

# In the Zone\*

## PricewaterhouseCoopers Bermuda's response to the 2007 Bermuda Budget Statement

**Social dividends increase, capital expenditures decrease, we are in a good place economically, and the outlook for 2007 is positive.** Such is a recap of the 2007 Budget released today by the Honourable Finance Minister Paula Cox. Following last year's announcement of the 'Age of Empowerment' the Government has welcomed a new era for stakeholders in North East Hamilton as the Economic Empowerment "Zone". Stating that it is not the time for across the board taxes, the Government by its budget is providing encouragement and assistance to those "who demonstrate a willingness". In the economic allocation process, there are those in the Zone, and those who contribute to the enhanced taxation. While Bermuda represents the "gold standard" as a domicile for international business, there will be increased costs to maintain this high standard, including enhanced corporate registry fees, a taxation on high income earners, and doubling of the tax on currency conversion from Bermuda dollars.

### in the zone

#### Bermudian entrepreneurs

- new businesses in the Zone to have concessionary payroll tax of 4.75%

#### Everyone

- No increases in bus or ferry fares
- No change to land tax
- Customs relief on building projects
- Landlord incentives

#### Tourists

- Reduced hotel payroll taxes
- Incentives to tour boat operators

#### Students & Apprentices

- Increased funding for training
- Programs for accreditation

#### Seniors

- Pension benefits increased by 4.5%
- Free prescription drug benefit increased to \$1,200 per annum
- Additional 2 medical visits per year
- Increase retirement age beyond 65

#### War veterans

- Medical, dental, and pension benefits will be enhanced
- Pension benefit of being doubled from \$400 to \$800 per month

### outside the zone

#### Business

- Salary cap to increase from \$235,000 to \$350,000
- Companies Act fees to increase by 5%

#### Everyone

- Currency tax rates double

While the Zone winners include students, entrepreneurs, seniors, veterans and those on remand; corporate Bermuda is expected to align with the Government's workforce objectives for the advancement of Bermudians. With the increase of Government expenditures to \$1 billion the social dividend has increased to 18.5%. What is noteworthy is that the Government's Capital Expenditure Plan has decreased from \$220 million to \$141million, with new projects limited to \$41 million. While the Budget outlines expenditures for venture capital programs, satellite initiatives and a Fishing Apprenticeship Scheme, there is limited discourse to address Bermuda's desperate housing crisis. With the proposed reduced customs duties, and the benefits of public-private partnership schemes, the Government has concluded that it is not necessary nor prudent to set aside the initial level of funding for housing.

As Bermudians continue in an 'Age of Empowerment' for the average Bermudian it will be important to ensure that they fit into the Zone.

# Impact on Business

"...although we do not regulate the costs of professional services and service-providers, in those areas within our remit, we did seek to do much to lower the costs of doing business by our tax policies and duty relief."

GDP growth is now expected to exceed the 3% for 2006. The anticipated growth rate for 2007 is between 3 to 3.25%.

The standard payroll tax rate remains at 13.5% in 2007/2008 with the salary cap increasing from \$235,000 to \$350,000. This increase is expected to yield an additional \$10 million in revenue. Going forward, Government will review this salary cap on a biennial basis.

Government has proposed increasing a selection of fees under the Companies Act of 1981 by 5% from April 1, 2007

Foreign currency purchase tax is increased by 100% to 50 basis points. The estimated revenue from this increase is \$7 million.

Bermuda Small Business Development Corporation will be provided with additional resources in 2007/2008 for the roll-out of the Economic Empowerment Zone. The grant for the BSBDC has been doubled to \$3 million.

New start-up businesses in the Zone will have a concessionary payroll tax rate of 4.75% in their first 12 months of operation.

