Internal Revenue Commission

A GUIDE TO

VALUE ADDED TAX

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1) Introduction

This guide has been written to help all businesses and organisations that have to charge VAT. The information in the guide will help you fill out your VAT returns. It is designed to give you a simple explanation of your tax obligations.

This booklet is intended as a guide only and is not a legal document. While every endeavor has been made to ensure the accuracy of the information in this guide, changes in legislation or judicial interpretation may mean that it is not wholly correct.

You should contact the Internal Revenue Commission (**"IRC"**) for advice. Specific determination requests or requests for additional information should be forwarded to -

Internal Revenue Commission
VAT Division
P.O. Box 777
Port Moresby

Ph 322-6600
Fax 321-7962

2) What is a Value Added Tax

A Value Added Tax or VAT is a tax, which is imposed on the sale of goods and services. VAT has been established at 10% of the value of goods and services in Papua New Guinea.

3) How does a VAT work

On every supply you buy for business use from a registered supplier, you will have to pay VAT of 10% in addition to the sale price. You will also have to pay 10% VAT on goods bought for your own use, but you cannot get an input credit for this, Business supplies include both goods (trading stock, machinery, furniture, buildings, etc.) and services (power, water, cleaning, accountancy security, etc.). The only requirement is they must have been bought for business use.

On every sale you make to your customers, you will have to charge 10% VAT to your customers.

At the end of each month, you will have to fill out a simple return form and send it to the IRC.

On that return form you will add up the total VAT for the month that you charged to your customers. This is called 'output tax'. You will also add up the total VAT you paid to your suppliers for business supplies. This is called the 'input tax' or 'input credit'.

You deduct the input credits (the VAT you paid) from your output tax (the VAT you charged to your customers) and send the difference to the IRC with the return form.

In some months, if purchases of supplies were greater than your sales, you might be entitled to a refund as your input credits would be larger than your output taxes. You might also be entitled to a refund if your sales are for export from PNG, as the VAT rate for exports is zero or nil.

In these cases, after receiving the return, the IRC will refund the excess VAT you paid for your supplies.

4) Why have we introduced a VAT

Papua New Guinea along with many other countries in the world including the Pacific Rim nations is committed to tariff reforms and economic development through competition and co-operation.

As part of this, we are reducing our import tariffs and replacing the revenue lost by introducing a VAT. A VAT has many advantages over our present system of using import tariffs to generate revenue.

Countries which have introduced Value Added Tax have become more efficient, competitive and more able to compete in the world market. This in turn has created business opportunities and more jobs and the country has begun to prosper.

The Government has embarked on a 7-year tariff reform programme, commencing in July 1999 with the removal of all Provincial sales taxes and the removal of import duties of 11% (and will include the 1.5% drought relief levy) on thousands of household items. Most other import duties will also be reduced. These have been replaced with a single rate of VAT of 10%.

Some import duties (at a reduced level) have remained to protect our local industries and some luxury items are subject to excise duties but overall the initial impact of these reforms will have little impact on the final consumer.

The VAT system in Papua New Guinea has been formed from the best established policies overseas and modified in certain areas to suit the unique economic environment of Papua New Guinea

5) The Provinces

The VAT has in part replaced the previous provincial sales taxes. It is therefore necessary to share the VAT revenue with the provinces, to ensure that they do not lose a major source of their revenue. This is managed in the following way.

Each Province will set up its own VAT trust account, into which VAT revenue from sales made or value added in that Province is paid. The National Government will set up its own trust account, into which VAT revenue collected at the point of import is paid.

6) Sales in more than one Province

If you carry on business in more than one Province, the correct amount payable to each Province must be calculated. Only one return needs to be lodged for your countrywide activities. However, the net amount payable on the return should be divided in the same ratio as your gross sales in each Province for that month are to your total sales for the month.

For instance, if you carry on business in NCD and Morobe and your gross sales for the month were K60,000, with K20,000 (1/3rd) sold in Morobe. Then, if the net tax payable (after calculation of input credits) is K3,000, this should be apportioned 1/3rd to Morobe ie. K1,000 payable to Morobe and K2,000 payable to NCD. Separate cheques payable to each Province must be attached.

If you do not wish to do this, you must lodge separate returns for your activities in each province.

7) VAT Registration

A Value Added Tax is a tax on goods and services used and sold by a business in the course of its taxable activity. VAT has been set at 10% on the value of goods and services.

A business whose annual turnover is greater than, or is expected to be greater than K100,000 must be registered for VAT. A business with a turnover less than K100,000 per year can register for VAT but it is not compulsory.

8) Why you should register

Businesses who must register, or those who register voluntarily, can take advantage of VAT credits on the VAT they pay to their suppliers. Those credits are deducted from the VAT collected from their customers to reduce the amount of VAT payable to the IRC.

If you do not register and are required to because your sales are more than K100,000 per year, you may be **required** to pay the VAT you should have collected on your sales. You will not benefit from an input (expense) credit. Other penalties will also apply.

If your turnover is less than K100,000 per year then registration is voluntary.

If you decide to remain unregistered you must not charge VAT to your customers nor will you benefit from a VAT credit on the VAT you pay your suppliers. Penalties will apply to businesses that are unregistered and charge their customers VAT.

