Revenue Laws.

Despite a number of administrative challenges, in terms of staffing levels and the skills and knowledge gap in the division, the Legal Services Team, despite the size of the Team, consisted of motivated and robust new lawyers which assisted tremendously in the Division achieving its 2012 Objectives. Promotion of a positive attitude and vibrant culture of team work contributed immensely to the division meeting the objectives in its 2012 work plan.

Our services included 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 2012 were:

Achievements

- Legal Advisory support for the IRC Institutional Housing Project, which resulted in the purchase of 3 institutional houses in 3 provinces and facilitated in obtaining a Certificate of Occupancy.
- Progressed and obtained delegation from the Secretary of Finance with respect to the Commissioner Generals – Write off power of irrecoverable debts.
- Provided legal support which resulted in the reduction of backlog of disciplinary cases.
- 9 out of 15 PSC Review Cases were progressed to the hearing stage.
- Regional Recognition – by the IMF to PNG-IRC at the PITAA (Pacific Islands Tax Administrations Association) conference for preparing the draft Charter and Constitution
- Signing of the Double Tax Treaty between GOPNG and the Government of New Zealand in November 2012.
- Tax Circulars – final stage to publication.
- Successful roll out of the Expectation Statements program for each officer.
- Successful transfer of the function to determine Charitable Status to Policy and Advice Division.

Taxes Types	2012 Actual Collection	Percent (%)
Direct Tax		
Individual Income Tax	2,645	45.2%
Corporate Income Tax	1,741	29.7%
Dividend Withholding Tax	176	3.0%
Mining & Petroleum Tax	981	16.8%
Stamp Duty	70	1.2%
Gaming Machine Tax	134	2.3%
Other Direct Tax	106	1.8%
Total Direct Tax	5,853	100.0%

Table 3: Revenue Collection by Tax Type; Value and Percentage

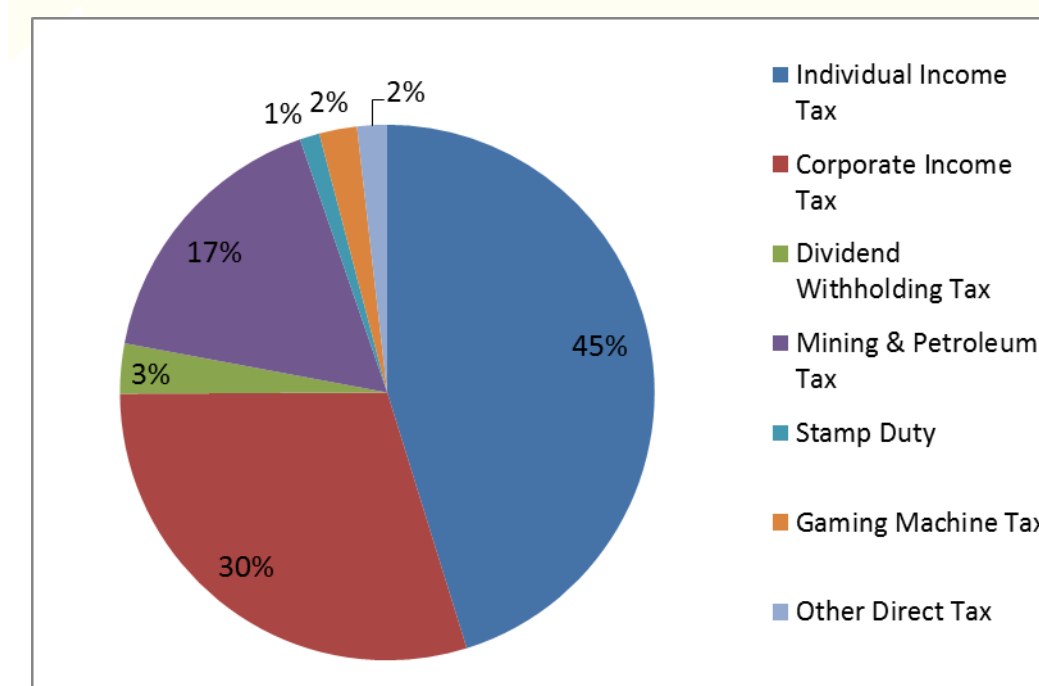


Figure 4: Total Actual Direct Tax Collection (2012) by Tax Type

Mining and petroleum tax (MPT) is company tax applied specifically to firms operating in the mining and petroleum sector (excluding dividend withholding tax from the sector), while 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.

Table 4 breaks down MPT revenue by sub sector and commodity. In 2012, mining accounted for 37% and petroleum 63% of MPT revenue.



Sector/commodity	2012 Revenue (million Kina)	Percentage of Total MPT
<u>Mining sector</u>		
Gold	226.4	23%
Copper	137.8	14%
Silver	2.3	0.2%
Mining sub total	366.6	37%
Petroleum sub total	614.5	63%
Total MPT tax revenue:	981.1	100%

Table 4: 2012 MPT Revenue by Sector/Commodity
(Note: gold, copper and silver revenue breakdowns
are based on estimates only)

Actual direct tax collections from 2012 and 2011 by tax type are compared in Table 5 and Figure 5. Corporate income tax increased 27% in 2012 and individual income tax, the largest value revenue stream, increased 23% from 2011. Gaming machine tax and stamp duty increased 20% and 10% respectively. The main direct tax types to fall between 2011 and 2012 were mining and petroleum tax (-53%) and dividend withholding tax (DWT) (-39%).