## The Main Tax Effects

|                                   |   |
|-----------------------------------|---|
| <b>Retail</b>                     | <ul style="list-style-type: none"> <li>New businesses in the Economic Empowerment Zone to have concessionary payroll tax of 4.75% in their first year of operation (to transition to tiered payroll system in the second year of operation)</li> </ul>  |
| <b>Tourism</b>                    | <ul style="list-style-type: none"> <li>Hotels granted extension to period in which they are charged payroll tax at 7.75% (November and March added to current time frame)</li> <li>Tour boat operators granted assistance in the form of duty-free fuel, a reduced rate on spare parts, and an amendment to an existing concession allowing sales of existing vessels overseas without a claw-back on the 10% duty concession</li> </ul>          |
| <b>Transport</b>                  | <ul style="list-style-type: none"> <li>No increases in bus or ferry fares</li> <li>No change in passenger taxes</li> </ul>  |
| <b>Real Estate / Construction</b> | <ul style="list-style-type: none"> <li>No change to ARV bands or land tax rates</li> <li>Customs Tariff Act to be broadened to increase the scope of duty relief on approved housing schemes</li> <li>Landlords participating in renewal / updating of property for rental to Bermudians will be granted a land tax honeymoon for one year</li> </ul>   |
| <b>Seniors</b>                    | <ul style="list-style-type: none"> <li>Pension benefits increased by about 4.5% effective August 2007</li> <li>annual free prescription drug benefit for seniors increased from \$1,150 to \$1,200 per annum</li> <li>Additional 2 medical visits per year for a total of 4</li> <li>Increase retirement age for those in the public sector who wish to work beyond 65</li> </ul>   |
| <b>War Veterans</b>               | <ul style="list-style-type: none"> <li>Medical, dental, and pension benefits will be enhanced</li> <li>Pension benefit doubled from \$400 to \$800 per month</li> </ul>   |
| <b>Business</b>                   | <ul style="list-style-type: none"> <li>13.5% standard payroll tax to remain unchanged</li> <li>Salary cap to increase from \$235,000 to \$350,000, with a biennial review of the cap on a go-forward basis</li> <li>Variety of Companies Act fees to increase by 5% effective April 1, 2007</li> <li>New telecommunications legislation to facilitate innovation and competition</li> <li>Development of a satellite services industry</li> </ul> |
| <b>General</b>                    | <ul style="list-style-type: none"> <li>Foreign currency purchase tax amended with effect from April 1, 2007 from 25 basis points to 50 basis points – 100% increase</li> </ul>  |

## Tourism Renewed sense of optimism

Marketing initiatives, a diligent sales team and increases in air lift and cruise arrivals spearheaded positive growth in the tourism industry in 2006 in terms of passenger arrivals, hotel occupancy and visitor spending. Continued growth in the U.S. economy and three major hotel developments in the pipeline point to the continued rejuvenation of the sector.

An extension of the period of reduced payroll tax for hotels by two months, combined with an initiative to further

stimulate German and Italian markets should boost hotel occupancy figures in 2007/08.

Capital expenditure of \$20m has been allocated to the building of a second cruise ship pier in Dockyard in order to accommodate larger cruise ships.

The proposed new 14-week paid apprenticeship programme targeted at construction and hospitality will work to the benefit

of the Tourism industry in 2007/08 in direct contrast to a decrease of 7% in jobs in hotels in 2006/07.

Concessions on fuel, spare parts and sales of existing vessels for tour boat operators and the launch of North Hamilton Train Tours are further designed to improve the tourism product.

# Social Agenda

## Housing

- No changes in land tax rates
- Broadened scope of duty relief on approved housing schemes
- Land tax honeymoon for buildings renovated as part of the vacant and derelict homes plan

## Seniors

- Enhanced dental care services
- Home delivery library book service
- Prescription drug benefit increased to \$1,200 (4.3% increase) from April 1, 2007
- Additional 2 medical visits per annum
- 4.5% pension increase from August 07
- Increased medical, dental and pension benefits for war veterans

## Healthcare

- National Health program launch in 2007/08 aimed to develop a healthier community by encouraging positive lifestyle changes
- An increase in residential bed capacity for substance abuse treatment

## Education

- Focus on improving literacy rates as a priority
- Establishment of a laboratory school in partnership with the John Hopkins University Center for Talented Youth and

its Bermuda subsidiary, the Centre for Talented Youth

- 14 week paid apprenticeship program connecting with the technical curriculum
- Expansion of student solidier program aiming to double participating in 2007/08
- Pilot program to deliver basic e-literacy
- Satellite libraries in West and East ends of the island
- Continuation of the Hands on Youth Outreach Programme

## Transport

- No increases in bus and ferry fares
- No changes in passenger tax
- Introduction of electronic vehicle registration in 2007/08 as a method to improve revenue collection and to keep the level of disqualified and uninsured drivers to a minimum.
- Expanded bus service along the four main bus routes out of Hamilton to the western and eastern Parishes with buses every 15 minutes from 6am to midnight
- Additional ferry services with resources to operate a sixth catamaran ferry
- Fast pass processing of Bermudians upon arrival at airport

## Environment

- Agricultural and Educational Outreach programme to link secondary school students to local farms
- Opportunities for young people to become apprenticed to experience fishermen

## Other

- An allocation of \$15m to Bermuda Football Association over the next 5 years
- Introduction of the construction industry training workshop for inmates at Westgate
- Amalgamation of the three existing fire services
- Amalgamation of mail processing facilities and installation of new equipment at the Bermuda Mail Processing Centre
- Online application for work permits
- Issuance of credit card sized work permits
- New system to improve effectiveness for processing passports, Bermudian status applications, land licenses and Border Management Systems
- Master plan for water supply
- New telecommunications legislation to facilitate innovation and competition
- Develop a satellite services industry

# Economic Performance

The revised estimate of total revenue for 2006/07 is \$856 million, which compared to the original estimate of \$835 million, represents an increase of approximately 2.5%.

