



Taxation Circular
TC 2013/4

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Internal Revenue Commission - Circular

Taxation Circular TC 2013/4: Administration of the Foreign Contractor Withholding Tax Regime

SUBJECT

How will the Commissioner General administer the Foreign Contractor Withholding Tax regime?
In particular:

1. What is a “Foreign Contractor”?
2. How will the Commissioner General apply the provisions where other withholding tax regimes may also apply?
3. What is the appropriate rate of withholding? and
4. How will the Commissioner General give effect to non-discrimination clauses in double tax agreements (“DTAs”) entered into by the Government of Papua New Guinea?

PURPOSE

5. This Circular confirms that where several withholding tax regimes may *prima-facie* apply concurrently, they will be applied in the following order:
 - a) First, Salary and Wages Tax (“SWT”);
 - b) Second, Management Fee (Withholding) Tax (“MFWT”); and
 - c) Finally, Foreign Contractor Withholding Tax (“FCWT”).

6. The Commissioner General reiterates the position in *Taxation Circular TC 2013/1* that where individuals are providing personal services on a routine basis over a period of time, in all but exceptional circumstances, they will be subject to salary or wages tax.
7. This Circular clarifies the Commissioner General's view that the appropriate rate of withholding under the Foreign Contractor Withholding Tax regime is 12%. In the event that a taxpayer, resident in a country with which Papua New Guinea ("PNG") has entered into a Double Tax Agreement ("DTA") containing a non-discrimination clause, believes they have been over-taxed, they will be entitled to lodge a tax return, be assessed on their actual taxable income and be taxed at a rate consistent with that set out in the relevant DTA.

CONTENTS

SUBJECT.....	1
PURPOSE	1
BACKGROUND.....	4
INTERPRETATION	4
Imposition of FCWT.....	4
Foreign Contractor.....	5
Resident exclusion	5
Salary or wages tax exclusion	5
Management fee (withholding) tax exclusion	7
Scope of Foreign Contractor	7
Prescribed Purposes.....	8
Liability of Agent	8
DTA Implications	9
Business Profits	9
Royalties.....	9
Dependent personal services.....	9
Independent personal services.....	10
Assessment of Tax.....	12
Annual Assessment	12
Conditions imposed	14
Non-Discrimination	16
EXAMPLES	17
Example 1 – Salary or Wages Tax v Foreign Contractor Withholding Tax.....	17
Example 2 – Interposed Entity & Discrimination.....	19
Example 3 – Individual Foreign Contractor.....	20
Application	22
Subject References	23
Related Taxation Circulars	23
Legislative References.....	23

BACKGROUND

8. For some years, taxpayers have written to the Commissioner General seeking registration of individuals for FCWT. In many cases these registrations have incorrectly been approved.
9. Over the past several years, a practice has become common where taxpayers seek to rely on the non-discrimination clauses within several of PNG's DTA's to achieve the best outcomes – adopting the simplicity of a withholding tax effectively applied on their gross income (without reference to their actual income, expenses or net profits) but also wanting to adopt their own reduced rate in purported reliance upon the DTA. The Commissioner General will no longer accept this as an appropriate method of relieving potential discrimination.
10. The Commissioner General has commenced a project to review the current FCWT registrations with a view to removing those who have been incorrectly registered and contacting taxpayers where SWT or MFWT provisions appear to have been overlooked.

INTERPRETATION

Imposition of FCWT

11. PNG's tax legislation incorporates two basic tenets:
 - The right to tax residents of PNG on their world-wide income; and
 - The right to tax non-residents on their PNG sourced income.
12. Ordinarily, common law rules would apply to determine a "source" of income. However, section 196B of the *Income Tax Act 1959*, ("the Act") deems income derived from a prescribed contract to have a source in PNG.

For the purposes of this section 196D(1), income derived from a prescribed contract is deemed to be derived from a source in PNG.

13. Section 196C of the Act imposes tax on a Foreign Contractor who derives income from a prescribed contract.

A foreign contractor who derives income from a prescribed contract is liable to pay tax on that income.

14. There are therefore two critical definitions: who is a "Foreign Contractor" and what is a "Prescribed Contract"?

Foreign Contractor

15. Section 196A of the Act defines a “Foreign Contractor” to mean:

a person who is a party to a prescribed contract and is not–

- a) a resident company of Papua New Guinea; or*
- b) a person, other than a company, who is ordinarily resident in Papua New Guinea; or*
- c) a person to whom the provisions of Part III.2B apply; or*
- d) a person who derives a management fee to which Division III.14C applies.*

Resident exclusion

16. Clearly, a resident individual or company will not fall within the definition of a Foreign Contractor.

17. In addition, the definition specifically excludes a person to whom the provisions of Part III.2B apply and a person who derives a management fee to which Division III.14C applies. Division 2B covers salary or wages tax while Division 14C covers management fee withholding tax.

