



Taxation Circular
TC 2016/1

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Internal Revenue Commission - Taxation Circular

Taxation Circular TC 2016/1: Salary & Wages tax

SUBJECT

This Circular will explain;

- What constitutes salary or wages tax;
- Exemptions and concessions to salary or wage tax;
- Rebates for salary or wages tax; and
- The administrative aspects of salary or wage tax including integrity provisions.

SALARY or WAGE TAX

1. Salary or wages tax is the fortnightly deduction of tax from the salary or wages of an employee. It is a final tax on that income.
2. Income to be included in salary or wages tax includes:
 - Salary or wages;
 - The value of all benefits or allowances (whether given or granted in money, goods, sustenance, the use of premises or otherwise);
 - The net amount of an annuity (excluding any amount of undeducted purchase price);
 - The capital amount of any allowance, gratuity or compensation paid in a lump sum or otherwise.
3. The values of some benefits are specifically excluded from income subject to salary or wage tax. Other benefits are valued at prescribed rates in the legislation. These benefits will be specifically discussed later in the circular.

4. 'Salary or wages' are defined in the legislation to include:

(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 Papua New Guinea,*

and without limiting the generality of the foregoing, includes any payments 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;

5. This definition extends the ordinary meaning of 'salary' and 'wages' to include payments to persons who, might usually be considered to be independent contractors, act as advisers, consultants or managers; or where they are otherwise paid under a contract that is wholly or principally for the provision of their labour. Therefore, while they might meet the 'common law test' to be considered an independent contractor, this extended legislative definition of 'salary or wages' may in fact include them as an employee for the purpose of PNG tax law. For further information on the distinction between an employee and an independent contractor refer to TC 2013/1 on our website.
6. The definition specifically includes any remuneration paid by a company to a director of a company. This will necessarily include all payments made by the company to its directors no matter how that payment might be labelled; i.e. *director's fees, executive allowance, commission etc.*
7. An employee is any person who receives, or is entitled to receive, salary or wages. An employee 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 Papua New Guinea.

8. Salary or wage income is, as a general rule, sourced where the duties are performed. It is the source of the income which determines PNG's taxing right over such income. The fact that an employee may be a resident of another jurisdiction and paid in a foreign currency into a foreign bank account is not relevant for the purpose of determining the source of the income in the hands of the employee. Salary or wage tax is payable in PNG.
9. In order to obtain treaty 'protection' from salary or wages tax in Papua New Guinea an employee must meet **all** of the requirements within the "Dependant Personal Services" article of the relevant treaty. By way of example, referring to Article 15 of the Australian Treaty :
 - The person must be present in PNG for no more than 90 days in the year of income;
 - The remuneration must not be paid by a resident of PNG;
 - The remuneration must not be (or be capable of being) deductible against the taxable profits of a permanent establishment in PNG; and
 - The remuneration must be subject to tax in Australia

It follows that employees of an Australian resident foreign contractor which is subject to foreign contractor (withholding) tax on the income from a prescribed contract will be liable to salary or wages tax in respect of income arising from services performed in PNG whether or not their employer is taxed on a deemed profit or actual profit basis even if the employee is working in PNG for less than 90 days.

10. Some International Agreements extend this general principle to include directors' fees earned in the capacity as a member of the board of directors of a PNG company to be taxed in PNG irrespective of where those duties are performed. By way of example Article 16 of the International Agreement with Singapore states:

"ARTICLE 16 - DIRECTORS' FEES

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State."

11. Salary or wages paid or payable by a foreign contractor (as defined in Division 14A) in respect of employment exercised in Papua New Guinea is deemed to be derived from a source in Papua New Guinea (s65E(3)). Therefore, we would expect to see the majority of these foreign contractors registered as group employers.

12. It should be further noted that the tax status of the employer entity has no corresponding bearing on the tax status of the employee. An entity whose income is exempt from tax still has obligations under the tax system to withhold and remit tax from the income of their employees. There is no cascading effect to the employee of the exempt status.

