2013-14 Budget

Contractionary policies threaten growth agenda

18 April 2013

The Government of Jamaica (GoJ) announces that "now is the time" to pursue a strong economic growth agenda - but recent contractionary policies threaten the successful pursuit of same.

Today, Dr. The Hon. Peter Phillips, Minister of Finance & Planning presented to Parliament the Government's plan to fund the 2013-14 Expenditure Budget of J$520.9 billion which had been previously tabled on 4 April 2013.

Executive Summary:

Though not unexpected, the business community and public will breathe a collective sigh of relief at Minister Phillips' announcement that there will be "*no new taxes*". It is of course more accurate to say that no <u>further</u> taxes are being imposed over and above tax package of J$15.9 billion tabled in Parliament on 12 February 2013 (these are considered further herein). Two new tax policy measures were announced today:

1. The reclassification of electricity supplies by the Jamaica Public Service Company to residential customers from exempt to zero-rated from a GCT perspective;

2. A revenue-neutral re-alignment of the application of the Customs Administration Fee to remove a bias in favour of the import of finished goods over raw materials.

The J$520.9m 2013-14 Expenditure Budget presented represents a 15% contraction of the previous year's Budget in nominal terms. Most of the reduction is attributable to projected interest savings (arising from the recently concluded National Debt Exchange (NDX)) as well as a significant reduction in principal payments that fall due in the current fiscal year.

The Minister's presentation outlined the Government's key strategies to pursue a growth agenda: the establishment of Jamaica as a Logistics Hub; further development of the ICT sector (including US$20m earmarked for the construction of ICT centres); the enhancement of agricultural production (through the use of Agro-Parks); casino gaming and the promotion of integrated resort developments; further strategic investments in the hotel sector (both new and renovation projects); various Public Sector Transformation (PST) initiatives and last (but not least) Tax Reform.

If Jamaica is to have a chance at achieving fiscal sustainability, economic growth and social development, it is critical that the Government pursues this growth agenda urgently and with a resolve to implement the measures to achieve same as quickly as possible. In an effort to secure an IMF agreement, the Government has recently had to subject an already fragile economy to significant contractionary policies including: a reduced National Expenditure Budget; a public sector wage freeze; the NDX (which compresses investor income/taxes); a J$15.9 billion tax package in February 2013; a withdrawal of J$45 billion from the NHT (over 3 years) and the extraction of surpluses from other state agencies. Each of these measures will negatively impact the country's ability to achieve required tax revenue and primary surplus targets.

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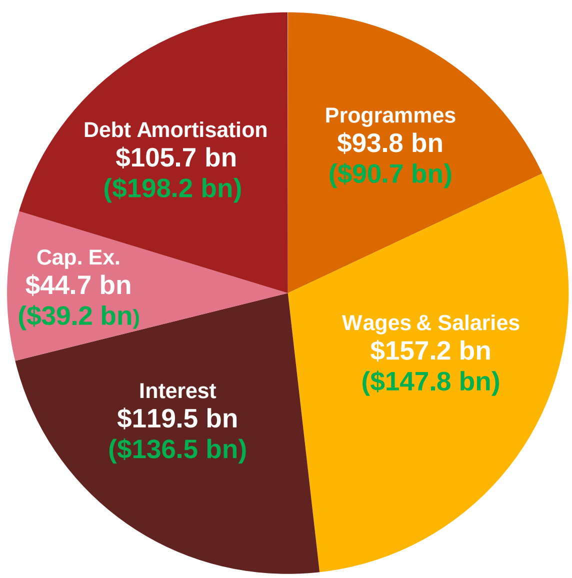
The Minister's closing rallying call "now is the time!" is clear – in our view Jamaica cannot afford any missteps in pursuing an aggressive growth agenda once and for all.

2013-14 Expenditure Budget and how it is to be funded:

The 2013-14 Expenditure Budget of J$520.9 billion represents a reduction of 15% in nominal terms compared to last year's Budget. On an inflation-adjusted basis however, this represents a reduction of closer to 21%. This curtailment in expenditure is in pursuit of the Government's wider strategy to strengthen the public finances, restore debt sustainability, enhance growth and bolster financial sector resilience.