9) What you need to do to register

To register for VAT, contact the Internal Revenue Commission and we will supply you with a registration form for you to complete. Once we receive your details we will provide you with a VAT registration number. This number will permit you to charge VAT. Registration forms are also available from your accountant.

10) Requirements after you register

When you have registered for VAT and have been issued with a VAT registration number you can charge your customers VAT on their purchases from you. You will also be required to issue Tax Invoices. Every month you must complete and send to the IRC a monthly VAT return detailing your sales and the VAT your suppliers have charged you. The return must be received by the IRC by the 21st of the month following the end of the VAT period.

11) Group registration

A company that has a number of branches or associated companies with a common and majority shareholding may elect to register as a group and submit one VAT return for the whole group.

You should note that if group registration is approved, you would need to lodge only one return each month for the whole group. However, if you have sales in more than one Province, you will be required to include a schedule with each month's return, showing the amount of sales in each Province. This is to ensure that each Province in which the group trades receives its proper share of the VAT income. See also section 6 for details of the specific payment requirements.

12) Cancellation of registration

You may cancel your VAT registration by writing to the Commissioner and providing details as to why your registration should be cancelled. If you decide to cancel your registration due to, for instance, a turnover less than K100,000 per year, you may continue in business but cannot issue Tax Invoices nor charge your customers VAT. To do so will incur severe penalties.

Special provisions apply to assets retained by the business after a cancellation of registration. Please refer to Retained Asset, Section 51.

13) VAT audits

The IRC will have a large number of staff who will be checking on businesses to ensure whether they are complying with VAT provisions. Other taxation aspects of your business might be examined as well.

The audits and inquiries will be conducted at random and usually no prior warning will be given to businesses of an intended visit.

You will be required to make available your accounting records (refer to record keeping) and to provide any other information that the auditor deems necessary for the completion of the audit.

14) Offences and penalties

Any registered person/business who does not comply with the Value Added Tax Act may be subject to fines not exceeding K25,000 for each offence.

Here are some examples.
- not registering when you are required to
- failing to file returns, keep records or supply information or Tax Invoices
- supplying false information on your VAT returns
- using VAT money collected by you for other purposes
- conspiring with anyone else to defraud the revenue or else to commit any offence against the Act.

15) VAT returns

When you register for VAT, you will be required to submit a monthly VAT return to the IRC. The period covered by the return will be the trading period commencing the 1st of each month to the last day of that month. The return and your remittance must be received by the IRC by the 21st of the following month. If you are late, then penalties will be applied.

16) VAT refunds

A business will incur costs that on occasions will exceed the revenue generated during a month of trading.

An example of this would be the purchase of a capital item or in the case of an exporter the costs incurred in the production of goods for export.

In those situations, a business will have a VAT refund. It is imperative that a business receives the refund they are entitled to as soon as possible. The trust account mechanism, which has been established, will ensure that money is available to pay the refunds.

The IRC has set up a section that will monitor the credits (refunds) as the returns are received. All refunds will be identified and many will be checked for accuracy and validity. This may involve a phone call requesting information to support the credit or a visit by one of our auditors.

You may be required to provide the Tax Invoice/s and VAT calculations or source documents to verify the refund prior to the release or the reassessment of the refund.

17) Accounting basis

VAT may be accounted for in two ways. In the first place, all registrations have to account for VAT on the accruals (invoice) basis.

If you are a local authority or a non-profit body then you have the option to elect a cash (payments) basis of accounting.

You may also apply in writing to the Commissioner for a change in accounting basis from an invoice to a cash basis if:
- you are a registered person with taxable sales not exceeding K500,000 per year; or,
- after registration, your taxable sales are unlikely to exceed K500,000 per year.

18) Invoice basis

A registered person who is required to account for VAT on the accrual (invoice) basis will account for VAT on sales on the issuing of a Tax Invoice or on receipt of income for that sale whichever occurs first. Note that you will be liable for the VAT on the sale of goods even if you haven't received any money for the supply.

VAT paid in respect of expenses (input credits) may be claimed on the actual receipt of a Tax Invoice whether the expense has been paid or not. Note that input credits cannot be claimed unless you have a Tax Invoice to verify the claim.

19) Payments basis

A registered person will return VAT on sales in the month in which payment has actually been received for the supply of those goods.

Input credits can only be claimed when the payment has actually been made. A Tax Invoice and receipts must be on file to verify the claim.

20) Tax Invoices

Tax Invoices are the same as any other invoice you currently issue with three main additions. The words **TAX INVOICE** must be clearly printed on the invoice. Your **VAT registration number** must also be clearly printed. An invoice without these requirements is not a Tax Invoice and will not be permissible for use as an input credit.

In addition, it will be necessary for you to show the amount of VAT being charged or alternatively, write the words **"This invoice includes VAT charged at 10%".** The person who receives your invoice may want to claim VAT as a credit and can only do so if the Tax Invoice clearly meets the above three requirements.

These requirements apply to all Tax Invoices issued.

If a supply is less than K50 then an input credit will be granted to businesses without a Tax Invoice, providing a receipt issued by a registered business for that purchase is on file.

If supplies in excess of K50 and less than K200 are made then a Tax Invoice must be issued. By law, the date, suppliers name, address and VAT number must be shown with a description of the price and the goods supplied.