13. Section 65E ensures that a person who derives income to which Division 2B applies has to pay salary or wages tax upon that class of income. Section 65E(1) states that the Division applies to income consisting of:

- “ (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*
- (c) the net amount of an annuity after the exclusion of any amount of undeducted purchase price by virtue of Section 49; and*
- (d) the capital amount of any allowance, gratuity or compensation paid in a lump sum, by virtue of Section 46B...”*

14. In determining the value of a benefit or allowance the IRC will include as assessable income of the employee the actual cost of the benefit to the employer unless it is otherwise excluded under another provision of the Act or specifically valued at a prescribed rate pursuant to section 65E(1)(e) to (k). However, any benefit granted outside PNG to an employee will continue to be at an amount equal to the cost to the employer of the benefit (s65E(1)(h)).

15. It is noted that Regulation 9A(1)(i) states:

“Employees provided with accommodation outside Papua New Guinea by their employer are automatically deemed to reside in AREA 1. They are subject to the inclusion of the taxable value for private high cost housing.”

The Commissioner General is of the view this regulation is in direct conflict with the legislation and therefore, in accordance with proper statutory interpretation, the legislation should prevail over the regulation.

16. A salary packaging arrangement, which is sometimes referred to as a salary sacrifice arrangement, allows an employer and employee to prospectively mutually agree changes to the terms of the employee's employment contract reducing that employee's entitlement to cash pay in return for a non-cash benefit. This can be financially beneficial for both employers and employees as certain non-cash benefits are wholly or partially exempt from income tax. To be an **effective** salary packaging arrangement, the arrangement must be for your future earnings rather than any salary, wages or

entitlements you have already earned and must be in respect of such benefits that are concessional taxed or are exempt. For example, an effective salary sacrifice arrangement cannot include annual or long service leave you have accrued before entering into the arrangement or include a fully taxable benefit.

17. You must permanently forego your sacrificed salary for the period of the arrangement. For example, if a salary packaged super contribution is not made and instead cashed out at the end of a salary packaging arrangement accounting period, the amount cashed out is salary and is taxed at your marginal tax rate.
18. With the exception of those benefits that are specifically exempted or valued at a prescribed rate below their actual cost, the value of the benefit received will remain assessable income in the hands of the employee. By way of example:

An employee enters into an arrangement with their employer for a novation (transfer) of a finance lease payment obligation entered into by the employee as part of his leasing of a new car (often referred to in the leasing industry as a partial novation). Under a partial novation the obligation to make lease payments is novated to an employer. Instead of the lessee making payments to the lessor, the employer makes these payments. Commonly, partial novation arrangements include an ancillary transaction whereby the lessee also subleases the vehicle to the employer. In the PNG context the lease payments made by the employer would be considered a benefit to the employee and form part of his assessable income. The income or benefit is calculated by reference to the value, equivalent to the lease payments, of the consideration received. That consideration is the promise by the employer to make rental payments directly to the financier in lieu of payments to the employee under the sub-lease between the employer and the employee.

However, where there is a full novation of all the rights and obligations in a finance lease or in a finance lease and sub-lease arrangement, such that the employer takes over all the rights and responsibilities contained in the original lease, then the employee will only be assessed where the employer provides the use of the vehicle to the employee free of charge or at a subsidized cost. In such cases the value of the benefit will be at the 'prescribed value' set out in the Regulations. However, a further benefit will arise at the time, if it should arise, that the ownership of the vehicle is transferred back to the employee. The value of that benefit will be the market value of the vehicle less any amount actually paid by the employee (usually the residual value of the lease).

19. Section 66A(1) ensures that no deductions can be claimed in respect to salary or wage tax income. However, expenditure or outgoings that would be deductible if not for section 66A(1) shall be considered for the purpose of calculating a rebate for the purpose of sections 214 and 214B. Rebates in relation to salary or wage tax will be discussed in further detail later in this Circular.

