

Tax News

March 16, 2007

Something for Everyone!

Overview

As the 2007 ICC Cricket World Cup in the West Indies gets under way, Prime Minister and Minister of Finance, the Right Honourable Owen Arthur, presented to Barbadians his statement of economic and financial policies on March 14, 2007 lasting a marathon three hours. One could ask why the financial presentation was delivered so late as compared to prior years. Tax advisors, us included, have been challenged by the timing of the presentation, as he chose to deliver his address at a time when we were focussed on completing corporate tax returns by the due date of March 15! *(We apologize that we were unable to host our normal breakfast discussion this year because of these conflicting time pressures).*

While some might question the Prime Minister's timetable, we think that most would appreciate, after listening to the presentation, that the number of issues addressed probably kept several government employees up late for many nights preceding the presentation.

This was a "something for everyone" financial presentation with a strong focus on new expenditures and less mention of the necessary revenue raising measures that will be required to fund the proposed expenditures.

The Prime Minister is particularly proud of the country's strong economic performance during 2006, noting especially the following:

- the rate of growth of the economy of 3.5%;
- the rate of unemployment of 7.6%, the lowest level in recent history;
- the decline in the rate of expansion of credit; and
- the reduction in imports of consumer goods by 12.6%.

Analysis

National Strategic Plan

The Prime Minister started his address by setting it within the context of the “National Strategic Plan 2006-2025”. The goals of the strategic plan are lofty. By 2025, Barbados is to become a fully developed society that is prosperous, socially just and globally competitive. The key themes of the Plan are developing Barbados as a premier world tourism destination and a centre for the performance of high quality financial, information and other services augmented by re-invigorated agricultural and manufacturing sectors. In light of this, it is not surprising that Government has tried to address so many issues.

The Prime Minister highlighted measures taken in prior years that he believes created the momentum to move Barbados to its current level of development. He indicated that, having achieved certain significant objectives, it was now time to move forward with a “second generation” of reform.

Key concerns raised by the Prime Minister and shared by many of us in the country include the following:

- a rate of inflation of over 7%;
- growth in the national debt;
- lack of resources in the health care sector;
- rising energy prices;
- increasing demand for consumer imports;
- a shortage of affordable housing;
- slow growth of domestic exports;
- the need for “greening” of Barbados;
- the need to reform the financial and capital markets; and
- the need to liberalize exchange controls.

Comments

Few will question that these are significant concerns and tough issues for a small country to face. Barbados is rich in many respects, with wonderful weather, well-educated people, a good infrastructure, great beaches and this year the 2007 Cricket World Cup finals! We believe the key to long-term real future prosperity for the country is to reduce the debt to GDP ratio, which stood at 71% at the end of the fiscal year. We are pleased to see that this is an objective of the Government, as the Prime Minister announced that he proposed to reduce this ratio to under 60% by 2012. This will be an extremely challenging task.

Exchange Control Liberalization

The Prime Minister, in his presentation, indicated that: “In my judgment, the exchange controls may be impairing the balance of payments rather than protecting it.” He made reference to the use of offshore companies by international investors to hold Barbados property.

Liberalization of exchange controls is required to meet the Government’s commitment to the Caribbean Single Market and Economy and the Prime Minister proposed that any remaining exchange controls with respect to the CARICOM area will be liberalized by year end.

In addition, the Prime Minister proposed the removal of substantially all of the remaining restrictions with respect to non-CARICOM transactions “as soon as practicable thereafter”. He also announced the removal of exchange controls related to the repatriation of the proceeds of sale of a property owned by a non-resident if the sale is to another non-resident and there is no net foreign exchange loss to the country.



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Comments

The requirement for Barbados to liberalise its foreign exchange control regime is clear. This system is seen by many as a disincentive to investment and in the Prime Minister's view has hindered the development of the island as a financial services centre. The further relaxation of the system should lead to increased cross-border investment, both inbound and outbound. The Prime Minister is very much aware of the risks and challenges associated with exchange control liberalisation, both to our balance of payments and our currency. The fundamental challenge continues to be the creation of further sustainable growth in the foreign exchange earning sectors.

