Papua New Guinea Taxation Review

Issues Paper No.6:
Excise Taxation

Prepared by
the Taxation Review Committee

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Consultation Process

The Tax Review Committee (Committee) is seeking your feedback and comments on this Issues Paper. This and other issues papers will be released throughout 2014 and the first quarter of 2015 and are designed to promote targeted discussion and debate on particular areas subject to Review. Consultation questions are included throughout the paper to guide responses but stakeholders should feel free to raise any issue of relevance.

Feedback in response to this Issues Paper will help to inform the development of the Committee's draft recommendations to Government, which will be subject to a further round of consultation before being finalized.

To ensure that there is transparency in the consultation process, all submissions are published on the Tax Review website (www.taxreview.gov.pg) unless the submission is by justification, marked 'CONFIDENTIAL'.

Submissions in response to this paper are due by 08 May 2015. All submissions should be sent via mail and/or email to:

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FOREWORD

In 2013, the O'Neill-Dion Government committed to comprehensively review PNG's revenue regime with the main aim of ensuring that PNG's revenue regime remains relevant, efficient and effective.

Government revenue is critical to funding essential services and infrastructure for Papua New Guinea, to share the benefits of prosperity across families, communities and regions and to lay the foundations for future growth. Consequently, this Review is a high priority of the Government and an important platform of its economic and fiscal strategy.

The last comprehensive taxation review was undertaken in 2000. PNG has undergone substantial economic, fiscal and technological developments over the past 15 years, so it is timely that another review is done to ensure the country's tax system is modern, robust, is congruent with economic, social, technological and political changes, and is able to support the country's medium and long-term economic and social development objectives. While formally titled a 'Tax Review', the Review will, in fact, consider other sources of revenue, including non-taxation revenues.

This paper is the sixth in a series of Issues Papers to be released by the Review process and focuses on PNG's excise tax regime, as provided for under PNG's excise legislation (other taxes often associated with excise taxation, such as gambling and environmental taxes, will be considered in a later issues paper).

The Excise tax regime in particular has been an integral part of the overall PNG tax system and has been an important source of Government revenue. It will continue to be so in the years to come. It will be essential for PNG to ensure that its excise settings are right, particularly as it explores options of reducing its reliance on income taxes, in particular personal income taxes.

The Committee looks forward to receiving submissions on this paper and to the future engagement with interested stakeholders on the future of Papua New Guinea's tax system.

Sir Nagora Bogan, KBE
Chairman, Tax Review Committee

EXECUTIVE SUMMARY

This paper first outlines the reasons why many countries, including developing countries, include excise taxes as an important part of their revenue mix. It considers the goods that excise is traditionally applied to (notably alcohol, tobacco, petroleum and vehicles) and the reasons why it is applied. It notes that one of the distinct advantages of excise taxes is their ability to raise substantial revenues, relative to the administrative cost of collection.

Chapter 2 then provides an overview of PNG's excise regime and its evolution over time. It highlights that the regime has undergone a number of amendments since the last tax review was undertaken in 2000 although excise revenues have remained reasonably constant as a proportion of GDP over time.

Chapter 3 discusses the views on the future of PNG's excise regime that have been raised in the course of consultations undertaken by the Review. Of note, a number of submissions to the Review have raised concerns about the apparent high rates of excise applying to imported vehicles.

Finally Chapter 4 considers the possible reform directions for PNG's excise regime, proposing a number of specific consultation questions to help inform the Committee's considerations. At a broad level, noting the advantages of excise taxes in a developing country context, the paper suggests that PNG at least maintain the current level of excise revenue and perhaps consider increasing it as part of broader efforts to reduce the country's reliance on income taxes, notably personal income taxes.

The paper also suggests that urgent legislative action is needed to clarify Schedule 1 to the Excise Tariff Act 1956 – the Schedule that lists the goods subject to excise and the rates apply. The numerous amendments over the years have, in the Reviews' view, left significant confusion as to how the excise regime currently applies. As part of this process, the paper also proposes options to reduce and simplify the regime.

One of the simplification options considered in the paper is reducing the range of goods subject to excise in PNG, proposing a system that focusses on the 'traditional' excisable products being alcohol, petroleum, tobacco and vehicles.

The paper also includes a theoretical discussion on the possibilities of extending excise to two other products – Buai and telecommunication services.

The paper also looks at the appropriateness of the excise rates applying to various products, noting the challenges in setting these rates given the various reasons they are applied. Regional comparisons are used for this purpose.

The paper finally looks at a number of indexation and administrative issues.

Consultation Questions

Below are the various consultation questions posed throughout the paper. They are intended to act as prompts only and stakeholders should feel free to raise any other related views/issues.

Maintain excise as an important part of PNG's revenue base?

Question 4.1- do stakeholders agree that excise should continue to be an important part of PNG's revenue mix?

Question 4.2 – would stakeholders support, in principle, a small increase in the overall revenue obtained from excise taxes, as part of broader efforts to reduce PNG's reliance on income taxes (notably personal income taxes)?

Clarifying PNG's Excise Schedule

Question 4.3 – do stakeholders agree that there is an urgent need to repeal and replace Schedule 1 to the Excise Tariff Act 1956 in order to provide legislative certainty as to the goods that are subject to excise and the rates applying to them.

Question 4.4 – to enhance transparency of the excise regime, should PNGCS publish on its website an updated list of excisable goods and applicable rates following each indexation period (i.e. every six months).

Goods subject to excise

Question 4.5 – do stakeholders support removing from the list of excisable goods, all items other than vehicles, tobacco, alcohol and petroleum products?

Question 4.6 – what sort of deterrent impact does applying excise to firearms and gambling products have? What value does applying excise to firearms and gambling products have? Given that this generates minimal revenues, is it preferable to instead focus on efforts to regulate and control guns and to focus on other tax instruments to generate revenue from gambling?

Question 4.7 – as part of the rewrite of Schedule 1, should consideration be given to rationalizing the number of items listed in the schedule.

Question 4.8 – what are stakeholder's views about removing the reference to the customs tariff items in Schedule 1 to the Excise Tariff Act?

Question 4.9 – what are stakeholders' views about the ongoing policy justifying different rates applying to certain excisable goods? Notably:

(a) lower rates applying to beverages with lower alcohol content

(b) lower rates applying to roll your own tobacco

(c) high taxation of ordinary motor fuel, as compared to other types of fuels

(d) lower taxation of diesel supplied to fishing vessels

Question 4.10 – what are stakeholders' views about introducing lower excise rates for tobacco products using locally grown tobacco?

Question 4.11 – what are stakeholder's views about applying excise to Betel Nut?

Question 4.12 – what are stakeholders' views about applying excise on telecommunication services in PNG?

Setting Excise Base Rates

Question 4.13 – do stakeholders agree that the current indexation arrangements applying to tobacco (10% per annum) should be maintained subject to developing a further understanding of the extent of tobacco smuggling in PNG?

Question 4.14 – what are stakeholders views about the rates of excise currently applying to alcohol?

Question 4.15 – do stakeholders consider that an excise rate on ordinary vehicles in PNG is too high? Would stakeholders support reducing this rate if this were to be offset with an increase in excise elsewhere, such as in relation to petroleum products?

Question 4.16 – what are stakeholders views about increasing rates of excise applicable to petroleum products**.** What implications would this have?

Indexation

Question 4.17 – should the existing 2.5% (5% annual) cap on indexation be removed, ensuring that increases in specific excise rates applying to alcohol products are increase by reference to the Consumer Price Index as determined by the NSO?

Question 4.18 – what are stakeholders views about the indexation of petroleum excise rates in PNG?

Question 4.19 – what are stakeholders views about the hypothecation (earmarking) of revenues in PNG?

Chapter 1: Context

Excise taxes are a form of indirect taxes (that is a tax on a good that is ultimately/indirectly paid for by a consumer) that targets specific goods or activities. This contrasts with other forms of indirect taxes such as the GST which seek to tax consumption more broadly (Cnossen 2005). This paper focusses on taxes imposed under PNG's excise legislation. It does not include consideration of gambling and environmental taxes which can also be regarded as a form of excise given their specific focus. These will be considered in a later Issues Paper.

Excise taxes are a significant source of revenue for developing countries (IMF 2011). Issues Paper 3 released by the Committee also highlights the ongoing importance of excise taxes as part of PNG's revenue base.

This Chapter outlines why countries impose excise on certain goods and what the general design features of such taxes are.

Why impose excise?

There are a number of reasons why countries impose excise. Many of these reasons are linked to the principles of good tax policy outlined in Paper 3.

Efficient form of taxation

Excise is often charged on goods that are 'price inelastic' – that is, a change in price of a good (such as a result of a change in taxation) has less of an impact on the demand of that good. This is desirable from a tax policy perspective - taxes should ideally have as little impact on decision making as possible.

Taxes on petroleum products are partly justified on this basis – given the demand for petroleum is relatively less impacted by price fluctuations.

Promotes equity

Imposing excise on 'luxury items' can enhance the progressivity of the tax system - that is, ensuring those with more wealth pay more. This is because generally it is wealthier people who are able to afford luxury items and therefore bear the ultimate burden of any taxes on these items.

Goods that are taxed on the basis of being a 'luxury' vary from country to country. However, vehicles are generally taxed on this basis, as are yachts and aircraft. Some countries impose excise on a broader range of goods perceived to be luxuries such as cameras and perfumes (IMF 2014).

Using the excise regime to introduce a measure of progressivity can be desirable particularly where the personal income tax system, traditionally the means of creating a level of progressivity in the tax system, does not do so because it applies only to a small part of the economy (the formal sector). This is the case in PNG.

