THE GREAT TIMBER HEIST

THE LOGGING INDUSTRY IN PAPUA NEW GUINEA

The Oakland Institute

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Acknowledgements

This report was authored by Frédéric Mousseau, Policy Director, with Peiley Lau, Intern Scholar at the Oakland Institute.

We are deeply grateful to the organizations and individuals who assisted with research on the ground as well as Advocates for International Development (A4ID) for their support.

The Oakland Institute is also grateful for the valuable support of its many individual and foundation donors who make our work possible. Thank you.

Design: Amymade Graphic Design, amymade@gmail.com, amymade.com

Copy Editor: Melissa Moore

Photographs: © Paul Hilton / Greenpeace

Cover photo: Rimbunan Hijau subsidiary Saban's logging site in Sebutuia, Milne Bay

Publisher: The Oakland Institute is an independent policy think tank bringing fresh ideas and bold action to the most pressing social, economic, and environmental issues.

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Executive Summary

With 3.8 million cubic meters of tropical wood exported in 2014, primarily to China, Papua New Guinea (PNG) has become the world's largest exporter of tropical wood, surpassing Malaysia, which had held the top spot for the past several decades.

PNG reached the coveted first place after expanding the exploitation of its forest resources in recent years through a legal mechanism called Special Agriculture and Business Leases (SABLs). The SABL scheme was officially intended for agricultural projects but was in reality widely used by logging companies to access new forest resources. The Commission of Inquiry (CoI) established by the government in 2011 to investigate SABL land deals found widespread lack of free, prior, and informed consent of the local people; failure of the state agencies in performing their duties; and fraud, misconduct, and incompetence as well as overall lack of adherence to proper procedures.[1] When Papua New Guinea's Prime Minister Peter O'Neill tabled the commission's report in Parliament in September 2013, he stated that it "revealed a shocking trend of corruption and mismanagement in all stages in the process."[2] He announced in June 2014 that all illegal deals would be canceled.[3] Yet, to date, the government has not taken any decisive action to cancel deceptive land deals, stop illegal logging, or return land to traditional owners.

However, SABLs are just the tip of the iceberg. The 5.5 million hectares leased under SABLs in recent years come in addition to 10 million hectares already allocated by the

Rimbunan Hijau subsidiary Saban's logging site in Sebutuia, Milne Bay government as logging concessions.[4] This means that more than one third of the country's 46 million hectares is now in the hands of foreign—mostly logging—firms.

Although PNG supposedly enjoys the most equal distribution of land on earth and is governed by a constitution that protects people's customary land rights and the environment, it has become a major target for international logging operators who are facing growing resistance and scarcity of timber resources in other countries. As documented in the Oakland Institute's report and film *On Our Land*,[5] logging in PNG obscures a multilayered tragedy of the betrayal of people's constitutional protections and the loss of cultural heritage and land for millions of Papua New Guineans. All over the country, local communities are being deprived of their resources and their rights while their government turns a blind eye to the deceptive practices of the forest industry and police forces that often work on behalf of logging companies.[6]

The industry and its proponents argue that logging contributes to the development of the country—pointing to tax revenues the government receives on log exports.[7] However, our research uncovers disturbing facts surrounding the practices and finances of the logging industry in PNG. This new information raises important questions about benefits to the national economy, given figures that suggest rampant tax evasion and financial misreporting in the sector.

This report examines PNG's forestry sector, focusing specifically on a number of subsidiary companies that are members of the largest logging firm in PNG, the Malaysian company known as Rimbunan Hijau (RH) RH Group.

Based on fieldwork conducted in PNG and analysis of the financial and tax records of dozens of individual companies and the industry as a whole, this report reveals the following about the logging industry in PNG:

- Most of the logging industry appears to declare little to no profit from the export of timber.
- The 16 subsidiaries of the Malaysian firm Rimbunan Hijau Group investigated in this report appear to have been working mostly at loss for over a decade.
- With no or little profit declared, most of the companies in the sector generally don't pay the 30% income tax on profit that businesses are required to pay according to national laws. Operating at a loss, the 16 RH subsidiary companies we investigated have together accumulated around $32 million in tax credit in just seven years.
- The discrepancies found in PNG timber export prices and the operational losses declared by many logging companies seem to indicate that transfer pricing is taking place in PNG's forest industry—resulting in a loss of tax revenue that may exceed $100 million per year.

This report suggests that the lack of reported profit does not accurately reflect the realities of the logging industry in PNG. The financial figures and structures indicate that *underpricing*, through which the declared prices of exported timber are understated, and *overpricing*, wherein expenses for the purchase of goods and services are overstated, may be happening in PNG.

The declared export prices for PNG timber are significantly lower than those of other major exporters of tropical logs.[8] For the past 15 years, the average price per cubic meter is 20% lower for PNG than the average of the other five major exporters of tropical timber. In 2014, the PNG export price per cubic meter was $210 vs. $388 for the average of the five other major exporters of tropical wood (making PNG timber 46% cheaper). Applied to the 2014 volume of log exports (3.8 million cubic meters), this variation makes a $679 million difference in annual revenue for the industry.

Our investigation of the web of firms, subsidiaries, and tax haven–based holding companies involved in PNG logging suggests that goods and services are often purchased from sister or holding companies, leading to a real opportunity for both overpricing and underpricing.

The industry pays export duties and levies on logs amounting to an average of $80 million per year, but the use of underpricing can have a significant effect both on income tax and export duties. Our research suggests that it is likely that hundreds of millions of dollars have been lost in recent years through such tax evasion.

Whereas the PNG Forest Authority acknowledges its inability to monitor and verify the activities and export prices declared by log exporters, the findings of this research call for relevant authorities such as PNG's Internal Revenue Commission, the agency in charge of collecting taxes and enforcing tax regulations, to urgently take action to defend the interests and rights of PNG citizens.

Introduction

In 2013, the Oakland Institute released *On Our Land*,[9] a report and a film documenting the massive grabbing of land and natural resources in Papua New Guinea in recent years.

Between 2003 and 2012, around 5.5 million hectares of customary land passed into the hands of national and foreign corporate entities through Special Agricultural and Business Leases (SABLs), a legal mechanism known as the "lease-leaseback scheme."[10] With many of the leases lasting as long as 99 years,[11] the land leased under SABLs amounts to more than 12% of PNG's total land area and more than 16% of the country's accessible commercial forests. As a result of these leases, the area of the country under customary land tenure, i.e. controlled by local tribes and clans, has dropped from 97% to 85% in just a few years.[12]

On Our Land exposed how the SABL scheme had been misused. The system, which was designed only for agricultural projects, was being used by many logging companies to develop and accelerate their felling activities. In 2014, the report of the Commission of Inquiry (CoI), which was established by the government to look into the operations of the SABL scheme, reported that most of these land leases were granted under threat, intimidation, and bribery, and/or without the free, prior, and informed consent of landowners.[13] The CoI identified all sorts of malpractice and violation of laws and regulations in the course of its investigation and concluded that the majority of the leases were actually illegal.[14] In fact, the CoI determined that only 4 out of 42 leases they investigated had received the proper consent of landowners.[15]

In 2014, Prime Minister Peter O'Neill declared that all illegal land leases would be canceled. However, to date, no action has been taken to return the land to its rightful owners. In the meantime, logging continues on the ground, devastating forests and the livelihoods that depend on them, while local communities around the country struggle to stop the massive theft of their land and the destruction of their natural resources.