The major contributor to this significantly smaller budget is the reduction projected in debt servicing costs, which is attributable to the National Debt Exchange (NDX) and Private Debt Exchange (PDX) programmes as well as reduced principal repayments due within the current fiscal year. The Minister indicated that total debt servicing costs (of J$225.2 billion) are projected to represent 43% of the total Expenditure Budget in 2013-14 in comparison to 54% in 2012-13 and that this signals a clear move in the right direction.

2013-14 Expenditure Budget (J$ billions)



How it is to be funded?

Revenues	J$ bn
Tax	360.6
Non-Tax/Bauxite Levy	36.1
Capital	1.1
Grants	9.4
Loans	103.3
Surplus from Entities	10.4
Total	**520.9**

Note: 2012-13 Expenditure Budget figures in parentheses

Impending IMF Agreement:

Following the conclusion of an IMF staff-level agreement in February 2013 on an economic programme that can be supported by the Fund, the IMF issued a press release on 8 April 2013 indicating that the Government of Jamaica had submitted documentation to the IMF to confirm that all prior actions have been met. Consequently Fund management will submit to its Executive Board a 48-month arrangement under the Extended Fund Facility (EFF) in the amount of SDR 615 million (about $958 million, or 225 percent of quota), with the recommendation that it be approved. The Board meeting is scheduled to take place on 1 May 2013.

The Growth Agenda:

The Minister outlined the Government's key strategies to pursue a growth agenda:

1. **Establishment of Jamaica as a Logistics Hub:** In light of the proposed doubling of capacity of the Panama Canal by 2015, an opportunity exists for Jamaica to position itself as a key international transhipment hub and logistics centre. A number of critical success factors have been identified to enable Jamaica to grasp this opportunity: the dredging of Kingston Harbour, the expansion of a port facility at Fort Augusta and Gordon Cay, the development of a Dry Dock facility at Jackson Bay, the establishment of a transshipment commodity port near Yallahs, the Caymanas Economic Zone and the construction of a cargo and maintenance, repair and operations facility at Vernamfield in Clarendon.

1. **Further Expansion of the ICT Sector:** In an effort to capitalise on Jamaica's relative competitiveness as a near-shore location for a variety of ICT activities (such as call centres and other business process outsourcing operations), US$20m in financing has been earmarked to construct ICT centres (i.e. technology parks) to attract players in this market space to locate here.

2. **Increasing Agricultural Production:** It is proposed to develop a number of agro parks in Jamaica in an effort to realise some of the potential that agriculture has to offer but which is currently constrained due to praedial larceny etc.

3. **Casino Gaming & Integrated Resort Development:** The Minister announced that he signed a Notice on 17 April 2013 to bring much of the Casino Gaming Act 2010 into operation and that the supporting Regulations were also Gazetted on this date. It is considered that this is a key to attracting integrated resort development projects. Minister Phillips indicated that he plans to commence inviting applications for such projects to be submitted for consideration by the Government from 1 June 2013.

4. **Further Tourism Investments:** A number of new hotel projects were announced as well as several proposed hotel renovation exercises thereby highlighting some of the further contributions that tourism is expected to make.

5. **Support to the Small Business Sector:** In recognition of the importance of the micro and small business sector to the economy, Minister Phillips indicated the Government's intention to explore ways to assist the sector further including initiatives to make financing more readily available for small businesses.

6. **Public Sector Transformation:** Minister Phillips announced public sector transformation efforts undertaken to date in the transitioning of Jamaica Customs to executive agency status with effect from 1 April 2013. He also

announced the Government's intention to merge several state bodies including the Betting, Gaming and Lotteries Commission with the Racing Commission.

7. **Tax Reform:** Minister Phillips indicated that it is the Government's intention to implement comprehensive Tax Reform over the next four years. In the short-term he noted that the proposed Omnibus Incentives Act must be tabled in Parliament by 30 September 2013. It is proposed that comprehensive legislative reform of the tax regime will be undertaken between 2014 and 2016. The Government also intends to modernise and strengthen tax administration through various initiatives including the standardisation and enhancement of the powers of TAJ and Jamaica Customs.

New Tax Policy Measures Announced

While "*no new taxes*" were announced, the Minister highlighted the following two new tax measures designed to address specific inefficiencies and distortions in the current tax regime.