Correcting for 'negative externalities'

Another class of goods that excise is traditionally applied to are those that cause 'negative externalities'. Traditionally, excise is charged on tobacco, alcohol and (in part) petroleum products on this basis.

'Negative externalities' refer to the broader economic, social or environmental costs associated with the consumption of a 'harmful' good. For example, excessive alcohol consumption can lead to road accidents, family stress and hospital costs. Much has also been written about the health consequences of tobacco and the corresponding cost that this imposes on a country's health system[1] The 'negative externalities' of petroleum include the environmental impacts (pollution) as well as congestion. Excise on petroleum may also be viewed as a proxy for charging road users for the cost of government-provided services.

The reasons for applying excise on such goods are twofold. Firstly, imposing excise on such a good increases its price, thereby discouraging its consumption. Secondly, the revenue raised from the charging of excise can be used to offset some of the public costs associated with the use of the product.

Administrative simplicity

Excise taxes are particularly useful as a source of revenue in developing countries because they are easy to administer, relative to the amount of revenue that they can potentially generate. This is an important consideration where administrative capacity is limited, such as in PNG. The relative ease of administration arises from the fact that excise usually only applies to a limited number of goods and are collected from a limited number of large suppliers.

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[1] See for example www.who.int/topic/tobacco/en/

One issue, however, particularly in relation to goods that are imported, is that excise rates set too high can encourage smuggling, which customs agencies may find difficult to combat. Concerns around the link between high excise rates and increased illegal activity meant some countries have been reluctant to increase excise rates (IMF, 2011).

General design features

There are a number of general design features common to many excise regimes around the world that are worth noting.

The first of these is the manner in which excise taxes are calculated. There are generally two methods for this – the specific rate method and the ad valorem method (or a combination of the two methods may be used).

As the name suggests the specific rate method involves applying a specific rate based on some feature of the product – whether it be the amount of tobacco, the litres of alcohol or the litres of petroleum.

As this method does not take into the changing value and price of the product, the rate that is applied is often indexed (increased each year to account for the rate of inflation). This ensures that the real value of the excise rate is applied.

Specific rate excises are usually applied to those products that create 'negative externalities' – including tobacco, alcohol and petroleum. This is because the purpose of the excise is to generate revenue to offset the harm caused by the product and therefore the price and value of that product is irrelevant.

Under an ad valorem system, the rate of excise is calculated with reference to the value of the product. Such a system can be more complicated given the need to accurately assess the value of the product. Such a system does not require indexation. An ad valorem system is traditionally and ideally applied to 'luxury' goods so as to capture the full value added throughout the production-distribution chain (IMF 2014).

Excise should apply equally to goods produced either domestically or imported. This ensures that the tax system does not provide an incentive to purchase one good over another[2]. This also ensures compliance with a country's World Trade Organization obligations.

[2] Note, however, that this is traditionally one of the justifications of imposing tariffs – that is, to protect domestic manufacturing.

Chapter 2: Overview of PNG's Excise Regime

PNG imposes excise duties under the Excise Tariff Act 1956. The agency responsible for the overall administration of the Excise tax is the PNG Customs Service (PNGCS).

Goods subject to excise

Schedule 1 to the Act lists the goods that are subject to excise and the rates of excise. It also lists the relevant tariff item number, based on the Harmonized Commodity Description and Coding System produced by the World Customs Organisation[3].

Excise duty is chargeable on both locally manufactured goods and on imported goods of the same class.

Schedule 1 has been subject to numerous amendments over the years and the Review team has faced challenges in clearly identifying the class of excisable goods and the rates of excise applying. However, it appears as though there are over 140 separate items that attract excise tax in PNG, with many being variations of the same product. These can be split into five broad categories of goods:

- Tobacco
- Alcohol
- Petroleum
- Vehicles
- 'Other' goods (a combination of goods deemed to be luxury items such as jewellery, televisions, cameras etc… and other 'harmful' goods such as firearms and goods associated with gambling).

[3] Under the terms of the Harmonised Standard Convention, PNG has the flexibility to include additional domestic splits under existing HS headings in the customs tariff. These additional splits can be employed where there has been a need to differentiate products to provide for the application of duties, the collection of statistics and the monitoring of trade in strategic goods

A summary of goods subject to excise in PNG, and the latest available rates, can be found at Attachment A.

Exemptions

The Excise Tariff Act 1956 provides for broad exemptions from excise for the Ramu Nickel Project (section 3A) as well as the PNG-LNG Project (section 3B). As identified in Issues Paper 5 on Tax Incentives, goods can be also exempted from excise by a gazettal notice (or have a reduced rate apply) under Section 3. This exemption has been applied to a range of projects and some of these are outlined below.

Project	Gazettal Date	Gazettal Notice number
1. Morobe Consolidated Goldfield Limits for the construction of Hidden Valley Mine	11-Sep-08	G165
2. PNG based Changhae Tapioka (PNG) Limited on Cassava based products.	1-Jul-09	G126
3. Bewani Oil Palm Plantations Limited	27-Apr-09	G152
4. Tzen Niugini (PNG) Limited and Tzen Plantation ltd for Illi-wawas Integrated rural development project and Oil Palm Development.	15-Jan-13	G12
5. 2015 Pacific Games	3-Nov-14	G514
6. Drimgas to Duara road project development	30-May-11	G137
7. Majestic Seafood Limited	8-Jun-10	G126

Calculation method for excise

PNG uses both the specific rate and ad valorem methods for calculating excise rates.

Consistent with generally accepted best practice, specific rates apply to tobacco, alcohol and petroleum products.

- For alcohol products, the excise base rate is based on the alcohol content of the product – that is, the higher the alcoholic content, the higher the excise.

- For tobacco products sold in cigarette form, excise is applied at a specific rate per 1000 cigarettes. For other tobacco products, excise is applied per kg of tobacco.

- For petroleum products, the excise base rate is applied per litre.

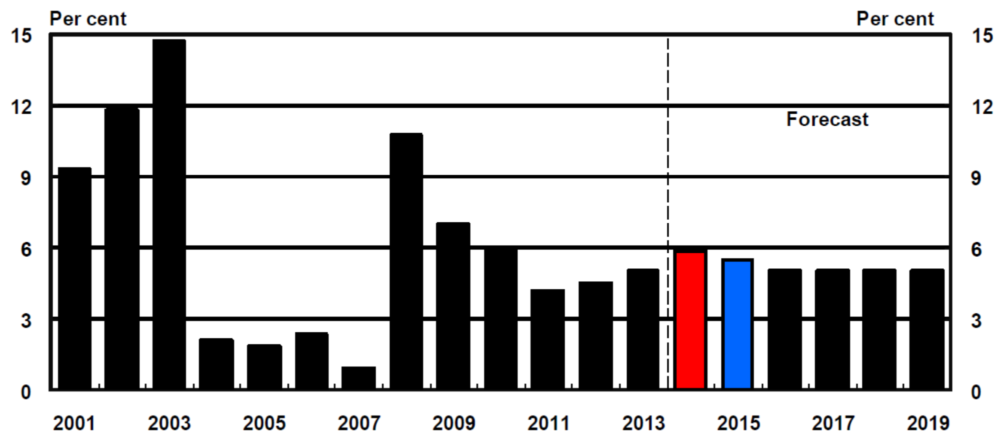
For the other excisable items, an ad valorem method is used, with rates varying between 15% and 120%. In many instances, these various rates reflect explicit policy choices which are explored further in Chapter 4. In practice the value is determined on the declared value.

Indexation

To maintain the real value of the excise, indexation applies to the specific excise rates for tobacco and alcohol products. The rates are adjusted twice a year (1 June and 1 December). Prior to recent changes made in the 2015 Budget, the same indexation arrangements applied (from 2006) to both alcohol and tobacco products. The increase was capped at 2.5% or the Consumer Price Index expressed in percentage, whichever is the lesser every six months (1 June and 1 December). CPI figures are determined by the National Statistical Office.

Figure 1 below shows the CPI rates over time (as well as Treasury projections going forward). It illustrates that, since 2008, annual increases in inflation have exceeded the 5% annual cap, meaning the cap has generally applied for the purposes of excise indexation.

Figure 1: Inflation rates (2001-2019)



Source: 2015 Budget (National Statistics Office, Department of Treasury)

As a result of changes in the 2015 Budget, different indexation arrangements now apply to tobacco products. For income years 2015 and onwards, tobacco products are now increased by a flat 5% every six months. The reason for these changes was (Department of Treasury 2014):

The Government has recognized the high health risk and increased treatment costs of tobacco related diseases and it has therefore chosen to recover part of the health cost through an increase to the excise duty on tobacco.

That is, the new indexation arrangements for tobacco are no longer simply a matter of maintaining the real value of the excise amounts, but also introduce an effective increase in the excise base rate over time. Issues related to the base rate of tobacco excise are discussed below in Chapter 4.

Indexation does not apply to petroleum goods. The Review understands that the current rates (see Attachment A) have applied for some time.

Hypothecation of diesel excise

Diesel is currently subject to a six toea a litre excise. Of this, four toea is allocated ("hypothecated") to the National Roads Authority for use to fund national road maintenance.

Evolution of excise tax policy development in PNG

2000 Tax Review

The 2000 Tax Review Report considered the Excise Tax Regime at the time, with the focus on simplifying the system to improve revenue administration, increase transparency and raise revenue. The recommendations in that Report included:

- Removal of the 40% ad valorem excise on imported concentrated spirits;
- Introduction of 2.5 per cent (%) indexation of alcohol and tobacco every six months;
- Imposition of a quota system equal to the average of monthly clearances during the past six months;
- Taxing lower strength beer more lightly to encourage the importation, manufacture and consumption of light beers; and
- Changing the method of taxation from ad valorem to specific rates on alcohol and tobacco.