20. Where a person lodges an annual return in order to claim a rebate against salary or wage tax paid, the lodgement will be treated as an objection. This lodgement must be made before the 1st of March in the year following the fiscal year in which the expenditure was incurred, or in such further time as the Commissioner General may allow.

Benefits specifically excluded from salary or wage tax.

School Fees.

21. School Fees are exempt by virtue of Section 29(1)(l) of the Income Tax Act. Section 29(1)(l) states in part;....

“The following pensions, allowances and other payments are exempt from income tax or salary or wages tax—.....

(l) allowances or expenses paid to meet the annual fees imposed by a school or college for the purpose of educating a student child of an employee but not including expenses of tertiary studies.”

22. Such pensions, allowances or payments will only be exempt income where they are used solely and fully for the purpose to which they are intended. In order to ensure that these payments are used as intended the Commissioner General administratively requires that the fees must be paid by the employer directly to the educational institution. It is only where this is done that the employer can treat the benefit as exempt income for salary or wage tax purposes. This administrative requirement is aimed at ensuring compliance at a minimal cost to the IRC, employees and employers.

23. The payment will be deductible to the employer where they have retained receipts to substantiate the expenditure. The receipts should be made out in the name of the employer and identify the name of the student and where possible his or her relationship to the employee.

24. Where the employee receives a cash allowance for the purpose of meeting such fees then the employer will be required to tax the amount as assessable salary or wage income and the employee would be required to lodge an objection by way of an annual return and substantiate that the allowance was actually used for the purpose provided. This will require substantiation by way of detailed receipts.

25. The fees may only cover the employee’s dependents, being the naturally born children or children that have been legally adopted by the employee. Employer’s should make every effort to assure themselves that the school fees they are paying are those of the children of the employee and not some other relative such as a grandchild, niece or nephew.

26. The payment of the school fees covers prep school to year 12 only. University fees, Technical College fees or any other fees in the nature of tertiary education are NOT covered by the exemption.

Approved Citizen Employee First Time Home Buyer Scheme

27. Section 29(1)(q) exempts benefits by way of a subsidy provided by an employer to a citizen employee towards the capital cost of purchasing their first residential dwelling from salary or wage tax. The exemption is dependent on the Commissioner General's approval that the dwelling is being purchased under a citizen employee first time home buyer scheme.

28. Employer's wishing to provide such a subsidy to their employee(s) will need to make a submission to the Commissioner General. Factors that the Commissioner General will consider before granting approval will include:

- The scheme must be available to all employees or class of employees identified by the employer.
- The scheme participant must be an employee of the employer providing the scheme.
- The employee must be a citizen of Papua New Guinea.
- The home being purchased must be the first home owned by the participant or his or her spouse.
- The participant must live in the home .
- The property to be purchased must lie within Papua New Guinea.
- The value of the property (land and building) must be K 500,000.00 or less.
- In order to be a participant the employee must be a member of the scheme.
- There is no limit on the value of the subsidy that the employer may offer to the participant (member).
- The scheme cannot be one that has the overriding purpose of tax avoidance.

First Home owner Advancements

29. Section 29(1)(r) exempts from salary or wage tax, payments made by an employer to an employee where such payments are **repayable** advances which have been debited against amounts owed in respect of recreation leave, furlough, superannuation or gratuity entitlements. Such advances must be used by the employee for the purpose of purchasing property used for housing the cost of which cannot exceed K400,000.

Leave Fares

30. As mentioned earlier at paragraph 13 of this Circular it is the intention of Section 65E to include in the assessable income of a taxpayer all benefits provided to the employee in respect of his employment. Section 65E(1)(e) goes on to further stipulate that:

“... subject to Section 40AA, of any air fares paid to or on his behalf by his employer or an associated person is the actual cost price of the air fares; ...”

