



Tax Reform - can we rise to the challenge?

© 2011 PricewaterhouseCoopers Jamaica. All rights reserved

Author: Brian J. Denning, Partner, PricewaterhouseCoopers Jamaica

brian.denning@jm.pwc.com

As the issue of tax reform returns to the front burner, it is worthwhile to look at what has been happening recently as well as some of the big challenges we will have to address if we are to facilitate our tax regime in acting as a catalyst for economic growth.

Jamaica’s tax system has been extensively studied over the years. Many important and balanced tax policy and administrative reform recommendations have been made over the years including in the 2004 Report of the Tax Policy Review Committee (also known as Matalon Report) and more recently in the 2009 Blueprint for Taxation Reform in Jamaica. A range of recommendations have been adopted but comprehensive reform has remained difficult to achieve.

The Government of Jamaica (GoJ) committed in its Macroeconomic Programme (as outlined in the GoJ’s Letter of Intent to the IMF in January 2010) to “*strengthen tax administration*”. This includes a series of specific initiatives to be implemented in the short-term and steps have already been taken on a range of these. In terms of tax policy, the Letter of Intent stated that the GoJ “*remains committed to significantly scale back the system of tax incentives and exemptions in order to significantly broaden the tax base, reduce distortions in the system, and allow a phased reduction in the corporate tax rate to a more competitive level*”.

Green Paper

In May 2011 an important step forward was taken when the Honourable Audley Shaw, Minister of Finance & the Public Service tabled in Parliament a Green Paper entitled "Tax Reform for Jamaica". This paper outlines the GoJ’s intention to undertake comprehensive reform of the country’s tax regime, the objectives it wishes to achieve as well as a menu of reform measures under consideration. The purpose of a Green Paper is to stimulate public debate on its content and to enable the GoJ to take account of representations by all stakeholders prior to formulating its official policy position. This will be subsequently published in a White Paper document. A bipartisan Parliamentary Tax Committee was established in July 2011 which intends to commence a review of the Green Paper reform proposals in September.

The Green Paper initially stimulated quite a degree of public debate on the topic of tax reform. Public discourse continues to be periodically punctuated by concerns expressed from stakeholders who feel that certain reform proposals will adversely impact their specific sectors. In contrast other stakeholders who presumably feel less impacted by the menu of reform measures outlined in the Green Paper have not actively participated in the debate (some perhaps in the hope that the status quo remains). The risk with such an approach however is that other reform proposals detrimental to these stakeholders could subsequently emerge without the benefit of their input. The clear message therefore is that all stakeholders should inform themselves of the GoJ’s proposals and how it could impact them as well as contribute to the review process.



The difficulty of securing agreement and implementing comprehensive and balanced tax reform should not be underestimated. Separate and apart from evaluating and modeling specific reform proposals, there are also a number of critical “big picture” issues which must be addressed if we are to rise to the challenge of reform.

Depoliticising reform

Our current fiscal situation demands urgent tax reform while at the same time it limits our options available (particularly in the short-term). The implementation of a comprehensive and balanced tax reform plan requires time, clarity of purpose and certainty. It simply cannot be driven by short-term political objectives or within the timeframe of each political cycle. This is a reality that faces us as a country irrespective of which part of the political spectrum you may align yourself to.

The Parliamentary Committee on Tax Reform provides our politicians with a great opportunity to demonstrate that an enlightened sustainable reform can be developed through collaboration and be properly implemented in the interest of the country. Such reform should have bipartisan support or it risks being subsequently reversed or attacked for political expediency. With elections constitutionally due in 2012, can we rise to this challenge?

Tax Incentives

Determining the role tax incentives will play in the future will be a particularly challenging one in carving a path for tax reform. Stakeholders within sectors which currently enjoy tax incentives (e.g. tourism, manufacturing, agriculture, export) will typically argue that they should continue to be incentivised and that this is critical to their survival. In contrast, stakeholders in non-incentivised sectors typically complain that they are consequently called upon to bear an excessive and disproportionate share of the overall tax burden in an effort to meet the tax revenue demands of the country.

This is further compounded by significant non-compliance by taxpayers who evade their obligation to contribute to the pot. It is argued that if everyone paid their “fair share” of taxes, the current burden could be significantly reduced, the general (non-incentivised) tax regime could be made more competitive and the country’s fiscal position improved. Whilst the Green Paper proposes a review and overhaul of incentives and waivers (and the pulling of same into an Omnibus Incentive Law), it does not make specific recommendations as to how this will be done.

Irrespective of one’s views on incentives, the reality is that doing nothing is not an option. Jamaica has already committed to the World Trade Organisation (WTO) to disband export-driven tax incentives for the goods producing sector by 2015 (not far away now) with similar pressures anticipated in the future for exported services. If nothing is done, export activities will then revert to becoming fully taxable under the non-incentivised tax regime (which imposes tax at relatively high levels).



Tackling our general tax regime must be a big part of any tax reform effort. At present the regime is characterised by high statutory tax rates which when combined with certain penal or business unfriendly provisions make it unattractive and more challenging to operate within. As a result, it becomes increasingly difficult for Jamaica to attract or stimulate the desired economic investment without granting extensive tax breaks.

