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A study on Income tax application on Employee's Long Service Payment in Papua New Guinea

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Abstract
The objective of this study is about the income tax rules and regulations which applies on employee's long service payment in Papua New Guinea under various cases. Papua New Guinea Income Tax System is based on the progressive nature i.e. as when the income level increase, income tax percentage rate also will increase thus, employees are heavily taxed under the salary and wages tax system of the country. The salary and wages tax have been amended at various stages throughout the budget proposals due to the changes in by the different regime of governments in Papua New Guinea. The salary and wages tax were introduced by the Australian Government before Papua New Guinea got its independence from Australia. It does not support the ordinary employees of PNG with their current salary and wages tax system

The researcher is more focused on the employees 'long service payments based on the different case studies. The readers of this paper can have a clearer understanding of the salary and wages tax rate application. The study has been done based on the author's previous research paper on fortnightly salary and wages tax system in Papua New Guinea with the experiences of lecturing corporate tax and business industry for the last twelve years.

Key Words: **Papua New Guinea Long service payment, Marginal tax rate, fortnight salary and Concessional tax rate**

1.Introduction

The treatment on tax for long service payment was amended in the budget proposal 2018 and was a significant change in the salary and wages tax system in Papua New Guinea. The long service payment had been taxed at the marginal rate up to 2017, but it was reduced to the lowest tax rate of 2% at the year of assessment 2018 and to date. The payment of tax on the long service payment has been rationalized in line with the superannuation tax rate. The substantial tax reduction on the long service payment can help the retired employees to have some savings in the latter part of their work- life which can be helpful to them. The concessional rates of salary or wages tax only applies to payments made as part of a bona fide termination payment. If the employee takes the long service payment in advance when he is not actually due for the payment then the marginal rate of tax will apply. The introduction of concessional rates for long service payment will improve the standard of living and bring happiness and joy to many employees when they retire from their employment. The tax reforms on the salary and wages tax has been highly demanded by the citizens of the country but few changes have been made since 1978 where, more changes are required in the current salary and wages tax system. The people of Papua New Guinea have been paying double tax by salary & wages tax and goods & services tax for many years. None of the governments have done any tax reforms on the goods services tax. Therefore, the living standard of the employees and their extended families have not been improved in line with other developing nations in the world

2.Literature Review

A study on Income tax application on Employee's Long Service Payment in Papua New Guinea has not been done in a proper manner yet however few studies were done in Australia and some other countries in the world. PNG Tax review 2013 -2015 states that PNG has a hybrid model similar to Australia where the contribution to a retirement fund, fund earnings and the payout of benefits are subject to a combination of tax concessions, exemptions and taxation at the contributor's marginal tax rate.

Corporate tax study textbook of International Training Institute states that long service leave accrues at the rate of 1.733 weeks per year and is calculated on a person's current salary.

The long service payment computed is based on the last fortnight basic salary not any form of allowances (Sivaruban, 2018).

According to loop news report (2018) if the long service leave is taken as leave and the employee continues to be employed then they are taxed at the normal fortnight rates of the salary or wages tax.

According to Papua New Guinea Budget 2018 -Deloitte from 1 January 2018, the taxation of long service leave payments shall be taxed similarly to the sliding rates that is applicable to superannuation lump sum payments.

3. Employee's Long Services Payment

Employees working for more than three years or equal to three years in the particular company without any service interruption is qualified for the long services payment on pro - rata basis. If any employee who has worked for 15 consecutive years in the same company is qualified for six months' salary or in other words the employee is qualified for 13 fortnight salaries. The Employees Act 1978 states the above provision. The income tax rate is applicable on the employee's long services payment had been complicated up to Year 2017 but it has changed in the year 2018, The previous government had changed the tax rate on long services payment in a simple manner so that the ordinary employees can understand the income tax application on the long service payment. The long service payment is considered on the last fortnight salary (basic fortnight Salary) for the resigned or terminated employee. Any other benefits are not part of long service tax computation.

A study on long services payment with income tax application is explained on the following steps:

Step 1: The given tax table below is based on the fortnightly salary structure in Papua New Guinea. Therefore, salary and wages need to be converted into fortnight salary based.

