

Tax News

January 16, 2006

CHALLENGES OF RISING ENERGY COSTS

Overview

Prime Minister and Minister of Finance, the Right Honourable Owen Arthur, presented to Barbadians his statement of economic and financial policies which are designed to tackle some of the challenges facing the nation. In so doing he gave us a mixture of incentives and increased taxation aimed at shifting some deep-seated consumer habits as the island grapples with the major twin challenges of fiscal liberalization heralded by CSME on the one hand, and on the other, inadequate foreign exchange earnings to satisfy the consumer habits of Barbadians.

In our comments on the 2004 financial review, we stated that to keen observers of national affairs, the presentation would confirm the general sense of unease in recent times concerning the Barbadian economy. This still prevails.

As a country, we continue to spend more than we earn and there has been an increasing tendency to boost our foreign reserve position by borrowing.

In the long term this is not a sustainable option. To ameliorate the current situation, commercial banks will be required to sell 6% of their holdings of foreign currency to the Central Bank. We do not believe that this is an unreasonable requirement.

We recognize that small open economies like Barbados can pose particular challenges for policymakers, as they are often called upon to manage events that have their origin in the international arena. The current energy crisis is one such example.

The energy crisis is intimately linked to the foreign exchange challenges which we face as a nation, and while the Minister has introduced a number of initiatives to conserve energy both in the private and public sectors, we wonder why measures to deal with some of the major root causes such as a comprehensive public transport system and the reduction of motor vehicle importation, both of new as well as used vehicles, has not been addressed more aggressively. Perhaps the reality is that both in economic as well as political terms, the Minister has little room to manoeuvre.

Analysis

Energy

The Minister expressed the view that the cost of energy was one of the most important factors affecting all aspects of our economy. He further stated that the high price of oil is unlikely to decrease in the short- or medium-term and that we needed to devise and implement strategies which will aid in the reduction of the high oil prices.

In light of this, Government is charting the way forward in the conservation and efficient use of energy by implementing a Public Sector Energy Conservation Programme, which will include:

- the use of alternative vehicle power sources for Government vehicles such as natural gas or ethanol;
- the use of hybrid vehicles by Government offices;
- efficient use of air conditioners by Government offices;
- periodic energy audits of Government buildings; and
- the use of florescent bulbs or more efficient lighting systems in all government buildings.

The Government will reduce the excise tax on crude oil to ensure that the tax remains the same in the midst of rising oil prices.

The Minister also introduced the following measures to alleviate the effects of the rising energy prices:

- intensification of the efforts in the maximisation of the production of crude oil and natural gas;
- diversification of the energy mix to increase the dominance of natural gas and other non-liquid fuels in the economy;

- the introduction and maintenance of a comprehensive set of energy conservation and efficiency measures in order to maximise the efficient use of energy; and
- ensuring that renewable energy plays a progressively more significant role in the economy.

The Government had previously set a target for renewable energy to contribute over 30% of the island's main energy by 2012. The Minister however stated that the Government would seek to do this in a shorter time period, therefore a programme would be carried out to develop other forms of renewable energy such as wind energy and fuel cane.

The Barbados Light and Power, with the Government's support, has developed its own in-house plan for wind energy investment and the development of a wind farm in Lambert's east site in St. Lucy.

In 2008, the Government plans to invest in an initiative to generate electricity from sugar cane.

The Minister has waived the import duty on energy systems such as hydropower systems, solar thermal systems and bio-fuel systems.

Government has reduced the import duty on energy efficient systems or components (such as roof insulation, thermal barriers) from 20% to 5%. The import duty on fluorescent light bulbs and fittings has also been reduced to 5%.

The cost of a household energy audit and recommended conservation systems/materials of up to \$2,000 will be allowed as a deduction from assessable income under the Income Tax Home Allowance Scheme. The Ministry of Energy and Public Utilities is to develop the criteria for approval/certification of the auditors.

With effect from April 1, 2006, a separate tariff structure will be created for diesel vehicles as set out below:

Engine capacity/chargeable value	Excise tax
Under 2000 cc and chargeable value under \$45,000	46.95%
Under 2000 cc and chargeable value exceeding \$45,000	64.35%
Over 2000 cc and chargeable value under \$45,000	76.34%
Over 2000 cc but less than 2500 cc and chargeable value exceeds \$45,000	93.73%
Over 2500 cc and chargeable value exceeds \$45,000	120%

From September 1, 2006, it will become mandatory for all taxi owners and operators of vehicles for approved tourism ventures to purchase a diesel powered vehicle if they wish to obtain the duty free concessions available under Part II B of the Customs Tariff.

