

# *Tax News*

November 2010

# *In the vortex of the storm*

## **Introduction**

The Minister of Finance has delivered his budget against the background of a deep economic recession internationally and a domestic environment of declining tax revenues, a contraction in Gross Domestic Product, an unsustainable fiscal deficit and a government debt which now stands at the frightening level of 110 percent of GDP.

Government has been borrowing to meet its current expenditures, including an increasing public sector wage bill, and the Minister of Finance recognizes that this cannot continue and that he has a heavy responsibility to protect the country from a further downgrade by the international credit rating agencies. Any further downgrade would reduce our government debt to non-investment grade or "junk bond" status.

In trying to craft strategies to buttress the Barbadian economy against the worst effects of the recession, the Minister of Finance acknowledged that the country does not have the financial resources to introduce any large scale economic stimulus package but that the aim of government is to contain the country's external debt, protect our foreign exchange reserves and maintain jobs in anticipation of the country returning to a sustainable growth path.

The Minister has introduced revenue raising measures which are estimated to result in additional gross revenue to government of \$204.1 million per annum, before consideration of the revenue reduction and expenditure measures, where there is less clarity on the full financial impact. The Minister has projected that the net effect of the measures proposed will reduce the projected deficit for 2011/2012 by 1.95%. Is this enough? We believe that more must be done to address the current level of expenditures and we are disappointed at the lack of any reference to a wages restraint policy in the current environment. This would seem to be a critical and indispensable component in tackling the current account deficit.

The measures aimed at protecting and encouraging employment are welcomed, as are any efforts to

stimulate the foreign exchange earning sectors. The productivity and innovation tax credit and the profitability and employment tax credit are interesting proposals, but they may prove challenging to implement and administer efficiently.

Following on from the recent government guarantee of the Four Seasons US\$60 million refinancing, we note the proposed additional guarantees of US\$50 million for the BIDC and \$100 million guarantee cover for the Tourism Loan Guarantee Facility. These are large numbers and, while there is a strong underlying rationale to support the country's productive capacity, these guarantees will need to be carefully managed to avoid negative consequences in the future.

While it is an unpopular tax, we wonder whether the timing is right to remove the environmental levy at this difficult point in time. Nevertheless, many will be pleased!

## **VAT & other indirect taxes**

### **VAT**

In an effort to correct the fiscal imbalance the Minister has proposed a temporary increase in the standard rate of the Value Added Tax from 15% to 17.5% effective December 1, 2010. The increase is proposed as a temporary measure for the next 18 months, an effort which is projected to raise Bds\$124 million. In addition, the threshold for VAT registration has been increased from Bds\$60,000 to Bds\$80,000.

### **Comments**

1997 heralded the implementation of the VAT and repeal of ten indirect taxes (consumption tax, surcharge, entertainment tax, stamp duty, hotel and restaurant sales tax, service tax on pleasure cruises, tax on quarriable minerals, travel ticket tax, airline business tax and tax on overseas calls). Over a 13 year period there have been numerous changes to the basket of zero rated goods and exempt supplies, with no changes in the standard rate on taxable supplies. A two percentage point increase in the VAT is not surprising given the 2009 IMF recommendations and global trends.

In 2009 the average VAT rate worldwide stood at 16.4% (see below), and rate fluctuations around the world are not uncommon. In the UK the standard rate was reduced from 17.5% to 15% in 2008 and increased to 17.5% again in 2010. The latest UK

budgetary proposals reveal a rate of 20% effective January 2011.

Region	Average Standard Rate
Worldwide	16.40%
Asia Pacific	9.88%
European Union	19.40%
Africa	15.95%
Middle East	10.33%
South America	16.00%

Hoteliers should be pleased that the concessionary rate applied to holiday or vacation accommodation remains at 7.5%, whilst presumably now allowing them to recover tax on inputs at 17.5%.

A Bds\$20,000 increase in the VAT registration threshold is not likely to reduce significantly the number of registrants, but coupled with the transition to an online filing system, the government should see reductions in the administrative cost of processing. Presumably persons making taxable supplies of less than the new threshold will have the option to deregister or to continue to be registered as small suppliers.