31. Section 40AA states that income or any benefit derived by an employee by way of—

- (a) (i) *one annual leave fare for himself and his family paid from his place of employment to the employee's place of origin or recruitment; and*
- (ii) *additional leave fares for travel within Papua New Guinea to a person employed solely in, or in connection with a mining lease, special mining lease or mining project or prospecting authority granted under the Mining Act 1992, or a pipeline licence or a petroleum development licence granted under the Oil and Gas Act 1998; and*
- (iii) *additional leave fares, where due to remoteness, or hardship as a result of being located in a remote area away from urban centres, and the Commissioner General is satisfied that the conditions warrant additional leave fares due to remoteness or hardship; or*
- (b) *recreational fares and accommodation within Papua New Guinea, to a value not exceeding the total value of the benefit allowable under Paragraph (a),*

is exempt from income tax or salary and wages tax provided that the income or benefit is applied exclusively for the purposes referred to in Paragraph (a) or (b).”

32. It is clear from the wording of the provision that section 40AA(a)(i) and (ii), along with subsection 40AA(b) operate solely on their facts. That is, by way of example, employees who are covered by the circumstances outlined in s40AA(a)(ii) may be provided with unlimited leave fares within PNG without any approval needed to be provided by the Commissioner General. The value of the benefit of those airfares will not form part of the assessable income of the employees.

33. However, the concessional treatment provided in section 40AA(iii) is dependant as to the extent that the Commissioner General is satisfied that the particular conditions warrant additional leave fares due to the remoteness or hardship arising from being located in a remote area away from urban centres. Employers who provide more than one leave fare per annum to an employee must include the cost of those additional

leave fares in the assessable income of the employee and deduct tax at the appropriate fortnightly rate. Employers who wish to have these additional leave fares treated as exempt income must apply to the Commissioner General for such relief. The Commissioner General interprets 'leave fares' to be any fare where the intention is to ensure that there is time away from the regular work place for rest and recreation to improve morale and productivity. On this basis, these fares are distinguishable from air fares otherwise provided in the course of employment to which no "benefit" can be said to be derived. By way of example:

A mining company holding a mining lease in a remote area of the highlands is able to provide unlimited leave fares within PNG to its employees working at that remote location under s40AA(a)(ii). However, it must get written consent from the Commissioner General before it can treat any additional leave fare outside of PNG as exempt under s40AA(a)(iii). It is difficult in such circumstance to envisage the need for any further exemptions under subsection (iii) as subsection (ii) will have already provided relief from the harsh or remote circumstances of the employees working conditions. It should be noted that the purpose of this provision is not to accommodate particular business model decisions such as 'fly-in/fly-out' operations.

34. In order to provide time for entities currently operating on a "fly in/fly out" basis the Commissioner General will not actively enforce this view until the 1st January 2017. Entities which have previously applied for and been granted exemptions will need to make new and fresh applications in respect of the 2017 year of tax and beyond.
35. In order to qualify for the exemption the employer must pay for the airfare (on behalf of the employee). The payment of this leave fare may be by way of the supply of an airline ticket or by way of a cheque payable to a reputable Travel Agent.
36. If the employer intends to issue a cheque to a travel agent, then they should ensure that they have an enforceable agreement in place whereby the tickets are non-transferrable, any refunds may only be made to the employer (sponsor of the ticket) and not to the employee.
37. Any refund to the employee, in cash, loses the exemption and so becomes fully taxable in the hands of the employee. An employee may negotiate with their employer to cash out a Leave Fare provided by the employer. If an employee takes a Leave Fare in cash the entitlement loses its exempt status and the employer must tax the amount at the employee's marginal rate of Salary or Wages Tax. In order to arrive at the employee's marginal rate of Salary or Wages Tax the employer must spread the payment over the

period it was derived (normally the previous 26 fortnights) and tax the payment accordingly.

Benefits valued at prescribed rates

Employee provided with a Motor Vehicle

38. Section 65E states that a motor vehicle provided to an employee free of charge or at a subsidised cost shall be a taxable benefit to the employee at the prescribed rate.

39. The rates are prescribed in Regulation 9A of the Income Tax Regulations. In relation to a motor vehicle benefit the prescribed rate for a vehicle supplied by an employer where the employee has unrestricted use are currently:

- K125.00 when fuel is also supplied; and
- K95.00 where the employee has to purchase the fuel.