In recent years, there has been much discussion regarding the situation whereby foreign investors have typically held their Barbados real estate in offshore companies as a means of avoiding property transfer tax (see below) as well as exchange controls on the repatriation of sales proceeds on a sale of their Barbadian property. By removing exchange controls and reducing the rate of property transfer tax, it is anticipated that more funds should flow into Barbados and the use of complex and costly offshore structures should no longer be attractive to such investors.

International Business

The Government recognizes the importance of international business to Barbados and particularly the under-developed opportunity that lies in the area of asset management. To this end it has established INVEST BARBADOS (formerly known as the Barbados International Business Promotion Corporation) to promote and

sell Barbados as a mature international business and financial services domicile. It will also introduce a new charter to confirm its commitment to the development of international business. Some key elements of this charter and other items affecting the sector are set out below:

- **from income year 2007 and onwards, dividends derived by Barbadian resident companies, including international business companies, will be exempt from tax in Barbados on dividends from an overseas company where the Barbados resident is a shareholder representing at least 10% of the capital of the overseas company and the shares are not held as a portfolio investment;**
- exemption of withholding tax on dividends paid by a resident Barbados company to non-resident shareholders out of foreign source income;
- reduction of the processing time and documentation for work permits;
- creation of 13 additional positions in the department of Corporate Affairs and Intellectual Property;
- enhancement of on-line delivery of services;
- establishment of a new position of Senior Immigration Officer with specific responsibility for work permits;
- establishment of a Financial Services Authority;
- simultaneous establishment of residency and licensing;
- creation of a single regulatory agency for Family offices, Treasury Management and Private Equity;
- removal of legislative anomalies dealing with "residence" and "domicile";



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- establishment of a Barbados International Arbitration Centre; and
- creation of an Institute of International Securities and Financial Regulation.

Comments

While all of these proposals are encouraging, we have highlighted the first item above because we believe this to be one of the most significant items in the financial presentation, not only for international business, but also for local businesses.

Currently, significant revenues are generated from the taxation of dividends received from other countries and routed through Barbados holding companies. Eliminating this tax is thus likely to reduce the income to Government coffers. On the other hand, this measure should significantly enhance the attractiveness of Barbados as a domicile for such holding companies. Therefore, although the measure may appear to be costly in the short-term, if well marketed, it should have a major positive impact on the growth of the international business sector.

From the perspective of local companies which have foreign subsidiaries, they will now be encouraged to repatriate dividends to Barbados, since these will no longer be subject to corporation tax. This should create further foreign currency inflows into the island.

The international business sector has benefited from changes recently legislated with respect to personal tax concessions granted to specially qualified expatriate employees and will welcome a system that facilitates the processing of work permits in a timely manner.

Tax Proposals

Personal Taxation

The last few years have seen significant reductions in both corporate and personal tax rates and an increase in the level of personal allowances.

While the changes benefited many Barbadians, the Government has recognized that many low income residents have not been assisted. In an effort to meet the needs of lower income individuals, the Government has introduced a number of new measures:

- the income threshold for eligibility for the reverse tax credit will be increased from \$13,000 to \$18,000 and the grant from \$500 to \$1,300 over the next 3 years; and
- personal allowances will be indexed for inflation and adjusted every three years.

Savings Initiatives

In an effort to encourage savings, the Government has proposed for income year 2007, that the maximum amount that can be contributed to a registered retirement plan and registered annuity be increased from the lesser of \$4,000 or 15% of assessable income each (or \$6,000 between the two plans) to \$10,000 to either or both plans.

In addition, the current \$3,000 annual allowance for investment in credit unions and the \$10,000 allowance for investment in mutual funds and new shares will be replaced by a \$10,000 consolidated allowance for investment in credit unions, new shares of public companies or mutual funds.



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Home Improvements

The allowance for home improvements has been increased from \$10,000 per annum to \$15,000 to take into account certain expenditures for green products.

Tax Rate Reductions

The tax rate for approved small businesses will be reduced from 20% to 15% and for businesses in special development areas from 30% to 15%.

In addition, companies constructing houses for sale at less than \$150,000 will benefit from a 15% tax rate.

Property Transfer Tax

It was proposed to reduce the rate of property transfer tax from 7.5% to 2.5% effective from income year 2007 (presumably April 1, 2007).

Withholding tax exemptions

The Prime Minister announced that there would be an exemption from withholding tax on dividends paid by a resident Barbados company to non-resident shareholders out of foreign source income earned by the company.

