

25 November 2003

Re-Engineering for the New World Economy

Overview

The Minister of Finance's marathon presentation on the economy on Tuesday 25th November 2003 was certainly innovative and demonstrated clear strategic vision in charting the way forward for Barbados in a world environment characterised by changes and challenges.

He laid before Barbadians in clear and unequivocal terms the initiatives which government perceives as critical to re-engineer the economy of which the new engine of growth is seen to be the services sector. In so doing, he has challenged the business community to rise to the occasion and has outlined the consequences to Barbadians of failure to do so. In particular, he has brought home to the business community that each business must assess its own vulnerabilities.

This presentation has been delivered at a time when other interests such as elections are not a concern. This adds to its credibility. In the Minister's view, successful transformation requires

- legislative facilitation,
- an honest assessment of our position within a competitive environment, and

- leadership capacity and the will to implement the strategies which are required to meet the new challenges.

Within that context, the Minister has introduced various measures to facilitate the required transformation.

Starting at the school level, entrepreneurship will be integrated into the school curriculum as a separate subject. This is innovative, but we are disappointed that Spanish as a compulsory second language has not also been made mandatory having regard to our geographical proximity to the South American continent where business opportunities lie for our service providers but where the language difference is the biggest non tariff barrier.

The vision for a new "creative economy" together with the proposals to enhance the protection of intellectual property should go a long way towards the development of existing and new industries based on indigenous Caribbean talent.

Adding the development of retirement villages to our tourism product will enhance the attractiveness of Barbados to many returning nationals and other expatriates and directly contributes to our foreign exchange earnings.

As to manufacturing, the introduction of strategic clustering is a model that has proven to be successful in a number of other countries. The initiative is to be commended.

The further liberalisation of exchange controls is also expected to remove certain impediments to business expansion.

On the question of international business, the minister was at pains to point out that “The development of a services-based economy will require an export driven culture that captures the imagination and intellectual talent of the whole society and will require the greatest expression of institutional coordination across ministerial portfolios”.

The challenge to the proposals made by the Minister now lies with implementation.

Making Barbados CSME ready

The introduction of the Caribbean Single Market and Economy is a vision conceived out of a necessity for the islands of the region to meet the challenges of globalisation. It also results from the need to enlarge one’s domestic market and to be competitive in the provision of goods and services in a dynamic world market where there will no longer be the same level of trade concessions and protection to the region. It envisages a time when there will be free movement of people, services, goods and capital among the islands of the region.

Barbados has chosen to be one of the forerunners in this process and this is evidenced by the proposed changes to legislation and exchange control regulations, which were presented by the Minister. He has proposed that this process be facilitated by five measures, three of which are legislative and two of which are non-legislative.

Legislative measures

Amendments to the following Acts would enable CARICOM nationals to engage in activities which were previously reserved for citizens,

permanent residents and immigrants:

- section 5 of the Travel Service Act Chapter 373A to enable CARICOM nationals to operate as travel agents;
- section 32 of the Port Authority Act Chapter 285B to enable CARICOM nationals to use a speedboat for water sports activity for hire or reward.
- the Small Business Development Act Cap318C to enable CARICOM residents to own a qualifying “small business”.

Non-legislative measures

These measures relate specifically to land transport (i.e. the services relating to car rental, taxi and minibus/omnibus operations) and small-scale specialised restaurants. The provision of such services is currently reserved for nationals. These restrictions will be removed to allow CARICOM nationals to submit applications for the provision of these services.

Comments

The movement towards the Caribbean Single Market and Economy is a progressive one, in which all governments in the region will be expected to remove restrictions on the movement of capital, services and skills. For some countries, this process will be easier than others. However, it remains a vision, which must be fulfilled if the CARICOM region is to survive the challenges of global and hemispheric trade liberalisation.

Liberalisation of Exchange Controls

The issue of the liberalisation of exchange controls remains one that Government has sought to address gradually, so as to monitor its effects on the national foreign reserves.

In recent years, the process of gradual liberalisation has been facilitated primarily through delegation of authority by the Central Bank to commercial banks.

Liberalisation thus far has been evidenced through the removal of almost all the restrictions on current account transactions and on the payment of goods and services as long as adequate documentation is provided.