Taxes Types	2011 Actual Collection	2012 Actual Collection	Percentage (%) Change
Direct Tax			
Individual Income Tax	2,158,794	2,645,116	23%
<i>of which: PAYE Tax</i>	2,081,996	2,570,037	23%
<i>of which: Business Payments Tax</i>	60,490	62,180	3%
<i>of which: Income Tax Assessed</i>	16,308	12,899	-21%
Corporate Income Tax	1,373,092	1,740,503	27%
Dividend Withholding Tax	290,708	176,495	-39%
Mining & Petroleum Tax	2,073,533	981,087	-53%
Bookmakers Turnover Tax	8,058	9,459	17%
Stamp Duty	63,557	70,156	10%
Royalty/Management Fees	15,625	17,843	14%
Bookmakers Licence Fees	0	43	
Court Fines	7	0	-100%
Departure Tax	4,661	6,543	40%
Training Levy	3,598	3,747	4%
Gaming Machine Tax	111,264	133,878	20%
Interest Withholding Tax	40,482	67,382	66%
Sundry Receipts	793	871	10%
Total Direct Tax	6,144,174	5,853,124	-5%

Table 5: Direct Tax 2012 Actual Collection and 2011 Actual Collection

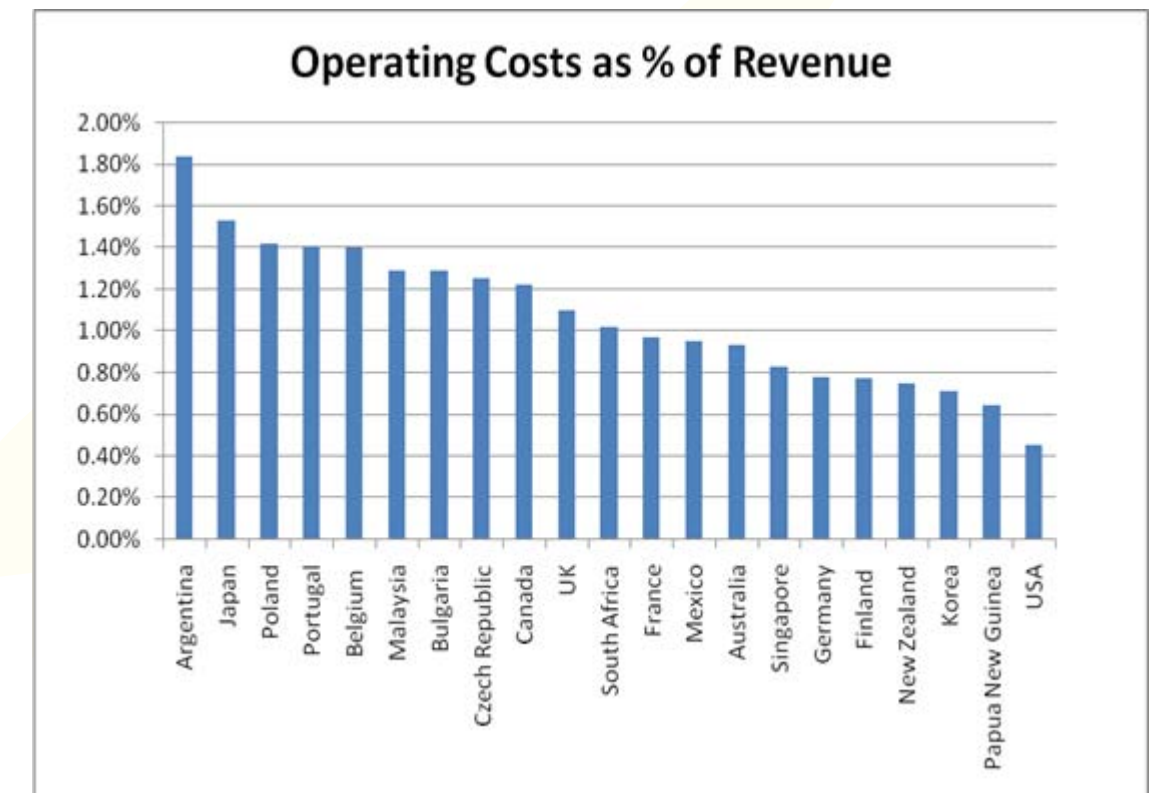


Figure 12: Cross Country Comparison: Operating Costs as Percentage of Revenue

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



Cost of Collection and Revenue Collection

In 2012, the cost of collection of revenue, i.e. IRC's operating costs, as a percentage of total revenue collected stood at 0.6%. This indicator has been on a downward trend from 0.8% in 2009 to 0.5% in 2011. This falling trend in operating costs as a percentage of revenue has been driven mostly by an increase in absolute revenue collections, but also by a decrease in IRC actual operating costs. 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 operating costs as a percentage of revenue represents a lack of spending on sufficient resources in the case of IRC.

In 2012, IRC's expenditure as a percentage of revenue increased by 0.1 percentage point to 0.6%, however this still represents a relatively low level of expenditure. IRC's operating costs includes expenditure on personal emoluments 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.