Salary payment Methods	**Acceptable formula by IRC –Fortnight Salary**
Annual Salary	Annual Salary / 26
Monthly Salary	Monthly Salary / Numbers days in the Months x 14 days
Weekly Salary	Weekly Salary x 2

Step 2: The employees have to work for a minimum of three years or equal to three years with the same company to be qualified for the long service payment. An employee will not be entitled for the payment on long service if he works less than three years as per the employee Act of 1978. The following formula has been used to calculate the long service payment for the employee:

$$\text{Long Service Payment} = \text{Numbers of years worked} \times \frac{13}{15} \times \text{Fortnight Salary (Basic Salary)}$$

If an employee works for the same company for 15 years then he/she will be qualified for the six months' salary i.e. it is equal to thirteen - fortnight salary. Therefore, 13 /15 remain unchanged for the above formula whereas, the number of years worked and last fortnight salary may differ from one employee to another.

Step 3: Once the long service payment is calculated then, the tax rate will be applicable and it is based on the number of years an employee has worked with the same company. The following tax table rate is applied based on the Income tax legislation of Papua New Guinea.

Long Service Payment – Income tax Rate

Numbers of Years worked	Less than 5 years	Not less than 5 years and not greater than 9 years	Not less than 9 years and not greater than 15 years	More than 15 years
Rate of Tax	Marginal rates of Tax	The lesser of **15%** or the marginal Rate of Tax	The lesser of **8 %** or the Marginal Rate of Tax	The lowest tax rate of **2%**

Step 4: The calculation for an employee who has worked for more than three years and less than or equal to eight years, the following tax computation rule /method will be applied for the long service payment.

Case Study 1: Mr. James Peter worked with XYZ Ltd for the last eight years and he received an annual salary of PGK 40,000 with three dependents.

Step I: Annual salary is converted into fortnight salary since PNG tax table is based on the fort nightly salary. Normally the annual salary is divided by 26 FNT which is equal to a fortnight salary.

$$\text{Fortnight Salary} = \frac{\text{Annual Salary}}{26\ \text{FNT}} = \text{Fortnight Salary} = \frac{40,000}{26}$$

Therefore, the fortnight salary for Mr. James Peter will be PGK 1, 538.46.

Step II: To Compute fortnight tax payable on the normal fortnight salary by using the table C of the Tax Table 2019.

Fortnight Salary of PGK 1, 538.46

Tax payable on the fortnight salary is PGK 1, 538.46

First PGK <u>(1, 276)</u> tax payable PGK 213.46

Balance PGK 262.46 tax payable PGK 262.46 X .35 toea = PGK 91.86

Therefore, total tax payable K213.46 +K91.86 = K305.32

Less: Three Dependents Tax Rebate K40.38.

Net Tax payable on Fortnight salary K1, 538.46 with 3 dependents shall be K264.94 (Total tax payable K305.32 –Three dependents tax rebate K40.38/-).

Step III: To Compute the long service payment for eight years of work (Please refer to the step II).

$$\text{Long Service Payment} = \text{Numbers of years worked} \times \frac{13}{15} \times \text{Fortnight Salary and wages}$$

Long Service Payment =8 years X 13/15 x 1,538.46 so K10, 666.66/-. Thus, the condition should be the lesser of **15%** or the marginal rate of tax. Therefore, the tax payable on long service payment is @the rate of 15% as prescribed by the Internal Revenue Commission of Papua New Guinea is K10, 666.66x 15/100 = K1,600.

Step IV: Compare the marginal rate of tax application procedures on the long service payment or tax rate at 15% whichever lesser.

Step A; The long service payment is divided by twenty - six fortnightly salaries, to long service payment per fortnight. (This calculation is done for the purpose of reducing the tax amount on the long service payment).

<u>Long Service payment</u> = Long service payment per fortnight.

Twenty-six fortnight per year
K10, 666.66 / 26 FNT = K410.26

Step B: Add the normal fortnight salary with long service payment per fortnight

Normal Fortnight Salary K1, 538.46
Add: Long service payment per FNT K410.26
Total amount for FNT including long service payment is K1, 948.72

Step C: Compute the fortnight tax payable from the total amount of FNT payment including the long service payment and the normal FNT Salary**.**

Tax payable on total amount K1, 948.72

Tax Table C	Frist K1, 276.00	Tax 213.46
	Add: Balance K 672.72 x.35 toea	Tax 235.45
	Gross tax payable	448.91
Less:	Three dependents tax rebate	(40.38)
	Net tax payable	408.53

Net tax payable for both FNT Salary and Long service payment is K408.53

Step D Compute the difference between the fortnight tax payable on normal fortnight salary including long service payment for the fortnight and normal fortnight salary.

Tax payable on fortnight salary with long service payment	XXX
Less: Tax payable Normal Fortnight Salary	(XX)
Difference (Tax payable on long service payment)	XXX

The purpose of the above tax computation is done logically to identify the tax component on the long service payment.