The SABL scandal highlighted the broader issues with the massive logging operations taking place in Papua New Guinea. According to the PNG Forest Authority, there are more than 10 million hectares (ha) under active logging concession.[16] When added to the surface area leased under SABLs, the total area of PNG land under some form of lease or concession is more than 15 million ha—one third of the country's land—and a much higher share of accessible and useable land.

The activities of logging companies have been criticized for many years by NGOs and government's reviews, often for the same reasons that led to the SABL scandal, including lack of consent by landowners, corruption, and mismanagement by the government agencies in charge.[17]

While the proponents of the forest industry boast about its significant benefits for the local economy,[18] comprehensive and objective analysis of the costs and benefits of the sector for Papua New Guinea is lacking. This led the Oakland Institute to conduct further research on the activities and practices of the logging industry in the country and the sector's dominant player—the largest logging firm in PNG—a Malaysian firm known as Rimbunan Hijau Group. The study's goal is to inform the public, government, and policymakers about potential serious wrongdoings that have a major impact on Papua New Guinea's economy and environment.

Research was conducted in 2014 and 2015. It involved fieldwork in the capital Port Moresby as well as in the Madang and East New Britain provinces, an in-depth analysis of the financial records of 16 subsidiary companies of the Rimbunan Hijau (RH) Group, plus the PNG logging industry's records over the past 15 years.

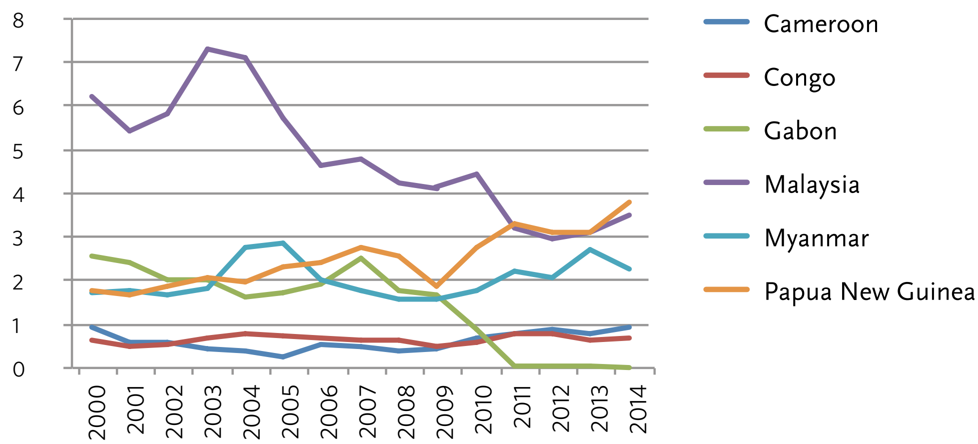
The first section of the report provides background information on the extent of logging in PNG. The second section analyzes the financial records of 16 subsidiary companies of the RH Group. The next section looks at the financial records of the forest sector as a whole. This is followed by two sections that detail the different ways logging companies evade taxes in PNG. The last section analyzes the taxes paid by the logging industry.

The Increase in Illegal Logging in PNG

Papua New Guinea has seen significant forestry activity since the 1980s. Over the past six years, the country has faced a dramatic increase in logging, with log exports nearly doubling between 2009 and 2014. As illustrated in Figure 1, PNG is now the largest exporter of tropical logs in the world.[19]

A 2006 review of the logging industry commissioned by the PNG government found that "the majority of forestry operations cannot credibly be characterized as complying with national laws and regulations and are therefore 'unlawful.'"[20] It revealed that the PNG Forest Authority is flawed, with major deficiencies and widespread corruption,[21] and that the "industry is allowed to ignore PNG laws and in

Figure 1: Exports of Tropical Roundwood by the World's 6 Largest Exporters (Millions m3)



fact gains preferential treatment in many cases, while the rural poor are left to suffer the social and environmental consequences of an industry that operates largely outside the regulatory system."[22] The illegality of this trade was denounced in a 2012 report by INTERPOL.[23]

The findings of the CoI on SABLs show that things have not improved since 2006.[24] Despite Prime Minister Peter O'Neill's 2014 public announcements, to date, no action has been taken to cancel unlawful deals and return the land to the rightful owners.

As documented in *On Our Land*,[25] logging in PNG obscures a multilayered tragedy of the betrayal of people's constitutional protections and the loss of cultural heritage and land for millions of Papua New Guineans. All over the country, local communities are being deprived of their resources and their rights, often with the complicity of their own government, while police forces work on behalf of logging companies.

The flawed land deals and logging activities in PNG violate the local people's customary land rights. These activities also deplete and destroy forest resources that are vital for a population that remains largely rural and reliant on the resources provided by their environment, the rivers, and forests that surround them.

Beyond this adverse impact, the forest industry appears to contribute only marginally to the country's economy. Despite PNG being a major timber exporter, the forestry sector contributes a mere 3% to PNG's total export earnings.[26] Furthermore, despite years of pledges[27] by the government to stop the export of raw logs and ensure wood is processed in the country in order to create jobs and add value to the products, more than 80% of the wood exported is unprocessed raw logs.[28]

Still, the logging industry and its proponents argue that they contribute to the development of the country thanks to the tax revenues the government receives on log exports.[29] Although the industry does pay a significant amount of duties on log exports, our research raises important questions about tax evasion and financial misreporting in the sector. As the following sections detail, logging appears to involve massive losses for public revenue in Papua New Guinea.

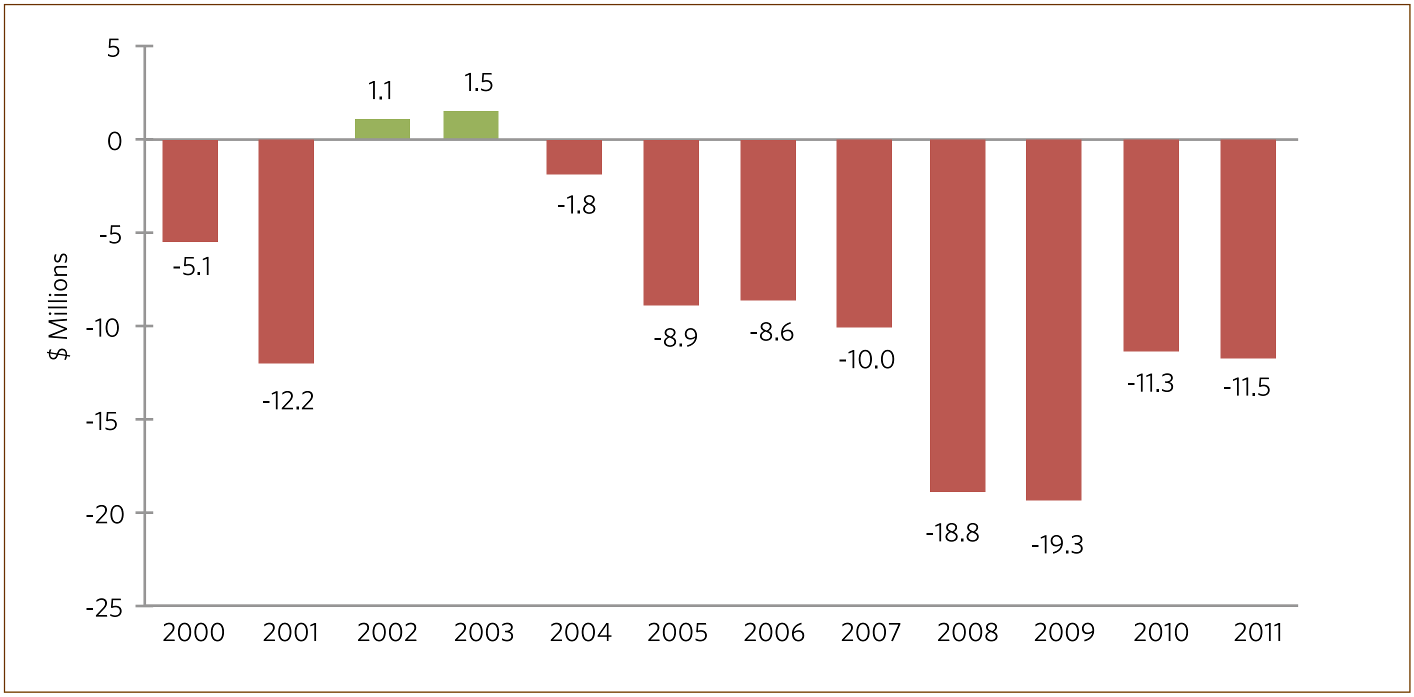
Rimbunan Hijau Working at a Loss?