With effect from April 1, 2006 hybrid vehicles as well as those powered by other energy sources will attract an excise tax at a fixed rate of 20% as opposed to the current lowest rate of 46.9% on regular cars.

Government will set up an energy efficiency audit and retrofit fund, managed by the Enterprise Growth Fund in the amount of \$10 million for the purpose of administering loans to those persons in the tourism industry seeking to purchase energy efficient devices and equipment.

With effect from April 1, 2006, Barbados will import 14 million litres of semi-processed raw materials from Brazil to be processed in Trinidad into ethanol to be blended with gasoline in Barbados.

It is hoped that the use of ethanol would result in a fuel saving of more than \$25 million.

Comments

It is vital that we seek alternative sources of energy in order to alleviate the impact of rising energy prices. Government has been carrying out studies on the potential of wind energy for some time.

However, other than the waiver of import duties, it does not appear that any further action was taken to make this form of energy a viable form of energy reduction for Barbados.

It does appear that Government has been proactive as opposed to reactive in an effort to find creative energy conservation methods. It is also commendable that Government is seeking alternative measures to reduce the effect of the rising oil prices on the society and has started by implementing a programme in the public sector, one of the single largest employers in the island and a very large consumer of energy.

Exchange Control Liberalization

Over the years, Barbados has seen a change in its exchange control regime which was very stringent. These have gradually been liberalized, with increased authority being given to the commercial banks; as Barbados sought to meet its obligations under CSME by December 2005.

The liberalization of these controls are intended to provide some reprieve for Barbadians, CARICOM nationals residing in Barbados and returning Barbadian nationals with respect to holding foreign currency accounts within prescribed limits without Exchange Control permission:

- Effective February 1, 2006, Barbadian and CARICOM nationals who have resided in Barbados for more than 3 years can hold a foreign currency account up to Bds\$20,000 provided the accounts are funded by foreign currency debits of at least \$50,000 per year. Exchange control permission will be required for limits in excess of Bds\$20,000.
- Returning Barbadian nationals may hold foreign currency accounts up to the equivalent of Bds\$100,000 provided the funds represent foreign currency earnings from abroad in the form of pension, rental income, interest, dividends or other income.
- Exchange controls with respect to travel within Caricom by Barbadian residents will be removed.
- The delegation of full authority to the commercial banks to provide foreign exchange to Barbadian residents traveling to any CARICOM destination has been effected by the commencement of CSME.

Comments

The removal of these stringent foreign exchange controls will certainly ease the pressures of smaller businesses, while at the same time create an environment in which Barbadian and CARICOM nationals can do business with each other.

It will also strengthen the country's economic position as additional foreign currency is likely to be brought to our shores and thus accessible for circulation within the economy by individuals, commercial banks and the Central Bank of Barbados.

Foreign Currency Reserve Requirement

The Prime Minister proposed a foreign currency reserve requiring the surrender of foreign currency by the commercial banks to the Central Bank based on the holdings of their foreign currency deposits. The proposed foreign currency requirement will be 6% of foreign currency deposits.

While the economy stands to benefit from this macro-economic adjustment, it is also intended that commercial banks earn interest at a rate which bears some relation to the US Federal Funds rate. The initial interest rate on such deposits will be 3.5%

Comments

This requirement appears to have been propelled by the influx of foreign currency expected to be generated by non-residents, returning and CARICOM nationals; by the advent of the CSME and the liberalization of foreign exchange controls.

It seems to compensate for any loss which may be suffered by the easing of the foreign exchange controls, while at the same time giving the Central Bank of Barbados access to the use of the foreign currency, thereby assisting in the stabilization of the country's balance of payments.

The change in the exchange controls and in the foreign currency reserve requirements can be of benefit to all parties involved.

Tax Reform

Corporation Tax

The legislated corporate tax rate for domestic companies has been reduced in 2006 to 25% from 30% in 2005. Effective January 1, 2005, the corporation tax rate for manufacturing companies was reduced to 25%.

Comments

The Minister made no mention of the promised further reduction in the corporation tax rate applicable to manufacturers.

Personal Tax

The higher rate of personal tax was reduced to 35% in 2006 from 37.5% in 2005.

The changes in personal allowances up to income for 2006 and 2007 are as follows:

Income Year	Allowance
2006	\$22,500
2007	\$25,000

Income Tax Act

The Income Tax Act was enacted several years ago. Although amended on many occasions to reflect the changing economic and financial circumstances this Act is in need of major revision. A committee will be established to review and make recommendations for the updating of this act together with the incorporation of the taxing provisions contained in many of our existing pieces of international business legislation.