Comments

Many of the fundamental tax reforms introduced by this administration have already been completed. However, the decrease in the property transfer tax rate is important to investors in Barbados property, both real estate and shares, and should be commended.

As noted above, this decrease in the property transfer tax rate, together with the relaxation of exchange controls, should discourage the use of offshore holding companies by foreign investors for holding Barbados real estate. It will be welcomed by all owners of property in Barbados, whether they are Barbadians or foreigners. There may also be further beneficial consequences of the reduction in the rate of property transfer tax in encouraging a more active domestic property market. As transaction costs fall, the incentive to sell property and reinvest the proceeds rather than holding for future capital gains increases.

The indexation of personal allowances is something that PricewaterhouseCoopers has advocated for many years (going back as far as 1992!) and we are pleased to see this now addressed. In line with other countries, the Government should consider indexing the tax brackets as well.

Agriculture

Continuing a major theme of last year's presentation, the Prime Minister introduced a number of new measures to support and encourage agriculture in Barbados.

Sugar

To support the efforts of the BMAC in the commercialization and marketing of sugar products, the Government announced a further capital injection of \$3,000,000 to assist with the transition of the sugar industry. \$250,000 was also allocated for a feasibility study directed at the establishment of a living sugar museum.



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Poultry

With a goal of making Barbados self-sufficient in providing its own poultry needs, the Government announced the establishment of a “Poultry Board” and possible assistance in establishing a self-insurance plan for poultry producers.

Pigs

With a goal of achieving self supply of at least 50% of Barbados requirements (compared to the current 13%), the Government announced \$300,000 to assist in the development of a pig artificial insemination program.

Dairy

To increase the production of milk from its current 75% of requirements, the Government announced financing support (through the Agricultural Development Fund) as well as the establishment of a new “Dairy Board”.

Water Harvesting

Assistance similar to that offered to crop producers will be extended to the livestock sub-sector. A 50% rebate on the cost of establishing water harvesting facilities was announced.

Arboriculture in Scotland District

To encourage arboriculture (the growing of fruit and forestry) in the Scotland district, the Government has proposed that it will offer registered farmers a 50% discount for the purchase of a minimum of 300 trees of approved species and the costs of management of the trees, provided certain conditions are met.

Other Agri-initiatives

- To encourage food exports the Government announced \$20 million to upgrade eight Ministry of Agriculture laboratories.
- To assist financing of farm initiatives, increased funding to the Agricultural Development Fund and the Rural Enterprise Fund through a \$40 million bond issue.
- To support the introduction of Barbados youth to the importance of agriculture, the Government announced a further \$2 million would be provided to the youth programme at Bath through the Agricultural Development Fund.
- To encourage the fishing industry, a 15-year tax holiday will be granted to organizations involved in fish procurement, processing and marketing.
- To encourage the use of new technology, a 15 year tax holiday is being introduced for those organizations investing in high-end technology.
- \$400,000 will be provided to assist the West Indies Sea Island Cotton Association in its restructuring efforts.

Comments

With many of these announcements, the devil will be in the detail. Inevitably there will be an element of administrative red tape relative to qualification for some of the announced incentives, particularly the tax holidays. As always, the challenge will be to ensure that the administrative procedures do not stifle the effectiveness of these initiatives.

The establishment of boards to deal with poultry and dairy products may or may not be helpful, but only time will tell. Their composition will be important. The Prime Minister expressed concern about Barbados' food security and is now eager for Barbados to become self-sufficient in 16 commodities. This is an ambitious and highly desirable goal, but the industry will require considerable monetary and administrative support to meet this objective.

Manufacturing

The Government is determined to transform the manufacturing sector in Barbados. Its plan involves a number of initiatives which will be rolled out over the next three to five years at a cost of approximately \$79.5 million. These include:

- creation of an Export/Import financing facility;
- exemption from VAT on import of raw materials, packaging and equipment by qualified registered exporters (currently proposed to be companies earning at least 40% of their annual revenue from exports sales);
- other technical assistance;
- establishment of an Export Promotion Agency;
- possible extension of existing fiscal incentives for a further 5 years based on new capital invested in the last three years of the holiday;
- sale of “long leaseholds” to manufacturers in industrial estates and use of the proceeds to finance new developments;
- establishment of a Medical Transcription Services training centre;

- establishment of a central processing facility for the condiments sector;
- expansion of the Basic Industries Program (no details were provided); and
- launch of the Barbadian Vernacular Furniture Initiative.