Our research analyzed the financial records of 16 subsidiaries of the RH Group involved in logging.[30] In any given year, these 16 companies cumulatively account for at least a quarter of PNG's total log exports by volume and value.[31] According to available financial records, most of these companies have been working at a loss for over a decade. Figures 2 and 3 describe the extent of these losses.

As shown in Figure 3, financial records for the 16 subsidiary companies from 2000 to 2011 reveal a total of 111 years of losses vs. 33 profitable years. During this period, RH PNG, the local parent company, declared nine years of losses and only two years of profits. Their two years of profits made a total of $2.8 million while their nine years of losses amounted to $42.2 million. This trend is consistent with most of the other 15 subsidiary companies analyzed.

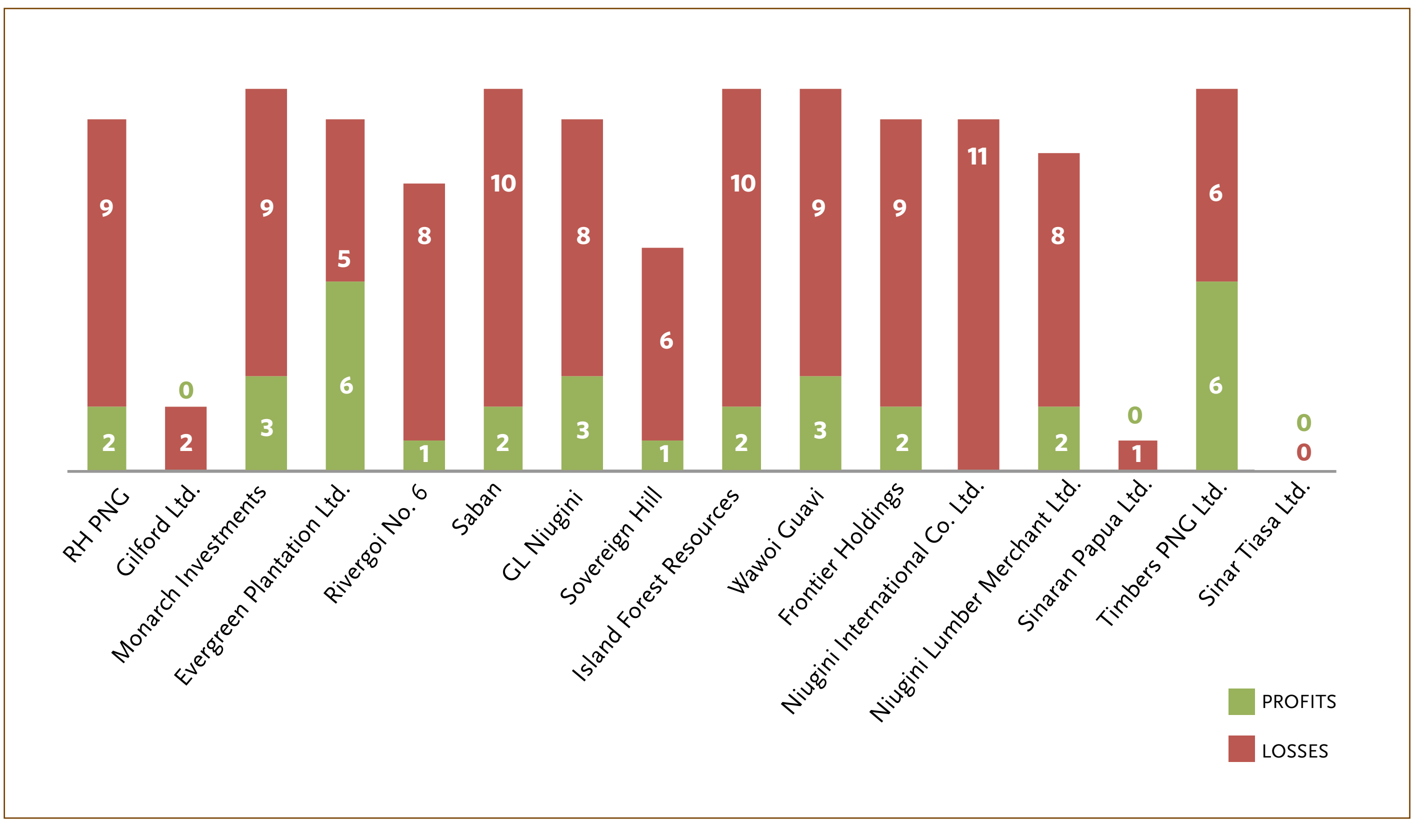
In Papua New Guinea, resident corporations are required to pay a 30% corporate income tax on their profits less any

Figure 2: Cumulative Operating Profits and Losses of 16 Selected RH Subsidiaries 2000-2011 as Declared in their Tax Records ($ Millions)*



*Data for available years; less data is available for the years 2002 and 2003.