18. Accordingly, it is the definition of “Foreign Contractor” itself which gives priority to the SWT and MFWT regimes.

Salary or wages tax exclusion

19. Section 65E of the Act specifically sets out the income to which Division 2B applies. This includes:

- a) salary or wages; and*
- b) the value to a taxpayer of all benefits or allowances given or granted in respect of or in relation to his employment whether so given or granted in money, goods, sustenance, the use of premises, or otherwise; and...*

20. “Salary or wages” is itself defined in section 4 of the Act which, in relation to any person, means:

- a) salary, wages, commission, bonus, remuneration of any kind or allowances (whether paid in cash or otherwise) paid (whether at piece-work rates or otherwise) in respect of, or in relation to the employment of that person as an employee; or*

b) *any remuneration by way of fees or otherwise for professional services, or services as an adviser, consultant or manager (whether at piece work rates or otherwise) where such remuneration is paid wholly or substantially for personal services rendered by that person in PNG,*

and without limiting the generality of the foregoing, includes any payment made—

c) *under a contract that is wholly or substantially for the labour of the person to whom the payments are made; or*

d) *by a company by way of remuneration to a director of that company; or*

e) *by way of superannuation, pension or retiring allowances; or*

f) *by way of commission to an insurance or time-payment canvasser or collector,*

but does not include payments of exempt income.

21. Section 299D of the Act states:

For the purposes of enabling the collection of salary or wages tax from employees, where an employee receives or is entitled to receive from an employer in respect of a fortnight, or part of a fortnight, salary or wages, the employer shall make a deduction from the salary or wages at such rate as is declared by the Act.

22. In order for the provision to apply there must be an “employer” making “salary or wages” payments to an “employee”. The terms “employer” and “employee” are also defined terms within the Act. “Employer” is defined in section 299C to be “a person who pays or is liable to pay any salary or wages...” Section 4 of the Act defines an employee to mean:

a person who receives, or is entitled to receive, salary or wages, and includes a member of the National Parliament, a person employed in the Public Service and a person employed by an authority constituted by or under a law of PNG;

23. Both of these definitions clearly leverage off the definition of “salary or wages” above. Accordingly, if a payment is made to a contracting party which can be captured within the wide definition of salary or wages, then the person making the payment will be considered to be an “employer” and the person receiving the payment will be an “employee” for the purposes of the Act, even if they are not considered to have an employment relationship at common law or under other legislation. *Taxation Circular TC 2013/1* sets out these considerations in detail.

Management fee (withholding) tax exclusion

24. Management Fee (Withholding) Tax is the collection of Income Tax on “Taxable Management Fees” paid to a non-resident, but not to the extent that that it is derived by the non-resident in carrying on a business in PNG at or through a permanent establishment in PNG, by:
- a PNG resident; or
 - by a non-resident where the management fee relates to an outgoing incurred in carrying on a business through a permanent establishment in PNG
25. Put simply MFWT will apply to payments for particular services performed entirely offshore.
26. Section 196S of the *Tax Act* defines a “Taxable Management Fee” to mean:
- ...that part of a management fee that is an allowable deduction after the application of Section 68AD or Section 155M, as the case may be.*
27. The definition of Management Fee clearly excludes an employee of the person making the payment, thereby indicating that SWT takes precedence over MFWT.

Scope of Foreign Contractor

28. A Foreign Contractor is:
- any person who is not a resident of PNG; and
 - a party to a prescribed contract; and
 - a party who receives payments for services under a contract where those payments cannot be considered to be either salary or wages, or management fees.
29. Any contract which contains overlap between the different withholding tax regimes will be applied in the following order:
- a) first, SWT
 - b) second, MFWT; and
 - c) only, where no other withholding tax regime applies, then FCWT.