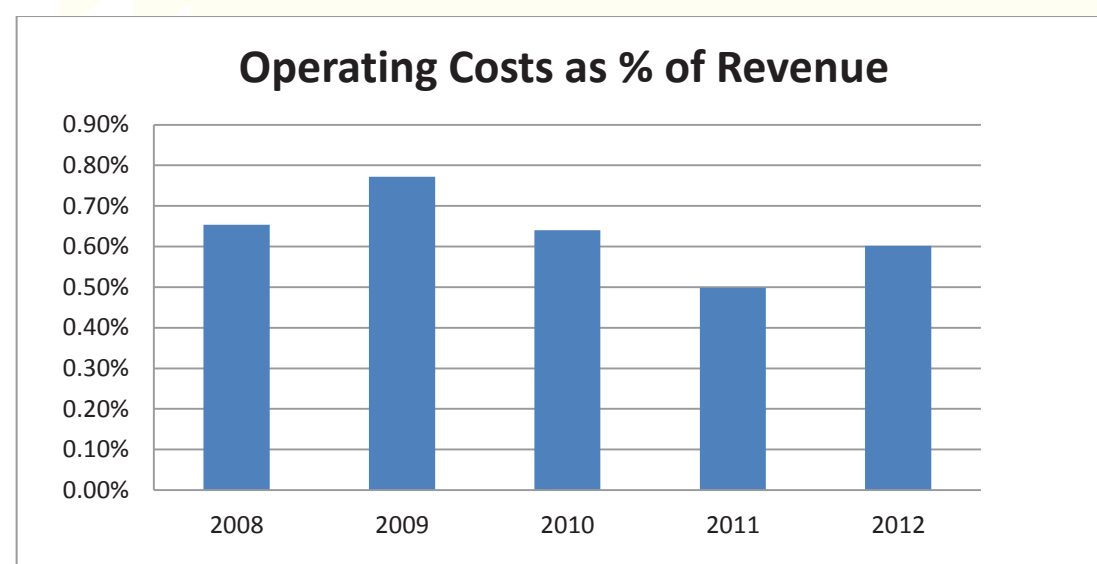


Figure 11: IRC Operating Costs as a Percentage of Total Revenue

A cross country comparison below shows that PNG has internationally very low costs of collection as a percentage of revenue collection (although it is worth noting that the coverage of activities may vary between revenue administrations). Further, since this data was compiled by the OECD in 2009, the investment in the IRC as a percentage of revenue collections has continued to drop significantly.

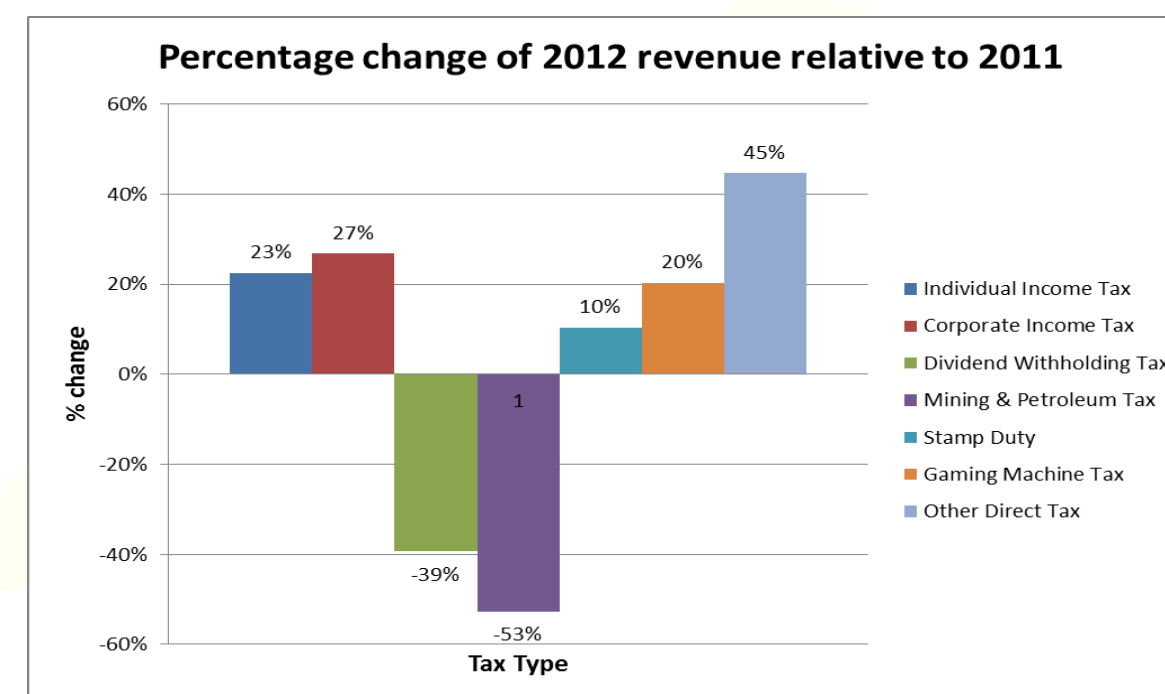


Figure 5: Percentage Change of 2012 Revenue Relative to 2011 Revenue by Direct Tax Type

Individual income and company tax actual revenue increased in 2012 due to continued strong domestic economic growth driven largely by the continuation of the construction phase of the PNG Liquefied Natural Gas (LNG) Project. The large investment in PNG associated with the construction phase of the LNG Project has resulted in greater profitability in 2012 for firms in the construction, transport, retail, and communication sectors, and other supporting industries. Growth in the number of new companies has also contributed to greater corporate income tax in 2012.