A reduction of the administrative load following implementation of the online filing system should provide the VAT office with an opportunity to focus on recommendations and proposals such as requests for group VAT registrations (groups of enterprises to register for VAT as a single registrant), the publishing of VAT Tribunal hearings and interpretative bulletins, and exemptions from penalties in instances of voluntary disclosure, among others.

## Excise Tax

A 50% increase is proposed in the excise tax on gasoline to approximately 54¢ per litre with effect from December 1, 2010.

## Comments

This increase on gasoline is projected to contribute \$22.7 million to government's revenue generating efforts and increase the costs of operating a motor vehicle.

## Environmental levy

It is proposed that the environmental levy be abolished from December 1, 2010.

## Comments

The main purpose of the environmental levy currently in force in Barbados is to defray the cost of the disposal of refuse generated by goods imported into Barbados.

Whilst we are aware of the eventual requirement to either abolish the environmental levy or broaden its application to include domestic goods, we query whether the removal of the charge on imports within fiscal 2011 at a cost of Bds\$42 million is prudent.

## Personal tax

## Removal of travelling and entertainment allowances

The Minister proposed to eliminate the tax-free allowances with respect to travelling and entertainment.

## Comments

The removal of these deductions is a clear indication that it cannot be business as usual, as the Government over the last ten years has been increasing the deductions with respect to personal allowances. This was to ensure that the disposable incomes of individuals was increased, thereby offsetting to some extent any increases in the price of goods and services.

The elimination of the travelling and entertainment allowances of up to \$7,200 and \$7,800 per annum respectively, which have been in place for more than 20 years, will cost a person who received the maximum of such allowances \$5,250 in additional tax. The Minister expects that the removal of these allowances will result in an additional \$25 million in annual tax revenues. This is essentially an increase in income taxes on the middle class, who are being asked to make a sacrifice in order to assist in the recovery of the economy.

The Minister's speech refers to the removal of these allowances "starting for the current income year". However, we would hope that the measure will not be introduced retroactively and will be introduced from income year 2011.

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## Removal of allowance for investments

The Minister also proposed to eliminate the allowances for savings with credit unions and investment in mutual funds with effect from income year 2011.

### Comments

Many individuals have looked forward each year to investing in these vehicles thereby reducing their income tax burden. These allowances were effective in stimulating personal savings and investments and also contributed to the growth of credit unions and mutual funds. Although unclear from the Minister's statement, we would like to think that investments in mutual funds will still attract a tax deduction under the separate provisions for investments in new shares.

## Corporate tax

### Credit for increasing employees

The Minister intends to offer a tax credit to any business which over the next three years, commencing income year 2011, is able to increase its profits and simultaneously boost its employment by at least 10% of its work force. The increase in employment must be maintained for 3 years in order to obtain the tax credit. The tax credit will be equal to 10% of the cost of wages of the company and will be applied against taxes payable. If the company does not have taxable income to utilise the credit in an income year, it will be carried forward for 3 years.

### Comments

As always, the devil will be in the detail. It will be interesting to see how this measure will be implemented in practice as the legislation will need to be drafted very carefully if it is to be useful. Can the company only claim the credit after it has maintained the increased employment for the 3 year period or can it be claimed in the first year of the three year period or on an annual basis? Who will monitor the company to ensure that it maintains the increased level of employment over three years? Will the tax credit be 10% of the company's total wage bill or will it be 10% of the additional wages paid to the new employees?

## Productivity and innovation credit

In order to encourage creativity and innovation and a willingness by entrepreneurs to invest in creating greater value added to ensure enterprise growth and a positive impact on national productivity, the Minister proposed a productivity and innovation tax credit which will focus on businesses placing emphasis on investment in the following areas:

- process innovation – development of new manufacturing process;
- product innovation – development of improved products and services;
- organisational innovation – establishment of a new venture for improved productivity; and
- service innovation – development of new services for local and international market.

The innovation must have been successfully introduced into the market. The qualifying businesses would be allowed to claim a tax credit equivalent to 25% of its expenditure in the year in which the expenditure was incurred for any of the areas noted above. The credit will be applied against taxable income. If the company has no taxable income, the credit may be carried forward for 3 years. The National Productivity Council ("NPC") will be responsible for certifying that a business has met the eligibility criteria.