Comments

Government must be commended for recognizing the need to undertake a major overhaul of the Income Tax Act. There are too many issues which confront practitioners on a daily basis which are not adequately addressed within the Act, and are left to administration determination since the Act is silent on these areas. Investors have also indicated that tax provisions are located in too many pieces of legislation

Property Transfer Tax

The Property Transfer Tax Act which has been amended on numerous occasions will also undergo a major revision. A committee will be established to review and make recommendations for the updating of this Act.

Rental Income Concession

Persons who have converted a residence into units for rental under the Home Accommodation Scheme will be permitted to claim an initial allowance of 50% on capital expenditure incurred. The remainder will be claimed at the rate of 4% annually thereafter

Income tax will be paid at a flat rate of 15% on all income derived from rental of home accommodation. A person renting the premises will be allowed to claim an amount of 20% of their assessable income or \$3,000.00 whichever is the lesser against the tax payable in any income year.

Comments

The increase in the initial allowance from 40% to 50% will provide a significant relief to individuals who are converting their premises into rental units.

This incentive does not assist those persons who are building new units and such persons should have been accommodated under this proposal.

It is necessary to define Home Accommodation since this term has been used in reference to those who are registered with the Barbados Tourism Authority. It is therefore not clear if the proposal of the 15% income tax rate applies to all rental units.

Educational Savings Plan

It is proposed to exempt from the payment of withholding tax the interest earned on special savings accounts to be designated as Education Savings Plans, which are created specifically to be used to help persons offset the cost of acquiring a tertiary level education.

Comments

This measure is a step in the right direction as it recognises that tertiary education will become more costly in the future. The proposal however does not go far enough as a deduction should have been allowed up to a specified limit on the amount invested instead of only a tax exemption on the interest. Government should therefore revisit this proposal and provide a deduction similar to that allowed under the registered retirement savings plan.

Agriculture

The Government has recognised the important role that should be played by the agricultural sector. As a result of globalisation and free trade, increasing challenges have descended upon this sector and to ensure its viability additional measures have been introduced.

Developments in the Sugar Industry

A plan has been approved to construct a multi purpose facility costing \$US 150 million which is expected to lead viable and profitable sugarcane industry. The proposed facility will include:

- 30 mega watts of electricity;
- 12,000 tonnes of refined sugar (for the domestic market);
- 10,000 tonnes of speciality sugar (for the export market);
- 5,000 tonnes of speciality sugar (for the local market); and
- 14 million litres of ethanol (for domestic and export market).

To support these initiatives the following additional incentives have been proposed:

- A capital injection of \$2 million to the BAMC to facilitate the various pre-investment activities
- A capital injection of \$32 million to bring an additional 8,000 acres of idle land back into production
- A capital injection of \$2 million to capitalise the Cane Replanting Incentive Scheme
- An annual amount of \$3 million will be used to provide incentives for the growing of fuel cane varieties
- Producers of approved varieties will receive a minimum payment of \$90

Restructuring of the Dairy Industry

The Prime Minister proposed the following incentives for this industry:

- rebate of 25% for the components of dairy housing up to a maximum of \$40,000;
- rebate of 40% of the cost of components for a milking parlour up to a maximum of \$60,000;

- initial capital funding of \$250,000 for the establishment of the Dairy Board;
- the provision of \$250,000 to facilitate a comprehensive plan for the industry as well as a plan for the Board; and
- the provision of \$300,000 over 3 three years for market research and development.

Youth in Agriculture

The government has recognised the importance of the youth and has provided an initial capitalisation of \$2 million to meet the costs of administering a Youth agricultural programme

Model Farms

In addition the Government has earmarked \$2 million for the research, production and training in agricultural practices in areas such as greenhouses and hydroponics

Cultivation Services Scheme

To assist small farmers Government will provide \$2.7 million to facilitate the purchase of 30 tractors under a lease buy initiative to aid in cultivation services and Government will further provide \$1 million towards the scheme to facilitate a rent – a- tool programme which will provide a pool of machinery and equipment to aid small farmers.

Comments

The measures introduced within the sugar industry will provide much needed assistance to this sector. Government is aware that it cannot continue to rely exclusively on the tourism sector but is seeking to ensure other sectors play a pivotal role in the long term sustainability of the economy.

This sector will however be challenged as the world economy with the removal of barriers will only ensure that the most efficient survives. One complaint that can be put forward is that such measures should have been in place earlier when there was still heightened interest in the sugar industry. The current measures must be applauded as they indicate that Government is making a determined effort to turn around the fortunes of the sugar industry.

The involvement of the youth in this sector cannot be underscored as a long term approach must be pursued in order to ensure that the youth can earn an acceptable livelihood from this sector.