Net tax payable for both FNT Salary and Long service payment is K408.53
Net Tax payable on Fortnight salary is K1, 538.46 and with 3 dependents is K264.94
Differences (Tax payable on the long service payment) is K 143.59

Step E: Gross tax payable on long service payment is based on the long service payment per fortnight multiplied by Twenty-six fortnight.

Gross tax payable; Difference (Tax payable on long service payment) X 26
Gross tax payable K143.59 x 26 = K3, 733.34/-

Step F: Please refer to step III to compare the lesser of 15% or marginal tax rate

Long service payment K10, 666.67 X 15/100 = K1, 600.00
Marginal tax payable for K10, 666.67 = K3, 733.34

The effective marginal tax rate is K3, 733.34 x 100 / K10, 666.66
35%

The is based on the above tax computation for the long service to compare for lesser tax amounting to K1, 600/- with K3, 733.34 (Marginal tax payable) so that the tax payable on the long service is K1, 600. (Concessional rate of 15% will apply). Therefore, the tax payer is saving 20% on the long service payment due to changes on the tax rate.

Step G: Net taken home pay on long service payment.

Gross payable on Long Service	XXX
Less: Tax payable on long service	(XX)

Net pay on long service	XXX

Long Service payment	K10, 666.66
Less: Tax payable on long service	K1, 600.00
Net pay on long service	K9, 066.66

Case Study 2

Mr. Philip Bala retired on March 31, 2019, after working for fifteen years in a company with two dependents. His salary at the time of retirement was K 120, 000 per annum. The following benefits were due upon his retirement;

1. Five weeks accrued annual leave pay.
2. Accrued long service leave pay.
3. Six months' salary as appreciation for his long service with the Company.
4. The superannuation at retirement was K125, 000of which his contribution was K35, 000.
5. Bonus was made for three weeks' pay

Computation on the tax payout on the total sum of termination.

Step 1: Convert the annual salary into fortnight salary

$$\frac{K120,000}{26\ FNT}$$

K4, 615.38

Step 2: Computation on the final entitlements

- Five weeks accrued annual leave is equal to 2 ½ fortnight so two weeks is equal to one fortnight.

Accrued Annual Leave 2.50 x 4, 615.38 =11, 538.45

- Computation for the Long service-based formula is given in step III

Long Service Payment = Numbers of years worked X $\frac{13}{15}$ X Fortnight Salary

$$15 \times \frac{13}{15} \times 4,615.38 = 60,000.00$$

- Six month's salary payment of appreciations for his long service to the Company;

Six month's salary equals 13 fortnight salary.

13 Fortnight salary X 4, 615.38 =K60, 000.00

- Superannuation pay out Total = K125,000

Less: Employees Contribution = K35, 000 (Already taxed)

Net Superannuation Pay out Liable to Tax K90, 000/-

- Bonus payment of three weeks is equal to 1 ½ Fortnight salary

Gross Bonus payment K4, 615.38 x 1 ½ =K6, 923.07

Step 3; Tax Computation at concessional tax rate of 2% as he worked for 15 years

• Long Service Payment	K60, 000
• Net Superannuation Payout	K90, 000
Total payout	K150, 000/-

Therefore, total tax payable K150, 000 X $\frac{2}{100}$ = K3, 000/-

Step 4: Tax Computation for other benefits at marginal rate

- Accrued Annual Leave 2.50 x 4, 615.38 = K11, 538.45
- 6 Months appreciation (13 FNT Salary) K60, 000.00
- Bonus Payment K6, 923.07

Total Payout K78, 461.52

Total payout= K78, 461.53 = K3, 017.75 per fortnight
26 FNT 26 FNT

Total payout per fortnight salary	K3, 017.75
Normal Fortnight Salary	K4, 615.38
Total amount	K7, 633.13

Gross tax payable on Total amount K7, 633.13

Table C –Method 1	(K2, 700.00)	Tax	711.54
Tax payable	K4, 933.13x.40	Tax	1,973.25

Gross Tax payable			K2,684.79
Less: Two dependents			(K28.85)

Net tax payable			K2, 655.94

Compute tax on fortnight salary and wages

Tax payable on fortnight Salary	K4, 615.38	
Tax Table C Method 1	K2, 700.00	Tax K 711.54
Tax payable	K1, 915.38 X0.40	Tax K766.15
Gross tax payable		K1, 477.69
Less; Two Dependents		(K28.85)
Net Tax payable on Fortnight Salary		K1, 448.84