### Comments

Unlike the credit for increasing a company's workforce, the NPC will be responsible for certifying that the business has met the eligibility criteria in order to claim this credit. However, again we envisage that this will be difficult to legislate. What would be the definition of "successfully introduced in the market"? The NPC must have specific set criteria by which to measure market success so that this process is not subjective. Also, the legislation must be clear in relation to whether all types of expenditure incurred as a result of the innovation (e.g. wages, consultants, and travel) will qualify.

## Waiver of interest and penalty

The Minister has extended the waiver and interest penalty programme for another year effective December 1, 2010 to provide the opportunity for persons to settle outstanding liabilities to the National Insurance, Land Tax, Income Tax and VAT departments.

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## Comments

It is hoped that the extension of this programme will result in a reduction in delinquent tax payers and additional income for the treasury should businesses utilise this programme. The criteria for qualification should be clearly communicated, so that taxpayers can take advantage of the programme to liquidate arrears.

## National Insurance

### Pensions

The Minister has proposed an increase in the national insurance contributory and non-contributory pensions with effect from January 3, 2011. The minimum contributory pension will be increased from \$155 to \$163 and non-contributory from \$127 to \$133, weekly.

### Comments

This increase in the NIS contributory and non-contributory pension of \$8 and \$6 respectively is a minimum increase in the income of those persons currently receiving pension. Given the already high cost of living, pensioners may have hoped for a higher increase in their disposable income. The Minister is, however, operating in a challenging environment.

## Fees

### Barbados Drug Service

Effective April 1, 2011, persons who fill their prescriptions at private pharmacies will pay a dispensing fee ranging from \$5 to \$12 for drugs costing between \$0.01 and \$40 and 30% on drugs costing over \$40.

### Immigration

With effect from December 1, 2010 the fees for services provided by the Immigration Department will be increased.

### Public transport

With effect from January 1, 2011, bus fares will be increased by 50 cents per ride in an effort to improve the finances at the Transport Board.

Fees for mini-buses and route taxis which are currently \$7,250 and \$4,500 per-annum will be

halved to \$3,625 and \$2,250 respectively effective April 1, 2011.

PSV drivers who are required to pay \$230 per annum for a driver's license in addition to the fee payable for a heavy duty license will, effective April 1, 2011, pay a flat renewal rate of \$80, the same fee currently paid by their counterparts at the Transport Board.

## Liquor Licences

The retail licence for small shopkeepers has been reduced from \$1,000 to \$500.

### Comments

Given the imposition of the dispensing fee, will the public sector pharmacies be able to efficiently service the increased demands which may arise as a result?

The increases in the fees for the services provided by the Immigration Department will impact significantly on the users as the percentage increase is between 33% and 87.5%. One would hope that the increase in fees will permit that department to reduce the length of time that it currently takes for approvals to be processed.

The increase in bus fares and the reduction in fees for mini-buses and route taxis will bring relief to that sector which has been lobbying for such over the years.

## Business incentives and facilitation

### International Business

The Minister has noted the importance of the International Business Sector to the economy of Barbados, and has expressed dissatisfaction with the Government's current inability to properly quantify the direct and indirect financial impact of this contribution. As such, consultants have been engaged to devise a methodology for the accurate compilation of this information via what is to be a collaborative public and private sector venture.

In the interim, an undisclosed level of financing will be made available to Invest Barbados for the execution of an aggressive marketing campaign throughout Canada in 2011. In addition, the Minister has undertaken to consider the appointment of an Invest Barbados representative



in Mexico in order to assist with the development of that market, as well as those of other Latin American countries. He has also given the Government's commitment to continue to work closely with the Barbados International Business Association.

## Comments

The Minister has addressed the long outstanding issue of quantification of the direct and indirect impact of the sector on the economy and the importance of developing a mechanism to consistently measure its relevance. This initiative is welcome. Earlier data has confirmed that prior to the economic recession international business accounted for some 60% of the country's corporate taxation. However, the Minister has noted that tax revenues from the sector are currently well below pre-recession levels.