Small farmers continue to bemoan the lack of support and once again government has shown their commitment in a tangible way .It is up to the small farmers to capitalise on these initiatives.

Scotland District

This area has been identified as a special development area and plans are underway to establish a Scotland District Development Authority.

The incentives will include:

- a ten-year tax holiday for investments in fruit production ,processing and marketing;
- support for a private sector initiative for the establishment of a 30 acre demonstration fruit orchard;
- an amended Orchard Development Subsidy to further promote the production of approved fruit trees and a forestation of the district; and
- a dedicated land cultivation scheme with an initial investment of \$1 million.

Comments

The Scotland District with its uniqueness has great potential as a tourist attraction. The measures announced will demonstrate Government's commitment to ensuring that this area will be tapped. It is necessary that continued assistance be given since investors may be reluctant to invest heavily in this area as a result of the terrain. Government must also assure investors that there will not be any adverse effects if it proceeds with the Greenland Landfill Project.

International Business

The Prime Minister recognised the importance of the international business sector to the economy of Barbados and acknowledged that this sector contributes more than 50% of Barbados' corporate tax revenues. He advised that as part of the policy to expand the country's network of Double Taxation Treaties, the Government is currently in pursuit of the ratification of Double Taxation Treaties with the Kingdom of the Netherlands and Austria, the commencement of talks with Mexico and Ireland and anticipated pre-negotiation talks with Chile, Brazil and South Africa.

The Prime Minister proposed effective income year 2006, that the existing 35% income tax and foreign exchange controls exemption available to certain qualifying expatriate employees in the sector, be refined as outlined below:

Level of income	Exemption granted
Less than \$150,000	35%
Between \$150,000 and \$500,000	50%
More than \$500,000	60%

The above concession will be automatic on the granting of a work permit for an initial period of three years; and can be renewed for a further three years subject to the demonstration by the permit holder of skills transfer.

In addition, Government will permit the transfer of the unexpired portion of a work permit from one international business entity to another.

Comments

The concessions announced to this sector recognise the continued importance of the sector to the economy of Barbados.

Though some effort is being made on the global level, recognition is given to the fact that Barbados, unlike its competing jurisdictions has not actively pursued the acquisition of the human capital required to build the island as a strong international business centre. The systematic approach outlined for the granting of the concession will be welcomed by the international business community as the granting of automatic exemptions to skilled professionals of the international business sector, enhances Barbados as an attractive place to live and do business. This approach will also assist businesses and the service industry to market Barbados with more accurate and definitive information.

These concessions will also attract skilled professionals, while presenting the opportunity for local professionals to acquire skills transferred by persons who are often globally recognized for their specialized knowledge. These concessions will definitely put Barbados in the market for the acquisition of human capital.

We would be very interested to know whether these income tax concessions will apply retroactively.

Manufacturing

The manufacturing sector has received particular mention, with the Minister highlighting efforts to boost local production in an effort to grow the industry. Amendments to concessions afforded to the sector include:

- An additional \$2m to the Special Technical Assistance Fund. This Fund, targeted at the garment, furniture, food and beverage industries, was established in 2001 and has to date disbursed over \$10m to 166 companies. Special focus is to be placed on the garment sector in an effort to stimulate synergies with the local fashion design and tourism industries. The Fund will be further expanded to provide:
 - technical assistance to companies indebted to government agencies;
 - assistance to enhance the physical infrastructure of companies;
 - grants to facilitate the acquisition of capital equipment; and
 - assistance to facilitate the establishment of new service/product sub-sectors.
- Continued protection from the 60% surcharge on certain imports, including women's suits.
- A phasing out of the surcharges on certain imported products by 2008, replacing assistance with technical assistance programs. This transition includes revisions to the list of items, including trousers and shorts, men's and boys' suits and curtains from which the surcharge will be removed. It is intended that this preferential treatment will be discontinued after an 18-month period.
- Reduction in the tariff rates to 20% on the abovementioned items will be effective April 1, 2006.

- Private sector partnerships which are being established to further enhance distribution networks and to further overseas market penetration.
- Reduction in the interest rate extended by the Industrial Investment and Employment Fund by 2%.

Comments

As Barbados continues to further its efforts to become compliant with WTO requirements and to pursue the CARICOM Single Market and Economy, Barbadians have and will continue to see the elimination of tariffs and surcharges which are deemed to provide preferential treatment to Barbadian industry. The Government continues to support the sector by increasing technical assistance providing limited grant funding.