The remaining restrictions on current account transactions as outlined below are expected to be removed within the next year:

- prepayments in excess of \$250,000 on imports;
- management fees in excess of \$250,000;
- individual private travel in excess of \$7,500 per year and business travel in excess of \$50,000 per year;
- cash gifts in excess of \$5,000, and
- imports of fruits and vegetables without documentation, in excess of \$5,000.

There currently remain restrictions on some CARICOM capital transactions. The government has committed to remove these within the next three years in order to fulfil its obligation regarding liberalisation of exchange controls on capital transactions within the CSME. These are:

- borrowing and lending transactions;
- transactions specific to commercial banks and other credit institutions;
- real estate transactions;
- direct investments in excess of \$250,000 in private companies;
- transactions conducted through the Stock Exchange in listed securities in an amount exceeding \$5,000,000 per transaction; and
- transactions in issues of government securities.

Though the Central Bank will seek to continue the liberalisation of these controls in order to facilitate the movement towards the CSME, it is forced to find a safe medium between the liberalisation of exchange controls and the sustainability of the economy with respect to foreign reserves, the stability of the Barbados dollar and protection of the economic system from persons who would seek to abuse the system.

In its commitment to be 'CSME ready' government has formulated a strategy, which will be subjected to continuous review. This strategy includes:

- the delegation of more capital account transactions to commercial banks;
- increases in the value limits of such transactions under delegated authority; and
- more slowly liberalising those transactions which lend themselves to speculation

Comments

The government of Barbados is seeking to be substantially ready for the CSME by the end of 2004, one year before the agreed implementation of CSME policies in the region. In its efforts it has sought to 'test the waters' in an attempt to foresee any issues that the country may face going forward.

Harmonisation of Tax Systems

Harmonisation of tax systems is a requirement under the CSME, in order to create similar tax regimes across CARICOM territories in which businesses and consumers operate.

The areas under consideration are as follows:

- Capital allowances - pooling of assets and claiming of capital allowances on a declining balance with 4 general pools depending upon the useful life of the plant and machinery;

Useful Life	
10 years or more	10%
4 – 10 years	25%
2 – 4 years	50%
Less than 2 years	100%

- Interest – the harmonised position is similar to what presently exists;
- Losses – indefinite carry forward period, but restriction on utilisation to 50% of taxable income;
- Pension – the harmonised position is similar to what presently exists;
- Insurance premium tax – no harmonised rate has been determined;
- Minimum corporation tax rate – this is an optional provision with no recommended rate;
- Mergers and splitters – the harmonised position recommends that where there has been a change of more than 50% in the underlying ownership or control of a company and where conditions obtain which are consistent with tax avoidance or where there is a change in the nature of the business, then any losses which exist at the time of the transaction shall not be carried forward;
- Disposal and acquisition of assets – the harmonised position is similar to what presently exists;
- Agreement for extra regional financing with implications for withholding taxes – the recommended maximum rate of

withholding tax on interest paid to non-residents is 20%. Barbados currently imposes a maximum rate of 15%;

- Exploration and research expenses – where such expenses are incurred prior to the commencement of the business, the recommended write off period is 5 years or more. However, expenses incurred during the operation of the business should be treated as revenue expenses.

Comments

The CSME is almost a close cousin of the European Common Market. As the latter has been in existence now for almost 11 years, it would be wise to learn from the European experience, realising that the process will be a slow and sometimes painful one, which will require the commitment of all within the CARICOM region.

We must be willing to face the challenges that lie ahead, since the competitiveness of the Caribbean region will improve only to the extent that we succeed in reducing our costs, both tax and operational, in addition to closing the gaps in information, knowledge and innovation through education, research, scientific development and technological application.

Implications of the FTAA

The Minister's comments on the FTAA are based on the assumption that the negotiations will be concluded by 2005. As he intimated, under the agreement, import duties will be removed on a wide range of goods and this will impact negatively on the duties and taxes collected on imports from FTAA countries.

To counter this, the Minister has announced a phased elimination of duties on four categories of

goods in the manner outlined in the following table.