Prescribed Purposes

30. To be covered as a “Foreign Contractor” under FCWT, the contract must be a “Prescribed Contract,” which is in turn defined as a contract for “Prescribed Purposes”. “Prescribed Purposes” are also defined under the *Tax Act* as follows:

Prescribed purposes means purposes for or in connexion with:

- a) *the installation, maintenance or use in PNG of substantial equipment or substantial machinery; or*
- b) *the construction in PNG of structural improvements or other works, including—*
 - i. *the construction of roads, including bridges, culverts or similar works forming part of a road; and*
 - ii. *the erection of buildings, fences or similar improvements; and*
 - iii. *the clearing or draining of land; and*
 - iv. *the construction of ports or port facilities; and*
 - v. *the construction of facilities for the provision of water, light, power or communication; and*
 - vi. *the provision or improvement of transport facilities of any kind; or*
- c) *the use of, or right to use, in PNG, any industrial, commercial or scientific equipment including any machinery or apparatus or appliance, whether fixed or not, and any vehicle, shipping vessel or aircraft; or*
- d) *the provision in PNG of professional services or services as an adviser, consultant or manager, including services in conjunction with the purposes set out in Paragraphs (a), (b) or (c) of this definition.*

31. These “Prescribed Purposes” are self-explanatory. There has been very little confusion over the scope of these reported to the Commissioner General. This Circular does not seek to provide further guidance on these.

Liability of Agent

32. Under section 196F of the Act, a person carrying on business in PNG (including through a PE) who has entered into a prescribed contract with a Foreign Contractor is deemed to be the agent of the Foreign Contractor. The resident withholding agent must:

- provide the Commissioner General with a copy of the signed contract or written notification of an agreement within 14 days of signing the contract; and
 - not make any payment of any income assessable under this Division to that Foreign Contractor, or transfer out of the country any income for the purpose of making such a payment, unless and until written approval is received from the Commissioner General.
33. Significant penalties may apply where there is a failure to forward the contract to the Commissioner General for review, or where there is a failure to withhold FCWT from any payment made to the Foreign Contractor.

DTA Implications

Business Profits

34. As noted above, FCWT generally applies to entities rather than individuals. In most cases in which the Foreign Contractor is resident in a country which has entered into a DTA with PNG, it will be the Business Profits Article in the relevant DTA which provides PNG with a taxing right, provided that the services are undertaken through a permanent establishment (“PE”) in PNG.
35. There may be cases where an individual contract is of insufficient duration to constitute a PE in PNG. In these cases, consideration will need to be given as to whether the Foreign Contractor is undertaking any other contracts in PNG and the nature and duration of those other contracts. Under the DTA, the issue of whether there is a PE in PNG needs to be considered on the basis of all of the activities of the Foreign Contractor in PNG – not only on an individual contract basis.
36. If after considering the entirety of the Foreign Contractor’s operations in PNG there is not considered to be a PE, then further consideration will also need to be given to other articles under the relevant DTA, to determine whether these may provide a taxing right in PNG.

Royalties and technical fees

37. Where there is no PE in PNG, either the Royalties Article or the Technical Fees Article (where applicable) in the relevant DTA may provide PNG with the relevant taxing right – although in those circumstances, the rate of FCWT may need to be reduced from 12% to 10% to ensure compliance with the DTA.

Dependent personal services

38. Many instances of individuals who are currently registered or seeking registration as Foreign Contractors involve the application of either the Independent Personal

Services Article, or the Dependent Personal Services Article. Where the individual falls within the Dependent Personal Services Article (which applies to employees) it is clear that the individual should be subject to SWT and will fall within paragraph (a) of the definition of salary and wages set out above.

Independent personal services

39. In other cases, an individual resident in another DTA country may be subject to tax in PNG by virtue of the Independent Personal Services Article. By way of example, Article 14 of the Australian Agreement provides (in broad terms) that an Australian resident individual providing “professional services or other independent activities of a similar character” will only be taxable in Australia unless:
- The services are provided from and attributable to a fixed base in PNG which is regularly available to the individual; or
 - The income derived by the individual exceeds \$8,000 within any 12 month period; or
 - The individual is present in PNG for more than 90 days in the income year.
40. Clause (2) of Article 14 defines the term “professional services” to include “services performed in the exercise of independent scientific, literary, artistic, educational or teaching activities as well as the exercise of the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.” Clearly, this article is intended to capture the services of individuals who are operating on their own account and not as employees. Nevertheless, this is not conclusive as to the method of taxation in PNG.
41. It must be noted that the purpose of the DTA is to allocate a taxing right between the two jurisdictions who are a party to the agreement. Once the taxing right is allocated between the jurisdictions, it does not determine the domestic taxing regime – although in many cases (dividends, interest and royalties for example) it may cap the rate of tax which may be imposed on a resident of the other jurisdiction.
42. Accordingly, even where the taxing right is allocated to PNG under the Independent Personal Services Article of a relevant DTA, it will still be necessary to consider which domestic taxing regime is appropriate under the Act. Any contract which contains overlap between the different withholding tax regimes will still need to be considered in the following order:

- a) first, SWT
 - b) second, MFWT; and
 - c) only, where no other withholding tax regime applies, then FCWT.
43. In most cases, paragraph (b) of the definition of salary and wages will apply since remuneration will generally be “by way of fees or otherwise for professional services, or services as an adviser, consultant or manager.” It will only be in cases where the remuneration is clearly demonstrated as being paid wholly or substantially for something other than personal services rendered by that person in PNG, that consideration will be given to MFWT or FCWT.
44. Cases where the services are provided wholly or substantially from outside of PNG, or where the individual’s services are ancillary to a contract which is primarily for the provision of something other than personal services (e.g. a contract to lease complex or high value machinery for a limited period of time where an operator may also be required under the contract) may attract MFWT or FCWT rather than SWT.
45. The Commissioner General considers that such cases are likely to be rare and will ordinarily expect all individuals to be subject to SWT. Where a taxpayer believes their circumstances are exceptional and that MFWT or FCWT should apply instead, clear evidence will be required to demonstrate either:
- that the majority of the services under the contract will be performed from outside of PNG; or
 - that the contract is not one which is substantially relating to personal services.
46. Where such a claim is made, the Commissioner General will require some indication of the amount of time that is anticipated to be spent in PNG and the amount of time that is expected to be spent undertaking the contract from outside of PNG. The Commissioner General may also wish to review records and timesheets of the individual to ensure compliance.
47. It should be clearly understood that where in fact the remuneration is paid wholly or substantially for personal services rendered by the individual in PNG, then the PNG resident withholding agent will remain liable for SWT – notwithstanding any approval the Commissioner General may have provided for MFWT or FCWT based on information provided which subsequently turns out to be incorrect.

48. Accordingly, a PNG resident needs to take particular care in the provision of information to the Commissioner General and ensure that the services provided under a contract are consistent with representations made to the Commissioner General, if they are seeking to have an individual contractor taxed under MFWT or FCWT rather than SWT.

Assessment of Tax

49. Subsection 196D(1) deems 25% of a foreign contractor's gross income to be his taxable income, or effectively his net profit from the contract.

...Where a foreign contractor has derived income from a prescribed contract, an amount equal to 25% of the gross income, whether paid or payable in Papua New Guinea, or out of Papua New Guinea, so derived shall be included in his taxable income.

50. This deemed taxable income is then assessed at the rates set out in section 6A of the *Income Tax Dividend (Withholding) Tax and Interest (Withholding) Tax Act* which is currently set 48% for foreign contractors. It is the application of these two provisions from which the 12% gross rate of withholding is derived:

25% of gross income x 48% rate of tax = 12% withholding on the gross.

51. Alternatively, where the actual taxable income is able to be determined to the satisfaction of the Commissioner General and approval is granted to lodge annual tax returns, it is the actual taxable income that will be taxed, and not a deemed 25%. Subsection 196D(2) set out the relevant provision:

Where, in the case of a foreign contractor who derives income from a prescribed contract, the actual profit or loss derived or made by the foreign contractor in respect of the prescribed contract is established to the satisfaction of the Commissioner General, the taxable income of that foreign contractor in respect of that profit, or of the amount of the loss so made by him, shall, subject to this Act, be calculated by reference to receipts and expenditure taken into account in calculating that profit or loss.

52. This provision would usually be exercised at the option of the taxpayer, by requesting permission to lodge an annual tax return.

Annual Assessment

53. Where a taxpayer wishes to be taxed on their actual taxable income, subsection 196D(4) enables the contractor to seek permission from the Commissioner General to adopt an annual basis of assessment. The Commissioner General may only grant

permission where we are satisfied that the Foreign Contractor will meet both their lodgment and payment obligations.

Where in a fiscal year a foreign contractor who derives or is about to derive income from a prescribed contract and seeks leave in writing to adopt a basis of annual assessment by virtue of Subsection (2) the Commissioner General may so grant leave subject to such conditions as he determines and provided that it is established to his satisfaction that the foreign contractor shall not default in either the lodgment of that return or in the payment of any tax due or which may become due in respect of the prescribed contract income.

54. Subsection 196D(4) does not set out any timeframe during which the Foreign Contractor may request the ability to be assessed on an annual basis, nor any timeframe in which the Commissioner General must respond. Accordingly, a Foreign Contractor may apply at the beginning of the contract, during the relevant income year, or even after the relevant income year.
55. Section 196E enables the Commissioner General to raise a deemed assessment where the taxpayer has either not requested, or has not been granted leave to lodge a tax return under subsection 196D(4) at or before the end of the next succeeding year of income.