Increased formal direct employment with the LNG contractors, and employment with secondary industries benefiting from the economic boom generated by the construction phase of the LNG Project, has led to employment growth of 6.4% in the non resource sector and 7.9% in the resource sector in 2012. This has been the main driving factor behind the growth in individual income tax revenue in 2012. However, these high levels of individual income tax revenue are only expected to be sustained in line with the duration of the construction phase and the additional employment it has generated.

The main contributing factor resulting in falling DWT revenue was the sale of shares of a large resource project from a private company (and former large DWT taxpayer) to the state, which is exempt from DWT. In practice, while this results in a decrease of DWT revenue, this is offset by an equivalent increase in the dividends received by the state because they are not subject to DWT (giving a zero net effect on state revenue).

**Why did MPT fall significantly in 2012 and was so much lower than budget projections?**

The main contributing factors to the overestimation of MPT collections in the 2012 budget and the fall in MPT collections in 2012 relative to 2011 are set out as follows:

2012 MPT budget projections set by GoPNG were based on relatively strong commodity price forecasts, particularly for gold and copper. These price forecasts implied an increasing trend in commodity prices throughout 2012, which did not in fact occur. Figure 6 illustrates the large disparity between average budget forecast prices for gold and copper (which were used as an underlying assumption for MPT projections) versus actual price trends in 2012, which were much lower. This resulted in high projections for MPT collections in 2012. In addition, the price of copper actually fell in 2012 from 2011, which contributed to lower actual 2012 relative to 2011 MPT revenue.

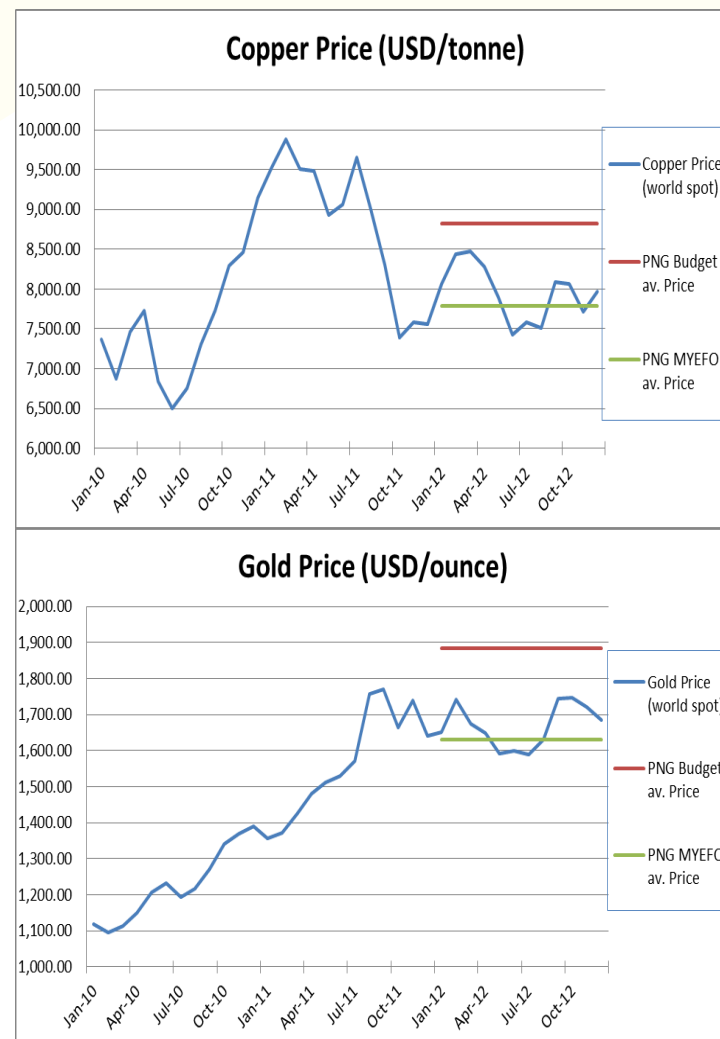


Figure 6: Copper and Gold Actual Price Trends (2010-2012) and 2012 Budget Projected Prices