Figure 3: Number of Years with Profit or Loss of 16 Selected RH subsidiaries 2000-2011 as Declared in their Tax Records*



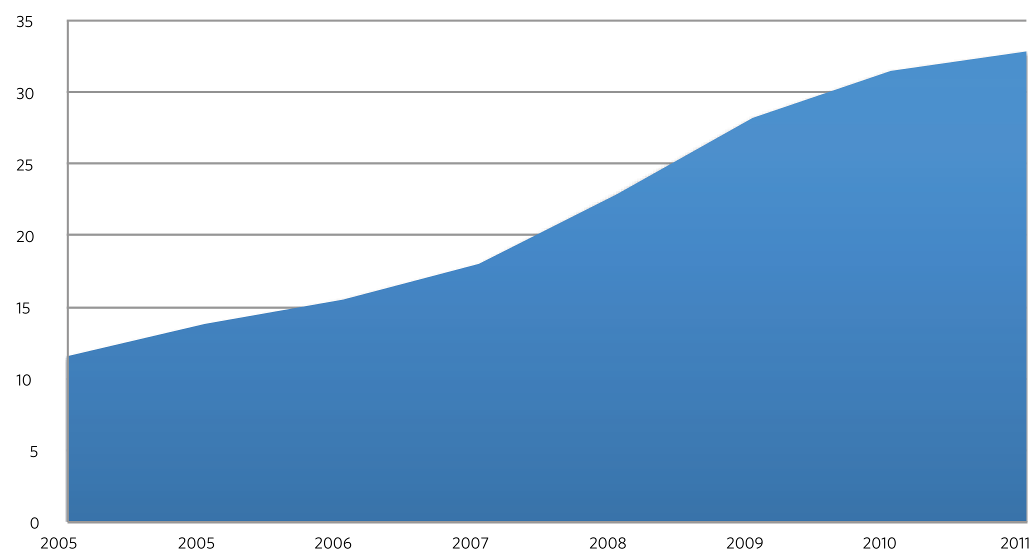
*Data for available years.

Box 1: Future Income Tax Benefit (FITB)

Under PNG tax law, when a company incurs a negative operating income, it doesn't have to pay any income tax and it is able to carry forward the loss for 20 years.[32] The ability to carry a tax loss forward allows the company to accumulate tax credits from the government and to apply these future income tax benefit (FITB) credits from prior years to reduce the amount of taxable income in following years.[33]

For example, if a company has an operating loss of Kina (K) 150,000 in year one, it is entitled to K45,000 (K150,000 x 30%) in FITB credits to apply toward future payable taxes. If it makes a profit of K200,000 in year two, it would be able to subtract K45,000 from its K60,000 income tax due, and pay only K15,000 of income tax for year two. Since the company can carry tax loss forward for 20 years, it is able to apply this reduction anytime between when the loss was incurred to 20 years out.

Figure 4: Cumulative Future Income Tax Benefit of 16 RH Subsidiaries 2004-2011 ($ Millions)[34]



deductible credit or rebate. According to tax filings for the period 2000 to 2011, most of the 16 RH companies analyzed have been working at a loss and never paid any income tax. As shown in Figure 4, these firms have instead accumulated a large amount of tax credit, which makes it likely that most of them may actually never pay income tax any time in the years to come due to the future income tax benefit (see Box 1).

Figure 4 shows how the 16 RH subsidiary companies analyzed in this study have accumulated more than $32 million in such tax credits in the period 2004-2011. It is puzzling as to how the group manages to operate at a loss for so many years yet still remains in business. If it were legitimately unprofitable to log and export timber from PNG, why would they continue their operations? One possibility is that the figures declared to the PNG government do not reflect accurately the true profits and losses of the RH subsidiaries. A serious audit of the activities and records of these companies would be required to ascertain whether this was the case. The following sections consider certain financial structures and practices that could explain the figures filed for tax purposes by RH.

Does the Forest Industry Accurately Declare Its Profits?

The above findings concerning RH and its subsidiaries reflect a more general pattern with the rest of the logging industry in PNG. The financial records of the industry show low profit margins resulting in low corporate taxes.[35]

Whereas the annual revenues of the PNG forest industry have been oscillating between $200 and $300 million in recent years, profits in the sector appear to be surprisingly very low—generally around $8 to $9 million per year.[36]

What is even more surprising is that every year, one single company, PNG Forest Product Ltd., accounts for 60 to 90% of the total profit declared by the dozens of companies[37] that comprise the industry—and therefore accounts for the lion's share of the corporate income tax paid by the whole forest industry (see Figure 5). Yet, the revenue of this company accounts for only 16 to 20% of the industry's revenue.

PNG Forest Product Ltd.'s records show an average profit margin of about 15% between 2008 and 2011. During the same period, the average profit margin of the rest of the industry was only 2%, including two years when the margin was close to zero.[38]

One explanation for this inconsistency might be that PNG Forest Product Ltd. operates differently from the rest of the industry. It is a supplier of timber and wood products that exclusively uses wood harvested in plantations run by the National Forest Services,[39] whereas the rest of the industry mostly harvests and exports wild-grown tropical round log. PNG Forest Product Ltd. is also 20% state-owned, which could affect its practices around taxation.[40]

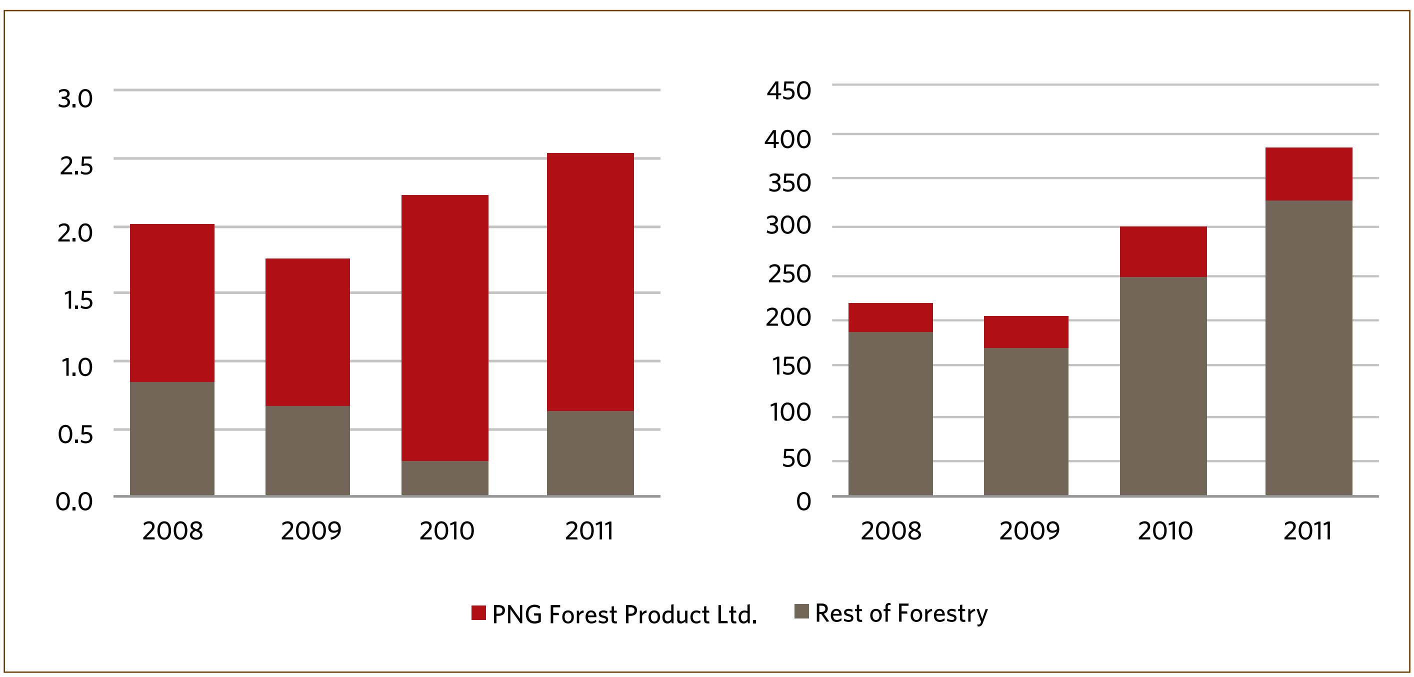
The financial records of the company, including its 15% profit margin, are in stark contrast with companies that are engaged in relatively similar activities but don't record anything close to the profits of PNG Forest Product Ltd. For instance, Saban Enterprise Ltd., one of the RH subsidiaries that specializes in sawn wood, accumulated $5.8 million in losses between 2000 and 2011, with an average annual loss of $481,000.