1. *Change to GCT Regime for Supply of Electricity to Residential Customers*

In February 2010 the GCT Act was amended so as to require residential and commercial consumers of electricity to pay GCT on the supply of electricity (which consequently became a taxable activity). The GCT Regulations were, however, amended to restrict the supplier of electricity from claiming an input tax credit in respect of supplies to residential and commercial customers. In June 2012 residential customers of the Jamaica Public Service Company Limited (JPS) were relieved of the burden of paying GCT on their electricity bills when the law was further amended so as to exempt the supply of electricity to residential customers from GCT.

In his presentation today the Minister noted that this arrangement has affected the cash flow of JPS and has generated increased costs that are being passed on to customers. He further indicated that whilst the Government was unwilling to extend a previously awarded tax waiver to JPS (which had mitigated the increased costs of expensing the tax that the company incurred), it had agreed after consultations with stakeholders to review the GCT regime for residential customers. He announced therefore that the supply of electricity to residential customers will be reclassified from being GCT-exempt to being a zero-rated activity with effect from **1 July 2013**. The intended effect of this is to allow the JPS to claim input tax credits in respect of GCT incurred on its inputs instead of them being treated as irrecoverable GCT. No indication was given as to what the net cost will be (if any) to the Consolidated Fund as a result of reinstating JPS's input credit entitlements.

In order to achieve the intended effect of this proposal, we believe that the Minister will also need to withdraw the specific prohibition in our GCT Regulations which currently prevents JPS from claiming input tax credits in respect of any GCT incurred by the company.

2. Modification of current CAF rate structure

A new Customs Administration Fee (CAF) (for implementation on 1 April 2013) was previously announced by the Minister in his presentation to Parliament on 12 February 2013.

In his presentation today the Minister noted that the CAF rate structure as initially announced resulted in a bias towards the importation of finished goods in comparison to the importation of raw materials by Jamaican manufacturers. This clearly would have a negative impact on the country's relative competitiveness and place local manufacturers at a disadvantage in comparison to their foreign counterparts. In light of this, Minister Phillips announced that certain amendments would be made to the CAF rate structure on a revenue-neutral basis in order to remove the bias identified.

Update on Recent Tax Measures

In the context of the foregoing we discuss below in some detail tax measures that were previously announced that have now been implemented through enabling legislation:

Corporate Income Tax

In his 2012/13 Budget presentation the Minister had announced the introduction of different tax rates for "regulated" and "unregulated" entities with effect from 1 January 2013. This new regime included a reduction in the rate of tax for unregulated companies to 25%.

In February of this year, he announced that a5% surtax[1] would be imposed on the incomes of large corporate bodies (defined then as those with gross incomes of more than $500 million per annum) which fall within the classification of "unregulated companies". At the time of his pronouncement it was widely believed that this "surtax" would be in place for a specified period and would not be a part of the permanent tax regime.

These tax measures have now been promulgated by Order dated 28 March 2013 under the Provisional Collection of Tax Act and we draw your attention to the following significant matters.

- The Order stipulates that the new rates of tax will be imposed ***"with effect from 1st, April 2013 upon the chargeable income of the categories of companies listed.........".***

  The statutory year of assessment is 1 January to 31 December of any given year, and it is the income that is earned within this period that is taxable for the particular year (though taxpayers earning income from a business may be permitted to use their financial accounting period in preparing their income tax returns for a specific year of assessment).

[1] "*Surtax*" was defined in Ministry Paper 15/13 issued on 12 February 2013 as "*a tax levied on income or capital in addition to another tax which is levied on the same income or capital*".

The Minister had also indicated earlier that the tax would have been imposed from 1 January 2013 which is in line with the year of assessment as defined in the Income Tax Act. It is therefore unclear as to whether there is an intention that taxpayers who will be affected by the change should compute their liabilities by reference to two rates of tax for the year of assessment 2013 and, if so, how the allocation of income should be achieved for the purpose of calculating the tax.

- The Order prescribes the following rates for the various classes of companies as follows:

Classification	Definition	Tax Rate
Regulated company	A company that is regulated by the Financial Services Commission, the Office of Utilities Regulation, the Bank of Jamaica or the Ministry of Finance and Planning.	33⅓%
Unregulated company	A company that is not a regulated company	25%
Large unregulated company	A company that is not a regulated company which has gross [annual] income of not less than $500 million	30% of the "income" that exceeds $500,000,000

- The Order does not speak to the imposition of a "surtax" as was announced in February, but introduces a rate of *"…30 cents in the dollar in (sic) the income equal to or greater than $500,000,000 of a large unregulated company…"* - hence the rate appears to be a permanent rather than a temporary measure.