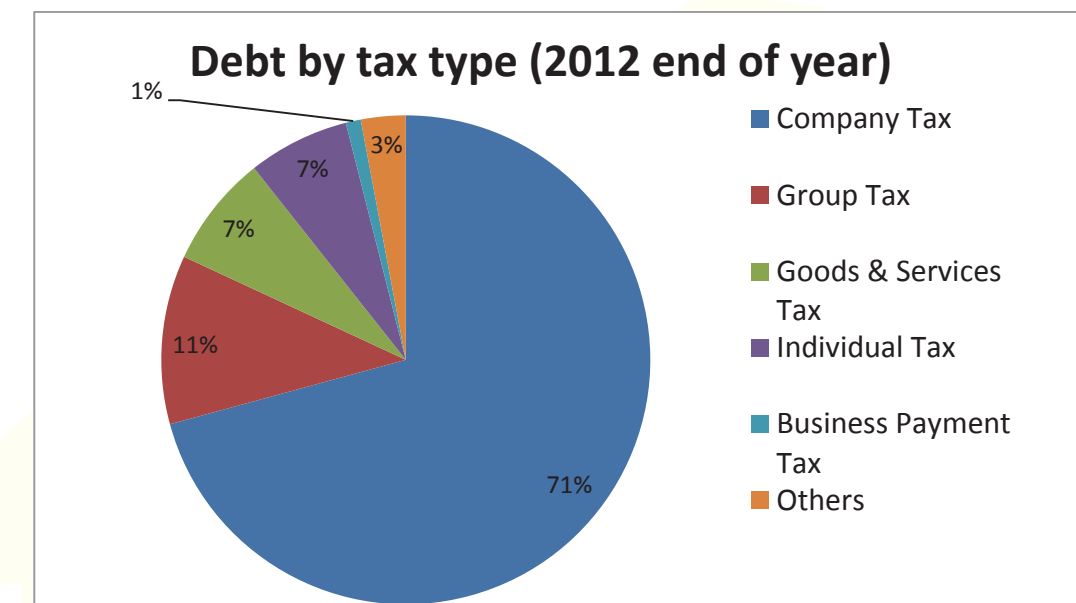


Figure 10: Debt by Tax Type, 2012

Enforcement of Penalties

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 voluntary taxpayer compliance which helps to improve revenue performance.

In 2012, IRC imposed penalties on 1,866 cases, which is a decrease from the total number of cases in 2011 (as shown in the table below). Assess and Prioritise Division temporarily reduced the number of imposed late lodgement penalties in 2012 in order to increase the rate of processing assessments, as part of the backlog clearing process in preparation for the new SIGTAS (tax administration) system. Similarly, the number of late payment penalties was also temporary reduced. This has allowed for an acceleration in the rate of processing tax assessments, leading to a net increase in revenue collection. However, these types of penalties will be enforced more rigorously in 2013 and will be imposed automatically by the new SIGTAS system once taxpayer data has been migrated across to the new system.

Penalty type	2008	2009	2010	2011	2012
Late lodgement penalty	1,315	1,310	1,003	1,768	45
Late Payment Penalty	2,366	1,628	3,945	3,763	1,835
Omitted Income Penalty	364	447	68	74	31
Total Penalty Cases	4,045	3,385	5,016	5,605	1,866

Table 13: Number of Penalty Cases by Penalty Type and Year



IRC Annual Report 2012

Of the total debt on hand at the end of 2012, K432 million of this debt (or 21%), was in a state of dispute and therefore currently in a state which is uncollectable. This includes debt which has a status where an objection has been lodged, an appeal has been lodged, or an amendment has been requested. However a proportion of this debt may become collectable again in the future when the status of the debt changes (e.g. the dispute is resolved).

Table 12 gives a breakdown of debt on hand by tax type in 2012, and the percentage change in debt between 2011 and 2012 for each tax type. Overall debt was reduced by 4% in 2012, which included a reduction in debt for most tax types apart from group tax debt which increased by 10% (note: group tax is the main component of individual income tax). This was due to a clearing of a backlog of group tax reconciliations in 2012, which resulted in the raising of additional group tax debt.

Tax Type	2011	2012	Percentage Change
Company Tax	1,494	1,440.1	-4%
Group Tax	206	227.3	10%
Goods & Services Tax	200	151.0	-24%
Individual Tax	147	136.5	-7%
Business Payment Tax	23	20.2	-11%
Others	52	60.1	15%
TOTAL	2,121	2,035.22	-4%

Table 12: 2011 and 2012 End of Year Debt by Tax Type (Million Kina)

Company tax debt makes up the largest proportion of debt (71%) as illustrated in Figure 10. This is followed by group tax debt (11%), GST debt (7%), and individual tax debt (7%).

Company tax debt is high relative to other tax types partly because it is one of the highest value revenue streams. In addition, there have been delays in the past with assessing company tax returns (partly due to their technically challenging nature) and delays issuing assessments. Delays of this kind increase the time period between when the company's income is earned and when the assessment is issued, which can make it more difficult to collect the company tax debt. Poor lodgement compliance amongst company taxpayers is also a factor. This has led to many cases of default assessments being issued which the taxpayer may then object to or be reluctant to pay, sometimes because they believe the assessment has been overestimated by assessors.

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Compared to 2011 levels, production volumes from the major mines in PNG fell significantly in 2012, which is unlikely to have been foreseen in formulating budget projections. For each of the major mines, production fell between 10-30% (approximately), which contributed to lower taxable income in 2012, relative to 2011, and lower tax revenue. Mining companies reported that the drop in production volumes was due in part to temporary mine closures at various points during the year due to civil unrest, bad weather, and trespassing, etc. Lower production volumes may also have been partly due to the aging nature of the currently active mines, which are starting to extract in more marginal areas of the mine with lower yields. Oil production also decreased approximately 18% in 2012 due to declining oil reserves.

In 2012, mining companies reported significant increases in their production costs, relative to 2011, which had a negative impact on their MPT liabilities. This was also a key factor which reduced taxable income and MPT payments in 2012 relative to 2011 and 2012 budget projections. Companies claimed this was mostly due to large increases in general operating costs, including salaries for increasingly scarce and highly demanded technical staff, and transport costs, etc.