Categories	Timetable	Criteria
Basket A	Immediate tariff elimination	Goods carrying very low tariff
Basket B	Elimination in less than 5 years	Goods with tariff of 5% - 15%
Basket C	Elimination over a 10 year period	Goods with tariff of 16% - 40%
Basket D	Elimination over a period of more than 10 years	Very sensitive products

He also intimated that this phased reduction in import duties would result in a corresponding reduction in VAT, because this tax is chargeable on the CIF value plus import duty (and excise tax where applicable). The removal of import duty will erode the tax base and hence VAT revenue. A similar situation will arise where excise tax is charged because excise tax is also computed on the CIF value plus import duty.

Comments

The revenue lost as a result of these new trading arrangements will have to be recouped without undue strain on taxpayers. As a first step, Government should sensitise the revenue collection agencies on the need for improved efficiency in the area of compliance and collection of taxes.

Depending on Government’s success in mitigating revenue losses through the phased reduction of tariffs, it may be necessary to look at other means of recouping any tax losses. Because of the popularity of the current direct tax reductions, it is likely that indirect taxes will be revisited with a view to recouping any shortfall.

Business Facilitation

The Minister has recognised the need to eliminate bureaucratic inefficiencies that are affecting

foreign investment and has outlined plans to improve efficiency and productivity in certain government departments.

The proposed business facilitation initiative speaks to the remedying of various administrative deficiencies within our environment which constitute either an impediment to efficient business operations or add an unnecessary element of cost which impacts negatively on our competitiveness or both.

Few will dispute the Minister’s assessment of the problems or question his remedies. However the real test lies in the implementation of the remedies – much of which falls within the scope of the public sector reform program, the success of which is unclear to date.

Rum Industry

The Minister spoke of the agreement brokered between the rum producers and Customs and Excise Department; namely, the decentralisation of the supervisory practices with respect to excise operations, the unsupervised transfer of warehoused spirits to the “bonded” warehouses of the same company and the rum producers full control of the keys to their own facilities.

Comments

This agreement augurs well for better management, greater flexibility and reduced cost within the rum industry.

Central Container Examination Facility

The Minister spoke of the imminent establishment of the Central Container Examination Facility and selectivity in the delivery of containers directly to the premises of importers.

Comments

This facility has been mooted for sometime and importers will be pleased with its establishment.

Charter for Small and Micro business

The Minister announced measures to enhance the operations of the Fund Access and Enterprise Growth Fund Limited (EGFL) by recapitalising these institutions. He stated that this was necessary because the proposal to capitalise Fund Access at \$7.5 million and EGFL at \$12 million did not materialise because the level of private sector investment envisaged in these two institutions did not materialise, rendering both of them under capitalised. These institutions will be recapitalised - in the case of Fund Access, from the present \$5.8 million by an amount of \$1.6 million per year over the next four years and with respect to EGFL, from \$4.7 million to \$10 million over the next four years.

The lending policies have also been revised as follows:

- with respect to Fund Access, the maximum loan will be increased from \$50,000 to an average portfolio loan of \$100,000 with the payment period extended from 5 years to 10 years;
- in the case of EGFL, in addition to providing venture capital, the fund will also provide loans starting from \$100,000; and
- the interest rate of Fund Access will be reduced to 6%.

In addition, the Minister announced that a new entity, the Barbados Development Finance Inc. would be established by 1 January, 2007, to amalgamate and build upon all the functions being performed by EGFL, Fund Access and the

Special Sectoral investment vehicles that have recently been created by government.

Comments

These measures are designed to promote small business development in Barbados and provide Barbadian small and medium size enterprises with access to resources that will enable them to capitalise on any opportunities that may arise from the introduction of the CSME. It is our hope that these funds will be aggressively accessed by such enterprises.