...Where a person has derived prescribed contract income to which this Division applies during a year of income and that person has not been given leave to lodge a return under Section 196D(4) in relation to that income at or before the end of the next succeeding year of income, there shall be deemed to be an assessment of prescribed contract (withholding) tax equal to the sum of the amount of instalments paid by or on behalf of the person.

56. We infer from this provision, that a taxpayer must ordinarily seek approval and lodge their return within 12 months of the end of the income year if they wish to be assessed on their actual taxable income. Where this does not occur, the law deems an assessment to have been made under section 196D(4) and the normal amendment periods set out in section 232 of the Act will then apply.
57. Nevertheless, a taxpayer who seeks to be taxed on their actual taxable income should lodge their return within the normal periods for lodgment set out under the Act and the Regulations, or as agreed to by the Commissioner General under any relevant tax agent lodgment program including substituted accounting periods. Obtaining approval to lodge a tax return under section 196D(4) does not of itself provide any extension to the normal lodgment periods.

58. Accordingly, the Commissioner General's usual practice will be to receive regular instalments of FCWT throughout the income year and allow the taxpayer to lodge a return in the following year in accordance with the normal lodgment rules and assess or refund any outstanding or overpaid taxes (as the case may be) at that time.
59. The Commissioner General will accept an application to lodge an annual income tax return if the application is made and the return is lodged at or before the end of the next succeeding year of income, even though the return may be late under the normal lodgment regime and may attract late lodgment penalties. An application after 12 months will only be accepted in exceptional circumstances.
60. Notwithstanding the application and granting of approval to lodge a tax return, the Commissioner General will further allow taxpayers to subsequently opt out of lodgment responsibilities, but having done so will not consider any further applications. This application to opt out will be considered final.

Conditions imposed

61. Section 196D(4) specifically states that the Commissioner General may impose conditions on the grant of approval to lodge an annual tax return, in order to ensure that the foreign contractor does not default in either the lodgment of the return or the payment of the tax. Section 196D(5) further provides that:

For the purpose of Subsection (2), the Commissioner General may seek an undertaking in writing from a person who or which pays or is about to pay a prescribed contract income payment to a foreign contractor, to the effect that should the foreign contractor default in respect of the provision of Subsection (2), that person shall pay any tax imposed by reason of that default.

62. Each case will need to be considered on its own merits. In determining whether to grant approval for a taxpayer to lodge an annual return, the Commissioner General will give primary consideration to obtaining the lodgment of the return (accurately setting out the assessable income and allowable deductions of the taxpayer) and the payment of the tax.
63. Ordinarily, the Commissioner General will seek to collect FCWT throughout the year from the withholding agent on all payments made to the foreign contractor. When a return is lodged after the end of the year, the Commissioner General would then raise an assessment on the actual taxable income of the taxpayer and pay a refund for any overpaid tax as appropriate.

64. Where a taxpayer requests to lodge an annual return and seeks exemption from incurring FCWT throughout the year, they will need to provide sufficient information to the IRC to give the Commissioner General confidence that an accurate tax return would be lodged in accordance with the ordinary timeframes and that the assessed tax would be paid. In determining such requests, the Commissioner General will consider:
- The degree of connection by the foreign contractor to PNG including:
 - The parties to the contract;
 - Prior contracts in PNG;
 - The length or expected duration of the contractual arrangements; and
 - Future business plans for operations in PNG;
 - The reputation of the foreign contractor and associated entities in their home jurisdiction or other jurisdictions in which they operate;
 - The importance to the taxpayer of retaining that reputation;
 - The financial resources of the taxpayer and any associated entities;
 - The compliance history of the taxpayer in terms of lodgements and payments;
 - The perceived tax risk associated with the taxpayer;
 - Any intelligence provided by other revenue agencies or from publicly available records in other jurisdictions; and
 - Any legally enforceable undertaking provided to the Commissioner General by the withholding agent or other relevant person to pay any assessed tax.
65. Over the past several years, a practice has become common where foreign contractors seek approval to lodge annual returns, but year after year disclose losses. It is questionable why a foreign contractor would continue to do business in PNG over many years if the losses sustained were genuine commercial losses. When considering the compliance tax risk profile of the foreign contractor, the Commissioner General will take into account the likelihood of any transfer pricing or other tax risks associated with a particular foreign contractor. This will be a factor when considering applications by Foreign Contractors to lodge annual tax returns.
66. Where a Foreign Contractor is granted leave to lodge annual tax returns and the Commissioner General agrees to allow Prescribed Payments to be paid gross to the Foreign Contractor, then the Commissioner General would ordinarily impose Provisional Tax or Advance Payments Tax on the Foreign Contractor as appropriate.