40. However, where the employee has restricted use of the vehicle the Commissioner General may determine a lesser value having regard to all relevant matters. Any request for consideration in this respect would need to be made in advance of any benefit being provided and in writing and provide full details as to the restriction of use being imposed.

A statutory authority provides a vehicle, with fuel supplied, to its senior officers which they can freely use on the proviso that the car is available to be used by other staff for work purposes if not needed by them during work hours should the need arise. This in practice never occurs as other vehicles are available should they be needed.

The senior officers should be assessed on the fortnightly prescribed value of this benefit of K125.00.

41. Where an employee is paid a motor vehicle allowance for either the use of his own vehicle for work purposes or to assist him to purchase a car, that allowance is fully assessable. No variations will be done in relation to motor vehicle allowances being paid or where an employee utilises his own car for work purposes. To the extent that the taxpayer might incur work related expenses in relation to the vehicle they are able to claim a rebate under section 214. The Commissioner General sees no distinguishable difference between these outgoings and any other employee expense that would have been otherwise deductible if not for s66A(1). Furthermore, it will reduce both the administrative costs of the IRC and the compliance costs of taxpayers to have the expenditure dealt with as originally intended by the legislation.

Housing Allowance

42. Section 65E states:

Subject to Sections 46B, 46C, 65F, 145 and 299E, this Division applies to income consisting of—

- (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*

....

provided that the benefit to an employee—

....

- (f) of a motor vehicle or housing provided to him free of charge or at a subsidised cost shall be the prescribed value thereof; and*
- (g) of a housing allowance shall be:—*
 - (i) when given to him under a citizen employee first time home buyer scheme —the prescribed value thereof; or*
 - (ii) when given to him in respect of housing occupied by him—the amount of housing allowance in so far as it exceeds housing expenditure and the prescribed value of that housing as if the housing was provided directly to him by the employer; and ...*

43. Therefore, housing provided to an employee free of charge or at a subsidised cost shall be a taxable benefit to the employee at the prescribed rate. This would include a situation where, under the employee's terms of employment, the employer pays the employee's rent directly to the landlord. That is they do not receive an allowance as such but rather are provided with a benefit.

44. A housing allowance paid directly to an employee under an approved citizen employee first time home buyer scheme, is also assessable but only at the prescribed rates. As the prescribed rate is nil, citizen employees who are in receipt of housing allowances and are engaged in a "citizen employee first time home buyer scheme", are not taxed on the allowance. Nor are they required to lodge a Housing Allowance Variation form.

45. Once the object of the Citizen Employee First Time Homebuyer Scheme has been met, that is the house is paid off, the participation of the employee ceases and the Housing Allowance becomes assessable in the hands of the employee. At this stage the employee would have to lodge a Housing Allowance Variation to claim any reduction in the taxable nature of the allowance. Employers offering "citizen employee first home buyer schemes" will need to monitor the ongoing compliance to the scheme to ensure they are not under deducting and thereby exposing themselves to liability of the shortfall amount pursuant to s299G(7).

46. The fortnightly prescribed rates in Regulation 9A are as follows:

ACCOMMODATION PROVIDED			
TYPE OF HOUSING	AREA 1	AREA 2	AREA 3
Very High Cost House or Flat	2,500	1,500	NIL
Up Market Cost House or Flat	1,500	1,000	NIL
HIGH COST House or flat	700	500	NIL
MEDIUM COST House or flat	400	300	NIL
LOW COST House or flat	160	150	NIL
MESS OR BARRACK STYLE BASIC ACC.	60	50	NIL
GOVERNMENT MESS OR BARACK STYLE	7	7	NIL
EMPLOYEES INVOLVED IN A CITIZEN EMPLOYEE FIRST TIME HOME BUYER SCHEME	NIL	NIL	NIL