Significantly, the Review highlighted the importance of introducing these changes gradually to limit the impact on the sector.

All the above recommendations were implemented. The first three proposals were implemented in year 2001 whilst the last two recommendation was implemented in two phases, the first phase was in 2003 and the second in 2004.

Other key changes since 2000

In the 2003 Budget, the Government increased the indexation rate of tobacco and alcohol from 2.5 per cent to 4 per cent every six months due to higher inflation in the economy. The reform was to ensure that price increases passed onto consumers was captured and translated into increased revenue collections for the Government.

However, following consultation with Industry in the same year, a temporary freeze (for 12 months) to all indexation was introduced due to concerns around the unfavorable economic conditions. The indexation reverted back to the earlier indexation rate of 2.5 every six months from December 2004.

In 2006, minor modifications to the indexation methodology of tobacco and alcohol excise rates were introduced. The indexation rate was capped at 2.5 per cent or lesser every six months and linked to the actual movements in Consumer Price Index (CPI).

In 2012, the excise tax rates on tobacco and alcohol were increased by 15 per cent. The 2012 Budget stated that the reason for the increase was (Department of Treasury 2012):

> *In recent years, the real value of excise rates on alcohol and tobacco products has been eroded by inflation (as the indexation of rates is capped at 5 per cent per annum). A one-off increase in excise rates of around 15 per cent would restore around 4 years of this erosion.*

In the 2013 Budget, excise tax on tobacco was increased by a further 10 per cent to further 'discourage smoking and minimize health costs imposed on the Government' (Department of Treasury 2013). The same Budget also increased the excise tax on pre-used motor vehicles in response to concerns about increased traffic congestion. The revenue was also used to help fund free education and minimize traffic congestion.

As discussed above, the recent reforms in the 2015 Budget increased tobacco excise indexation to a specific 5 per cent (%) every six months.

Relationship of the Customs duties to Excise taxes

In PNG, excise is chargeable on excisable goods manufactured in PNG but also (at the same rate) on the same class of goods that are imported. Applying excise to both locally manufactured and imported goods of the same class recognizes the policy reasons for charging (as outlined above – raising revenue, deterring consumption, efficiency of taxation) apply regardless of whether the product is imported or manufacturing locally.

However, as well as excise duties, imported excisable goods may also be subject to customs tariffs (or import duties). These duties have a different purpose – that is, to promote the growth of local industries by protecting them from imports. In PNG, the following customs duties apply to excisable goods:

Good	Rate
Beer	K55.00 Per Lal
Beer Concentrates	K6.25 Per Kg
Spirits	K55.00 Per Lal
Tobacco Leaf	K0.45 per kg
Cigars, cheroots and Cigarillos containing tobacco	K45.00 Per Kg
Cigarettes containing tobacco	K65.00 per 1000
Smoking tobacco, whether or not containing tobacco substitutes in any proportion	K45.00 per Kg

The imposition of customs duties (the goods and the rates applies) raises a range of issues relating more broadly to PNG's trade policy and will be considered as part of a separate paper.

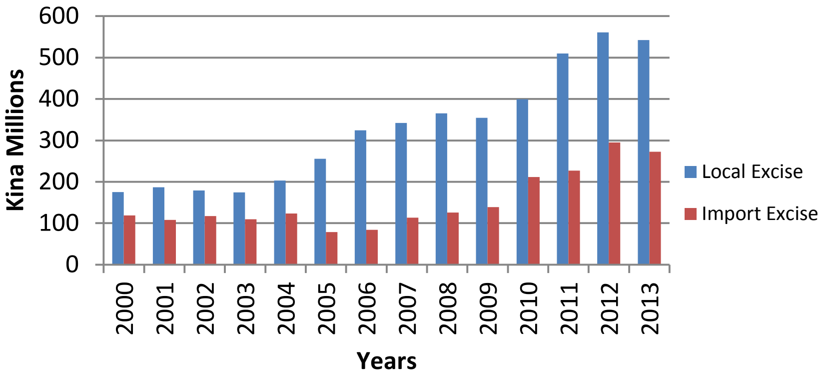
Contribution of excise to revenue

Excise tax revenue receipts are an important source of tax revenue for PNG, with K814.4 million being collected in 2013. This represents 9.48% of overall tax revenues.

The trend in excise collections is illustrated in Figure 2 below which shows collections since 2000, with a breakdown for excise collected on imported and locally produced goods. The consistently greater collection from locally manufactured excisable goods reflects the significance of excise collected on locally manufactured alcohol and tobacco products – this likely reflects the impact that tariffs have had on deterring the importation of such products.

Figure 2 highlights an overall trend of increasing excise revenues over time (in absolute terms). This is not unexpected given the increasing value of goods, the expansion of the economy (and demand) and the introduction of indexation in this period.

Figure 2: Excise Tax Revenue (2000-2013) divided into Local and Import Excise



Source: Budget Vol 1 and Final Budget Outcome, Various years

Figure 3 below illustrates how Excise has changed over time relative to total tax revenue, non-mining and petroleum tax revenues and as a proportion of GDP.

Figure 3: Excise-Total Tax Revenue Ratio over time (2003-2013).

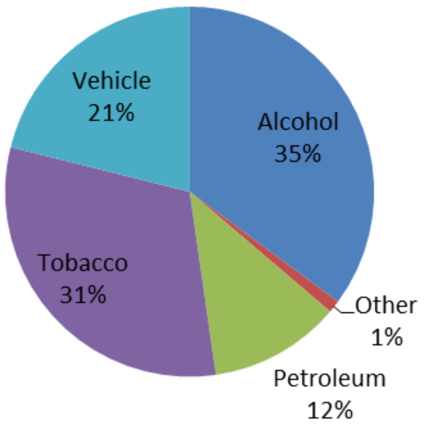
As can be seen, excise has remained relatively constant as a proportion of nominal GDP over time at or around 2.5%. In addition, relative to both total tax revenues and non-mining and petroleum taxation revenues, excise revenues have fluctuated. Relative to total tax revenues this would be expected as it reflects the volatility of mining and petroleum taxes in PNG and their impact on revenue trends.

Relative to non-mining and petroleum tax revenues, there is a slight trend downwards – in recent years this may reflect the fact that increases in revenue have been largely driven by increased income tax collections. Without policy interventions to increase excise rates in recent years it is likely that this trend would have been more significant[4].

Figure 4 illustrates excise tax revenue contributions by product classifications in 2013. The figure shows that excise on alcohol, tobacco and vehicles combined account for around 87% of all excise revenues. Of the remainder petroleum products account for 12% and the collection of 'other' excisable items account for only 1%.

[4] Whilst the Review did not have any data available to substantiate this, it should not be discounted that the recent trend downwards, including a decrease in absolute excise revenues in 2013, may be a result in part of recent increases in tobacco excise and their impact on illegal smuggling.

Figure 4: Excise revenues by product (2013)



Source: PNG Customs Service

CHAPTER 3: VIEWS FROM CONSULTATION

As part of its blue sky consultation process, as well as ongoing consultation, the Review has received a number of submissions that have addressed the future of PNG's excise regime.

Excise on imported cars

A number of submissions challenged the high rates of excise currently applying to imported vehicles. The submissions suggested that they be either removed or significantly reduced. This was largely on the basis that motor vehicles should no longer be seen as a 'luxury' item in PNG but are a necessity, particularly given poor public transport options[5].

One submission further argued that rates, for both new and used cars, should be reduced to as low as 10% to make vehicles more affordable to a broader range of Papua New Guineans. To address the issue of the importation of increasingly old and potentially hazardous vehicles, the submission suggested that the importation of vehicles over 5 years simply be banned[6].

Fuel excise

Comments received during one consultation noted that the existing rebate available for diesel used by local fishing vehicles (in which the effective excise on diesel is 3 toea as compared to 6 toea per litre) no longer has much value given increases in fuel prices. A similar sentiment was expressed during one of the open consultation processes to the effect that local agricultural production could be supported if the Government could identify a means of reducing fuel costs, such as through reducing the excise on fuel.

Tobacco

Another submission to the Review has suggested that the excise regime applying to tobacco be used to encourage the domestic production of tobacco (along with other policies). This could involve, for example, a tiered excise structure with lower rates of excise applicable to products with higher

[5] See for example comments from BPNG staff in BPNG Submission, 6 May 2014 available at www.taxreview.gov.pg/submissions

[6] See submission from Ray Paul. 14 May 2014 and available from www.taxreview.gov.pg/submissions

proportions of local grown tobacco leaf. A similar system operates in Fiji which has lower excise rates applying to tobacco products containing locally grown products.

The Review has also received a submission from the Department of Health with respect to tobacco taxation. The Committee is appreciative of this, recognising the importance of a whole of government approach to issues relating to tobacco taxation, given the link between both the revenue and public health systems.

The submission outlined some of the health concerns regarding tobacco consumption in PNG and the role that tobacco taxation can play as a cost effective public policy tool in combating tobacco consumption. Of relevance to the Review are proposals to increase tobacco excise by 30% annually, in order to move towards the recommended minimum level of 70% taxation as a proportion of the retail price – also outlined in the Department of Health's Tobacco Control Policy as well as under a proposed Tobacco Products (Health Control) Bill.

A further recommendation was that a proportion of tobacco excise revenues be allocated to a tobacco control fund. This would be used to fund programs to include addressing the illegal tobacco trade, assist people to combat addiction and awareness programs to prevent people from starting to smoke.

The Department's recommendations are considered below.