Between 2011 and 2012, the Kina appreciated by approximately 12% against the US Dollar (using the annual average rate), which was largely due to LNG construction related inflows. Since the export price for resource commodities is typically denominated in USD, a stronger Kina has a downward effect on export income of the resource extraction projects, when that income is converted from USD to Kina. For resource projects that maintain accounts and lodge their tax returns in Kina, the appreciation will have a negative effect on their gross income, taxable income, and MPT payments.

Goods and Service Tax (GST)

Total GST collections in 2012 were K2,204 million (which is 4% above budget projections) and total GST disbursements equalled K2,415 million, leaving a net balance of GST revenue equal to -K211 million (Table 6).

Goods and services tax experiences constant flows as GST registered taxpayers both remit GST revenue from taxable sales⁴ to IRC, and claim GST refunds. When GST incurred on inputs exceeds GST collected from sales during the period, (which is usually the case for export and resource oriented sectors) registered taxpayers are entitled to receive a refund of the difference. This results in significant 'churn' between collections and refunds. Besides flows of GST between taxpayers and IRC, there are also disbursement flows of GST to provincial governments and the central government Waigani Public Account (WPA).

The reason behind the -K211 million net balance for 2012 is mainly due to a large disbursement of GST transferred to WPA in January 2012, which was the result of a build-up in the balances

⁴ It should be noted that Customs also collects GST on imports which is then able to be reclaimed from IRC as input credits by registered taxpayers in their GST returns.



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of the GST accounts over the preceding several months in 2011. This resulted in a greater overall GST disbursement in 2012 than would have otherwise been the case. Total tax revenue is calculated as total direct tax plus GST transfers to WPA for a given time period.

	2012 Actual Collection/ Disbursement (K '000)	2012 Budget Forecast (K'000)	Percentage Change
GST Collections			
Import GST Revenue (collection from ports)	1,185,465	1,253,930	-5%
Inland GST Revenue (collection from provinces)	1,018,717	855,720	19%
Total Collection	2,204,183	2,109,650	4%
GST Disbursements			
Total GST Refunds	1,133,106	1,304,093	-13%
GST Distributed to Provinces	272,316	272,054	0%
GST Distributed to WPA	1,010,000	545,302	85%
Total Disbursements	2,415,421	2,109,033	15%

Table 6: GST Collection and Disbursements; 2012 Actual and 2012 Budget Forecasts

Tables 7 and 8 show the total GST collections from ports and provinces (including NCD) for 2012 and 2011, as well as the GST disbursements which include GST refunds, GST distribution to provinces and GST transferred to WPA. Compared to 2011 figures, GST collections increased 13% in 2012, which included an 11% increase in import GST and a 16% increase in inland GST (from all provinces). GST disbursements increased 38%, which includes the late transfer of GST to WPA which was counted as 2011 GST collection but 2012 GST disbursement.

The continuation of strong wages growth and employment in 2012 has resulted in higher disposable incomes for households, which has supported higher levels of consumption and GST tax revenue.

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The IRC has continued strong efforts during 2012 to recover and reduce taxpayer debt by finalising as many outstanding cases as possible given the resource constraints. During 2012, 3,922 debt cases were finalised, and the total cases on hand at the end of 2012 is equal to 8,794, down from a stock of about 12,000 at the end of 2011.

As a result of the direct actions undertaken by debt reduction officers, a total of K1,651 million of debt was collected through payments received during the year. The actions undertaken to collect this debt and the amount of debt reduced by payment from implementing these actions is presented in the table below.

The action which led to the greatest amount of debt reduced (K579 million) was 'issuance of final notice' which is the first action taken against overdue payment. K27 million and K490,000 were collected through garnishee notices and legal action respectively. In 2013, IRC will embark on a more aggressive programme of recovering outstanding debts through legal action, where earlier actions (e.g. issuing notices) have not been successful.

In addition, a further K150 million of debt was reduced by other actions (non-payment) in 2012 including write offs, transfers, and additional tax for late payment reduced.

Actions Taken to Reduce Debt (2012)	Debt reduced (Kina)
Actions whereby debt reduced by payment:	
Issuance of Final Notice	579,132,632
Issuance of Demand Letter	372,337,084
Manual Demand	276,568,093
Garnishee Notice	26,535,634
Legal Action	489,530
Extension Granted	396,043,566
Debt Reduced by Payment Sub-total	1,651,106,539
Other Actions: whereby debt reduced (non-payment):	
Write Offs	4,752,820
Transfers	118,670,027
Additional tax for late payment reduced	26,363,442
Debt Reduced by Other Action Sub-total	149,786,289
TOTAL Debt Reduced	1,800,892,828

Table 11: Debt Reduced From Direct Actions Taken by Debt Reduction Officers in 2012 Taking into account new debt received during 2012, the net result for the year was a reduction in the total debt on hand by K86 million.