Non-Discrimination

67. The Commissioner General is aware that several DTAs include non-discrimination, or limitation of discrimination clauses which may impact on the application of the FCWT regime. Article 24 clauses (1) and (2) of the Singapore treaty are indicative:

The Nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which the nationals of that other State in the same circumstances and under the same conditions are or may be subjected.

The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in the other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances and under the same conditions.

68. It is the Commissioner General's view that such a clause assures a taxpayer in a treaty partner country that they would be treated in the same or similar manner as PNG companies, but this argument does not support a taxpayer in arguing that the applicable company tax rates discriminate against them because the tax rate in their own country is less than our tax rate.
69. The FCWT regime represents an administrative concession to the ordinary calculation of taxable income and so corporate income tax payable. This is given effect as per section 196A(1) by firstly deeming 25% of the gross income to be taxable income and then applying a tax rate of 48%. This administrative concession is not available to resident entities undertaking business in PNG.
70. In some cases foreign contractors who are subject to FCWT have been of the view that this administrative concession actually disadvantages them and argued that the FCWT should be reduced to a lower rate to reflect the application of the resident corporate rate as opposed to the non-resident corporate rate.
71. The Commissioner General does not believe the correct way to relieve potential discrimination is to adjust only the rate of tax applied without a proper determination of the taxable income. Rather, the Commissioner General is of the view that subjecting the Foreign Contractor to precisely the same tax requirements that would be applicable to a PNG resident taxpayer effectively satisfies the non-discrimination requirements of such treaties. That is, the Foreign Contractor should maintain accounts for the project (in English in PNG), must lodge an annual income tax return

declaring their actual income and expenses in order to calculate their taxable profit or loss in the same manner as any other PNG resident. They would then be assessed on that profit at the relevant non-resident rate or as otherwise reduced by any such non-discriminatory clause that might exist in the relevant DTA.

72. To adjust only one element of the regime may perpetuate discriminatory tax treatment contrary to the DTA, or may in fact provide Foreign Contractors with an unfair tax advantage over PNG resident taxpayers.
73. For these reasons, the Commissioner General will levy all FCWT at the rate of 12% and where a Foreign Contractor believes that this has resulted in tax treatment which is less favourable, then the Commissioner General will consider the lodgement of a tax return from the Foreign Contractor provided that it is lodged in accordance with the terms and conditions of that approval.

EXAMPLES

Example 1 – Salary or Wages Tax v Foreign Contractor Withholding Tax

Facts

74. ABC Ltd has entered into a contract agreement with Bert Williams as a “Re-Settle Advisor.” Bert is a resident of Singapore and specialises in human capital, international assignments and the development of supporting human resources policies and procedures. Bert’s family continue to live in the family home in Singapore and Bert commutes back to Singapore for two weeks after every four weeks of service in PNG. His contract is representative of a person engaged on a fly-in fly-out basis, a not uncommon commercial practice.
75. Under the contract, Bert is responsible for developing procedures and frameworks to accommodate the large influx (and ultimately repatriation) of expatriate officers working on a major infrastructure project, providing training on HR matters to the staff of ABC and its contractors, monitoring adherence to the newly drafted policies and procedures and undertaking other HR duties as requested by ABC.
76. The contract is for a two year term, but may be extended. Bert has a 12 month work permit and has been sponsored by ABC. Bert’s contract pays USD \$1,500 for every day worked in country and he is entitled to claim a reimbursement for any travel expenses incurred commuting to and from Singapore. Bert is required to render an invoice on a

monthly basis and will be paid into a USD denominated account he is required to maintain in Singapore, by ABC from their account with the National Bank of Singapore.

77. Bert is expected to spend approximately 2/3rds of his time in Port Moresby and about 1/3rd of his time travelling between the different camp sites. Bert is required to adhere to all safety requirements of the constructions sites and sign up to a code of values and a code of conduct developed by ABC. His contract can be terminated without notice for breach of any of these. Bert is provided with accommodation and meals at the plant site and the construction sites and he is required to wear an official ABC uniform. Medical insurance is provided through an annual subscription to contract medical providers. Bert is also provided with an office from which to work in the ABC compound.
78. Bert's contract specifically states that he is a contractor and not an employee of ABC. He is not entitled to annual leave or sick leave under the contract and is required to take out his own insurance for accident, injury or loss of income. He must also make his own superannuation contributions and is required to meet any PNG tax obligations. Bert is not registered for GST in PNG.
79. ABC has written to the Commissioner General seeking registration for Mr Williams under FCWT.