Administrative Issues

One submission to the Review highlighted the enforcement and compliance challenges facing revenue administrators in PNG, in particular in combating illegal smuggling which undermine excise revenue collections. The submission supported the development of capacity and increased resourcing for both IRC and PNGCS as well as a renewed whole-of-government focus on combating illegal smuggling[7].

The same submission also suggested a change to the manner in which excise payments were made. Currently payments are made to PNGCS weekly on a Customs Duty Assessment Notice which requires weekly assessments of liabilities and relevant administration.

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[7] The submission was provided to the Review in Confidence.

To make this process more efficient it was proposed that this be changed to a monthly process complemented by weekly advance payments calculated on the basis of current weekly liabilities. The monthly payment would therefore involve a reconciliation of the payment against actual liability.

Another submission proposes to review the time limit of 14 days allowed prescription in law when claiming a refund after a good subject to excise becomes unfit for human consumption.

The submission argued that the prescribed time limit of 14 days is insufficient for the taxpayer to adequately meet the requirements. The submission considers extending the time limit up to 28 days which is said to be realistic and allows ample time for taxpayer to adjust.

Chapter 4: Possible Reform Directions

This Chapter explores possible reform directions for PNG's excise regime going forward. As noted earlier in this paper, whilst specific consultation questions are included, interested stakeholders are encouraged to raise any relevant issues as part of their submission.

Maintain excise as an important part of PNG's revenue base?

Issues Paper 3 noted that PNG relies proportionally heavily on income taxes (notably personal and corporate income taxes) and relatively less on indirect taxes such as the GST. That paper sought feedback from stakeholders on whether they would support an increase in GST in exchange of a reduction in personal income taxes.

Consideration of shifting from a reliance on direct taxes to indirect taxes could also include a consideration of excise taxes. Chapter 1 noted a number of the strengths of excise taxes, in particular in a developing country context – its administrative simplicity, ability to generate significant revenues relative to the administrative costs, role in promoting equity, and its economic efficiency (if designed well).

Chapter 2 noted that PNG's excise revenues have remained relatively constant (around 2.5%) as a proportion of GDP over time. In addition, they have remained reasonably constant as a proportion of non-mining and petroleum tax revenues, with a slight trend downwards that may reflect the particular strength in income tax collections in recent times.

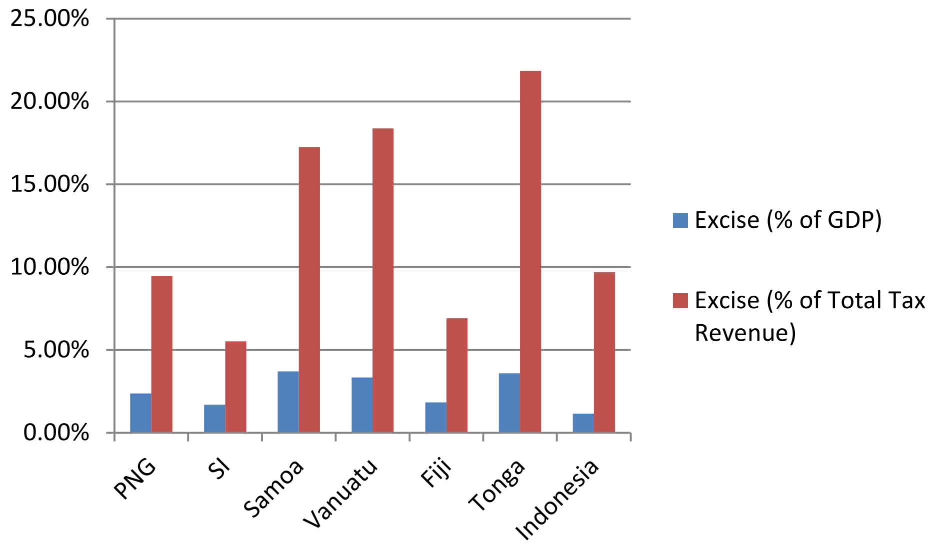
The question for PNG is whether or not it should seek to maintain or indeed increase its reliance on excise taxes as part of any efforts to reduce its reliance on income taxes.

The Review team could not identify any comprehensive review of optimal excise levels for the region. A paper looking at the role of excise taxes in Ghana did find at the time (2001) that Ghana as with most other Sub-Saharan African countries, could seek to mobilise around 4 per cent of GDP from excise, still lower than the OECD average at the time of 5 per cent (Terpar 2001).

A more recent review of OECD excise rates has highlighted a general decline in excise as proportion of total tax revenues and GDP – with excise collections in 2011 averaging around 8% of total tax revenues and around 2.7% of GDP (OECD 2014).

A comparison between PNG and other countries in the region is perhaps more instructive. Figure 5 below illustrates PNG's excise revenues as a proportion to GDP and total tax revenues relative to a selection of other countries in the region.

Figure 5: Excise revenues as a proportion of nominal GDP and total tax revenues for selected countries in the region



Source: data obtained from Ministry of Finance, IMF and World Bank websites. Data is for a single year based on latest available public data – PNG (2013), Solomon Islands (2013), Samoa (2013), Vanuatu (2011), Fiji (2013), Tonga (2012/13), Indonesia (2012).

Figure 5 shows that PNG's excise collections fall within the middle range compared to other countries in the region – that is, they are neither disproportionately high or disproportionately low by regional standards.

This analysis suggests that PNG's broad excise settings (in terms of revenue collections) are about right. Whilst the strength of excise taxation outlined in Chapter 1 suggest that excise collections should, at a minimum, be maintained, there may nonetheless be scope to consider a small overall increase in excise revenue collections consistent with the broad directions Issues Paper (Paper No.3) to reduce PNG's reliance on income taxes, in particular the personal income tax.

Question 4.1- do stakeholders agree that excise should continue to be an important part of PNG's revenue mix?

Question 4.2 – would stakeholders support, in principle, a small increase in the overall revenue obtained from excise taxes, as part of broader efforts to reduce PNG's reliance on income taxes (notably personal income taxes)?

Clarifying PNG's excise schedule

The Review team has faced significant challenges in identifying the types of goods that the excise regime currently applies to. Schedule 1 to the *Excise Tariff Act 1956*, which should provide a comprehensive list of excisable goods and rates applying to those goods, has been subject to numerous amendments over time. In the Review's experience, this creates confusion as to what goods are legally subject to excise, their precise description, the correct tariff item number and the rates applying to them.

There is an urgent need to repeal and replace Schedule 1 in its entirety providing certainty to both PNGCS officers and taxpayers alike. This amendment would provide an opportunity to simplify the schedule (as discussed below) and make any other amendments agreed to by Government that result from this Review process.

Question 4.3 – do stakeholders agree that there is an urgent need to repeal and replace Schedule 1 to the *Excise Tariff Act 1956* in order to provide legislative certainty as to the goods that are subject to excise and the rates applying to them.

For those goods subject to indexation, rates will change over time. Whilst this does not require ongoing amendments to the legislation (changes will be automatically made) to enhance the overall transparency of the excise regime, PNGCS should publish an updated list on its website of excisable goods, and their rates, at 6 months intervals, following each indexation period.

Question 4.4 – to enhance transparency of the excise regime, should PNGCS publish on its website an updated list of excisable goods and applicable rates following each indexation period (i.e. every six months).

Goods subject to excise

This sub-section explores possible areas of reform in relation to the scope of goods that should be subject to excise in PNG. As noted in Chapter 2, a full list of excisable items is found at Attachment A.

Simplifying PNG's excise regime

PNG imposes excises on all the 'traditional' excisable products for the reasons outlined in Chapter 1 – this includes tobacco, alcohol, petroleum products and vehicles.

However, it is questionable whether PNG should continue to apply excise to the current scope of goods, in particular those goods that were once seen as a luxury item. Whilst such goods may continue to be regarded as luxury items in PNG, it is questionable whether continuing to collect excise in them is worth the administrative burden. As illustrated in Figure 3 above, these other items account for only around 1% of excise revenues.

PNG could consider removing excise on these items and instead focus on excise collections in relation to the traditional 'key' products – tobacco, alcohol, petroleum products and vehicles.

Question 4.5 – do stakeholders support removing from the list of excisable goods, all items other than vehicles, tobacco, alcohol and petroleum products?

One issue may be with some of the 'other' items which may also be regarded as goods that have negative externalities. This includes firearms and goods associated with gambling which are currently subject to excise.

However, to the extent that firearms may have broader social consequences (as they certainly do) these would perhaps be better addressed through direct regulation and tighter gun control. With respect to products in relation to gambling the generation of revenue from gambling may be best left to the gambling specific taxes.

Question 4.6 – what sort of deterrent impact does applying excise to firearms and gambling products have? what value does applying excise to firearms and gambling products have? Given that this generates minimal revenues, is it preferable to instead focus on efforts to regulate and control guns and to focus on other tax instruments to generate revenue from gambling?

Another means of simplifying the excise regime may be to reduce the number separate items in the schedule. In a number of instances, similar items are listed individually (all with the same rate applying) due to an attempt to reflect the tariff coding system. For example:

- There appear to be 6 separate items for various wine products, all of which have the same rate applying.
- There are numerous items applying to spirits with the same rate applying.
- Tobacco products with the same rate applying could be grouped under a single item.
- Separate items apply to vehicles depending on their cylinder capacity and also whether they are petrol or diesel/semi-diesel – however the same rates apply.

One option would be to simply dispense with the references to the Customs Tariff Items numbers in Schedule 1, instead referring only to the description of goods. This has been done, for example, under Australia's *Excise Tariff Act 1921*. This would not prevent PNGCS from continuing to record revenue collected against particular tariff items for other purposes.