In fact some of these “incentives” are needed merely to counteract or remove a disincentive which otherwise exists in our general regime. Rather than eliminate the disincentive entirely, there are instances where we have removed it for certain sectors as part of the “incentive” offered. For example, GCT registered taxpayers cannot claim GCT incurred on materials used in the construction or repair of their business premises (so they must absorb the GCT as an additional cost). In my view this is a business unfriendly provision and inconsistent with general GCT principles. We then exclude hotels from the application of this provision. So is this an incentive that we give to hotels or a disincentive imposed on everyone else who wishes to maintain or enhance their business premises? Why not eliminate the provision entirely?

Where existing statutory incentives are unable to address the disincentives in specific instances, the only mechanism left in the short term to address the matter is by way of a Ministerial waiver of tax. While the issue of tax waivers has been the subject to much public discourse recently, many people fail to appreciate that the number and extent of waivers is symptomatic of the deficiencies in and burdensome nature of our general tax regime. It also reflects our tardiness over the years in implementing comprehensive legislative reform. To put it simply, if our general tax regime was more competitive, business friendly and efficient, the pressure for tax waivers would dissipate. In addition to allowing for a more transparent distribution of the tax burden, our public sector officials (including at a Ministerial level) would be relieved from the very significant administrative burden that the current web of incentives, concessions and waivers places upon them.

If we do not address this situation, then matters will get worse. As our general tax regime becomes more burdensome, we will be increasingly pressured to give further tax breaks (whether by incentive, waiver etc.) in an effort to stimulate desired investment. In doing so, we will drive ourselves further along a path we do not want to go – further narrowing our tax base, imposing new or higher taxes to sustain revenues, enhancing the incentive to evade taxes, further undermining the competitiveness and viability of the tax compliant business sector and so on.

A key challenge will therefore be secure some level of consensus amongst the various stakeholders as to what role tax incentives will play in our tax regime going forward and how our general tax regime can be made more competitive to promote economic growth etc. In this regard it will be critical for the debate to undertaken in an open and frank manner in the interest of the country as a whole and not to allow the debate to descend to sectors pitting themselves against each another. It is not a zero sum game. There is a big world out there and my prosperity is not dependent on your failure. Can we rise to this challenge?



Social Welfare

If the moral test of government is how that government treats those who are in the dawn of life, our children; those who are in the twilight of life, our elderly; those who are in the shadows of life; our sick, our needy and our physically and mentally challenged, then we still have much to do. While extensive and laudable charitable efforts are undertaken by the private sector, NGO's and the general public in an effort to bridge the gap, these must supplement, not replace the State's responsibility in this regard. The constant cry however is a lack of resources.

So how is this relevant to tax reform? The primary reason is that we have repeatedly used the tax system as a tool to deliver social welfare assistance to those in need. It has cost us dearly however because the tax system is simply not designed to achieve this efficiently. Separate and apart from the gross inefficiency, some of these provisions also facilitate tax evasion thereby making matters worse.

The classic example of this is the suite of GCT exemptions granted on a series of items deemed to constitute the shopping basket of our poorest members of society. This is undoubtedly well-intentioned but the same items are bought by everyone else (and probably greater quantities) so the tax forgone by Government is much greater than the value of the benefit accruing to those who we wish to target. The Green Paper estimates that GCT forgone at the port from exempt goods imported is approximately J\$5.3 billion.

The issue is further compounded by the fact that we have pushed our general GCT rate over the years in an effort to yield tax revenues needed from our general tax regime. It is obviously more difficult therefore to remove exemptions in circumstances where the standard GCT rate is 17.5% instead of (say) 10% and so any such removal should ideally be accompanied by a meaningful reduction in the standard GCT rate.

How can we address this? The textbook solution is to replace the GCT exemption with a targeted expenditure programme so that the benefits can be delivered directly to the people in most need. If properly implemented, this should be much less costly and can even provide greater benefits than a GCT exemption (which does little to help those who cannot afford to buy the product in the first place). The difficulty of course is that mechanisms distributing state-sponsored goodies tend to be costly and are susceptible to corruption and partisanship – the Jamaican public does not need any convincing of this based on past experiences over the years. While it is recognised that the matter is politically sensitive, this is a national issue and will remain so irrespective of which party is in power. So the question is - can we rise to the challenge of finding a bipartisan solution to this and then implement in a manner that we can all be proud of?



Conclusion

If you think that reforming our tax regime cannot impact our economy, then you should think again. By way of illustration, I draw your attention to just two recent tax policy reform changes which were announced by Minister Shaw in his 2011/12 Budget presentation in April. The first was the removal of transfer tax/stamp duty to facilitate the development of the corporate bond market and the second was the reduction of stamp refinancing/transfer of mortgages. Both of these measures are having a positive impact and have contributed to the reduction in lending rates over the last few months. If you have a mortgage, this will have had a direct positive impact on your pocket. By way of contrast, the recent significant reduction of taxes on motor vehicles cannot have helped in managing our country's massive trading deficit (which is at the core of our problems).

The above measures are just examples of how tax reform measures can have a direct and meaningful impact on our economy. Certain important steps have been taken but we now need move forward decisively to complete the job in the interest of Jamaica as a whole. With the relative stability currently being experienced, can we now exploit this window of opportunity to undertake comprehensive, balanced and transformative tax reform – the question is not whether we can rise to this challenge, it is can we can afford not to?