

## PROPOSED CHANGES TO TAXATION – INCOME TAX ACT

DATE: Monday 20<sup>th</sup> September 2004

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### Background

Two particular issues have come to NASFUND's attention that will require changes to the Income Tax Act 1959. The issues are

- Current retirement age vs. entitlement to concessional tax rates and
- Taxation of distributions from an ASF

### Issue No 1

At present there is an inconsistency between the Superannuation Act, which states that the eligibility age is 55, and the Tax Act, which states that if a person is aged 50 or more, they are entitled to the concessional tax rates.

#### Problem Scenario

A woman aged 50 retires from work. She has been working for 5 years. She is subject to lesser of marginal tax rates or 15% on employer contributions and interest.

A woman aged 50 retires from work. She has been working for 7 years. She is subject to 2% on employer contributions and interest.

#### Desirability

The aim of the legislation should be to treat a class of workers (over 50 years of age) equally. Considering that

- The portion of active 50 years plus still in the private sector workforce is no greater than 5% and
- The mortality rate in PNG remains under 50 years of age that

Anyone reaching the age of 50 should be subject to concessional rates

#### Recommendation

The Income Tax Act should be amended in line with the Superannuation Act so that concessional tax treatment applies only at 55 years of age or the Superannuation Act should be amended in line with the Income Tax Act so that the eligibility age for the withdrawal of benefits is 50 and not 55

Considering the mortality age in Papua New Guinea remains under 50 years of age, the Superannuation Act should be amended so that the eligibility age for the withdrawal of benefits is 50 and not 55.

### Issue No 2

At present there is no clear understanding on the taxation rate applicable to partial withdrawals. While the Superannuation Act provides for both full and partial withdrawals, the Income Tax Act does not distinguish between full and partial withdrawals. The Tax act refers to *"paid in a lump sum in consequence of retirement from, or the termination of, an office or employment"* – Sect 46B(1).

Similarly

According to section 46B (4), distribution from a Superannuation Fund which relates to payments accrued from 1 January 1993 shall be deemed to be salary or wages paid in a period of 26 fortnights preceding the date on which the payment is made. Therefore this section gives the understanding that distribution of benefits accrued after 1 January, 1993 would be subject to tax at marginal rates. This is inconsistent with the apparent policy of the Act and Section 46B(2A), according to which concessional rates would apply to distributions from a Superannuation Fund under prescribed conditions.

This ambiguity suggests (although far from clear) that if a member is unemployed and withdraws under the hardship partial payment rule, those payments could be deemed not to be a lump sum and taxed at the members marginal tax rate at the time of becoming unemployed. If however the same member waited 12 months and withdrew under the lump sum provision, then the taxation on withdrawal would be as per the tax amendment effective 01 January, 2004. That is, the member is subject to tax on withdrawal of his employer contributions and interest based on the number of years contributing to an ASF and not his marginal tax rate.

Problem Scenario

A Member has recently been made unemployed. The member earns K100,000 on a marginal tax rate of 47% and has been with an ASF for 8 years. The members superannuation employer balance and interest is K50,000

- a) If the Member waits 12 months. The tax is 8% - K4,000 tax
- b) If the Member takes partial payments, the gross of the partial payments is K50, 000 over 12 months subject to 47% tax or K23, 500

While the case example is not atypical, it highlights the current ambiguity in the Act

Desirability

The aim should be to treat taxation on Member withdrawal as tax neutral on whether the Member seeks partial payments after three months or a lump sum after 12 months.

Recommendation

That section 46B(1) of the Income Tax Act be amended to read

“paid in a lump sum **or in partial payments pursuant to the Superannuation Act 2000** in consequence of retirement from, or the termination of, an office or employment”

AND

That section 46B(4) be abolished or amended to conform to the prescribed conditions

<b>Years of Membership</b>	Less than 5 years	Greater than 5 years and less than 9 years	Greater than 9 years and less than 15 years	Greater than 15 years
<b>Rate of Tax</b>	Marginal Rate of Tax	The lesser of 15% or the marginal tax rate	The lesser of 8% or the marginal tax rate	2% tax on interest and employer contribution

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