Supplies greater than K200 must have the above details and also show the name and address of the buyer.

These requirements are additional to the requirement to show the words 'Tax Invoice', the suppliers VAT registration number and the amount of VAT charged or the words 'this invoice includes VAT charged at 10%'.

Tax Invoices can only be issued by VAT registered persons. Tax Invoices issued by non-registered persons are illegal. This is a serious offence and legal action will be taken against offenders as well as requiring payment of the VAT charged to the IRC without the allowance of any input credits.

21) Credit notes

A supplier issues credit notes when the price for a supply is reduced after a Tax Invoice was issued. For example, this may occur when faulty goods or quantity sales discounts are given.

There is little difference between the credit notes issued under a VAT system and those that you would normally issue in your business. Like a Tax Invoice, a credit note must have the registration number of the business issuing the credit note and the Kina amount of the credit note plus the VAT that applies to the credit.

22) Debit notes

A supplier issues debit notes when the price is increased after a Tax Invoice was issued.

These must show the words Debit note in a prominent place, the trade name and registration number of the supplier as well as the amount of the increase and the VAT applicable.

23) Agents

Sometimes an agent buys or sells goods and services on behalf of someone else (the principal). The principal is still the buyer or seller and not the agent.

If both the principal and agent are registered persons, the agent may issue a Tax Invoice on behalf of the principal. The Tax Invoice need only be issued in the name of the agent and there is no need for the agent to include the principal's name on the invoice. The principal cannot issue a Tax Invoice for the same supply as well.

However only the principal can claim VAT for the sale or purchase.

If the agent buys goods for the principal the supply is deemed to be made to the principal and not to the agent. However, an agent can ask the supplier for a Tax Invoice as though the supply had been made to the agent.

In either case, only the principal can show in his monthly return the VAT output debits or input credits for the sales or purchases made on his behalf by his agent.

The agent must keep a record of the name, address and registration number of the principal in any such transaction.

24) Time of supply

The time of supply is important when VAT first starts. It decides whether VAT is payable for goods, bought before VAT started, but delivered or paid for after VAT starts.

Goods bought before VAT starts will not be liable to VAT if the buyer became the <u>legal owner</u> of the goods before the start of VAT, i.e. if they were paid for before that date or, where they were not paid for, if the buyer took <u>delivery</u> before the start of VAT.

If the goods are not to be removed (for instance a building), then VAT is not payable if the buyer became the legal owner, or if the goods were made available to him (for instance occupancy of the building) before the start of VAT.

For services, the time the services are performed decides whether VAT is payable. Services are liable to VAT, to the extent that they are performed after the start of VAT. This applies regardless of when payment is made. If, for instance, club fees are paid before VAT starts, but cover membership for the year after the start of VAT, then VAT is payable on the full amount paid.

Where services are carried out partly before the start of VAT and partly after the start, the VAT liability is calculated on a time basis. The cost of the service is apportioned on the basis of how much of the total time spent on providing the service is before the start of VAT and how much is after. The proportion of the payment relating to the time after the start of VAT must be charged with VAT.

25) Taxable activity

A taxable activity is the conducting of a business activity whether or not that activity results in a profit. It involves the acquisition of and the provision of goods or services for a consideration, that is the purchase or sale of goods or services for money or otherwise, for instance the trade of one good for another.

Government Departments and Non-profit bodies may carry on taxable activities.

26) Zero rated supplies

Zero rated supplies are supplies (goods or services) taxed at zero percent.

Zero rated supplies include:
- Exported goods;
- the sale of a "going concern ";
- duty free goods;
- goods not in Papua New Guinea at the time of supply (because VAT only becomes payable on import of those goods);
- temporary imports;
- the transport of passengers into and out of Papua New Guinea;
- certain export services;
- the first sale by a refiner of pure gold;
- mineral ores etc.;
- aid projects.

This list is not conclusive. If you need any further information on zero-rated supplies, contact the IRC or your accountant.

Registered persons who make zero rated supplies do not add VAT onto their zero rated sales and therefore do not need to return VAT on zero rated income. They are entitled to claim as an input credit, the VAT they have paid on producing those supplies. Zero rated suppliers will find that they may be in a VAT refund situation.

A business making zero-rated and taxable sales must be able to differentiate within their accounting system what income earned applies to what category. This will have an impact on how much VAT a company has to pay to the IRC.

27) Sale of a 'going concern'

The sale of a going concern is the sale of an operating business that is sold "lock, stock and barrel" with business being able to carry on as usual at the time of sale.

The sale of a going concern is zero rated only between registered people or, if the buyer registers at the time of sale. Both parties must agree to zero rating in writing for the sale to be zero-rated. Otherwise, the sale is one of a taxable supply.

If part of a taxable activity is sold and that part is capable of separate and independent operation, this sale may be zero-rated.

28) Exported goods

Export sales other than logs are zero-rated. Zero-rating only occurs if the goods are exported within 28 days, unless unforeseeable circumstances delay the shipment of goods e.g. a wharf strike. If goods are not exported within the 28-day period then the supply will be charged with tax.

29) Duty free shops

Goods purchased for export by international travelers from duty free shops are zero-rated.

A tourist may purchase goods from a retailer (not a duty free shop) and request that the retailer pack the goods and send the goods to their overseas address. These sales will be zero-rated.