Question 4.7 – as part of the rewrite of Schedule 1, should consideration be given to rationalizing the number of items listed in the schedule.

Question 4.8 – what are stakeholder's views about removing the reference to the customs tariff items in Schedule 1 to the Excise Tariff Act?

Policy rationale of sub-categories of products

The discussion in Chapter 2 provided an overview of the types of goods that are subject to excise in PNG. A comprehensive list is also included in Attachment A.

Within many of the broad categories of products there are a number of 'sub-products' listed in relation to which different rates are applied. In many cases this reflects an implicit policy intention. The table below lists some of the distinctions and the apparent policy rationale:

Product/Distinction	Apparent policy rationale
Alcohol Products	
• Lower excise applies to certain alcoholic beverages made from fruits grown in PNG	• Promotes the use of local produce in the fermentation process
• Generally beverages with high	• Promote the consumption of

alcoholic content are taxed more highly in PNG per unit of alcohol (e.g. lower strengthen beers are taxed more lightly than higher strength beers)	lower strength beverages over more alcoholic beverages
• Beer is taxed more lightly (per unit of alcohol) than spirits and wine	• As above, but also to target higher wealth individuals who may have a preference for wine
Tobacco Products	
• Lower excise applies to tobacco used in roll your own cigarettes	• This was introduced to combat the growing market share of locally grown 'Brus' tobacco – to create a product (with lower excise) that could compete against products not compliant with the excise regime.
• Higher rates apply to cigarettes without filters and cigar/cigar-type products	• Recognises the greater harm caused by these goods.
• Higher rates apply to "homogenized" or "reconstituted" tobacco	• Unclear
Petroleum Products	
• Kerosene is excise free	• Recognises the extensive use of kerosene throughout PNG (in particular rural areas) for lighting and cooking.[8]
• Diesel, aviation fuel and other heavier fuels (those used for industrial/commercial purposes and those used in power generation) are taxed significantly less than ordinary motor fuel (gasoline)	• These goods are arguably taxed more lightly because this reduces the cost to business. Also recognises that the excise applicable to 'ordinary' fuel acts as a proxy for broader environmental damage
• Diesel used by fishing vessels is subject to a lower excise rate than	• To support the local fishing industry

[8] See for examples PNG' Household Income and Expenditure Survey (2009-2010) Summary Tables, Page 61.

diesel used for other purposes	
Vehicles	
• Generally used vehicles are taxed at a higher rate than new vehicles	• To deter the importation of used vehicles into PNG.
• Vehicles used for commercial purposes (tractors, public transport, security vans, dumpers, utility trucks, delivery trucks, refrigerated lorries, refuse collectors) generally subject to lower rates	• To limit cost on business
• Sports cars subject to a higher rate	• Targeted as a 'luxury' item at high wealth individuals

Feedback from stakeholders is sought on whether the policy rationale for these distinctions remain valid and whether the higher/lower rates are achieving their policy purpose.

With respect to the lower excise rate applying to tobacco used in 'roll your own tobacco', the Review understands that the product that this lower excise regime was intended to support (in competing with 'Brus' consumption that existed beyond the excise regime) is no longer available. This is reflected in the fact that negligible excise revenue was collected with respect to such goods in 2013. Similarly negligible excise was collected on homogenised or reconstituted tobacco products.

In relation to alcohol, international experts have suggested consideration be given to removing distinctions between different types of alcohol, suggesting instead that all beverages should be taxed on the basis of the amount of alcohol they contain regardless of the type of beverage (whether it be wine, spirits, light beer, heavy beer etc). At the same time there is some recognition that it is appropriate for the excise regime to encourage people to consume beverages with lower alcohol content (see Cnossen 2005 and AFTS 2009)

Question 4.9 – what are stakeholders views about the ongoing policy justifying different rates applying to certain excisable goods? Notably:

(a) lower rates applying to beverages with lower alcohol content

(b) lower rates applying to roll your own tobacco

(c)	high taxation of ordinary motor fuel, as compared to other types of fuels
(d)	lower taxation of diesel supplied to fishing vessels

As identified in Chapter 3, one submission to the Review suggested introducing a new category or categories of tobacco items to provide for lower excise rates for tobacco products with local tobacco content. This would, it was argued, help support the development of local leaf growing industry.

Such a proposal would be akin to using the tax system to achieve a non-tax outcome, an issue that was broadly addressed as part of Issues Paper 5 on tax incentives. The direction proposed in that paper was for PNG to seek to move away from the provision of tax incentives with a focus instead on making the tax system overall simpler, fairer and more competitive. In addition it is not clear how efforts to support local leaf growing could be reconciled with the underlying purpose of the excise regime applying to tobacco – that is, to deter its consumption. Nonetheless the Committee is seeking broader views about the merits of this proposal.

Question 4.10 – what are stakeholders views about introducing lower excise rates for tobacco products using locally grown tobacco?

Identifying other goods that could be made excisable

Notwithstanding the discussion above regarding simplifying the existing excise regime by significantly reducing the number of excisable goods, it is worth discussing two other products not currently subject to PNG's excise regime.

Buai/Betel Nut

There are a number of reasons why Buai, or Betel Nut, could be considered as a good candidate for being made subject to the excise regime.

First of all, as with alcohol and tobacco, it is a good that has clear 'negative externalities'. A recent report by the World Health Organisation identified betel nut consumption (along with tobacco chewing) as a significant public health problem for countries, like PNG, in the Western Pacific (WHO 2012) – with Betel Nut identified as a Group 1 carcinogen and a cause of oral cancer by the International Agency for Cancer Research. If the taxation system could be used to introduce a price increase for betel nut this could, as with tobacco, serve the dual purpose of deterring consumption (alongside broader public health initiatives such as raising awareness of the risks) and generating revenues approximating the broader public health costs.

In addition, Betel Nut is widely consumed in PNG suggesting that, if excise could be applied, it could generate significant revenues.

However, by far the greatest impediment to making Betel Nut an excisable good are the administrative challenges. Overwhelmingly Betel Nut production and sales occur within the informal economy making applying a tax system (be it excise at the point of manufacture or GST at the point of consumption) extremely challenging, particularly in light of the limited resources available to revenue administrators. As identified in Chapter 1, one of the key advantages of excise is in being able to collect a proportionally large amount of revenue from a few, centralized manufacturers (as is the case with tobacco and alcohol).

However, recent developments in Port Moresby should be followed closely. Following a ban on betel nut consumption in the capital in 2013, there have been moves by the NCD Government to formalize the purchase and distribution of betel nut in the capital. Whilst the success of this venture remains to be seen, this may present an opportunity to reconsider the administrative feasibility of applying excise to betel nut.

Question 4.11 – what are stakeholders views about applying excise to Betel Nut?

Telecommunication Services

Whilst the traditional rationale for applying excise taxes does not fit neatly with telecommunication services, a number of countries[9] nonetheless raise significant revenues from applying excise to these services (in addition to other consumption taxes such as GST/VAT).

Introducing such a tax (applied at a very low rate per call) was a recommendation of the IMF in relation to the Philippines, as a means of increasing overall excise receipts (which had fallen over time) without the need to significantly increase other excises such as those on petroleum, tobacco and alcohol (IMF 2012).

[9] In the Asia-Pacific – Bangladesh, Cambodia, Sri Lanka and Pakistan have specific charges in addition to a VAT. Thailand repealed it on the basis that it was no longer a luxury item – IMF 2012.

Applying an excise to telecommunications could be seen as a proxy for a tax on rents, where telecommunication services are provided by few operators (as there are in PNG). The limited number of service providers also makes collecting the taxes administratively simple, one of the key advantages of excise regimes in developing countries. It also provides an opportunity to extend the taxation system into the informal economy (a key challenges for PNG's tax system generally) where mobile phone use is prevalent and has been increasing.

It should be noted, however, that whilst there have been significant developments in PNG's telecommunication sector in recent years, it still lags behind many nearby countries in South-East Asia including the Philippines (ADB 2012) – this includes in relation to telecommunications infrastructure. One option could be to use some/all of the revenues to help expand the network, as is done in the UK.

Question 4.12 – what are stakeholders views about applying excise on telecommunication services in PNG?

Setting excise base rates

Since excise rates can be readily changed, there may be a temptation to increase excise rates in order to meet short term revenue needs. However there are a range of considerations that could and should be taken into account when considering appropriate excise rates. These include:

- the ability to raise revenue relative to the cost of administration
- the other bases upon which excise is applied to certain goods – that is,
    - the role in deterring consumption and raising revenue to offset social and economic costs
    - the perception that the item is a 'luxury'
    - the 'inelastic' nature of the product (i.e. where changes in price do not have a significant impact on demand)
- the fact that higher excise rates may come with them a trade off in terms of encouraging greater levels of smuggling (e.g. in relation to tobacco[10]) or in encouraging substitution for other, more dangerous,

[10] The illegal trade at the PNG borders has been acknowledged by PNG Customs Service during the regional consultations. This is evident in the prevalent of illegal products including tobacco products sold in the streets of Port Moresby.

goods (for example, home brew);
- the impact that the tax has on the poor.

In reality determining prices on the basis of these varied criteria is challenging. For example, alcohol and tobacco rates should be set having regard to the economic and social costs associated with their consumption. Whilst this is good in principle, in reality there is limited data in PNG available to make such an assessment.

The sections below seek to promote discussion on appropriate rates for the four key excisable items identified above. However, further consultation will be required with industry, key agencies (notably Health and PNGCS) and other interested stakeholders.

One option is to consider PNG's excise rates relative to other comparable countries. This is discussed further in relation to the relevant excisable good below.