47. **Low cost housing** is any unit of accommodation which would fetch K400,000 or less if sold on open market, and in any other case for which the market rental is K1,000 per week or less. **Medium cost housing** is any unit of accommodation which would fetch between K400,000 and K800,000 if sold on the open market, and in any other case for which the market rental is between K1,000 per week and less than K3,000 per week. **High cost housing** is any unit of accommodation which would fetch more than K800,000 if sold on the open market, and in any other case for which the market rental is between K 3,000 per week but less than K 5,000 per week. **Up-Market cost housing** is any unit of accommodation which would fetch between K1,500,000 and K 3,000,000 if sold on the open market, and in any other case for which the market rental is between K 5,000 per week but less than K 7,000 per week. **Very High cost housing** is any unit of accommodation which would fetch more than K3,000,000 if sold on the open market, and in any other case for which the market rental is K 7,000 per week or more.

48. The areas mentioned to in the above table refer to the area located in or within a 15 Kilometre radius of the boundaries of any of the following towns.

AREA 1: Alotau, Goroka, Kimbe, Kokopo, Lae, Madang, Mount Hagen and Port Moresby.

AREA 2: Arawa, Buka, Bulolo, Daru, Kainantu, Kavieng, Kerema, Kiunga, , Kundiawa, Lihir, Lorengau, Mendi, Popondetta, Pongera, Rabaul, Tabubil, Vanimu, Wabag, Wau and Wewak.

AREA 3: Any place within Papua New Guinea not included in Areas 1 and 2.

49. A housing allowance paid in respect of housing occupied by the employee is assessable income of the employee to the extent that the amount of housing allowance exceeds

the total of housing expenditure as defined and the prescribed value of that housing as if the housing was provided directly to him by the employer.

50. A housing allowance is defined in section 4 to mean

... any allowance paid or provided to an employee, whether directly or indirectly, for the purpose of subsidizing residential accommodation to be occupied by the employee

Housing expenditure is defined in section 4 as:

"housing expenditure" means expenditure (including rental (at arms-length) in the case of rented premises) and amounts deductible by way of depreciation on the house (not being a boat) and its fittings, incurred by an employee deriving a housing allowance (which shall include, where the housing occupied by that employee is jointly owned with his or her spouse, net expenditure incurred by the spouse in respect of that housing) for the provision of housing (not being a boat) occupied by the employee as his or her sole or principal residence in Papua New Guinea and shall be an amount equal to the amount which would be deductible pursuant to the provisions of this Act, if at all times that property had been income-producing in his or her hands, provided that—

- (a) the amount deductible cannot exceed the amount of the allowance; and*
- (b) prescribed expenditure of a personal nature is not deductible;*

51. In order to assist employers in calculating the correct value of the benefit in such circumstances and to prevent abuse of the provision the IRC considers the allowance to be fully assessable until such time as a Housing Allowance Variation notice is supplied to the employer.

52. Where a variation is obtained, the employee is taxed on the prescribed value of the accommodation and to the extent that the allowance exceeds the actual cost of the accommodation.

53. Employees may obtain variation on housing allowances by lodging a Housing Allowance Variation form with the Internal Revenue Commission. The form is available on the IRC website.

54. When a Housing Allowance Variation is lodged:

1. All details must be completed on the form using the section relevant to your situation (that is if you are renting/leasing or buying).
2. If you are renting or leasing the property then you must include:

- A. Copy of the Stamped Lease Agreement.
- B. Complete details of landlord, including their TIN number, as required on the Variation form.
- C. Copy of employment contract or payslip showing the amount of the Housing Allowance.

Remember to keep your receipts (issued by the landlord for payments made by you). It is important to note that if the lease document does not include the landlords TIN number the variation form will not be processed.

3. If you are purchasing a property then you must include:

- A. Copy of the deed for the property
- B. A letter from the bank or financial institution, showing the repayment amounts, including the annual mortgage interest and the break-up of the land and building valuation components.
- C. Letter from the insurance company showing the amount of insurance paid annually (this letter may also show details of the land and building values insured).
- D. Copy of Council rates and taxes bill (supplied by your local council i.e. NCD)
- E. Copy of body corporate fees charged (in relation to apartments or units).
- F. Copy of a payslip showing the amount of the housing allowance paid.