Comments

A lot of initiatives and a lot of Government involvement, which the Prime Minister clearly views as necessary. Consider the last proposal. It attempts to encourage the growth of the furniture sector by “establishing a covenant with the local tourism and distributive sectors to purchase locally produced items, subject to our producers meeting the requirements for quality, consistency of supply and competitive pricing”.

While any “buy local” or “100% Bajan” purchasing decisions are highly desirable, it will be important that this not become an exercise in frustration for local hoteliers or other major investors.

The exemption from VAT on importation of raw materials, packaging and equipment by manufacturers who have significant exports will go a long way to alleviating the chronic issue of VAT refunds due to these businesses and significantly improve their cash flows.

Some of the proposals, such as the creation of an Export/Import financing facility and the establishment of an Export Promotion Agency are really not new initiatives but may better be described as a revival of prior initiatives, hopefully with a renewed focus.

Housing

In response to local demand for affordable housing, the Government has introduced a number of measures aimed at encouraging/mandating developers to provide a mix of housing options and to provide access to housing options for low- and middle-income earning Barbadians. These include the following:

- increasing the allocation of land for residential purposes;
- sale of Government owned land at a reasonable cost;
- mandating developers to provide low cost options in conjunction with upscale/ luxury housing;
- providing leased land to low-income earners to construct their own homes; and
- amendments to the Land Registration Act and Land Adjudication Act to ease administrative burdens.

Comments

There has been considerable public debate over the past few years on the topic of access to land ownership by Barbadians.

The attractiveness of Barbados property, especially west coast property, to non-nationals has contributed to an escalation in property prices across the island. The financial presentation represents the Government's attempt to ensure lower price options for Barbadians.

The proposal to require the development of affordable housing as a pre-requisite for

planning approval for luxury, upscale projects is an initiative modeled on a UK precedent. From a business perspective we have to question how practical these provisions will be. Will a developer of a west coast property want to be committed to constructing \$150,000 homes next to \$2 million dollar homes? Will the Government allow a developer to develop affordable housing in a separate location from the high cost developments? While the objective of the proposal is laudable, it will require care in its application.

Green Economy

In this presentation the Government renewed its commitment to making a Green Economy for Barbados. Some of the commitments made include:

- duty and excise tax exemptions for alternative fuels and vehicles with lower emissions;
- a new tax regime for importation of "Green products";
- income tax incentives for "greening" a home; and
- extension of the list of recyclable containers.

To assist in the greening of Barbados, the Government has proposed an increase in the Environmental Levy from 1% to 2% and to double the rate on specific items.



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Comment

Any “greening” initiatives are welcome and many would argue overdue. Given the pace and extent of physical development of Barbados in recent years, we believe that physical planning and the social impact of this rapid development should be seen as issues of central concern.

The waste generated by Barbadian householders and businesses surely cannot be sustained at its current level on an island with scarce land resources. Every effort should be made to educate the public and to encourage Barbadians to “reduce, reuse and recycle”.

We are encouraged by comments acknowledging the need to address the stresses on our environment.

Special Development Incentives

The Prime Minister addressed some areas that he believed deserved special attention. These include:

- health related tourism, including retirement villages;
- support for Private Heath Facilities by providing VAT and duty concessions for new facilities, major upgrade or modernization;
- support for the Queen Elizabeth Hospital;
- support of the motor sport industry through VAT and duty concessions;
- support of the transport sector through a reduction in the duties charged on importation of vehicles; and
- various measures to support the development of St. Lucy.

Land Tax

The Prime Minister proposed the following changes to the land tax rates once the new valuations are issued in 2008.

Improved Property	
On which there is a dwelling house that is occupied by the owner or his immediate family	
▪ On the first \$150,000	Nil
▪ On amounts between \$150,000 and \$400,000	0.10% on the improved value
▪ On amounts between \$400,000 and \$1,000,000	0.45% on the improved value
▪ On amounts in excess of \$1,000,000	0.75% on the improved value

Comments

The level of any tax savings will depend on the extent to which the benefit of these reduced rates is outweighed by any increase in assessed values.



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