Tobacco

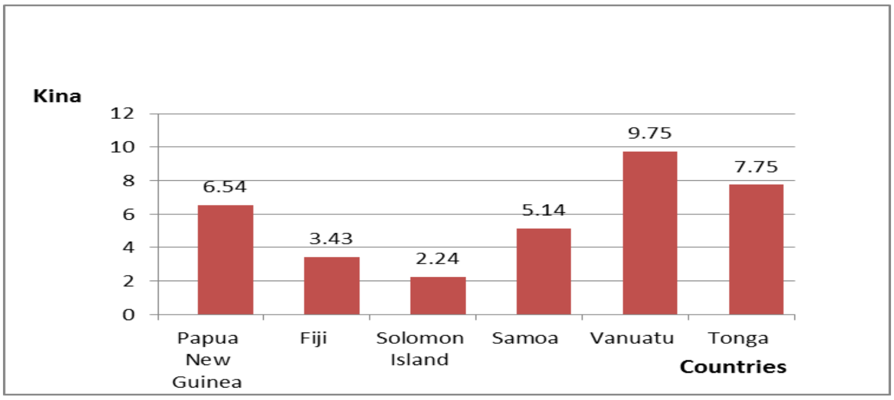
As noted above one of the primary purposes of applying excise on tobacco is to deter consumption and to collect revenues in line with the social and economic costs that its consumption imposes. This requires a sense of what these costs are. In its submission to the Review, PNG's Department of Health provided background information on tobacco consumption prevalence and related diseases in PNG. Whilst the danger and costs of tobacco consumption are generally well known, of relevance to PNG:

- PNG has the highest prevalence of tobacco consumption in the Western Pacific region with estimates of around 43% of 13 to 15 years olds and almost 44% for the adult population – one survey suggests that PNG may even have one of the highest rates of tobacco consumption globally.
- This is in addition to 80% of children being exposed to second hand smoking either in their homes or in public places.
- The Department of Health has also collected some preliminary information highlighted relatively high incidences of cancer commonly linked to tobacco consumption – this includes cancer of the cervix in women, oral or mouth cancer and breast cancer.
- Costs of treatment are high

The Review understands that the Department's work on undertaking an economic impact assessment of tobacco consumption is still ongoing.

With respect to the specific rates of excise on tobacco, and whether these are appropriate, Figure 6 provides a comparison of excise rates on other regional countries. It shows that PNG is third highest where it imposes excise tax of K6.54 per 25 packet cigarettes compared to Vanuatu and Tonga. Solomon Islands charges the least followed by Fiji.

Figure 6 shows Excise Tax amount in a packet of 25 cigarettes in selected countries in the Region



Source: Department of Health

As highlighted in the Department of Health's submission another way of thinking about setting excise rates in relation to tobacco is in examining the proportion of taxes (including excise) that forms part of the final retail price of a packet of cigarettes. Traditionally the World Bank and World Health Organisation have cited 70% as a goal for countries, a figure also noted by PNG's Department of Health. In a study across countries of different income levels, the World Health Organisation found that total taxes on cigarettes accounted for around 50% of the final retail price although it was slightly lower, at 45%, for lower middle income countries (WHO 2010). For those lower middle income countries imposing specific excises in cigarettes (as is done in PNG) the average proportion of excise relative to the retail price is 34%.

In PNG, a standard packet of 25 cigarettes costs around K23.50 with excise rates, proposed under the 2015 Budget changes, set at K261.51 per 1000 sticks. This equates to K6.54 per packet or around 28% of the retail price. When taken together with other taxes applying to tobacco products, including GST (10%) and Import Duties (K65.00 per thousand sticks) total taxes represent approximately 43% of the retail price of a packet of cigarettes in PNG.

This analysis suggests that, all else equal, there may be some scope to increase tobacco excise rates. However this would need to be balanced against the impact that this would have on illegal smuggling, something that is country specific and which the Review does not have any clear information on with respect to PNG. However, the Review understands that PNGCS does have some concerns of what increased tobacco prices may have on illegal activity.

Overall, there appears to be scope to increase tobacco excise in excess of inflation but at present this may be best achieved through the newly implemented indexation arrangement – which put in place an effective marginal increase in the excise base rates for tobacco over time – subject to further investigation into the extent of tobacco smuggling in PNG.

Question 4.13 – do stakeholders agree that the current indexation arrangements applying to tobacco (10% per annum) should be maintained subject to developing a further understanding of the extent of tobacco smuggling in PNG?

Alcohol

As with tobacco, alcohol excise rates should ideally be set having regard to the costs associated with alcohol consumption in PNG. Indeed PNG has a history of high alcohol consumption, a significant contributor to road deaths, hospital admissions and domestic violence (WHO 2004). There are also concerns that substance abuse, including alcohol abuse, has been rising in recent years although clear data on this is not available (ABC 2012).

The comparison table below shows the excise and tariff rates applied to different types of alcohol products in the region. According to the data provided to Tax Review, PNG is the only country that imposes tax[11] based on the alcohol content while rest of the countries indicated were on the bases of the liquid.

The table shows that PNG appears to impose relatively very low excise on light beer and heavy beer and even lower put together with tariffs compared to other countries. For wine, the imposition of excise is high but the combined effect put together with tariffs is average with the other countries in the region.

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[11] Tax in this context refers to both excise and tariff

In regards to a bottle of Scotch, PNG charges very high excise but the combined effect put together with tariffs is very low in comparison to the countries in the region.

	Fiji		Solomon Island		Samoa		Vanuatu		PNG	
	Excise Rate	Tariff Rate	Excise Rate	Tariff Rate	Excise Rate	Tariff Rate	Excise Rate	Tariff Rate	Excise Rate	Tariff Rate
330ml light beer	15%	K3.20 per lt	K1.60 per lt	K3.99 per lt	K2.29 per lt	K2.08 per lt	K3.46 per lt	75%	K1.17 per lt	K0.82 per lt
330ml heavy beer	15%	K4.35 per lt	K2.01 per lt	K5.02 per lt	K2.29 per lt	K2.08 per lt	K7.41 per lt	75%	K1.56 per lt	K0.82 per lt
750ml bottle Wine	15%	K6.02 per lt	free	K3.99 per lt	K4.58 per lt	K2.08 per lt	K7.41 per lt	40%	K9.44 per lt	free
1000L bottle Scotch	15%	K68. 17 per lt	K12.35 per lt	K30.82 per lt	K15.12 per lt	K3.12 per lt	40%	K29.63 per lt	K38.38 per lt	free
Source: PNG Customs Service										
Converted to Kina: BSP 31st March 2015 exchange rate for conversion purposes										

Question 4.14 – what are stakeholders views about the rates of excise currently applying to alcohol?

Vehicles

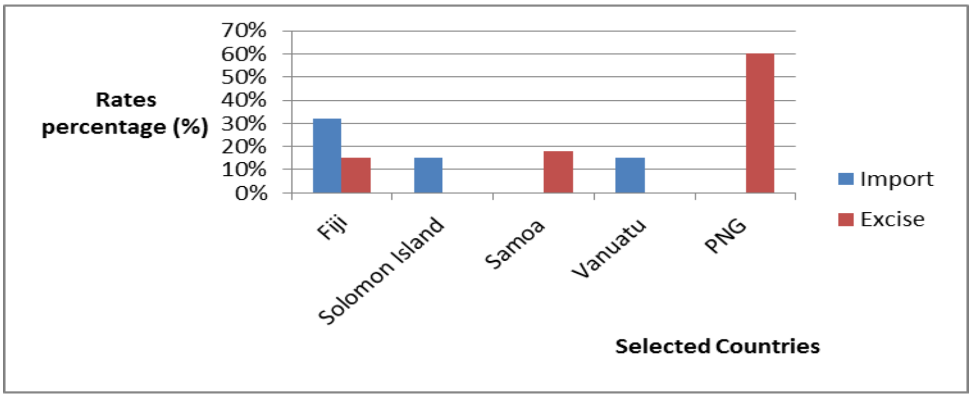
As identified in Chapter 3, a number of submissions to the Review suggested that vehicles should no longer be regarded as a luxury item in PNG and should therefore have excise rates applied to them reduced.

Whether an item is a 'luxury' item is in large part a subjective assessment of any society. In PNG, it is certainly true that the number of vehicles on PNG's roads has increased and vehicle ownership has become accessible to more and more Papua New Guineans.

As discussed in Chapter 1, however, there are a number of reasons why a country may wish to apply excise to vehicles beyond their classification as a 'luxury item'. First of all, collecting excise on vehicles is administratively simple, relative to the revenues that can be generated. It is also an efficient tax, as demand for vehicles is reasonably unresponsive to changes in price. Relative to other excisable items (such as tobacco and alcohol) there is also limited capacity to substitute imported vehicles through illegal smuggling.

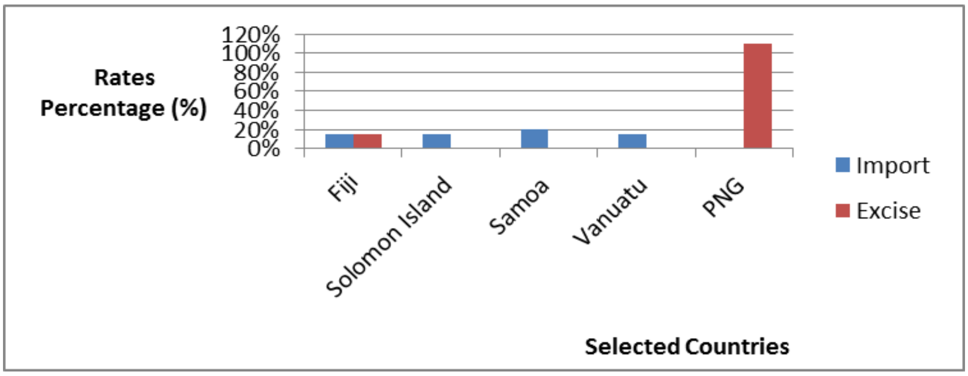
Figure 7 and 8 highlights the rates of excise on vehicles applicable in a number of other countries.