30) Diplomatic missions

Goods imported by diplomatic missions for use by these missions are exempted from VAT.

Imports by a diplomatic agent for personal use are also exempted.

Goods purchased within Papua New Guinea for the use of missions and for diplomatic agent's and their families' use are charged with VAT. The VAT charged will be refunded on submission of the appropriate VAT return.

To qualify for an input tax credit, the amount of credit will be subject to the same processes of verification that apply to all registered people. The applicable records must be made available to an officer of the Internal Revenue Commission on request.

31) Imports

Goods imported into Papua New Guinea have VAT charged at the rate of 10% on the cost, including freight, of those goods. The VAT is collected as part of normal customs procedure at the point of entry. The customs entry, together with proof of payment, is a 'Tax Invoice' for which an input credit deduction can be claimed if applicable.

32) Temporary imports

Goods and services relating directly to items temporarily imported into Papua New Guinea for period of a few days only are zero rated for VAT purposes and will not have any import duties applied. For example, services supplied to international aircraft or ships entering for a short period only.

Any supply of goods supplied in connection with temporary imports e.g., repairs and maintenance on an overseas ship, the repair of an overseas container, etc are zero-rated.

If temporary imports remain in Papua New Guinea for a period longer than a few days, or are for use in the country, the Customs Department will impose import duties in the form of a bond, payable immediately to Customs. This bond will also include VAT and will be held in trust. A Tax Invoice will not be issued immediately.

Should the temporary import leave Papua New Guinea within a 12-month period, then the bond, including VAT, is returned to the importer.

If the temporary import remains in the country for longer than 12 months it is deemed a permanent import and the bond and VAT will be forfeited.

A Tax Invoice will then be issued by Customs for the supply.

Anyone importing goods or services, as a temporary import must keep a copy of the Import Entry issued by the Customs Department. A Tax Invoice will be issued by the Customs for the import.

33) Aid projects

Approved aid projects in Papua New Guinea are zero-rated. This provision means that all VAT paid on supplies obtained in Papua New Guinea for an aid project will qualify for an input tax credit. This provision enables local contractors and suppliers to bid on an equal footing with overseas tenders. Similarly, income received by contractors from such projects is zero-rated.

An aid organisation, which imports goods itself for an aid project, will not pay VAT to Customs when those goods are imported. This will be zero-rated.

Where an aid project buys supplies or services locally, in the first place they will have to pay the VAT charged on that supply. On lodgment of the appropriate return, they will be allowed a refund of the VAT paid.

34) Supply of fine metal

The supply of unrefined ore or a metal by a miner to refine is zero-rated.

Refined gold sold by a refiner to a dealer is zero-rated.

Refined gold sold by a dealer in gold to a manufacturer is exempt.

Manufactured gold sold by a manufacturer, for example gold jewelry sold by a jeweler to an end user, is taxable.

Fine metal manufactured into goods for sale is a taxable supply other than fine metal ingots or fine metal coins.

Fine metal is defined as:
- gold with a fineness of not less than 99.5%
- silver with a fineness of not less than 99.9%
- platinum not less than 99%

35) Exempt supplies

Exempt supplies are supplies that are not subject to VAT. This means that VAT is neither added to the sale price of goods or services nor can VAT be claimed back on the cost of expenses.

Some exempt supplies include:
- financial services
- doctors, hospitals, dentists
- the supply of unprocessed logs
- the supply of fine metal
- PMV and taxi fares
- school fees

If a business has both exempt and taxable supplies, certain rules apply.

An apportionment must be made to separate the VAT paid for use in making taxable supplies and for use in making exempt supplies. This is because input credits cannot be claimed for VAT paid on purchases of goods or services used in producing exempt supplies. An input credit can only be claimed for the VAT paid in making taxable supplies

Note that zero rated supplies are a taxable supply. It is only exempt supplies for which an input credit cannot be claimed. For instance if a business sells goods for export (which are zero rated) and also sells exempt goods, it can only claim input credits in respect of the exported (zero rated) goods, not the exempt goods.

36) Financial services

The provisions dealing with the financial services sector are quite large and complex. Detailing all the options within this industry is beyond the scope of this guide. Should you have any questions relating to this sector, contact the IRC or your accountant for details.

37) Medical industry

The supply of medical and related services by a hospital, a doctor, dentist, optician or nurse or an aid post orderly is exempted from VAT.

The supply of prescription drugs or medical prostheses by a medical practitioner or prescription lenses with or without frames by an optician are zero-rated.

38) Timber

The supply of unprocessed woods is exempt, whether sold in Papua New Guinea or exported. Unprocessed wood is defined as logs, flitches or woodchips, which have not been converted into sawn timber, plywood, veneer or a product suitable for sale to an end user. If these items are going to be exported and entered as such, they will not be zero-rated.

A taxable supply will occur when that wood has been processed.

39) Education

The supply of educational services by an educational institution, such as tuition, boarding services, text books and writing materials have been given special treatment to reduce the cost to parents of their child's education.

By registering for VAT an educational institution is able to claim as a VAT input credit, the VAT paid to their suppliers for certain goods and services. These are purchases of textbooks, writing materials and any other material relevant to a child's education.