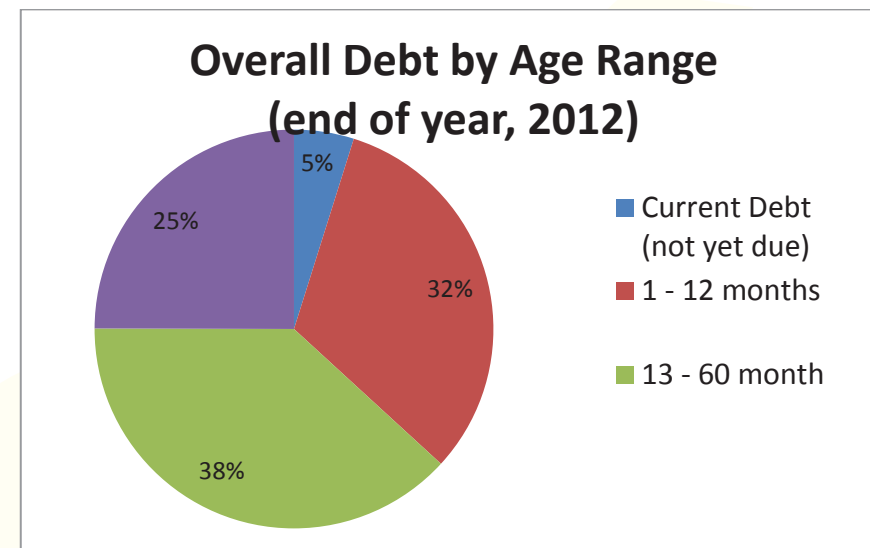


Figure 8: Proportion of the Total Debt on Hand by Age Range of Debt (2012)

Figure 9 illustrates the change in debt as a percentage of revenue over time by age category of debt. This shows that debts aged over 12 months represent a higher proportion of revenue; although showing a declining trend since 2009 (from 25% of revenue in 2009 to 18% of revenue in 2012). Debts less than one year are lower in value, and have remained more constant as a percentage of revenue (around the 10-13% mark).

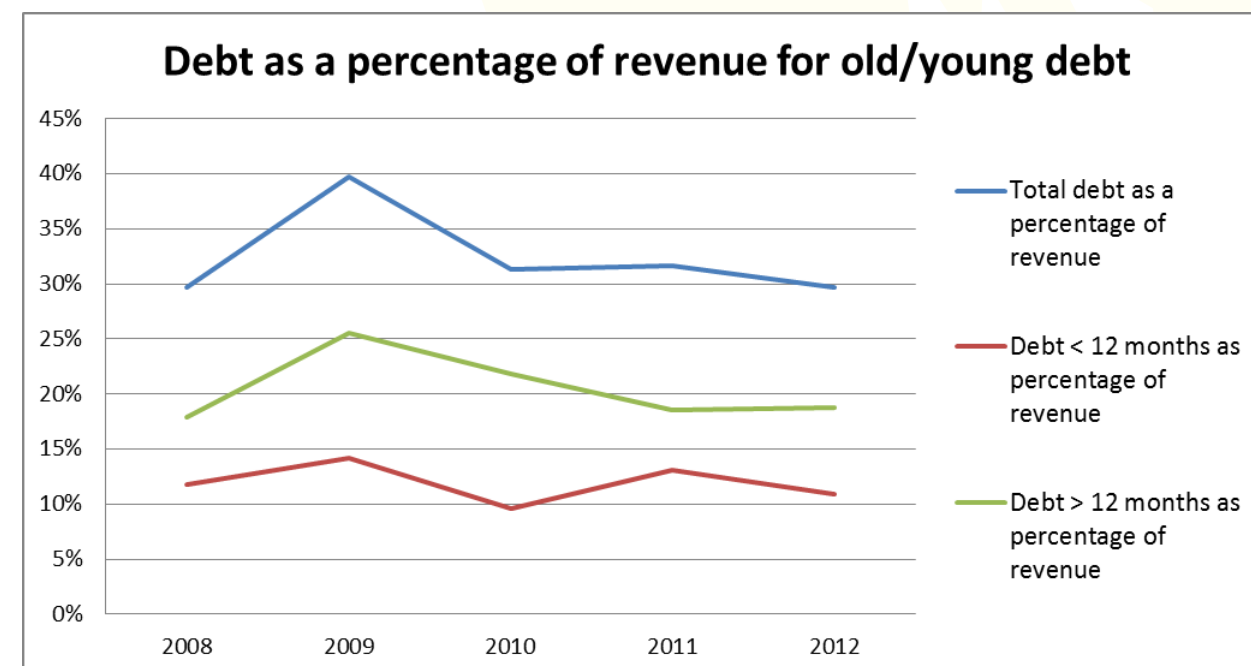


Figure 9: Debt as a percentage of revenue for old/young debt

GST Collection Type	2011 Actual Collection (K '000)	2012 Actual Collection (K '000)	Percentage Change
GST collections at Ports	1,071,200	1,185,465	11%
GST collections in Provinces:			
Central	5,503	6,378	16%
East New Britain	26,906	34,012	26%
East Sepik	10,625	16,880	59%
Eastern Highlands	37,653	46,754	24%
Enga	2,263	3,412	51%
Gulf	748	766	2%
Madang	18,265	22,470	23%
Manus	1,759	1,343	-24%
Milne Bay	11,561	10,561	-9%
Morobe	141,716	175,846	24%
National Capital District	496,020	553,926	12%
New Ireland	11,613	16,044	38%
Autonomous Region of Bougainville	9,700	7,603	-22%
Oro	5,588	5,717	2%
Sandaun	3,515	3,185	-9%
Simbu	8,381	5,733	-32%
Southern Highlands	12,876	18,946	47%
West New Britain	17,227	20,853	21%
Western Highlands	40,843	56,531	38%
Western province	13,074	11,759	-10%
GST collections in Provinces Sub Total	875,833	1,018,717	16%
Total GST Collection	1,947,033	2,204,183	13%

Table 7: GST Collections; 2012 and 2011 Actual Collections

Of the sum of GST revenue disbursed in 2012, the largest proportion was allocated to GST refunds (47% of total GST disbursements). The balance was then allocated between transfers to provincial government accounts⁵ (11%) which is a fixed amount, and WPA (42%), as illustrated in Figure 7.