Figure 7: Regional comparison of Excise Tax and Import Duty rates for ordinary car



Source: PNG Customs Service

Figure 8: Regional comparison of Excise and Import Duty rates for sports car



This comparison highlights that excise rates on ordinary vehicles are high by regional standards.

If PNG were to consider reducing excise applicable on brand new vehicles including imposing a restriction on second hand imports, given the analysis above that excise revenues should at least be maintained as a proportion of GDP and total revenue, the foregone revenue would need to be sourced elsewhere from within the excise tax base. As identified below, increasing excise on petroleum products may be one option.

Question 4.15 – do stakeholders consider that excise rates on ordinary vehicles in PNG are too high? Would stakeholders support reducing this rate if this were to be offset with an increase in excise elsewhere, such as in relation to petroleum products?

Petroleum Products

Petroleum products subject to excise include motor spirits (petrol), diesel fuel, aviation gasoline, aviation turbine fuel, fuel oil and kerosene. The imposition of excise on petroleum products has been associated with its ability to raise revenue for the Government.

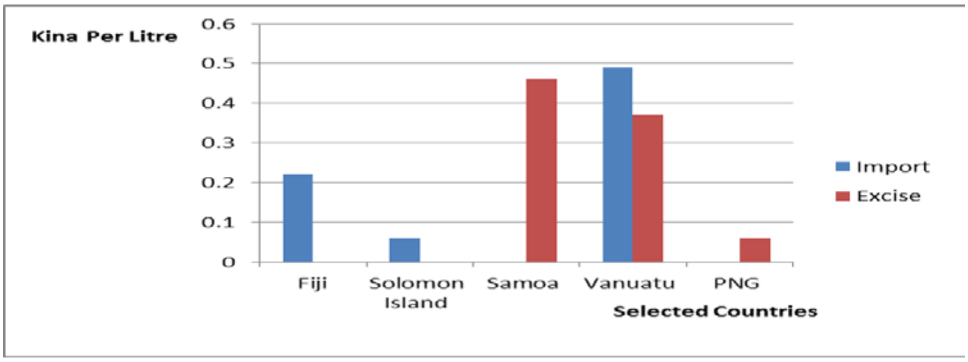
Petroleum products tend to be highly inelastic where the demand is unresponsive to changes in its price. Consequently, increases in petroleum excise rates generally lead to an almost proportional increase in revenue, with a minimal change in the volume of fuel consumed. Thus, it has a minimal impact on economic welfare because it creates less distortion in economic decisions.

From an administrative perspective, it is simple to administer because there are only a few collection points for a significant amount of revenue. Tax evasion is very difficult and has relatively very low compliance costs.

Figure 9 and 10 highlights the rates of excise on diesel and gasoline applicable in a number of other countries. It shows that the imposition of excise on diesel has been very low by regional standards. For Gasoline, it is very high by regional standards.

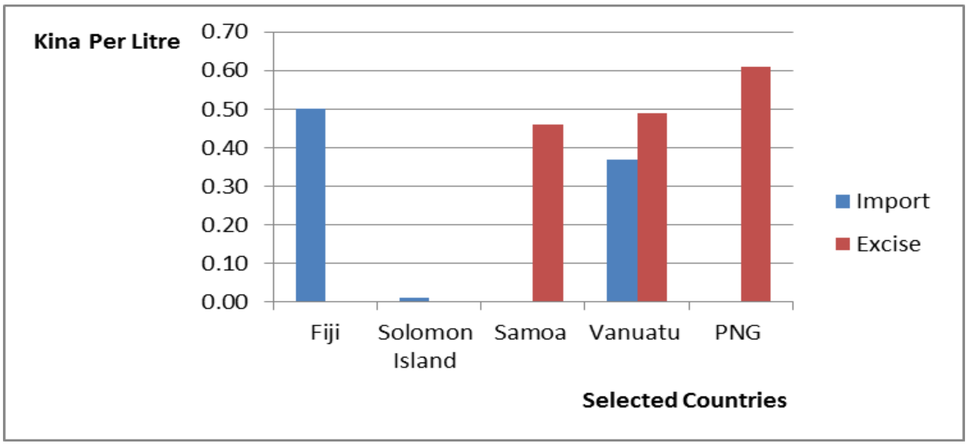
Apart from gasoline excise, figure 9 suggests that there is definitely scope to increase excise on diesel. This will complement the suggestion to reduce excise on vehicles more broadly.

Figure 9 Regional comparison of Import duty and Excise on Diesel



Source: PNG Customs Service

Figure 10 Regional comparison of Import duty and Excise on Gasoline in the region



Source: PNG Customs Service

Question 4.16 – what are stakeholders views about increasing rates of excise applicable to petroleum products particularly diesel**.** What implications would this have?

Indexation

As identified in Chapter 2, the specific excise rates applying to both alcohol and tobacco products are indexed (increased) every six months to maintain the real value of the excise rates.

As a consequence of changes made in the 2015 Budget there are now two different methods of indexation for the two products. Alcohol products are increased by the lesser of 2.5% or the Consumer Price Index whilst tobacco products are increased by 5% every six months (incorporating not only indexation to maintain the real value of the excise amount but also an effective increase in the excise base rate applying to tobacco).

The history of PNG's indexation arrangements outlined in Chapter 2 highlights an ongoing challenge for PNG in settling on a consistent indexation system. In particular the changes in the 2012 Budget (which introduced one-off increases for tobacco and alcohol products on the basis of the need to 'catch up' with inflation) suggest that there are limitations with the current system (now applying only to alcohol products) whereby the increase is capped at 5% per annum, regardless of the level of inflation for that year as measured by the NSO. One off 'catch-up' and large increases in excise rates are arguably not desirable as they can lead to some (additional) illegal trading (IMF 2012). Increases are instead preferably introduced incrementally over time.

Given this history, consideration could be given to simply abandoning the 2.5% cap, ensuring that alcohol products are indexed on the basis of the consumer price index over time. This would remove any incentive to introduce one-off large increases in excise as a means of 'catching up' on inflation levels.

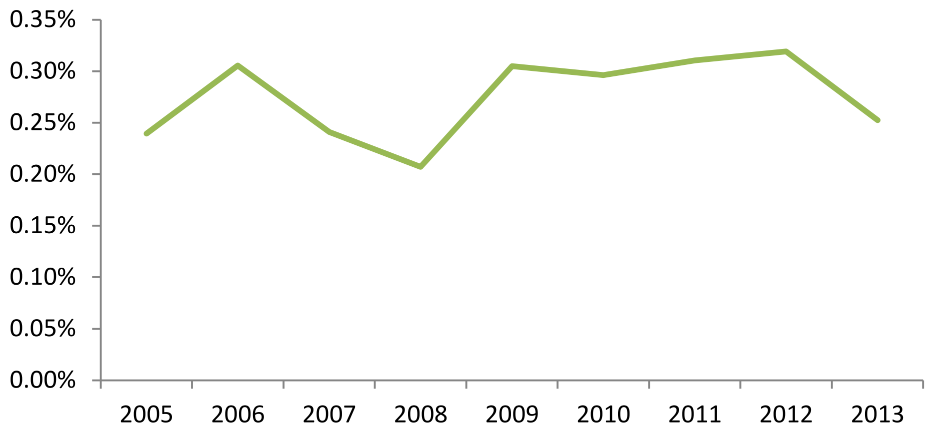
Question 4.17 – should the existing 2.5% (5% annual) cap on indexation be removed, ensuring that increases in specific excise rates applying to alcohol products are increase by reference to the Consumer Price Index as determined by the NSO?

Indexation of excise applying to petroleum products

As identified in Chapter 2, unlike the two other products subject to specific rates of excise (alcohol and tobacco), the specific excise rates for petroleum products are not indexed each year. This means that the real value of excise rates applying to petroleum products have reduced over time.

Notwithstanding this as Figures 11 below shows, excise from petroleum products has remained relatively steady as a proportion of GDP.

Figure 11: Petroleum excise revenues as a proportion of GDP (2005 – 2013)



Feedback is sought from stakeholders on the merit, and issues associated with introducing indexation arrangement for petroleum excise, either as a means of lifting overall excise revenues or in compensating for reductions in excise rates elsewhere (such as with vehicles).

Question 4.18 – what are stakeholders views about the indexation of petroleum excise rates in PNG?

Administrative Issues

The Committee supports efforts to enhance the capacity of PNG's revenue administrators and is considering the result of the administrative diagnostic reviews undertaken into each agency.

The Review considers that there may be some merit in considering the proposed revised collection mechanism (see Chapter 3) whereby weekly payments (for selected taxpayers) can be made at an agreed set rate and reconciled at the end of each month. Further consultation with PNGCS will be required to identify whether this is feasible and what legislative changes would be necessary.

Hypothecation of tax revenues

Hypothecation of tax revenues (or *earmarking* of tax revenues) refers to the allocation of specific revenues sources for specific purposes – that is, the revenue does not form part of general revenues that are allocated through the general budget processes.

Although not limited to excise taxes, hypothecation issues do arise in the context of PNG's excise regime because it currently applies in relation to a portion of diesel excise being allocated to the National Roads Authority for road maintenance work and the Department of Health's submission to the Review has suggested consideration be given to allocating a portion of tobacco excise revenues to a fund to help combat tobacco consumption and related diseases.