Net tax payable on other benefits including FNT Salary	K2, 655.94
Less: Net tax payable on FNT Salary	K1, 448.84
Net tax payable on other benefits	K1, 207.10

Therefore, Gross tax payable on other benefits K1, 207.10 x 26 FNT = 31,384.60/-

Total other benefits other than long service and Superannuation Fund	K78, 461.53
Gross tax payable	K31,384.60
Net pay taken home (Other Benefits)	K47,076.93

Gross tax payable Summary

Gross tax payable on Long service and superannuation	K 3, 000.00
Gross tax payable on other benefits	K31,384.60
Grant total tax payable	K34,384.60

Case Study 3

Ms. Sentha worked for XYZ Company for the last four years and she was paid K750 per fortnight, with three dependents. She received three weeks accrued annual leave.
Compute: Tax Computation on long service payment and annual leave.

The marginal tax rate will apply for any long service payment if it is less or equal to five years of service.

The following tax application method will apply on long service payment

$$\text{Long Service Payment} = \text{Numbers of years worked} \times \frac{13}{15} \times \text{Fortnight Salary}$$

$$= 4 \text{ years} \times \frac{13}{15} \times 750.00 = K2,\ 600.00$$

Annual Leave payment for three weeks is equal to 1 ½ fortnight.

Annual leave payment = K750.00 x 1.50 Fortnight = K1, 125.00

Total resignation sum of payment

Long service payment for four years	K2, 600.00
Annual Recreation Leave	K1, 125.00
Grant total	K 3, 725.00

Total resignation payment divided by twenty-six fortnight = $\frac{K3,\ 725}{26}$ =K 143.27

Total resignation payment per fortnight K143.27

Add: Normal Fortnight salary	K750.00
Grant Total	K893.27

Tax payable on K893.27 with three dependents (Table B) K 64.08 (Please refer to column 1 and column 4).

Tax payable on K893.27	K64.08
Less Normal Fortnight Salary K750.00	K37.40
(Table A with three dependents)	
Net tax payable on total resignation payment	K26.68

Gross tax payable on long service payment K26.68X 26 = K693.68/-

Total resignation payment	K3, 725.00
Less: Tax payment	K693.68
Net pay	K 3, 031.32

There shall be differences of the tax on the long service payment based on different circumstances and the three types of case studies discussed earlier indicating the different applications for each. The salary and wages tax application for long service payment with less than five years has become more complicated. It has involved too many steps to compute in the final tax on long service payment. The tax treatment on other finish pay will be different from the long service payment if it is more than five years. The Finish pay includes annual leave payment, bonus, Lieu on notice payment, appreciation payment for long service apart from the long service payment.

4.Data Collection and Analysis:

A study on Income tax application on Employee's Long Service Payment in Papua New Guinea is based on published journals, books, website searches, newspapers and articles. Also, inclusive of the authors study while working in Papua New Guinea for the last 12 years with his wide experience and knowledge on the subject matter, it was used to write this article. Formal research has not been done in this study.

5. Scope of the Study:

A study on Income tax application on Employee's Long Service Payment in Papua New Guinea is vital for the employees to understand the practical salary and wages tax application on the long service payment and furthermore, this study can help any future researcher on the same subject. This is the first article published on a study in Income tax application on Employee's Long Service Payment in Papua New Guinea.

6. Recommendations

1. The marginal tax rate for the long service payment within five years needs to be reduced. It is highly advisable to reduce the marginal tax rate to 22% in line with the lowest income rate for the personal Income.

2. Any employee who resigns or is terminated on medical reasons other than normal retirement should be considered in the different tax rates. (on provision of the valid medical report provided by the employee).
3. The long service payment is purely based on the basic salary without any other allowances or employment benefits but it's highly advisable to extend the basic salary with other certain benefits. The employees have earned those additional benefits apart from the basic salary during their employment period as they are qualified for these benefits.

7. Conclusion

The main objective of this study is done on Income tax application on the Employee's Long Service Payment in Papua New Guinea in detail. There are the different types of tax treatment on the long service payment and is explained in a simple and logical manner. The researcher has been teaching the subject taxation for the last twelve years in Papua New Guinea. He has used a very simple method to explain the complex tax calculation on long service payment. Most of the employees cannot understand the proper way of the salary and wages tax computation on long service payment. They end up confused so extra preparation is given towards the understanding of this topic. Therefore, the researcher has explained the method of the salary and wages tax application on the long service payment in the three different case studies.

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