The industry's low average profit margin reflects the fact that, according to financial records, a number of companies such as Saban appear to be working at a loss. As discussed earlier, this is the case for most of the RH Group subsidiary companies analyzed for this research.

A comparison of the tax figures raises the following questions: How is it possible for one single company to declare far more economic benefit and pay far more income tax than any other firm in the forestry sector? How are other companies able to keep their profits low and avoid paying the 30% corporate income tax that applies to profits? There are two ways in which this could be accomplished, the first being to undervalue the price of logs that are sold and exported. The second one is to overvalue operational expenses through the use of multiple companies and subsidiaries in logging operations.

Figure 5: Corporate Income Tax Paid by PNG Forest Product Ltd. and the Rest of the Forest Industry in PNG ($ Millions)

Figure 6: PNG Forest Product Ltd.'s Revenue Compared to the Total Revenue of the Forest Industry in PNG ($ Millions)



Palm oil nursery in West Pomio

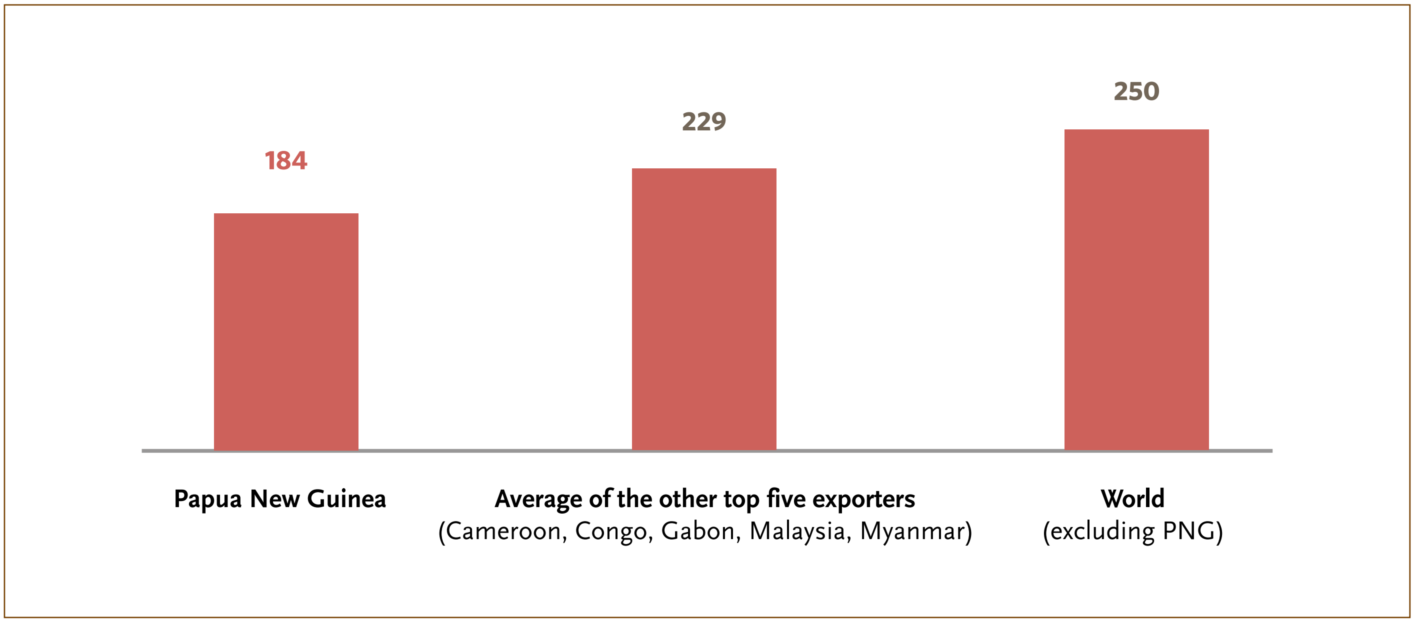
Underpriced Log Exports

Undervaluing the price of logs that are sold and exported is called transfer pricing. The practice supposes that the buyer, under an arrangement with the seller, officially pays a lower price than the real cost of the goods. The practice is difficult to ascertain, given that logging companies exporting logs sell their products to buyers in international markets and there is no control or traceability mechanism that would allow the verification of the prices by the government or international bodies. SGS, the private inspection and verification company contracted by the PNG government, monitors log exports and reports on volumes and prices on a monthly basis. However, there is no mechanism in place to verify the prices or what happens to the logs once they are exported from the country.

There are strong reasons to believe that underpricing is practiced by the logging companies in PNG. As shown in Figure 7a, export prices declared for PNG timber are significantly lower than those declared by other major exporters of tropical logs—except Malaysia, which has similarly low prices.[41] At an average of $184 between 2000 and 2014, the price per cubic meter for PNG exporters is 20% lower than the average of the other five major exporters of tropical timber and 26% lower than the average for the rest of the world.[42]

In 2014, PNG's export price per cubic meter was $210 vs. $388 for the average of the five other major exporters of tropical wood, a difference of $178 per cubic meter (46% lower than the five other major exporters).[43] Applied to the 2014 volume of log exports (3.8 million cubic meters), this variation amounts to a difference of $679 million in annual revenue for the industry. Figure 7b also shows the alarmingly deepening gap between PNG prices and those of other exporters in recent years.

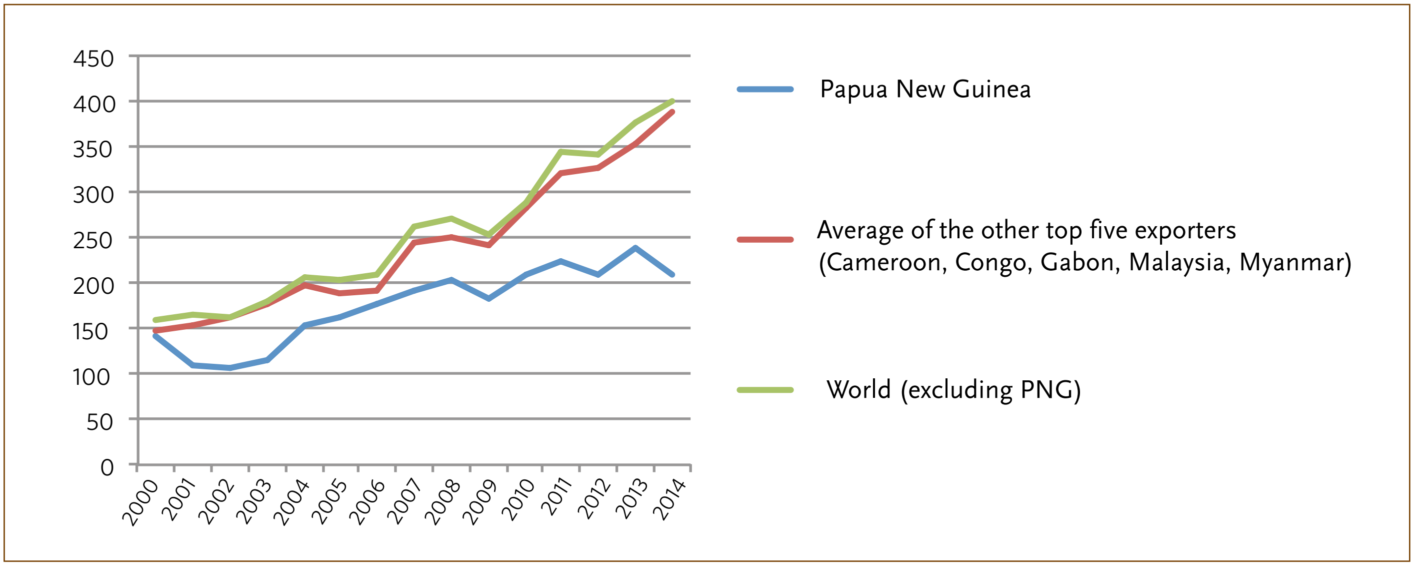
Figure 7a: Average Price for Log Exports 2000-2014: Comparison between PNG, the Other Five Main Exporters of Tropical Timber, and the Rest of the World ($ / cubic meter) [44]