The Minister's mention of Canada as a key area of focus for the marketing efforts of Invest Barbados acknowledges the continued importance of that market to Barbados. However the Government's clear commitment to the development of new and diversified markets such as Mexico is vital if the sector is to fulfil its potential as a major source of direct taxation, foreign exchange and employment for Barbados.

## Tourism

In an attempt to further increase arrivals from the United Kingdom, the Barbados Tourism Authority will embark on a new marketing program in the UK, featuring radio and television advertising at a cost of \$6 million. This will be in addition to the additional \$10 million provided to the Authority last year.

While it is hoped that this will provide a timely boost to the number of UK visitors, this initiative also forms part of a larger effort to frontload expenditure to increase market profile and share in the UK ahead of March 2011, when the Minister noted that there would be an increase in UK airlift to Barbados.

Allied to this is a proposed fund to support the small hotels of Barbados, namely the establishment of a \$20m Small Hotels Refurbishment Programme. The Minister spoke of higher standards being demanded by discerning visitors from existing and new markets and it is hoped that this fund will allow approximately 300 Barbados hotel rooms to be upgraded to international three star standards and above.

In addition, the Minister also proposed the establishment of a Tourism Loan Guarantee Facility; to provide ongoing financial assistance to hotels. The fund will provide working capital support and assistance with debt payments for qualifying businesses in the tourism sector. The sum of \$15m has been allocated as capital for the fund and it is hoped that this can provide guarantee cover for facilities totalling Bds\$100m.

## Comments

As the most important market for Barbados tourism, it is to be expected that the UK should be given prominence in the marketing budget. However, it will be important to ensure that these marketing initiatives do not simply boost the volume of tourist numbers, but also serve to attract long stay and repeat visitors who will generate revenue in other tourism related businesses and contribute to the wider local economy.

Competition for the funds available under the Small Hotels Refurbishment Programme will no doubt be fierce, but this is a sizeable investment by the Government and will be a welcome boost for the local manufacturers and contractors at whom the benefit of these funds is also aimed.

The establishment of a Tourism Loan Guarantee Facility is an interesting step for the Government. Other industries may also clamour for a Government backed guarantee to reduce their cost of borrowing.

## Manufacturing

The Minister has stated that in light of the sector's important roles as a generator of foreign exchange and local employment, support must be provided during what continues to be a challenging economic period. The Barbados Industrial Development Corporation has therefore been mandated to procure a \$100 million loan from a foreign financier to facilitate improvements in its own operations and to enhance its ability to assist manufacturers. The funding, which will be guaranteed by the Government, is subject to loan negotiations slated for completion in April 2011 and is intended to assist with plan upgrade, technological advancements and general production capacity.

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## Comments

The Government continues to acknowledge the importance of the manufacturing sector to the economy of Barbados and has taken definitive steps to provide vital support to the sector. The amounts involved here are significant and the funds must be carefully managed to ensure they do generate strong productive capacity.

## Other

The Minister announced a number of steps to encourage indigenous business, such as the Cultural Industries Development Bill. He also noted the significant contribution of the Richard Stoute Teen Talent Show to the cultural development of Barbados and announced the establishment of a Trust to support the contest indefinitely.

One much discussed issue on which the Government has taken action is in the increase of the audit threshold above its longstanding limit of Bds\$1m. This threshold, which mandates that any business exceeding \$1m in gross assets or revenue must be locally audited, is now to be raised to \$2m, affecting all companies with a year end after December 31, 2010. The threshold will be further raised to \$4m in 2014 for companies with year ends after December 31, 2014.

The Minister spent some time detailing where he considers that Government agencies, such as the Customs department and the Town and Country Planning department, can improve operations and by so doing make Barbados a more attractive place to do business. He spoke of his desire to reduce the time that trade processes, especially thorough the seaport, are taking in Barbados, and government is considering a public/private partnership for a central container examination facility at the seaport and airport.

The Minister made note of working capital difficulties encountered by many small business enterprises. Fund Access, an existing government agency that provides funding for businesses, will be granted an additional \$1.5m to further assist and develop the Barbados small business sector.