The projected total revenue for 2007/08 is \$917 million, which compared to the revised estimate for 2006/07 of \$856 million, represents an increase of approximately 7%. However the projected total revenue for 2007/08 is almost 10% higher than the original estimated figure of \$835 million for 2006/07.

The Government's current spending is projected to increase by 7.6% to \$885 million in fiscal 2007/08.

There are indications that the overall employment level in 2006 rose to 39,611, a 2% increase, reflecting a net addition of 644 jobs across the entire economy. An analysis by sector shows:-

International Business up 3% to 4,469  
Construction up 5% to 3,646  
Business Services Sector up 5% to 4090  
Financial Sector up 1%  
Hotels down by 7%  
Real Estate down by 3%  
Retail Sector down by 1% to 3,200

The Current account Surplus for 2006 is estimated to be in the range of \$820 - \$850 million.

The international business sector is expected to continue to expand, further solidifying its position as the largest contributor to the island's GDP (accounting for 21.9% of GDP in 2005, up significantly from 14.5% in 2001). Employment is expected to rise slightly, supporting income increases and domestic demand. The construction sector is expected to remain strong, with a variety of public and private sector projects underway.

It is anticipated that GDP growth in 2006 may exceed the original target of 2.75% to 3.0%, especially in the wake of the robust expansion of 4.6% in Bermuda's GDP in 2005. The outlook for 2007 is believed to be positive. The consumer price inflation averaged 3.1% in 2006, exactly the same as in 2005. The Ministry of Finance anticipates GDP growth in the range of 3.0% to 3.25% with inflation tracking around a core rate of 3% if oil prices perform as anticipated.

# Economic Figures

The economic figures in this table have been adjusted to reflect actual figures for the prior years. Percent changes relate to original estimate. Please note that the Government now uses current market prices for GDP calculations.

| Highlights of the 2007/2008 budget:  |                         |                          |            |
|--|-------------------------|--------------------------|------------|
|  | 06/07<br>Revised<br>\$m | 07/08<br>Estimate<br>\$m | % Change   |
| Revenues   | 856                     | 917                      | 7.1        |
| Current Account Expenditures (Excluding Interest and Sinking Fund)                                   | 822                     | 862                      | 4.9        |
| Capital Expenditures   | 126                     | 141                      | 11.9       |
| Budget Surplus / (Deficit)   | (92)                    | (86)                     | (6.5)      |
| The economic figures in the table below have been adjusted to reflect actual figures for prior years |                         |                          |            |
|  | 2005                    | 2006                     | 2007       |
| Population (Estimate)  | 62,000                  | 62,000                   | 62,000     |
| GDP (at constant market prices (1996), \$b) - ESTIMATED  | 4.2                     | 4.3                      | 4.4        |
| GDP per Capital (\$)   | 67,704                  | 69,566                   | 70,968     |
| % Change   | 2.5 - 3.0               | 2.5 - 3.0                | 2.75 - 3.0 |
|  | 05/06                   | 06/07                    | 07/08      |
| Current Account (\$m)  |                         |                          |            |
| Revenue  | 798.4                   | 856                      | 917        |
| Expenditure (Excluding Interest and Sinking Fund)  | (711.2)                 | (862.0)                  | (1,003.0)  |
| Balance  | 87.2                    | (6.0)                    | (86.0)     |
| Current Account Expenditure per Capita (\$)  | 1,470.5                 | 13,903.2                 | 16,177.4   |
| % Change   | 0.1                     | 21.2                     | 16.4       |
| Capital Expenditure (\$m)  | 138.3                   | 126.0                    | 141.0      |
| Capital Expenditure per Capita (\$)  | 2,230.5                 | 2,032.3                  | 2,274.2    |
| % Change   | 59.3                    | (8.9)                    | 11.9       |

This briefing is intended as a general guide to the Budget 2007. It is not intended to be comprehensive and should not be used as a basis for decisions. For that purpose advice should be obtained which takes into account all the client's circumstances.

Every effort has been made to ensure the accuracy of the information contained herein. In view of its purpose the reader will appreciate that we, the Bermuda firm, are unable to accept liability for any errors or omissions which may arise.

% changes relate to revised estimate/actual as appropriate

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