

How could PNG's income tax schedule be improved?

by Anna Kapil and Stephen Howes

19 February 2025



Revenue Haus in Port Moresby is the headquarters of Papua New Guinea's Internal Revenue Commission.

Photo Credit: Shepherd Fungke

Income taxation is a hot and very sensitive topic in Papua New Guinea. Last January's Port Moresby riots were provoked by the police going on strike after a payroll error gave rise to rumours that the tax-free threshold was being reduced.

Income tax should be a hot topic in PNG because it is so important, raising about 4% of Gross Domestic Product. This is only half of the 8-9% of GDP the personal income tax raises on average in developed or advanced economies, but about double the 2% that is on average raised in developing economies ([IMF report, Figure 3](#)). This reflects the high degree of duality in the PNG economy, with a very large resource sector but also a very large rural population. [One study shows that](#), out of 59 poor countries, PNG has the fourth-highest ratio of direct taxes to GDP and the highest ratio of direct to indirect taxes.

How has the income tax schedule changed in PNG? And how can it be improved?

In our new [Devpol Discussion Paper](#), we have gone back to PNG's independence, and have documented all the changes to the tax schedule since. There have been 17 changes in all, some major, some minor.

Over the entire period, the main changes that we find can be summarised as follows:

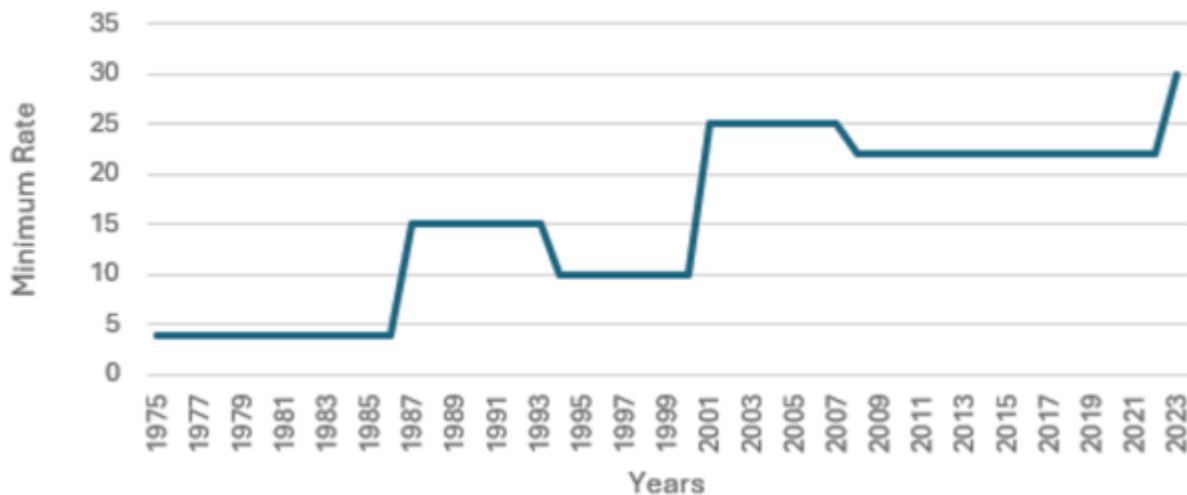
- The number of rates has been reduced by two-thirds. There were 12 rates at independence and only four now.
- The maximum rate has been slightly reduced. It was 50% at independence and is 42% now.
- There has been an uneven but downward trend in the maximum threshold. Now the maximum rate (42%) kicks in at K250,000; at independence, the maximum rate (50%) kicked in only at almost K700,000 in today's prices.
- After adjusting for inflation, there is no overall trend in the minimum (tax-free)

threshold, that is, the income level below which no taxes need to be paid. When it was introduced in 1987, it was K20,300 at today's prices, and now it is K20,000, almost identical.

- There has been a steep increase in the minimum non-zero rate. The lowest rate used to be 4%. Then, in 1987, when the tax-free threshold was introduced, the lowest non-zero rate was 15%. Now the lowest non-zero rate is 30%.
- With a lower maximum and higher non-zero minimum, there has been a sharp compression in tax rates, with the gap between the maximum and non-zero minimum now only 12 percentage points; it was 46 percentage points at independence.

One of the attractive features of the income tax regime is its progressivity, the fact that richer people contribute proportionately more. We show that overall, the tax schedule is more progressive than at independence because of the introduction of the tax-free threshold in 1987. However, the tax schedule has become less progressive since 1987 because of the massive increase in the minimum non-zero income tax rate, shown in Figure 1 below.

Figure 1: Minimum non-zero income tax rate



Note: Before 1987, there was no tax-free threshold. Source: [Authors' discussion paper](#).

PNG in fact now has the highest minimum non-zero tax rate in the region at 30%. (Indonesia runs a close second with 28%.) Other minimum non-zero rates in the region are in the range of 5-20%, and the global average for developing countries is around 15%. Despite the recommendations of the 2015 Tax Review Committee, the minimum non-zero tax rate has continued to rise.

Today, the tax-free threshold, adjusted for inflation, is the same as when it was introduced (1987), but the rate facing those just above the tax-free threshold has doubled over the same period, from 15% to 30%. To restore the progressivity of the

income tax to its 1987 level, the minimum non-zero income tax rate should be reduced.

Of course, reducing the non-zero rate, say returning it to 15%, would cost the government money and would have to be paid for, either by other adjustments to the income tax schedule, increases to other taxes or cutting expenditure. In our view, it would be well worthwhile. Whether you look at it from a historical perspective, a regional perspective or an international perspective, PNG's 30% minimum non-zero rate is simply much too high.

Download the [discussion paper](#) for the full list of changes and sources.

Disclosures:

This research was undertaken by Anna Kapil under the [Greg Taylor scholarship program](#) at the Development Policy Centre.

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