The school will not charge parents or children VAT on the supply of those goods and services. They will however charge VAT if they sell those goods to persons other than children attending the school or their parents

This special treatment is not to be confused or associated with the zero rating of the supplies provided. The suppliers of goods and services to schools will regard all such supplies as a normal taxable supply.

40) Vehicles

Registered dealers must charge VAT on the sale of any vehicle.

However, no input credits can be deducted for cars and other vehicles (except commercial vehicles) unless you are a dealer in motor vehicles or vehicle rental operator.

Input credits are allowable for commercial vehicles. A commercial vehicle is defined as a truck, utility or a van that carries 1 tonne or more or a bus that carries 9 or more passengers.

41) Other exempt supplies

The following goods and services are also exempt from VAT:

- the retail supply of newspapers
- the supply of betting, lotteries and games of chance
- postage stamps
- the supply of housing or a motor vehicle to an employee by his employer in the course of employment (refer to Section 57)

42) Primary producers

Small holders and farmers are subject to special treatment. They will incur VAT on the goods they purchase for their farms but will not need to register for VAT. So that they will not be financially disadvantaged by VAT they are permitted to increase their prices to the buyer by a set percentage that has been established according to the industry. This should recover more or less the VAT they are paying on their farm supplies. The buyer will be permitted to claim an input tax credit for the extra paid to the farmer.

43) Non-profit bodies

Goods donated to a non-profit body are exempt from VAT.

The importation of donated goods for or by a charitable non-profit body may be exempt from VAT.

Refer to the IRC to see if you qualify.

Goods imported for the organisations own business use will be charged VAT by Customs. If the organisation is registered for VAT then they can claim the VAT back as an input credit.

44) Donations

A donation is an unconditional gift. It is a gift that will not recognise, promote, advertise or have any benefit whatsoever to the donor. If the donor gets any recognition then it is not an unconditional gift and will be subject to VAT input tax.

A donation may be in the form of money or goods.

45) Charities

A charity is an organisation approved as a charity by the Commissioner General of the Internal Revenue Commission.

Goods imported into Papua New Guinea by a charity that will be using those goods for charitable work - education, poverty relief, emergency relief supplies or significant social and community works, will be exempted from VAT, subject to the written approval of the Commissioner General.

The VAT rules applying to charities are the same as non-profit bodies.

46) Second-hand goods

The supply of second-hand goods between VAT registered people is deemed to be a normal supply of goods between two or more registered persons. VAT must be charged and the supply must be supported with a Tax Invoice. The second-hand goods provisions do not apply.

Where a registered person buys second hand goods from an unregistered person for use in the registered person's taxable activity, the purchaser will be permitted an input credit of $1/11^{th}$ of the amount paid.

Second-hand goods purchased and exported will not be permitted a deemed input credit. VAT will not apply to the acquisition of or to the supply of those goods.

The following requirements for second-hand goods must be met.

- payment for the supply must have been made regardless of whether the registered person is registered under the invoice (accruals) basis or a payments basis of accounting.

- details of the vendor, contact number and a description of the goods purchased must be obtained

If second-hand goods are purchased from an associated person then the input credit will be $1/11^{th}$ of the price paid or the open market value which ever is less.

47) Lay-by sales

Lay-by sales are determined by the time of supply rules. The goods remain the property of the vendor until final payment is made. That is when the title passes to the purchaser.

A retailer will not account for VAT on the lay-by sale until the final payment has been made and the ownership of the goods pass to the purchaser. This will permit the goods to be returned to stock without a VAT adjustment if the lay-by sale is cancelled.

If, on cancellation, the vendor retains a portion of an amount paid by the purchaser then that portion retained is subject to VAT.

48) Private use of business assets

If there is private use of business assets then the private use must be calculated as a percentage of the overall use. The VAT relating to the private use must be apportioned by that percentage of private use and cannot be claimed as an input credit.

If there is also private use of assets bought for business purposes, then only part of the VAT paid on the purchase is allowable as an input credit. The VAT paid on purchase must be apportioned by reference to the proportion used for business purposes. E.g. if premises are brought ¼ (25%) for business use and ¾ (75%) for private residential use, then only ¼ (25%) of the VAT paid on purchase is deductible as an input credit.

49) Sale of business assets

A registered business selling business assets must charge VAT on the sale of those asset/s.

If an asset was purchased prior to the introduction of VAT and sold, the asset is still subject to VAT on that sale.

Where a sale is to an associated body the VAT charged on the sale must be calculated at the lower of cost or open market value.

50) Change of use

An adjustment of VAT must be made when there is a change of use after the original purchase. Please refer to the IRC for further information. .

51) Retained assets

Should a business cease trading and assets are retained (kept) by the owner or shareholders then the asset is treated as if it were sold by the business. Therefore, VAT of 1/11th of the value of the asset must be returned in the final VAT return of the business.

If the business ceases to be registered then the assets are similarly treated for VAT purposes as being sold by the business. Again, VAT of 1/11th of the value of those assets must be returned in the final VAT return.

52) Insurance

All insurance policies other than life insurance are subject to VAT. This applies to both private and business policies. Registered businesses can claim an input credit for VAT paid on business insurance.

53) Insurance claims

A registered business who makes a claim to an insurance company for compensation for loss or damage will be required to treat the insurance moneys received as assessable income for VAT purposes.