Application of law to facts

80. The Commissioner General is satisfied that his usual place of abode is outside of PNG and he does not intend to take up residence in PNG. In effect he is considered to be a fly in fly out person.
81. Although Bert is not resident of PNG, nor can he be treated as a foreign contractor. Even if he is not considered to be a common law employee under paragraph (a) of the definition of salary and wages, he will be receiving remuneration by way of fees or otherwise for professional services, or services as an adviser, consultant or manager where such remuneration is paid wholly or substantially for personal services rendered by that person in PNG under a contract that is wholly or substantially for the labour of the person to whom the payments are made.
82. Therefore, notwithstanding the clause in the contract specifically stating that Bert is not an employee and the fact that he is non-resident, ABC will still need to ensure that SWT deductions are made for all applicable payments of salary and wages to Bert. This will include payments made to him even when he is in Singapore, since these payments are sourced from the work performed in PNG under the contract. (Section

40AA may have relevance here, but for the purposes of this example, has not been considered.)

Example 2 – Interposed Entity & Discrimination

Facts

83. Ramu Ltd has entered into a contract agreement with Don Fox & Associates Pte Ltd a company incorporated in Malaysia. Don Fox & Associates Pte Ltd will provide consulting services on eight components of Marine surveying to constitute a total solution for the company.
84. Don Fox & Associates Pte Ltd will engage designated personal as agreed by the company. Mr. Fox himself (an Australian resident) is designated as the primary consultant in the contract. The primary consultant on the contract can only be changed with the consent of Ramu Ltd.
85. Mr Fox is a leading marine biologist and under the scope of services to be provided, will sample appropriate reef fish, crustaceans and molluscs from shallow marine waters in accordance with standardised methodologies and undertake a comparison with baseline survey data to monitor impacts on the marine environment which may be caused by Ramu operations.
86. Don Fox & Associates Pte Ltd will complete a professional report with details of survey procedure, methodology, and results. They also undertake to deliver professional training to Ramu staff in terms of fish collection, description, identification and sample preparation etc. Don Fox & Associates Pte Ltd has all the equipment and expertise to deliver the services under the contract.
87. The services will be provided in PNG through a Permanent Establishment.
88. Ramu has written to the Commissioner General seeking registration of Don Fox & Associates Pte Ltd for FCWT. They have cited Article 25 regarding non-discrimination in the Malaysian agreement and requested confirmation from the Commissioner General that the correct rate of withholding is 7.5%.

Application of law to facts

89. The contract between Don Fox & Associates Pte Ltd and Ramu will be a prescribed contract since it relates to the provision in PNG of professional services or services as an adviser, consultant or manager, and all payments made by Ramu to the company will be under FCWT provisions.

90. Don Fox & Associates Pte Ltd will be a Foreign Contractor since they are a non-resident company and the services provided do not fall within the definitions of salary and wages or management services. However, withholding under FCWT will occur at the full rate of 12% - not 7.5% as requested.
91. If Don Fox & Associates Pte Ltd feels that the 12% rate of withholding on the gross is discriminatory, they may apply to the Commissioner General for permission to lodge an annual income tax return and lodge such a return prior to due date for lodgment. In these circumstances, the Commissioner General will still require Ramu to withhold 12% of each payment, but will accept an income tax return from Don Fox & Associates Pte Ltd. In recognition of the non-discrimination clause of the agreement that PNG has with Malaysia the actual taxable income will then be assessed at the domestic corporate rate of 30%. Don Fox & Associates Pte Ltd will then be required to pay any additional tax (where there is a shortfall) or to receive a refund from the Commissioner General of any overpaid tax.
92. Mr Fox will be subject to tax in PNG as an employee of Don Fox & Associates Pte Ltd under paragraph (a) of the definition of salary and wages and Don Fox & Associates Pte Ltd will be required to register for SWT, withhold tax and remit it to the IRC as required. No refund of overpaid income tax/FCWT will be paid until all SWT obligations have been fulfilled.