Manufacturing

The following initiatives were announced to advance the government's goal of improved output and exports by the manufacturing sector during the next three years:

- expansion of the technical assistance programme to \$7 million per year;
- an additional contribution of \$5 million to the Industrial Investment and Employment Fund (IIEF) and acceleration of its capitalisation;
- expansion of the scope of the IIEF to provide assistance to companies seeking to expand into CARICOM and further abroad;
- provision of technical assistance via the Barbados Investment and Development Corporation (BIDC) and funding through the IIEF for the formation of clusters of manufacturing entities;
- extension of the zero tax regime for co-operative societies to co-operative producer enterprises formed to facilitate manufacturing clustering; and

- reduction of the corporation tax rate for manufacturers to 25% in 2005 and the further reduction of that rate after 2005 when the general corporation tax rate falls to 25%;

The protection currently provided to the manufacturing sector in the form of surcharges on selected imported goods will continue.

Comment

A key success factor for the growth and increased output of this sector will be the marketing of products both locally and abroad. In the Minister's 2002 presentation, the establishment of a trading and marketing enterprise with responsibilities for selling Barbadian goods abroad was announced. While the new measures should be of assistance to the sector, a focus on the proper development of this marketing enterprise must also be maintained.

Another important factor for the success of this sector will be the quality of the products produced. Standards must be developed that will ensure that local products will be able to compete in international markets, particularly in light of the trade liberalisation that will ensue with the advent of the CSME and FTAA. The protections currently offered to the sector will of course come under increasing scrutiny as these trading arrangements are negotiated.

Agriculture

The Minister has announced a number of new incentives and initiatives for the agricultural sector, in an effort to resuscitate and develop this important sector. These specifically target the areas of sugar, poultry, pig and black belly sheep production for further development and include:

- exploration of the export potential of branded versus raw bulk sugar as well as a new focus on the exploitation of other by-products of the sugar cane plant;
- a capital injection of \$1 million into the Cotton Research and Development Fund;
- full implementation of the Agricultural Development Plan for the Scotland District;
- replenishment of the Agricultural Development Fund;
- a 50% grant up to a maximum of \$250,000 to registered farmers' organisations for the establishment of beef feedlots; and
- upgrading of the fisheries infrastructure.

Comment

The incentives outlined in the Minister's address are a continuation and extension of those presented in 2002.

Sustained growth of the industry as a result of these initiatives is yet to materialise, perhaps in part due to the newness of the measures. One may question why the agricultural sector has not been granted an acceleration in the reduction of the corporate tax rate as has been done for the manufacturing sector.

The Creative Economy

The Minister's vision for the "creative economy", which encompasses cultural industries and cultural services, has the potential to impact positively on the quality of our tourism, the range of our manufacturing products, and the national effort of social transformation.

Its implementation will be rooted in infrastructural building, institutional strengthening and tax incentives supported by the requisite legislation.

The proposals provide for:

- a national performing arts school.
- a restructuring of the national arts gallery.
- A creative centre to be established for government to promote product design and development.
- A joint public – private sector entity to promote, market and distribute cultural products.
- The development of Barbados as a location for film and video production.

To give impetus to the initiative, government will allocate 1% of the total cost of new government buildings for the acquisition of local artwork to be displayed within these buildings.

In addition, a sports and cultural endowment fund for the arts will be established and corporate investors in the fund will be allowed to deduct from taxable income an amount equal to 150% of the actual amount contributed while persons investing in any approved cultural project will be allowed a deduction of up to \$10,000 against the assessable income of that person.

International Financial Services

To those engaged in the international financial services sector, there were few significant initiatives in the Minister's presentation, which will be of direct interest.

Efforts to improve connectivity between those government ministries impacting directly on the sector will always be welcomed, as will funding for the research and development capability of the

International Business Unit of the Ministry of Industry and International Business.

The positive impact of the proposal to amend the Exempt Insurance Act to allow Barbadians to own international captive insurance companies is uncertain given the nature of these enterprises. The majority of these entities are either "pure" captives, providing a level of structured self-insurance to major foreign corporations, or "association" captives, which provide insurance flexibility for specialised industry groupings. In the case of both pure and association captives, ownership will naturally lie with the insurers themselves. As such, the opportunities for Barbadian ownership of these international enterprises are unclear.

The Minister indicated general satisfaction with the rate of new incorporations of IBCs and ISRLs, while the number of new exempt insurance companies and banks continues to disappoint.

Given the quality of the supporting infrastructure, Barbados continues to be heavily underutilised as an insurance domicile, perhaps largely due to an absence of visibility in the U.S. market.