⁵ 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 prior - except for Bougainville (ARB) for which distributions are calculated as 30% of GST collections from the current year.



GST Disbursement Type	2011 Actual Disbursement (K '000)	2012 Actual Disbursement (K '000)	Percentage Change
GST Refunds	925,539	1,133,106	22%
GST Transferred to Waigani Public Account	560,500	1,010,000	80%
GST Distributed to Provinces:			
Central	963	2,000	108%
East New Britain	10,923	9,611	-12%
East Sepik	3,140	4,436	41%
Eastern Highlands	10,822	10,550	-3%
Enga	879	1,233	40%
Gulf	51	250	388%
Madang	5,971	4,747	-21%
Manus	206	189	-8%
Milne Bay	3,342	2,512	-25%
Morobe	46,763	57,143	22%
National Capital District	155,826	149,649	-4%
New Ireland	2,542	3,741	47%
Autonomous Region of Bougainville	1,923	261	-86%
Oro	1,442	1,249	-13%
Sandaun	657	1,128	72%
Simbu	1,564	1,692	8%
Southern Highlands	923	1,587	72%
West New Britain	3,964	3,930	-1%
Western Highlands	11,991	13,190	10%
Western province	2,648	3,217	21%
GST Distributed to Provinces Sub Total	266,539	272,316	2%
Total GST Disbursement	1,752,579	2,415,421	38%

Table 8: GST Disbursements; 2012 and 2011 Actual Disbursements

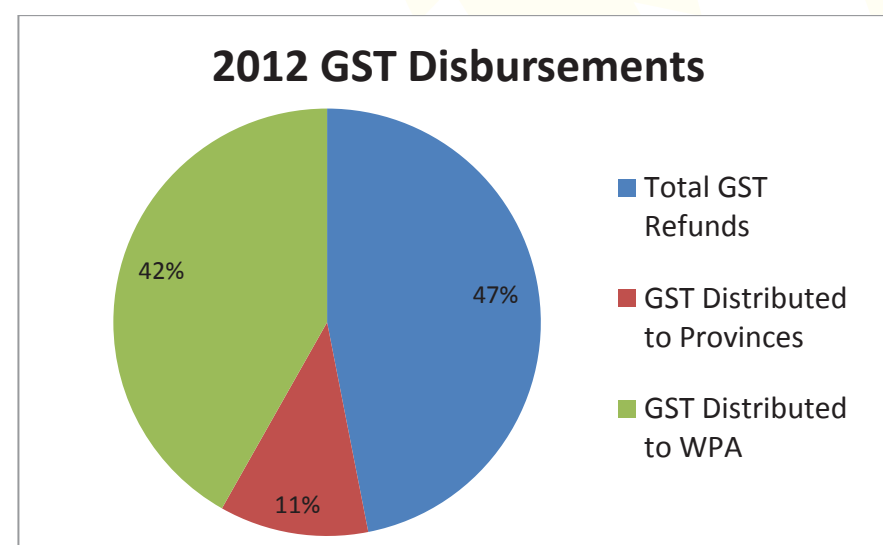


Figure 7: 2011 GST Disbursements by Destination (%)

Collecting Debt

	2008	2009	2010	2011	2012
Total outstanding debt (end of year), million Kina	1,474	1,680	1,732	2,121	2,035
Total tax revenue, million Kina	4,972	4,230	5,524	6,705	6,863
Debt percentage of revenue	30%	40%	31%	32%	30%

Table 9: Debt aged 1-12 Months Compared to Total Tax Revenue (million Kina)

At the end of 2012, total taxpayer debt to IRC stood at K2,035 million, or 30% of total tax revenue. (Table 9) Over the past five years, debt as a percentage of revenue has remained fairly constant, at around 30%, apart from in 2009 when revenues fell causing the ratio to spike.

Total taxpayer debt on hand decreased from K2,121 million at the end of 2011 to K2,035 million at the end of 2012. 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.

As shown in Figure 8, 38% of the total debt stock at the end of 2012 is aged between 1 and 5 years old, and 25% of the debt stock is over 5 years old. The majority of the debt of this age becomes increasingly difficult to recover as the ability of the taxpayer to repay this debt diminishes over time as his or her debts accumulate, until they are prohibitively high. Over this time period, companies may also have ceased trading. However a proportion of this older debt is recoverable and the IRC's Manage Debt Division is undertaking a number of new strategies and approaches in 2013 to maximise debt recovery of old debts and new debts. A significant proportion of the stock of debt, 37%, is less than 12 months old and has a higher probability of collection.

Age of Debt	2008	2009	2010	2011	2012
Current Debt (not yet due)	71	35	36	236	99
1 - 12 months	513	564	492	641	650
13 - 60 month	653	759	826	805	778
> 60 months	238	322	377	439	508
Total Debt Holdings	1,474	1,680	1,732	2,121	2,035

Table 10: Total Debt by Age of Debt and Year (Million Kina)