Example 3 – Individual Foreign Contractor

Facts

93. Mr Abbot works as a Professor in the biology department of a prestigious Australian university. The university encourages its academic staff to spend at least three months of every year undertaking research in order to ensure the currency of their skills and to promote the university, which receives significant kudos in the international community due to the number of leading edge peer-reviewed papers which are published by its academic staff.
94. The university encourages academic staff to undertake these research activities as private consultants outside of the core teaching calendar and provides access to its research facilities and laboratories outside of the academic calendar for the purpose of assisting in this work. However, the university will be acknowledged in all academic publications and have joint intellectual property rights over the research.
95. Fraser Corporation (a PNG resident company) is introducing new agricultural initiatives in rural locations in PNG and has engaged Mr Abbot to undertake a research program

considering the suitability of different types of plant specimens for the region, grafting and comparing different methods of pollenisation to achieve hardy crops with high yield.

96. Mr Abbot will be required to prepare a report at the conclusion of his research and give a presentation to the Board of Directors of Fraser Corporation of his findings and recommendations. The contract will cover a 12 month period and Mr Abbot will be expected to be in PNG for approximately 6 weeks to gather samples and make observations. Fraser Corporation will also be taking regular samples which will be sent to Australia for analysis. It is envisaged that Mr Abbot will spend a further 6 weeks full time on the project in Australia (during term break) and approximately ten hours per week over the remainder of the year. Mr Abbot will be paid a total of \$70,000 under the contract and is responsible for his own airfares and other costs.
97. Fraser Corporation has written to the IRC seeking registration for FCWT.

Application of law to facts

98. In this case, the Commissioner General is unable to apply the SWT regime since Mr Abbot is not a common law employee within the meaning of paragraph (a) of the definition of salary and wages, nor will he be captured by paragraph (b) since the personal services are not *substantially rendered* in PNG. Given the nature of the work undertaken outside PNG and the utilisation of research facilities and laboratories, neither will paragraph (c) in regard to the concept of wholly or substantially for the labour of the person. The services are not technical or managerial in nature in the context of the management fee provisions, but do fall within the definition of prescribed purposes for FCWT, being professional services as a consultant.
99. After considering the DTA with Australia, the Commissioner General has determined that PNG has no taxing rights under Article 7, Business Profits, as the enterprise is not carried on through a permanent establishment in PNG. Paragraph (7)(b)(ii) specifically excludes PNG from applying FCWT in respect of business profits under this Article. However, a taxing right under Article 14 – Independent Personal Services, which covers income derived by a resident of one Contracting State from the performance of professional services in the other State would enliven PNG taxing rights. It provides that income will be taxable only in the State of residence unless:
- the services are provided from and attributable to a fixed base in PNG which is regularly available to the individual; or

- the income derived by the individual exceeds \$8,000 within any 12 month period; or
- the individual is present in PNG for more than 90 days in the income year.

100. Although Mr Abbot will be present in PNG for less than 90 days, the value of the contract will exceed \$8,000 and thus PNG will have a taxing right. The Commissioner General would give effect to this taxing right via the application of the FCWT provisions or alternatively allowing Mr Abbot to lodge a tax return in accordance with section 196D(4) should he apply to do so.

Authorized by



Betty Palaso
Commissioner General of Internal Revenue Commission

Issued

16 December 2013

Application

This Tax Circular sets out the Commissioner General's view in relation to salary or wages tax and management fee withholding tax both prospectively and retrospectively.

In relation to changes in the administration of Foreign Contractor Withholding Tax, in particular, the rate of withholding tax and the method of relieving any discriminatory treatment for residents of other jurisdictions with which PNG has entered into a DTA which includes a non-discrimination or limitation of discrimination clause, then these changes as they relate to Agent withholders will apply from 16 September 2013. Foreign contractor assessments remain subject to the Commissioner Generals power of review for periods prior to this date should it be deemed appropriate to execute those powers.

Subject References

Double Tax Agreement

Employee

Employer

Foreign Contractor

Foreign Contractor Withholding Tax

Management Fee (Withholding) Tax

Salary or Wages

Salary or Wages Tax

Related Taxation Circulars

Taxation Circular TC 2013/1: Distinguishing Employees and Independent Contractors and their Tax Implications

Taxation Circular TC 2011/2: Transfer Pricing – Determination of the Taxable Income of Certain Persons from International Transactions

Legislative References

Income Tax Act 1959

- Section 4 definitions: management fee; salary or wages; residence;
- Section 65E
- Section 196A
- Section 196C
- Section 196D
- Section 196F
- Part III Division 14C
- Section 232
- Section 299D
- Section 299C

Income Tax (International Agreements) Act 1987

- Schedule 2: Agreement with Australia
- Schedule 3: Agreement with Singapore
- Schedule 5: Agreement with Malaysia