The amount of VAT payable is 1/11th of the amount received.

The VAT returned as output tax will be offset by an input claim for the replacement of the lost or damaged goods. If the lost or damaged goods are not to be replaced, VAT will still apply to the receipt of the insurance moneys.

54) Insurance companies

An insurance company is able to make an input tax claim of 1/11th of any non life-insurance money paid out on a policy.

Should the insurance company recover any money from another party in relation to an already paid out policy then the insurance company must return 1/11th of this as output tax.

55) Construction

All building and construction activities are subject to VAT on all purchases, payments, and sales. The cost of any building under

construction on the date VAT is introduced is subject to VAT from that day onwards.
A valuation must be undertaken to ascertain the value of construction as at 1 July 1999. VAT is payable on the difference between the total cost and the valuation as at 1 July 1999. This valuation must be completed by 1 September 1999.

56) Contracts

All contracts for the supply of goods or services entered into before the introduction of VAT will be subject to VAT from the date VAT commences, providing services or goods are supplied after that date and the supplier is liable to be registered for VAT.

The VAT Act provides that, from the date VAT starts, the contract price is automatically increased by the amount of VAT payable. The purchaser becomes liable to pay 10% VAT on top of the value of the contract, to the extent supplies are made after the introduction of VAT. This must be collected and paid as VAT output tax by the supplier.

If the contract specifically provides that the contract price will not be increased by the introduction of VAT, then the contract price stays the same and the supplier must pay $1/11^{th}$ of the contract receipts as VAT output tax.

57) Leases/Rents

Leases, residential and commercial rents whether by written agreement or otherwise will be subject to VAT on the proviso that the lessor is registered for VAT otherwise no VAT may be charged. Lessors may find it advantageous to register for VAT so input credits in respect of monthly expenses may be claimed back. They must register if total 'sales' (rents received and any other sales) per year are greater than K100,000.

Those who lease business premises may claim back as an input credit the VAT they pay on that lease.

Employers who provide employee accommodation (an exempt supply) are unable to claim as an input credit VAT paid on costs associated with the provision of the accommodation.

A private individual who pays rent on a residential dwelling and pays VAT on that rent may not register for VAT or claim the VAT back even if he is registered for other purposes.

58) Hire purchase agreements

On hire purchase agreements, VAT is payable not when the goods are originally supplied, but (on an emerging basis) as hire purchase payments are made.

On the introduction of VAT, you will need to recalculate the sales price of the goods to reflect the reduction in the effective cost of purchases.

This is because your cost is reduced. Firstly, the reduction in import duties and the elimination of provincial sales taxes will reduce costs. Secondly, VAT paid by businesses is not a final cost on purchased goods because they are allowed an input credit for the VAT paid by them. VAT should therefore not be included in the sale price, but calculated separately.

Interest and other financial charges are exempt from VAT and no VAT is therefore payable in respect of the portion of the monthly payment representing those amounts.

The supplier must charge VAT only in respect of the portion of each payment representing the principal cost of the asset being purchased.

Any hire purchase agreement must therefore clearly show the principal amount borrowed, the monthly hire purchase charge on that principal and the interest that is being charged. If you enter into such an agreement, ensure that these details are provided.

Leases are not hire purchase agreements. VAT is payable on the full amount of a lease.

59) A typical VAT situation

A business with an annual turnover greater than K100,000 per annum must be registered for VAT. VAT will be charged in addition to the sale price.

The approach to VAT should be twofold. Adequate records of sales must be kept by the issuing of Tax Invoices for each sale made and to record daily sales. A registered business needs to add up its total sales including VAT each month.

Suppliers to the business have also charged VAT on the goods and services purchased. If the suppliers are registered, they will issue a Tax Invoice in respect of each supply. Those invoices must be kept on file. At the end of each month, the business will need to add up the VAT on those invoices. This is the total VAT it has paid on its supplies and expenses during that month. That total will be entered into the monthly VAT return.

It is important to note that if goods or services are purchased from an unregistered business or person no VAT input credits can be claimed on their supply. The sole exception is for second hand goods purchased for resale or for use within the business.

The business may or may not have a great accounting system. There are no specific accounting requirements for VAT other than the requirement to record sales and expenses accurately.

HINT: For businesses using a cashbook to record their turnover and expenses. Create an additional column in the cashbook next to the total expense column. Title or head this column 'VAT'.

Enter the VAT charged by your suppliers into this column (use the Tax Invoices as a source for this information). At the end of the month, the business will have an accurate and verifiable record of the VAT credit it is claiming.

For invoices that are tax inclusive, VAT is $1/11^{th}$ of the total. The cost is the balance of the total.

If a supply does not contain VAT, for example a supply from an unregistered vendor, do not enter an amount into the corresponding VAT column.

A business may enter the daily banking into the income column and this may not reflect the true sales. Ensure that the cashbook or the accounting records used show the <u>total</u> daily sales.

Whatever recording system is used, ensure the VAT charged on expenses is accurately recorded as well as the monthly sales. The filing of Tax Invoices from suppliers in monthly bundles is also worth considering.