Logging pond in West Pomio

Logging site in West Pomio

Figure 7b: The Growing Gap: Comparison of Export Prices of Tropical Timber between PNG, the Other Five Main Exporters of Tropical Timber, and the Rest of the World ($ / cubic meter)



The officials at the Forest Authority in PNG are unable to explain the reason for such discrepancies.[45] Questioned over the ability of the government to ensure that logging companies declare the actual price, the Director of the Forest Authority in PNG responded that the Forest Authority has no means to conduct such verification and, although it suspects wrongdoings, it is unable to prove the reality and the extent of transfer pricing.[46]

The Overseas Development Institute (ODI) confirmed the problem in a recent study, stating:

"The current price endorsement mechanism for log exports appears to lack institutional checks and balances in two ways:

- The price endorsement procedure is located wholly within the Forest Authority, without a role for the Government bodies tasked with the collection of revenue, such as the Internal Revenue Commission or the Treasury.
- The Marketing Branch of the Forest Authority does not have a set of procedures and an objectively verifiable source of information to determine whether the FOB (Free On Board) price provided by the exporter for his shipment is in line with prevailing market circumstances."[47]

The above elements concur to indicate the strong likelihood that transfer pricing is happening in PNG through underpricing. The next section shows how transfer pricing may also take place through the overvaluation of operational expenses by logging companies.

Box 2: Transfer Pricing in PNG's Logging Industry[48]

Transfer pricing occurs through the overvaluation of imported goods and services and undervaluation of exported goods and services.

Forest operations in PNG are heavily dependent on imported capital goods and also consumables and services. In importing goods and services, transfer pricing can take place through:

- Overpricing of imported equipment, machinery, spare parts, and consumables.
- Transfer of overhead costs from headquarters and the costs of unrelated business activities to local operations.
- Overpricing of services and expatriate consultancy work.

Regarding the export of forest products, transfer pricing through underpricing may take place in two ways:

- A direct agreement between buyer and seller on an extra payment to be made in addition to the formal invoice presented by the exporter to the exporting country authorities.
- Selling logs to an offshore parent company that will then re-invoice or re-export for a substantially higher price.

There is a strong likelihood that transfer pricing is happening in PNG. In 1999, it was estimated that PNG lost $9 to $17 million in tax revenue due to transfer pricing.[49]

Although unable to obtain formal proof, a 2002 government review[50] found "unexplained and substantial . . . discrepancies in price and volumes . . . that could be evidence of transfer pricing." The review called for further investigation into the matter.

A 2014 Chatham House study[51] found that there was a $20 price difference per cubic meter between export prices from PNG and import prices for logs to China, accounting for freight and insurance costs.

The unexplained discrepancies found in different reviews, the difference between PNG export prices and the export prices of other major exporters, and the operational losses declared year after year by many logging companies seem to indicate that transfer pricing is taking place in PNG's forest industry—resulting in a loss of hundreds of millions of dollars to the country.

Employees of Rimbunan Hijau with newly cut logs in West Pomio

Box 3: Rimbunan Hijau, a Ubiquitous Player in Papua New Guinea

Tiong Hiew King ©The Star, Malaysia

Rimbunan Hijau (RH), a major player in the logging industry in PNG, has been involved in several major controversial land deals.[52] The firm is controlled by Tiong Hiew King, one of Malaysia's richest men.[53] RH is a large Malaysian multi-industry company present in more than 15 countries. Founded in 1975, the group is involved in many sectors, including forestry, oil palm plantations, media, information and communications technology, biotechnology, plastic manufacturing, mining, real estate, insurance, oil, and gas.[54]

The company's most recent investment in PNG's capital is a billion-kina project known as Vision City, which already contains the largest shopping mall in the Pacific islands region, and will soon be expanded to include "an office tower block, service apartments, a hotel and convention centre."[55]

Officially, Rimbunan Hijau accounts for less than 30% of the log exports from PNG[56] but some official estimates suggest that the company controls as much as 45% of all logging in the country.[57]

A Financial Structure that Allows Opacity and Embezzlement

There is another method by which logging companies can artificially reduce profits—by overvaluing their operational expenses so their costs exceed the profit made through the sale of timber. This practice is made possible through the use of multiple companies and subsidiaries in logging operations, including holding companies generally located in tax havens.

Companies belonging to the same group are able to charge each other an artificially high price for goods, equipment, and services, thereby increasing the sister company's operational expenses.[58] The charges can be high enough that the company's expenses end up greater than its revenue, thus allowing the company to declare an operational loss for the year. By declaring losses every year based on inflated operational costs, it is possible for companies to evade corporate income tax when in fact the group as whole is turning a profit.