Remember that estimates for “Repairs and Maintenance” should be as accurate as possible and must not include amounts for improvements or additions.

55. If the Housing Allowance Variation is approved then an Income Tax Return must be lodged, claiming the amount of the “Housing Allowance” paid and the amount of allowable “Housing Expenditure” deductions incurred.

56. Failure to lodge an annual return will lead to the Housing Allowance Variation being cancelled. The employer will be advised to fully tax the Housing Allowance.

57. A new application must be lodged each year. Approvals granted for a prior year will not be effective for the following year.

Employer sponsored superannuation

58. Employer sponsored superannuation is the payment of superannuation directly to an Authorised Superannuation Fund by the employer. This form of superannuation is not considered to be income assessable to the employee and as such does not attract Salary

or Wages Tax. The income is considered to be income in the hands of the Authorised Superannuation Fund.

59. Under Section 88 of the Income Tax Act the employer is allowed to make a contribution equivalent to 15% of the employee's fully taxed Salary or Wages to an Authorised Superannuation Fund. This contribution is allowable as a deduction to the employer.
60. Any amounts in excess of the 15% are not allowable as a deduction to the employer and when distributed by the Authorised Superannuation Fund, to the employee upon retirement, any amount in excess of the 15% becomes fully taxable at the employees marginal rate of Salary or Wages Tax.

Related matters

The 60/40 Rule.

61. The Commissioner General will accept salary packaging arrangements where they are reasonable and are not blatantly designed to evade Salary or Wage Tax. In this regard the Commissioner General will not generally challenge arrangements that do not attempt to concessionally package more than 40% of the employees overall salary. This is commonly referred to as the 60/40 rule.
62. The 60/40 rule is an administrative policy applied by the Commissioner General to mitigate the risks involved with employers/employees abusing the concessions available under the Income Tax Act. It is also a Policy that protects the employee from overcommitting their salary to allowances and thereby leaving little or no disposable income to address their normal needs (food, clothing etc.).
63. Under the 60/40 rule the employee may utilise 40% of their total Salary in respect of any or all of the concessional benefits and allowances. 60% of the employees total Salary must be fully taxed and the net paid to the employee.

Contracts or arrangements to evade tax.

64. Employees and employers are reminded of the existence of section 361. Section 361 is a general anti avoidance rule which can make void for salary or wages tax purposes any arrangement for which the purpose, or one of its purposes or effects, is to avoid tax. Tax avoidance is defined to include the following:
- (a) *directly or indirectly altering the incidence of any income tax, dividend (withholding) tax, specific gains tax or salary or wages tax;*
 - (b) *directly or indirectly relieving any person from liability to pay any income tax, dividend (withholding) tax, specific gains tax or salary or wages tax or make any return required to be made under this Act;*

- (c) *directly or indirectly defeating, avoiding, evading, reducing or postponing any duty or liability imposed on any person by this Act; or*
- (d) *preventing the operation of this Act in any respect.*

65. More specifically section 361(4A) states that where an arrangement, whether by contract, agreement, plan or understanding purports to structure an employee's pay package, and the purpose or effect (not being a merely incidental purpose or effect) of such an arrangement is to avoid the payment of salary or wages tax then

- (a) *the employer, who is a party to such arrangement, in addition to any other penalty stipulated under this section, is liable to a fine of not less than K5,000.00 and not exceeding K50,000.00; and*
- (b) *the employee for whom the arrangement is made shall be assessable to tax on the full amount of the benefit without regard to the exempt amounts stipulated under Section 65E(1).*

66. Example of such arrangements would be:

An individual registers a business name with the IRC and obtains a Certificate of Compliance. He then purports to be an independent contractor to his employer whilst being employed on the same terms and conditions of an ordinary employee.