A 2010 World Health Organization sets out some of the general arguments for and against the hypothecation of tax revenues (WHO 2010a)

Arguments for the Hypothecation of Tax Revenues

- Accountability and trust: Rather than paying taxes into a perceived black hole, hypothecated taxes provide taxpayers with in-built accountability for public spending. At times when a government is suspected of following its own agenda, this can help to restore trust between it and its citizens.

- Transparency: Hypothecated taxes can educate people about the cost of particular services, such as healthcare.
- Public support: In some cases, hypothecation can even generate public support for tax increases.
- Protecting resources: Because of the relative public support for such spending, ministries of health are often in favour of hypothecated taxes for health. They see it as a way to ring-fence their resources from competing political interests and a way to by-pass budgetary constraints mandated by ministries of finance.

Arguments against hypothecated taxes

- Exemption from review: Unsurprisingly, ministries of finance rarely endorse hypothecation as it undermines their mandate to allocate budgets as they see appropriate. It exempts the tax revenues in question from scrutiny and potential cuts that others are subjected to. There is also no obvious answer as to who should set rules on the level of hypothecation. Furthermore, when the hypothecation affects a large amount of public expenditure, as is typical for health, it can severely impact on other public spending should cuts be necessary.
- Undermining solidarity: Financing from tax revenue is one of the major mechanisms allowing governments to achieve a fair distribution of the cost of healthcare. Some fear that specifying each individual's share of the cost vis-à-vis services received could undermine this solidarity.
- Inappropriate funding levels: Hypothecated taxes are accused of linking spending not to the requirements of the services but to unrelated macroeconomic circumstances. Rather than determining health spending by how much a tax raises, it should be based on the health needs of the population. Severing this link between need and provision risks wasteful spending when the tax base is buoyant and insufficient budgets when it is depressed.
- Tying the hands of government: By taking decisions on spending levels out of government discretion, hypothecating tax revenues constrains its ability to deal with economic cycles.

The Review has some concerns about the hypothecation of both taxation and non-taxation revenues in PNG, due to the extent to which it occurs and the moves being undertaken to apply it further in a range of circumstances. The primary purpose of the tax system is to raise revenues that can be allocated depending on the Government's priorities through a transparent Budget process. Extensive hypothecation can undermine this. This is arguably also true for measures such as the Infrastructure Tax Credit Scheme which sees a portion of revenues derived from the Mining and Petroleum, Agriculture and (to a lesser extent) Tourism sectors, allocated to infrastructure projects. To the extent that a desire to earmark revenues for particular purposes reflect concerns about the general Budget process, then issues with the Budget process are better addressed directly.

Nonetheless, particularly in the context of excise which is often imposed for public policy purposes beyond simply generating revenue, the Review would be interested in any broader views about the value of using hypothecated revenues in PNG.

Question 4.19 – what are stakeholders views about the hypothecation (earmarking) of revenues in PNG?

ATTACHMENT A – CURRENT EXCISABLE GOODS AND RATES IN PNG

Alcohol Products[12]

Item Description	Rate
Beer (Tariff Items 2203)	
• 'Light Beer' – beer containing less than 2.5% alcohol	K53.37 per litre of alcohol (LAL)
• 'Light/Mid-Strength Beer' – beer containing between 2.5% and 3.5% alcohol	K68.87 per LAL
• 'Mid-Strength Beer' – beer containing between 3.5% and 4.5% alcohol	K78.47 per LAL
• 'Heavy Beer' – beer with more than 4.5% alcohol	K91.14 per LAL
Wine (Tariff Items 2204) and Vermouth and other Aromatic Wines (Tariff Items 2205)	
• Sparkling wine sold in containers of less than 2 litres	K96.69 per LAL

[12] Data obtained from PNG Customs Services – these are also very different to Schedule 1 as revised in the *Excise Tariff (Amendment) Act 2014* No. 19 of 2014 which was supposed to have commenced1 January 2012.

• Wine of all descriptions including sparkling wine, fortified wines, vermouth and other aromatic wines	K96.81 per LAL
Other fermented beverages (e.g. cider, perry, mead) (Tariff Items 2206)	
• Other fermented beverages, fermented from fruit grown in PNG	K44.96 per LAL
• Other fermented beverages	K91.02 per LAL
Spirits (Tariff Items 2208)	
• Spirits containing less than 50% alcohol	K96.69 per LAL
• Spirits containing between 50% and 80% alcohol	K103.73 per LAL
• Concentrates used in the manufacture of other beverages	Free
• Mixed drinks containing less than 3% alcohol	K78.38 per LAL
• Mixed drinks containing between 3% and 4.5% alcohol	K71.04 per LAL
• Mixed drinks containing more than 4.5% alcohol	K82.50 per LAL

Tobacco Products[13]

Item Description	Rate
Cigars, cheroots, cigarillos and cigarettes (Tariff Items 2402)	
• Cigars, cheroots and cigarillos containing tobacco of any kind	K261.51 Per Kg
• Cigarettes – without filter	K261.51 Per 1000 Sticks
• Cigarettes – with filter containing tobacco other than dark fired tobacco	K261.51 Per 1000 Sticks
• Cigarettes – with filter with dark fired tobacco	K130.77 Per 1000 Sticks
• Cigarettes - with filter and using tobacco and tobacco substitutes and containing dark fired tobacco	K163.15 Per 1000 Sticks
Other manufactured tobacco (Tariff Items 2403)	
• Coarse shredded tobacco for 'roll your own' cigarettes	K42.15 Per Kg
• Smoking tobacco, chewing tobacco, snuff, twist or trade tobacco, stick tobacco	K87.20 Per Kg

[13] Most recent rates obtained from the *Excise Tariff (2015 Budget) (Amendment) Act 2014*

• Homogenised or reconstituted tobacco	K120.11 Per Kg
• Other	K87.20 Per Kg

Petroleum Oils

Item Description	Rate
Light Oils (Tariff Items 2710.12)	
• Motor spirit (gasoline) including aviation spirit	K0.61 Per Litre
• Aviation gasoline	Free
• Jet-A1	K0.02 Per Litre
• Kerosine (household)	Free
• Other light oils	K0.07 Per Litre
Other (Heavy) Oils (Tariff Items 2710.19)	
• Diesel	K0.06 Per Litre

• Diesel when supplied to a fishing vessel for its own use	K0.03 Per Litre
• Fuel Oils, Heavy	K0.02 Per Litre
• Gas Oils	K0.02 Per Litre
• Other Oils	K0.02 Per Litre

Vehicles[14]

Item Description	Rate
Tractors (Tariff Items 8701)	
• Tractors other than - pedestrian controlled tractors (i.e certain small agricultural tractors), road tractors for semi trailers and track-laying tractors	10%
Motor vehicles for the transportation of 10 or more persons (Tariff Items 8702)	
• All	10%

[14] Taken from Excise Tariff (Amendment) Act 2014, which took effect from 1 June 2014 – amendments were made to new Schedule B

Motor vehicles primarily for the transportation of less than 10 persons (Tariff Items 8703)	
• Security Vans – New	15%
• Security Vans – Used/Reconditioned	20%
• Sports Cars – Brand New	110%
• Sports Cars – Used/Reconditioned	120%
• Diesel or Semi-Diesel Vehicle with a cylinder capacity exceeding 2700cc – Brand New	110%
• Diesel or Semi-Diesel Vehicle with a cylinder capacity exceeding 2700cc – Used/Reconditioned	120%
• Other Motor Vehicles - New	60%
• Other Motor Vehicles – Used/Reconditioned	80%
Motor vehicles for the transportation of goods (Tariff Items 8704)	
• Utility Trucks (double cab with a separate open back), not exceeding 3.5 tonnes – Brand New	40%
• Utility Trucks (double cab with a separate open back), not exceeding 3.5 tonnes – Used/Reconditioned	60%
• Other vehicles for the transportation of goods - New	15%

• Other for the transportation of goods – Used/Reconditioned	20%

Other Goods[15]

Rate	Items
30%	• Perfumes • Photographic Film (not X-Ray) • Microwave ovens • Video recording or reproducing apparatus • Still image video cameras • Small clothes dryers • Hair dryers • Televisions and other video equipment, including cameras • Answering and dictating machines • Audio hi-fi equipment without recording capability • Lenses for photographic equipment • Binoculars • Articles for funfair, table or parlour games, except for gambling or coin or disc operated

[15] Taken from latest version of excise schedules from legislation published online. Need to check – the schedule 1 created by *Excise Tariff (Amendment) Act 2014No. 19 of 2014* which purported to amend Schedule 1 only includes the items highlighted.

	• Roundabout, swings, shooting galleries
40%	• Natural or Cultured Pearls • Diamonds (other than industrial diamonds) • Previous and semi-precious stones • Synthetic or reconstructed previous or semi-precious stones • Dust and powder of natural or synthetic previous or semi-precious stones • Silver, semi-manufactured • Base metals clad with silver • Gold, semi-manufactured • Based metals or silver clad with gold • Platinum (other than unwrought platinum or platinum in powder form) • Palladium, rhodium or iridium unwrought or in powder form • Base metals, silver or gold clad with platinum • Waste and scrap of precious metal or of metal clad with precious metal
60%	• Arms and ammunitions, except for defence force, police or correctional institutional use
150%	• Poker machines Other games, coin- or disc-operated Casino or parlour games tables

ABBREVIATIONS

AFTS	Australia's Future Tax System (Review)
GST	Goods and Services Tax
IMF	International Monetary Fund
IRC	Internal Revenue Commission
PNGCS	Papua New Guinea Customs Service
WTO	World Trade Organisation
LAL	Litre of Alcohol

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