- Furthermore, given that the preamble to this provision specifies that the rates apply to the "chargeable income", the wording suggests that it is only such part of the (chargeable) income of "large unregulated companies" that equals or exceeds $500 million that will attract the 30% tax rate and not the entire income of such companies (whose revenues exceed $500 million). This is dramatically different from the policy position previously articulated.

- Chargeable income is defined in the Income Tax Act as *"…the aggregate amount of income of any person from all sources remaining after allowing the appropriate deductions and exemptions under this Act…"*, that is the company's net profits computed on the basis of income tax principles, less allowable losses.

- In summary we note therefore that the 5% surtax has been abandoned and replaced by a new corporate income tax rate for large unregulated companies. It no longer seems that this is a temporary measure. The taxation rates of all other persons remain unchanged.

Increase of Withholding Tax Rate on Dividend

You will recall that the tax relief that was afforded to Jamaican residents on dividends received from Jamaican resident companies was withdrawn effective 1 June 2012 when a rate of 5% was imposed on such dividends.

The rate was further increased to 15% effective 1 April 2013. This represents a final tax on such dividends (i.e. it is not recoverable and the dividend income on which the tax is payable may not be offset by tax losses). Furthermore, "*expenses incurred in earning dividend income*" are no longer deductible for income tax purposes (with effect from 1 June 2012).

Dividends paid to non-resident shareholders continue to be liable to withholding tax at rates of 25% for individuals and $33^{1/3}$% for companies, subject to any tax treaty protection which may be available.

Special rules continue apply to the taxation of preference dividends.

The Ministry of Finance estimates this measure will yield an additional J$0.80 billion for 2013-14.

Dividends - Group Relief

Provisions have been introduced to relieve from tax, dividends received by Jamaican companies from other Jamaican companies in which they own more than 25% of the voting rights. This measure provides relief in group situations as any dividends paid upstream by subsidiaries to Jamaican resident parent companies would not be liable to tax. Hence dividends will be liable to tax only when paid to persons outside of a Jamaican group structure: i.e., when passed on to individuals, minority corporate shareholders (those owning less than 25% of the voting rights) and non-residents shareholders.

Education Tax

The legislation to impose the previously announced increases in Education Tax is also now in place. With effect from 1 April 2013 Education Tax imposed on employees has been increased from 2% to 2.25% of their taxable emoluments.

The corresponding employers' portion of Education Tax contribution has also been increased from 3% to 3.5% of the said emoluments. The contribution by self-employed persons who are earning (in excess of minimum wage) has been increased from 2% to 2.25% of chargeable income.

The above-mentioned increases in real dollar value terms is effectively a 'claw back' of a portion of the increase of the approximately $66,000 in the tax-free income tax threshold granted with effect from 1 January 2013.

National Insurance (NIS) Contributions

With effect from 7 January 2013 the annual NIS contribution payable by an employee who is over the age of eighteen (18) years and under retirement age (not being a domestic worker or a member of the JDF or Jamaica Youth Corp) has increased from a maximum of $25,000 (i.e. 2.5% of maximum annual emoluments of $1,000,000) to $37,500 (i.e. 2.5% of maximum annual emoluments of $1,500,000).

The employer's annual contribution in respect of the employee's emoluments has also been increased to the same level while self-employed persons are now liable to pay NIS at the rate of 5% on a maximum chargeable income of J$1,500,000.

Property Tax

Property tax is computed on the unimproved value of land and is payable annually by owners. For the twelve calendar months beginning on 1 April 2013 the rate of property tax has been increased as follows:

Category of Property	Rate of Tax
On unimproved property valued at ≤ $100,000	$1,000
On unimproved property valued at › $100,000 but is ≤ $1,000,000	
(a) for first $100,000	$1,000
(b) for every dollar thereafter	1.50%
On unimproved property valued at › $1,000,000 –	
(a) for first $100,000	$1,000
(b) for the next $900,000	1.50%
(c) for every dollar thereafter	2.00%

These new rates reflect a more than 100% increase in property tax for most property owners.

Transfer Tax

Transfer Tax has been increased from 4% to 5% of the gross consideration payable for the transfer of any chargeable property with effect from **1 April, 2013**. This also applies to any capital distributions made by any locally incorporated company.