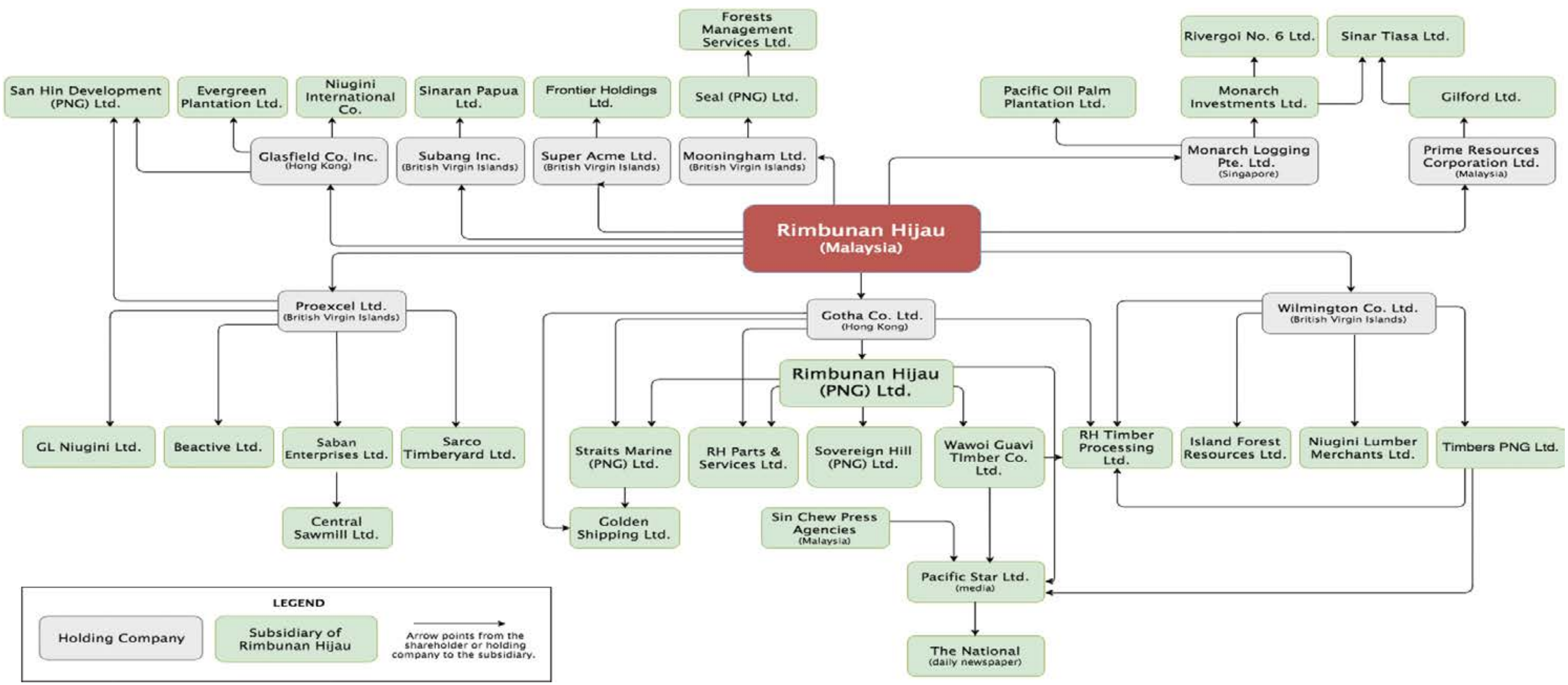
Whether this practice is being used in PNG's logging industry and by RH is difficult for independent researchers to ascertain, given the opacity of the system and the lack of effective public information and control. However, logging companies, including Rimbunan Hijau, the largest logging operator in the country, have set up and operate a complex web of companies and subsidiaries, with the majority held by companies registered in tax havens, primarily the British Virgin Islands (BVI). Such complex financial structures could lend themselves to tax evasion.

Of the 60 or so companies in PNG identified as being owned or controlled by the Tiong family (see Box 3),[59] the 30 companies in Figure 8 are significant players, directly and indirectly, in the country's forest and agribusiness industry. All but two of them have the same registered address at 479 Kennedy Road in the capital Port Moresby. Furthermore, while the composition of company directors varies slightly from subsidiary to subsidiary, all of the 30 companies list either James Sze Yuan Lau, managing director of RH (PNG) and son-in-law of Tiong Hiew King, the founder of Rimbunan Hijau,[60] and Ivan Su Chiu Lu, executive director of RH (PNG) Ltd.,[61] or both, as their directors. The other directors of these companies include different combinations of the Tiong family, including Ik King Tiong, Chiong Ong Tiong, Hiew King Tiong, and Thai King Tiong.

The principal activities of these subsidiaries range from timber processing and shipping to repair of heavy machinery and oil palm production. In addition, the parent company RH Group also controls *The National,* one of PNG's two major daily newspapers, which has often been accused of protecting RH's interests and suppressing and controlling journalists to this end.[62] For example, Rimbunan Hijau operates through at least 3 subsidiaries as part of a single logging and palm oil project in West Pomio, where local communities have been opposing the project since 2007.

Logging roads between Bintepuna and Bairaman River concessions

Figure 8: Mapping Rimbunan Hijau's Subsidiary Companies that Are Directly or Indirectly Involved in Logging Operations[63]



Gilford Ltd., controlled by Prime Resources Corporation Ltd., which is registered in Malaysia, is the firm that obtained an SABL lease for logging and the establishment of a palm oil operation on about 40,000 hectares. Two other RH subsidiaries are also involved in the same operation: Sinar Tiasa Ltd., controlled jointly by Gilford Ltd. and Monarch Investments Ltd. (a subsidiary of Monarch Logging Pte. Ltd, which is registered in Singapore), and Niugini Lumber Merchant Ltd., a subsidiary of Wilmington Co. Ltd. registered in British Virgin Islands. Beyond the three companies directly involved in the Pomio project, Gilford's financial records indicate financial transactions with a total of 16 RH subsidiary companies (Figure 9).

A further in-depth investigation into the operational expenses incurred by RH subsidiaries is needed to determine whether these companies are overpaying other subsidiaries or their holding companies for goods and services as part of their operations. However, it is of note that RH companies do spend significant resources on activities, goods, and services that are likely to involve sister companies. For instance, about a third of Wawoi Guavi Ltd.'s annual operational expense (between $4 and $8 million per year) is spent on felling, skidding, and logging. In 2011, 45% of Gilford Ltd's operational expense ($2 million) was spent on extraction and hauling. Between 10 and 30% of RH (PNG) Ltd.'s annual operational expenses (between $1 and $3 million per year) is incurred by the purchase of sawmill logs. Since RH has a variety of subsidiaries involved in different aspects of logging and timber processing (e.g. RH Timber Processing Ltd., RH Parts & Services, Central Sawmill Ltd., etc.), these operational expenses could be charged to sister companies.

Figure 9: Financial Participation of RH Subsidiary Companies in Gilford Ltd.'s Operations[64]

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GILFORD LIMITED
AND ITS SUBSIDIARY COMPANY

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31ST DECEMBER 2010

	GROUP 2010 K	GROUP 2009 K	COMPANY 2010 K	COMPANY 2009 K
10 PAYABLES				
Audit	7,500	3,000	4,500	3,000
Accruals	13,950	-	13,950	-
Withholding tax	360	383	360	383
Other creditors	321,587	60,000	315,000	60,000
	343,397	63,383	333,810	63,383
11 RELATED COMPANY ADVANCES				
Rimbunan Hijau (PNG) Limited	-	148,191	-	148,191
RH Parts and Services Limited	2,935,764	3,848,129	3,029,296	3,848,129
Rivergoi No. 6 limited	750,000	750,000	750,000	750,000
GL Niugini Limited	659,200	695,900	659,200	695,900
Beactive Limited	238,883	166,783	238,883	166,783
Sinar Tiasa (PNG) Limited	-	-	167,274	-
	4,583,847	5,609,003	4,844,653	5,609,003
12 DUE TO RELATED COMPANIES				
Fonsen Timber Processing Limited	9,246	9,246	9,246	9,246
Niugini Lumber Merchants Limited	628,481	464,283	131,454	464,283
Saban Enterprises Limited	3,389	3,389	3,389	3,389
Wawoi Guavi Timber Company Limited	530,157	546,297	530,157	546,297
Rimbunan Hijau (PNG) Limited	1,585,843	-	1,030,726	-
Island Forest Resources Limited	3,138	-	3,138	-
Travel Planners Limited	5,542	-	5,542	-
Tropicair Limited	17,160	-	17,160	-
Golden Shipping Limited	434,358	-	-	-
Sarco Timberyard Limited	186,374	-	-	-
	3,403,688	1,023,215	1,730,812	1,023,215