CAUTION: Whatever accounting system is used, ensure that whenever the business is subject to an IRC audit or inquiry, it is able to provide the Tax Invoices. This must include copies of Tax Invoices issued by the business itself and the original Tax Invoices issued to it by its suppliers for the period under inquiry. <u>Failure to do so will result in a reassessment of VAT returns.</u>

60) Record keeping

Proper accounting records such as Tax Invoices and sales turnover figures must be kept, so the Internal Revenue Commission can readily assess the VAT liability. These records must be held in Papua New Guinea, written in English and must be kept for a period of seven years.

For VAT purposes records may include:
- cashbook's
- computer ledgers/audit trails
- till tapes
- receipts
- Tax Invoices
- credit and debit notes
- bank statements
- debtors/creditors lists

The record keeping requirements of a business will depend on the type of business it is. Some businesses do not generate much paperwork, others do.

At the very minimum the IRC will require Tax Invoices, proof of payment and proof of earnings. Without evidence of earnings and expenditure a business with poor record keeping is not only committing an offence, but will be subject to reassessment of its monthly returns and heavy penalties.

Should you have any doubt as to the records you should be keeping, please contact the IRC or preferably your accountant who will advise and examine your accounting system to ensure you can meet your obligations.

If we cannot determine what your income and expenditure is from the records kept, or we regard income and expenditure as being unrealistic for the business under examination, then we may have to determine what the income and expenditure should be. In that case, we will reassess the businesses income and expenditure and its monthly returns.

61) Tax Invoices

An invoice is a record of a purchase or a supply of goods or services. A Tax Invoice must show certain additional information.

In general, for a supply of more than K50 a Tax Invoice must be held to claim a VAT input on a purchase. For supplies less than K50, a receipt must be held, although a Tax Invoice if available is preferable.

62) Duplicate Tax Invoices

A registered person can only issue one Tax Invoice for each taxable supply. If the purchaser loses an invoice, he can request a copy from the suppliers and there is 28 days to provide a copy of the invoice. The copy must be marked with the words COPY ONLY.

63) Supplies of more than K200

For supplies of more than K200, the Tax Invoice must clearly show the following:

- the words **“TAX INVOICE”** in a prominent place;
- the name and VAT registration number of the supplier (yourself);
- the name and address of the recipient (the purchaser);
- the date the invoice was issued;
- a description of the goods and/or services supplied;
- the quantity or volume of the goods and/or services supplied, e.g. litres, hours, kilos etc.;
- The invoice must also have the amount charged and either the VAT listed as a separate amount and then the total, or a single amount inclusive of VAT. Note that if a single figure is used, the invoice must have the words **“This invoice includes VAT charged at 10%”**, or words which clearly show that VAT is included in the price, printed clearly on the invoice.

64) Supplies of K200 or less

For supplies of K200 or less (VAT inclusive), a simplified Tax Invoice is acceptable. It must clearly show:

- the words "**TAX INVOICE**" in a prominent place;
- the name and registration number the supplier (yourself);
- the date the invoice was issued;
- a description of the goods and/or services supplied;
- the total amount payable for the supply; and
- either the VAT shown separately or a statement that VAT is included.

65) Supplies of K50 or less

A Tax Invoice is not needed for supplies of K50 or less including VAT. However in order to claim VAT back on your purchase a receipt for the purchase must be on file, showing the suppliers VAT registration number.

MONTHLY VALUE ADDED TAX RETURN

NAME:	**MONTH 1999**
ADDRESS:	**VAT No**
	Name of Contact
	Phone

I CERTIFY THAT THE INFORMATION SET OUT BELOW IS TRUE AND CORRECT IN EVERY PARTICULAR.

Signed:………………………………………………Name:……………………………………..Date………………..

VAT PAYABLE OR REFUNDABLE

1	Output Debits (from line 11 below)		K
2	Deduct Input Credits (from line 22 below)		- K
3	**Value Added Tax Payable** (remittance enclosed) **or Refundable**		K

OUTPUT DEBITS

4	Total Sales and Income for the Month (including Vat charged)		K
5	Tax Value of employee benefits provided (see note 1)		K
6	Add line 4 and 5		K
7	Less Exempt Sales (see note 2)	K	
8	Zero Rated Sales (see note 3)	K	
9	Add line 7 and 8.		-K
10	Deduct the total in line 9 from line 6 (Result = Value of Taxable Sales)		K
11	Divide Taxable Sales (line 10) by Eleven = **Output Debits** (to line 1)		K

INPUT CREDITS

12	VAT paid on **ALL** business purchases during the month		K
13	Transitional trading stock deduction (from line 24 below)		K
14	Transitional capital goods deduction (from line 26 below)		K
15	Add lines 12, 13 and 14		K
16	Less VAT paid for exempt sales (from line 31 below)	K	
17	VAT paid for private purposes (see note 4)	K	
18	% of VAT paid for capital goods (see note 5)	K	
19	Add line 16, 17 and 18		-K
20	Deduct the total in line 19 from line 15		K
21	Credits available from prior months (see note 6)		K
22	Add the totals in line 20 and 21 = **Input Credits** (to line 2)		K

TRANSITIONAL TRADING STOCK DEDUCTION

23	Qualifying Trading Stock on hand 1/7/99 (see note 7)	K
24	Divide line 23 above by 110 = **Trading Stock Deduction** (to line 13)	K