Cess

Imposed on September 1 2005 initially for a period not exceeding 18 months, the cess represents a 3% tax on extra-regional imports. The cess will be increased to 6% effectively immediately, and all funds generated are to be funneled into the Export Promotion and Marketing Fund (EPMF) to enable the Government by way of grant to fund corporate entities including statutory corporations involved in the business of exporting, and to assist these entities with the development, promotion and marketing of products and services. The Fund is administered and managed by the Enterprise Growth Fund Limited. The provisions of the EPMF Act and the cess are slated to remain in place for a further 18 months.

The cess is applied to the customs value (i.e. cost plus insurance plus freight) and will affect the VAT collected.

Items which are zero rated under the provision of the VAT Act, and baby napkins, special foods for diabetics, and special healthcare articles for the elderly will not be subjected to the cess.

Manufacturers are also exempted from the cess on goods imported by companies operating under fiscal incentives, and on articles imported for the purpose of manufacturing for export to the US or Canada.

Comments

One feature of the cess and the revenue to be collected from the excise tax on cars and environmental levy on used motor cars is it will first be paid into the Consolidated Fund and then transferred to the EPMF which is to be administered by the Enterprise Growth Fund. The question arises as to who will determine how the funds collected by the EPMF will be disbursed. Is the Fund meant to finance activities that are separate and distinct from those receiving direct allocations from the Consolidated Fund or is it meant to jointly finance export promotion activities in the tourism, international business and manufacturing sectors?

Clearly the imposition of the cess and its subsequent increase are an attempt by Government to curtail the level of expenditure, especially consumer spending in order to improve the current account of the balance of payments.

Telecommunications

The liberalization of the telecommunications sector has yielded substantial increases in the number of mobile users, along with substantial reductions in the mobile and international rates, in charges for ADSL and broadband usage.

The Minister has sought to avail the sector further incentives.

The Government has fulfilled its intention to provide licences to operators wishing to develop wireless technologies, in an effort to further develop the sector and to avoid a monopoly or duopoly market conditions.

The Minister has committed to avail the public of the services of the Government through online access. He has pledged the integration of certain Government agencies, including the Land Tax Department, The Land Registry, and the Registration Department by September 2006, and the inclusion of the Customs Department and Inland Revenue Department by September 2007.

Full integration and availability is targeted for the end of the calendar year 2008 at a cost of approximately \$5.0 million.

National Insurance and Pensions

The following changes were made to insurable earnings:

- Effective January 1, 2006, insurable earnings increased from \$3,190 to \$3,290 monthly and from \$736 to \$759 weekly.

Comments

This change in the level of insurable earnings is in line with the reform of the social security system amended in 2002. From January 2006, the national insurance rates increased from 9.5% to 10% for employees and from 10.75% to 11.25% for employers.

For example, an employee who works for \$3,300 per month, the charges will be as follows:

Computation of National Insurance on monthly earnings of \$3,300		
Year	National Insurance	
	Employee (\$)	Employer (\$)
2005	\$314.00	\$355.00
2006	\$330.00	\$371.00
% increase	5.10	4.51

With effect from February 6, 2006, NIS contributory pension will be increased to \$116 per week, while non-contributory pension will be increased to \$93 per week.

Persons with severe disabilities and persons between 45 to 65 years old will receive an increase in their welfare stipends to \$63 with effect from February 6, 2006.

The Funeral and Maternity Grants payable by the National Insurance Board will be increased to \$1,485 and \$850 respectively.

Comments

The move by Government to implement these measures will result in some increase in the standard of living of these individuals.

Land Tax

The Minister of Finance has amended land tax rates for 2006/2007. Every parcel of land in Barbados is subject to this tax which is assessed by the Commissioner of Land Tax annually. Every property is visited by personnel of the office of the Commissioner of Valuations every three years as they assess the current market value of the property and notify the owner.

Such valuations have resulted in increases on average of 25% to 30% in property values in 2005/2006, and have led to significant increases in the tax payable on properties with values ranging from \$350,000 to \$850,000. The proposed rate reduction from 0.65% to 0.45% on properties with effect from the land tax year 2006/2007 is targeted to benefit 9,300 residential properties. The changes to the rate structure are highlighted below:

Improved Property	
On which there is a dwelling house that is occupied by the owner or his immediate family	
▪ On the first \$125,000	Nil
▪ On amounts between \$125,000 and \$350,000	0.10% on the improved value
▪ On amounts between \$350,000 and \$850,000	0.45% on the improved value (2005: 0.65%)
▪ On amounts in excess of \$850,000	0.75% on the improved value

Comments

The reduction in the land tax rate for these properties is likely to benefit approximately 9,300 residential properties, and will be a welcome relief.

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