Alternatively, where an expatriate is granted a work permit and employment visa to work as an in line employee/consultant with a government department. The parties, in order to minimize the total remuneration costs of his employment cost, agree to contract with an interposed entity of which the individual is the sole shareholder and director. The government department merely deducts and remits 12% foreign contractor withholding tax. The interpose entity fails to register for tax purposes and fails to deduct and remit tax on the basis that the individual receives no remuneration for the services performed in PNG but rather is paid a dividend from the profits of the interposed entity.

Rebates of Salary or Wage Tax

67. A rebate is not a deduction. It is not subtracted from assessable income to calculate taxable income. A rebate is an amount which is deducted from gross tax paid/payable.

A rebate of salary or wage tax cannot exceed the total salary or wage tax paid during the year in which the rebate arises.

Rebate in relation to otherwise deductible expenditure

68. Section 214(1) allows a taxpayer to claim a rebate where they have incurred expenditure in excess of K200 in the course of deriving/earning their salary or wage income that would have otherwise been deductible pursuant to Section 68(1) if not for the application of section 66A(1).
69. In order to claim such a rebate a taxpayer must make a submission to the Commissioner General in writing before the 1st March in the year following the fiscal year in which the expenditure was incurred. This is done via the lodgement of an 'I' return and will be deemed an objection.
70. The rebate is calculated as an amount equal to 25% of the expenditure incurred. By way of example, if expenditure of K1,200 is incurred, to which there has been no reimbursement, in relation to earning salary or wages. First deduct K200 as this has already been allowed in calculating your fortnightly deductions. The rebate will be K250 (being 25% of K1,000). The K250 will then become a refund payable to the employee.

Rebate in relation to non-salary or wages loss

71. Where a taxpayer has both salary or wage income and non-salary or wage income derived in Papua New Guinea, section 214(4) converts any loss incurred in earning the non-salary or wage income into a rebate. This means that the loss cannot be carried forward and applied in future years even if the whole of the rebate cannot be utilised to obtain a refund of salary or wages taxes paid.
72. The rebate is the difference between the gross tax payable on your salary or wage income (not including certain concessionary taxed amounts) and the gross tax payable on your salary or wage income (not including certain concessionary taxed amounts) after deducting the non-salary or wage loss. The loss is first reduced by the K200 annual deduction already allowed in respect of salary or wage income. By way of example:

Ben earns salary or wages during the year ended 31 December 2014 of K50,000 from which K12,210 tax has been deducted. He also has rental income on which he derived a loss of K10,000 during the same year. The rebate will be the difference on the gross tax paid on the K50,000 income and the K40,200 income (being his salary or wages income after deducting the K9,800 loss); that is $12,210 - 8,780 = K3,430$ rebate.

73. The rebate cannot exceed the salary or wages taxes paid during the fiscal year in which the non-salary or wage loss was incurred. Where the loss is equal to or greater than the

salary or wage income the rebate will be equal to the salary or wages tax deducted during that fiscal year. This is specifically stated in s214(4)(e) and therefore, when read in conjunction with s101(8), ensures that no loss can be carried forward and applied in future years even if the whole of the rebate cannot be utilised.

Rebate of education expenses

74. Whilst salary or wage earners are unable to claim a deduction under section 70A they may claim an education rebate under section 214B. The rebate is the lesser of 25% of the education expenses incurred or K750 in relation to each dependant student.

75. A rebate is limited to the salary or wage tax paid by the employee and cannot be used to reduce tax on other income.

76. An application for a rebate for education expenses will require the taxpayer to lodge an annual income tax return (Form I) along with their statement of earnings and receipts evidencing the total amount of the expenditure being claimed.

Application

The administrative aspects of this circular, to the extent that they are a change in policy, will have prospective application as of the issue date of this Circular.

Authorized by

Betty Palaso
Commissioner General of Internal Revenue Commission

Subject References

Salary or Wage Tax
Employee
Assessable income
Rebates

Legislative References

Section 40AA
Section 65E
Section 214

Related Taxation Circulars

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