TRANSITIONAL CAPITAL GOODS DEDUCTION

25	Qualifying Capital Goods on hand 1/7/99 (see note 8)	K
26	Divide line 25 above by 220 = **Capital Goods Deduction** (to line 14)	K

VAT PAID FOR EXEMPT SALES

27	VAT paid on inputs used for both exempt & taxable sales (see note 10)	K
28	Divide amount in line 27 by total sales (from line 4)	K
29	Multiply amount in line 28 by exempt sales (from line 7)	K
30	Add VAT paid on inputs used solely for exempt sales	K
31	Add lines 29 and 30 = **VAT Paid for Exempt Sales** (to line 16)	K

32	Write here the Province where sales were made -	
	(If sales are made in more than one Province, attach a list showing the value of sales in each Province)	

66) How to complete your VAT return

This is a brief guide on how to complete a monthly VAT return. A full guide is available from the IRC on request, free of charge.

The first 20 months of the introduction of VAT is a transitional period, where trading stock and capital items on hand at 1 July 1999 get a VAT input credit. This has resulted in additional areas on the VAT return where those credits are calculated. Refer to the transitional period section of the full guide for further information. Those additional areas add to what looks like a complicated and difficult VAT return.

However, the return looks far worse than it really is. <u>All the instructions needed to complete the return are on the return form.</u>

Please examine the example of the VAT return form preceding this text and follow it through. You shouldn't have any difficulty completing the return but just in case, as mentioned above, we have a detailed 'return guide completion brochure' available on request. Contact the IRC and we will send you a copy.

Here is a summary of the VAT return.

1 - The first part of the monthly return is the business name, registration number and the month of the return. We also need the name of the person responsible for the completion of the return.

2 - The first 3 calculation lines in the body of the return are the final areas to be filled in. They give the result of the calculations carried out in the rest of the return. Those lines will show if you are entitled to a VAT refund or, if your firm is trading well, the amount to pay.

3 - The transitional period will result in calculations that will vary little during the initial phase. It is suggested that you go to line 23 – the transitional trading stock deduction and complete that area. After the first month, you could copy the previous months figures, as they should remain the same throughout the initial months.

4- Complete the transitional capital goods deduction in the same manner as above.

5- VAT paid for exempt supplies. The majority of business will not have exempt supplies. If you do then complete the calculation from lines 27 to 31.

6- Once these have been completed, go to the output debits box and complete lines 4 to 11.

7- Then continue to complete the input credits, lines 12- 22.

8- The final activity is the transfer of the figure in line 11 (output debits) and the figure in line 22 (input) credits to the VAT payable (refundable) section on lines 1-3.

Finally, you should show in which Province the sales for the month were made. If this is not shown your provinces share of total VAT revenue will not be correct. If you trade in more than one province, show the <u>sales</u>, by Province, on a separate sheet of paper. Separate cheques should be attached for the proportion of tax payable in each province (see section 6 for explanation of how to calculate the proportion).

67) Do's and Don'ts – Traps for the unaware

Output tax is the VAT collected on your sales of goods and services. It is the VAT you have collected from your customers. It is trust moneys given to you by your customers.

Output tax is not calculated on what you have left in the till, or the bank, or in your pocket after paying some of your suppliers as well as the wages and your lunch.

Remember output tax is calculated on total turnover i.e. total sales. It is not a tax on profits.

Input tax (or input tax credit) is the VAT you have paid on the supplies purchased for use in your business (the taxable activity). It is the amount you deduct from your output tax, to arrive at the amount payable.

Input tax credit does not include the VAT paid for any goods or services purchased for your private usage, even though you may be a registered person.

An input claim cannot be made just because you have paid for something or said you have paid for something. You must be able to prove it. A VAT or Tax Invoice is the only evidence we will accept as proof of purchase.

Cheque butts are unacceptable as proof of purchase, but are required to be kept as a means of reconciliation by the IRC.

VAT refunds. If you are an exporter, you will get regular refunds. If you do not export and get a refund then this is usually indicative of a large purchase during the month. You must be able to prove this with evidence of a Tax Invoice.

If neither of these events occur and you are getting VAT credits or in fact paying very little in VAT then please check that the VAT return is not being completed in reverse i.e. that you are not deducting your output taxes from the input credits. If the returns are being completed correctly, you may want to check that your business is actually trading properly.

The rule of thumb with a value added tax is - if you remember that the amount paid to the IRC is the VAT on the difference between sales and expenditure, the higher the sales and the lower the expenditure the more VAT will be collected by you and paid to the IRC. A good sign that your business is healthy and you are making good profits.

If you are paying very little in VAT or getting small refunds constantly there may be a good reason for this or there may well be a problem somewhere within the system. We will be interested in these cases. It is strongly suggested that if your business is not trading well (and VAT is generally a good indicator of a business's trading pattern) **seek professional accounting advice.**

68) Conclusion

This guide is designed to be an informative summary of VAT. There will be many businesses that have specific information and VAT requirements.

However, it is recommended that as part of normal business practice you seek professional advice if you are unsure of any procedure or technical aspect of VAT that you may encounter in relation to your business.

The VAT Act is available for a nominal fee by contacting the Internal Revenue Commission.

Authorised by JAMES LOKO
Commissioner General
Internal Revenue Commission