Changes to Stamp Duty on Conveyances

The tiered rates for stamp duty on conveyances have been removed and replaced with a flat rate of $40.00 per $1,000 or fraction thereof (i.e. 4%). The implementation date of this measure is **1 April 2013**.

The transfer tax and stamp duty measures are expected to yield an additional J$2 billion for 2013-14.

Revised Asset Tax Regime (including the imposition of an ad valorem Asset Tax to be imposed on specified regulated entities):

Specified Regulated Entities

With effect from 31 December 2012, the Minister of Finance & Planning modified the Asset Tax regime for deposit-taking institutions regulated by the Bank of Jamaica (BoJ) and securities dealers and insurance companies regulated by the Financial Services Commission (FSC). An ad valorem Asset Tax at the rate of 0.14% was imposed on the 'taxable value' of their assets as determined by the Asset Tax (Specified Bodies) Act.

The taxable value of assets is broadly determined as the value of assets on the balance sheet, less withholding tax recoverable on interest income, less capital required to be maintained by regulators. Deposit-taking institutions should add any acceptances, guarantees and letters of credit carried as off-balance sheet items and such other contingencies as the BoJ may by notice specify and deduct 'Loan Loss Reserves'.

General insurance companies should deduct 'Reinsurance Recoverable for Unpaid Claims and Adjustment Expenses' and 'Reinsurance Recoverable for Unearned Premiums'. Life insurance companies should deduct 'Assets Supporting Annuity Liabilities'.

Asset Tax rates applicable to other entities

In addition, the following modifications were made to the Asset Tax regime applicable to other entities falling within the scope of the Act:

Assets Value	New Asset Tax Rates	Old Asset Tax Rates
Less than J$50,000	J$5,000	$1,000
At least J$50,000 but less than J$500,000	J$25,000	$2,000
At least J$500,000 but less than J$5m	J$50,000	$4,000 to $10,000
At least J$5m but less than J$50m	J$75,000	$15,000 to $20,000
At least J$50m	J$100,000	$25,000 to $35,000

The due date for Asset Tax Returns was changed from 1 September to 15 March (i.e. to coincide with the due date for filing of annual Income Tax Returns).

The Ministry of Finance had estimated that this measure should yield an additional J$1.95 billion for 2012-13.

Administrative Reform

The Minister also restated the Government's commitment to continuing its efforts in achieving tax reform and strengthening tax administration so as to:

- Meet revenue demands
- Ensure equity and simplicity in the tax system, and
- Increase the rate of compliance

Improving the Revenue Collection & Compliance

Citing our low tax compliance rate which was described as being "well below acceptable standards", the Minister spoke of the Government's plans to enhance revenue collections as a means of relieving the country's debt burden. A number of measures to achieve this were announced within the context of a comprehensive tax reform programme to be undertaken over the next four years. Measures to be put in place commencing in the current financial year include:

- Widening the tax base by removing most GCT exemptions and zero-ratings except for export activity;
- Reforming the existing regime pertaining to waivers and incentives which should see the introduction of Omnibus Incentive legislation by September 2013. In this regard Ministerial discretionary powers to grant waivers have already been significantly eliminated with stringent caps placed on such waivers.
- A specific regime is to be developed and implemented for the treatment of charities including the enactment of a Charities Act by September 2013;
- Modernising the Property Tax regime by 2014 - 2016 to increase the relatively low compliance rate;
- Electronic lodgement facilities being provided by Jamaica Customs to assist in auditing and the collection of arrears;
- Finalising the legal framework to support debt write-off; and
- Providing more autonomy to Tax Administration Jamaica (TAJ) and Jamaica Customs Department. To this end, in March 2013, Parliament passed legislation to establish TAJ as a Semi-autonomous Revenue Authority (SARA) and effective 1 April 2013, the Jamaica Customs Department was transformed into an Executive Agency.

Let's talk

If you have any further questions in connection with the above or would like to explore further how these Budget pronouncements may impact your business or personal arrangements, please feel free to contact any member of our specialist tax team listed below or your usual PricewaterhouseCoopers Jamaica contact.

__Important Notice:__
PricewaterhouseCoopers Jamaica has prepared this Budget Newsletter to alert clients on the principal changes announced in the 2013-14 Budget. The changes are outlined in general terms and for information purposes only and therefore should not be acted upon without securing professional advice.

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