A fund of \$500,000 was also announced that would try to ensure that disadvantaged primary school children would be able to access the requisite texts and workbooks needed for their education.

The Minister singled out local farmers for assistance in the agricultural sector, suggesting a change to

the water rates that would allow registered farmers to pay the same low rate as manufacturers, a move estimated to cost the Barbados Water Authority \$5.7m.

## Comments

The raising of the audit threshold has been discussed for some time and is in accordance with recommendations from the Institute of Chartered Accountants of Barbados. Small practitioners upset at lost business may at least be grateful that the threshold has been raised in two stages. Many small businesses will welcome this reduction in their annual compliance budgets.

The Minister spoke in some detail about the practices of the Barbados ports and of the intention of the late Prime Minister to improve the ability of the Town & Country Planning department to work more efficiently to the benefit of developers and home owners. Recognition that such services need to be improved is welcome.

The investment in Fund Access and the support for disadvantages primary school children will be well received.

Farmers will appreciate the reduction in water rates.

## Energy

\$2m of funding was allocated to a new Global Environmental Facility for the implementation of renewable energy demonstration projects, namely the installation of 3,000 power meters, 1,500 compact fluorescent lamps and one micro wind system in selected households and other places.

The Minister also gave details of two large scale renewable energy projects funded via a loan from the Inter-American Bank, a \$45m investment in the energy sector to promote sustainable energy and a \$20m fund to address those market failures and irregularities that prevent a country like Barbados from readily adopting renewable energy sources.

## Comments

This announcement of two major renewable energy initiatives signals a decisive deepening of Barbados' commitment to sustainable energy and development. While small scale schemes such as tax allowances/deductions have existed for some time it is encouraging to see this large scale approach by Government to driving this effort.

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Some may question the scale of funds allocated in light of the austerity of which the Minister spoke and the scale of some of the tax rises, but the Government's approach demonstrates vision and an understanding of the long term implications of

our dependence on oil and gas as sources of energy. There also appears to be the hope that such a large investment in this sector will boost local companies in the domestic and possibly regional markets.



## *Schedule of Financial Proposals*

<b>Additional Government revenues - tax increases &amp; other increased charges</b>	<b>(\$ millions)</b>
VAT – rate increased from 15% to 17.5%	124.0
Removal of personal allowance for travel and entertaining	25.0
Removal of personal allowance for investing in mutual funds and savings with credit unions	9.0
Excise tax on gasoline – 50% increase to \$0.5358 per litre	22.7
Barbados Drug Service - dispensing fee for prescriptions filled in private pharmacies	11.0
Immigration Department – increase in fees	4.0
Transport Board – increase in bus fares of 50 cents per ride	8.4
<b>Total projected annual revenue increase</b>	<b>204.1</b>
<b>Additional Government expenses – tax reductions &amp; other reduced charges</b>	
Removal of environmental levy	42.0
Reduction in PSV fees	1.4
Reduction in liquor licence fees	Unknown
Enhanced BTA marketing program	6.0
Enhanced Invest Barbados marketing program for international business	Unknown
Registered farmers – access to commercial rate for water	5.7
Increase in welfare grants and food vouchers	1.1
Text Book Grant Scheme for primary school children	0.5
Productivity & Innovation Tax Credit – 25% of qualifying expenditure	Unknown
Profitability & Employment Tax Credit – 10% of qualifying expenditure	Unknown
<b>Total projected annual revenue decrease</b>	<b>Unknown, but &gt; 56.7</b>
<b>Other funding proposals</b>	
Fund Access/Barbados Youth Business Trust – additional funding	1.5
Richard Stoute Teen Talent Competition Trust	0.4
Small Hotels Refurbishment Program	20.0
<b>Total – other funding proposals</b>	<b>21.9</b>
<b>Government Guarantees</b>	
Tourism Loan Guarantee Facility - \$100 million, requiring estimated capital of \$15 million	
BIDC Loan Guarantee – US\$50 million	
<b>Accelerated capital works program:</b>	
BWA water mains replacement – US\$50 million	
Warrens road expansion	
Housing program - \$44 million on various projects mentioned	
Extension of Mangrove Pond landfill - \$27.5 million	
School Meals Centre	

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