Some analysis on the nature of the IBCs being incorporated would be useful as the real value to the Barbados economy lies in those IBCs with substantive operations in Barbados, which therefore contribute more to the overall economy.

Tax convergence

The subject of "tax convergence", where a common rate of taxation is applied to both international and domestic enterprises, has been alluded to by the Minister in earlier statements to Parliament but was not addressed in this presentation.

Given the implications for international businesses, this is a topic that will undoubtedly require further comment from the Minister over the coming months.

Special Development Areas (SDAs)

The Minister announced the expansion of the Special Development Areas by declaring that the SDA Act would be amended to include Baxters Road, Roebuck Street and Nelson Street. Investors in these areas would therefore benefit from the provisions of the incentive schemes approved for SDAs.

In addition, he mentioned that incentives and concessions would be provided under the SDA Act to developers involved in housing development in the Greater Bridgetown Area, either on their own accord or in joint venture arrangements with the National Housing Corporation and the Urban Development Corporation.

Comments

These measures are in keeping with government's policy of regeneration of the city of Bridgetown. The various concessions should provide the catalyst for investment in these depressed areas, thereby providing for improved housing, business facilities and the general improvement of the areas.

Retirement villages

The Minister announced that there was much interest in the establishment of retirement villages in Barbados. He referred to the benefits of such villages, pointing out that this type of tourism investment would lead to the development of non-coastal land. To this end, he proposed to

consider retirement villages as tourism projects under the Tourism Development Act.

Comments

It is logical that these projects be regarded as tourism projects. The potential contribution to the local economy is enormous. They generate significant employment of the type that is synonymous with the tourism sector. We hope that retirees living in these villages will not be confined to non-nationals or returning residents.

Leases

Effective 1 April 2004, property transfer tax (PTT) will apply to leases with a duration of 25 years or more, and to short term leases that are continuously renewed for a period equal to 25 years or more.

Comments

Clarification on the application of PTT as it relates to leases will be much appreciated by the business community, as this issue has been a source of great concern. We recommend that this measure be made retroactive to 2002 when the amendment was made to the Barbados Income Tax Act disallowing payments made by a lessor or lessee under the terms of a lease that had not been registered and the applicable property transfer tax and stamp duty paid.

Value Added Tax

The Minister proposed measures to make the VAT Division more business friendly. One such measure is to allow registrants whose accounts are in credit to carry forward (from 1 April 2004) this credit balance to the next VAT accounting period. He also announced that from 1 April 2004, the interest rate of 1.5% per month currently imposed on unpaid VAT would be reduced to 1% per month to bring it into line with what obtains in the income tax and land tax systems.

Comments

The above measures are overdue and will be greatly appreciated by the business community. The carrying forward of credit balances will have a significant impact on the cash flows of some registrants and the reduction in the interest rate will take a tremendous strain off those registrants who may for whatever reason default on a payment or inadvertently omit a significant output tax.

The business community has always regarded the higher interest rate as discriminatory. We regret that no provisions were included to facilitate the waiver of penalties and interest in the event of voluntary disclosure of genuine errors made by registrants.

Computers

The Minister announced that from 1 April 2004, VAT would be removed from computers. In addition, he stated that from 1 April 2005, VAT

would be removed from peripherals and computer accessories.

Comments

These measures will give more Barbadians access to computer technology. The inclusion of peripherals and accessories will be welcomed because the computer has evolved to the point where it can now be used in a wide variety of ways (with a wide range of peripherals) for a myriad of businesses.

Property Transfer Tax

Effective 1 April 2004, the rate of property transfer tax will be reduced from 10% to 7.5%, in an effort to bring the tax rate in line with the best rates in CARICOM. Comments

The reduction in the PTT rate is the fulfilment of a manifesto promise, which has long been anticipated and will considerably reduce the cost of doing business in Barbados.

Contact

PricewaterhouseCoopers

The Financial Services Centre
P.O. Box 111
Bishop's Court Hill
St. Michael, Barbados, WI.

Tel: (246) 436-7000

Fax: (246) 436-1275

www.pwc.com/bb



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