Box 4: Rimbunan Hijau in Tax Havens

According to the Tax Justice Network, "round tripping is one of the main reasons people use tax havens."[65] This describes when businesses leave proceeds from export sales and share offerings in a tax haven for a period of time, then send them back to their home country disguised as foreign direct investment (FDI). This helps the business to avoid paying capital gains or income tax.[66]

The majority of RH holding companies are located in the British Virgin Islands (BVI): for example, Super Acme Ltd., Mooningham Ltd., Wilmington Co. Ltd., Subang Inc., and Proexcel Ltd. The other holding companies are spread across Singapore (i.e. Monarch Logging Pte. Ltd.) and Hong Kong (i.e. Gotha Co. Ltd. and Glasfield Co. Inc.). The role of BVI, Singapore, and Hong Kong in facilitating illicit financial flows, such as tax avoidance and transfer pricing, is well documented.[67]

BVI boasts an attractive zero tax rate and corporate secrecy laws that obfuscate the true ownership structure of the 900,000 companies registered there.[68] BVI is an attractive hub for incorporation of companies, accounting for 41% of global offshore companies.[69] Its popularity is due to its zero effective income tax, zero capital gains tax, convenience of incorporation, and its no-questions-asked approach.[70] The law hides companies' owners and asset holders behind nominee company agents, making it difficult to trace the owners and shareholders of the firms incorporated there. According to the Tax Justice Network, this legalized opacity "has translated into effective *carte blanche* for BVI companies to hide and facilitate all manner of crimes and abuses, worldwide."[71]

Singapore is a popular tax haven, projected to overtake Switzerland as the largest global offshore wealth centre by 2020.[72] Many critique the Singapore government's ineffective enforcement of its anti-corruption law and lax monitoring of businesses, allowing companies to engage in tax avoidance and tax evasion.[73] Using a veil of secrecy to protect company owners and shareholders, it attracts illicit or abusive financial flows.[74]

Hong Kong has a long history as an offshore financial centre and is known for its relaxed attitude towards illegal commercial activities.[75] It has a very favourable tax regime for multinational businesses, no capital gains, dividends or deposit interest tax and does not tax overseas profits accrued by domestic wealth managers.[76] Hong Kong is commonly used to facilitate transfer pricing.[77]

What the Logging Industry Pays . . . and What It Doesn't Pay

Although the logging industry is able to largely avoid paying corporate income tax in PNG, it does pay a number of other taxes, levies, and duties resulting from its activities. On average, the industry pays some $80 million annually in export duties and levies on its log exports.[78] The log export tax—levied on a progressive scale on the price of exported logs—constitutes the bulk of this amount and the main source of forest revenue for the government.

Although this revenue is significant for PNG's economy, if transfer pricing is actually taking place through an undervaluation of log exports, the export duties are therefore underestimated as well, which would amount to a significant loss in public revenue.

For instance, a $50 undervaluation of log export prices per cubic meter (a conservative assumption given the $178 price difference determined earlier between PNG prices and prices for the other major exporters), would result in a loss of $60 million in public revenue in terms of export duties and levies for 2014 alone. The loss on export duties and levies would thus amount to hundreds of millions for the country in just a few years.

Added to the corporate income tax loss discussed earlier, it seems likely that the loss of tax revenue in PNG's logging sector exceeds $100 million per year.

Box 5: Impunity for the Loggers and Criminalization of Customary Land Holders: RH's Land Grab in Pomio

Protests in West Pomio

Among the controversial land deals involving RH in PNG, one of the most egregious is an SABL lease in Pomio District, East New Britain Province, where its subsidiary Gilford Ltd. has secured 40,000 hectares for 60 years with a further 30-year option on the lease.

Local communities in Pomio, who have opposed the deal since 2007, have been under heavy pressure, facing intimidation, arrests, and multiple actions in court.[79] Police forces are working on behalf of the loggers and, according to local communities, they often travel in company vehicles.[80] On multiple occasions, locals attempting to prevent the logging operations through roadblocks and peaceful protests have been arrested and taken away, generally to the far-away provincial capital Kokopo.[81] Several opponents of logging were beaten then locked up in shipping containers for several consecutive nights at the end of 2011.[82] On another occasion, armed policemen forced people to sign consent documents.[83] Police forces have also investigated people and NGOs involved in eco-forestry programs that harvest timber in sustainable ways and bring actual benefits for the communities.[84]

When the CoI visited the island of East New Britain in October 2011, 64 Pomio District community members travelled to the provincial capital Kokopo to meet and testify before the Commission of Inquiry Commissioner Alois Jerewai. The commissioner received firsthand testimonies from community representatives on the land grab unfolding in Pomio, on the fraud and forgery involved in the signing of the land deal, as well as on the repression of dissent by local police forces. Having examined the contract and project documents, the commissioner noted a number of clauses and conditions in the land lease that made it greatly unfavourable to land owners. For instance, the agreement stipulated that if the landowners wish to terminate the lease, they would have to compensate Gilford Ltd. for up to K10 billion ($5 billion),[85] effectively making it impossible to stop the project.[86] The commissioner also noted that the contract did not mention of any benefits to the local communities, apart from K1 ($0.40) per hectare per year and timber royalties, which were expected to end within four years.[87]

When the final report of the Commission of Inquiry was released and tabled in Parliament in 2013, local villagers were shocked to discover that the investigation of the Pomio project was not included in the final report. To date, there has been no official explanation for this exclusion.

In November 2014, with nearly 20,000 ha of customary land already cleared for logging and palm oil (out of the 40,000 ha lease), the communities of Pomio were able to get a restraining order from the local court on the activities of Gilford Ltd. In July 2015, the restraining order was lifted by another court in the capital Port Moresby, allowing the resumption of logging in the area.

Children in Lau Village, in West Pomio, protesting the grabbing of their land

Conclusion

Customary landowners in PNG are largely dependent on their land for their livelihoods. Their collective ownership of land and natural resources is supposed to be protected by the Constitution and other national laws. Instead, they face arrests and law suits, whereas logging companies enjoy apparent impunity.

This report uncovers financial practices of the logging industry in PNG that raise important questions about the extent of tax evasion and financial misreporting in the sector. The report's findings call for relevant authorities such as PNG's Internal Revenue Commission, the agency in charge of collecting taxes and enforcing tax regulations, to take action urgently to defend the interests and rights of PNG citizens. Effective legal action to protect customary land rights, stop the appropriation of resources, and prevent human rights violations of the citizens is lacking. The question is, will the government of PNG take action to stop illegal activities, tax evasion, and other wrongdoings of the logging industry?

Endnotes

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18 See for instance *Uncivil Society: A review of activist NGOs in PNG*, *Op. Cit.*

19 International Tropical Timber Organization. http://www.itto.int (accessed June 1, 2015).

20 *Logging, Legality and Livelihoods in PNG: Synthesis of Official Assessments of the Large-Scale Logging Industry*, *Op. Cit.*

21 *Ibid*.

22 *Ibid*.

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