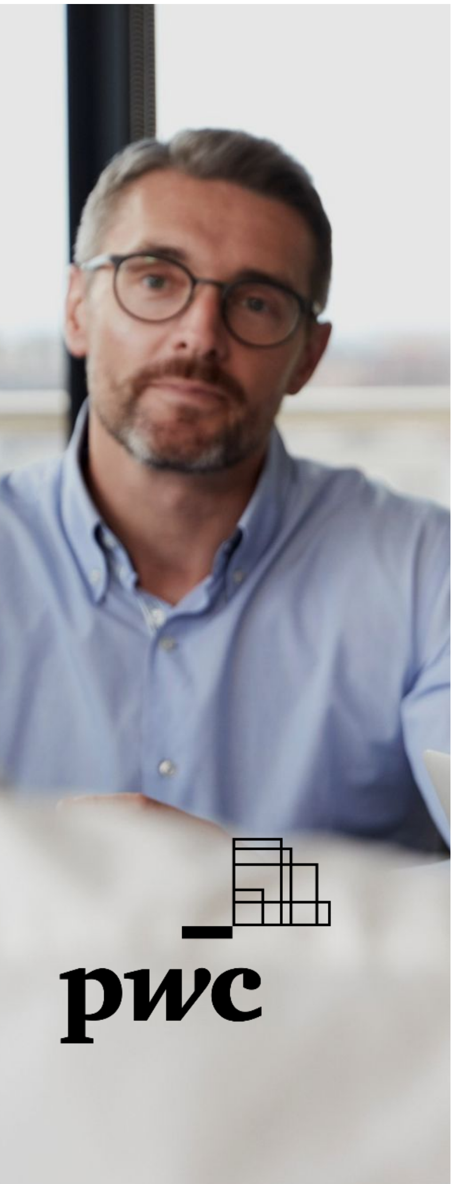
Jamaica

Some Recent Tax Updates



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Overview

Brian J. Denning
CARICOM Tax Leader

Recent Tax Changes

A number of legislative amendments have been made and technical advisories issued with a view to enhancing the tax regime as well as to maintain compliance with international requirements.

Employment Tax Credit (ETC)

The ETC regime has a clawback mechanism where profits are distributed to shareholders who are taxed on such income at less than 10%. This clawback is triggered at the time of the distribution and is payable within 14 days of the following month. In practice, this clawback has been challenging to monitor alongside the annual ETC claims.

TAJ has indicated that ETC clawbacks should be accounted for on the Annual Income Tax Return (in Schedule 7), which is expected to assist in its administration. It will be important however, that this administrative approach is ultimately codified in our tax law to minimise the risk of dispute.

The ETC regime has also been expanded to include business income as eligible for an ETC claim.

Treatment of Leases

While the accounting treatment of leasing transactions has evolved over the years, the taxation treatment has followed the form of the transaction irrespective of whether the lease is classified as an operating or finance lease.

This has, however, limited the ability of lenders and borrowers to structure financing arrangements in the form of a lease (which can provide greater security for the lender) but have the transaction treated as a pure financing arrangement for tax purposes.

TAJ has recognised the need to address the taxing of such transactions and has issued detailed advisories on the income tax and GCT treatment of various types of leasing arrangements. Again, this will ultimately need to be codified into law in order to minimise the risk of dispute.

Special Economic Zones (SEZ)

The SEZ Act was amended to remove tax on dividends paid to investors. We have highlighted this and other changes in the body of the Tax Alert.

Changes affecting the Employment Tax Credit

In brief - Employment Tax Credit (ETC)

The ETC is an income tax credit, available to eligible persons and is calculated as prescribed by the ITA. It is designed to benefit compliant employers, through a reduction of their effective income tax rate from 25% to as low as 17.5% (where the maximum ETC is claimed).

The ETC clawback mechanism is triggered when distributions that are subject to withholding tax of less than 10% are made to investors/shareholders.

ETC Clawback - Schedule 7

The ETC calculations should be included on Schedule 7, which forms a part of the Income Tax Return and which was recently updated by TAJ. TAJ has advised the public, through a series of workshops, that the ETC clawback, where applicable, should be recorded on Schedule 7. This is contrary to the provisions of the ITA, which require that the ETC clawback be repaid within 14 days of the end of the month in which the distribution is made. Legislative changes may be required to accord this guidance with the current provisions of the ITA.

Inclusion of Business Income

The exclusion of business income from the assessment of ETC affected many taxpayers negatively. Ranging from the loss of credits associated with certain income (e.g. rent) to audit adjustments by TAJ, this was flagged as a vexing issue for many taxpayers. This was largely due to the ETC being represented as a tangible benefit for all eligible compliant taxpayers, as opposed to industry specific incentives. This recent change to the legislation to include business income will be welcomed by eligible employers.

There remains however, some uncertainty around what constitutes “business” income, and whether certain forms of income, for example interest, should be considered as falling within scope and under what conditions.

Overview

In Brief - Changes to the Taxation of Finance Leases

General:

- TAJ's Technical Advisories (GCT/Income Tax) propose a distinction between finance and operating leases. The basis of taxation for new and renewed finance leases has changed, effective 1 January 2023.

- IFRS 16 which came into effect on 1 January, 2019 will not be adopted by TAJ for tax purposes. Rather, aspects of the previous standard, IAS 17 will be adopted.

- A finance lease is defined as an arrangement in which the risks and rewards incidental to ownership of the non-current asset are substantially transferred to the lessee.

- The Commissioner General, TAJ, may use specified criteria to determine whether a contract may be classified as a finance lease; including whether there is an option to purchase the asset or a transfer of ownership to the lessee at the end of the lease, and the length of the lease term.

- The Commissioner General, TAJ, retains the final authority to determine how lease contracts between connected persons would be impacted by income tax and GCT.

Income Tax:

- The income tax treatment of operating leases remains unchanged, with the lease payment being treated as a rental charge.

- For finance lease arrangements, the interest rate implicit in the lease will be used to calculate the initial measurement of the lease liability, assuming that the rate can be readily determined. This rate is based on the discount factor that equates the present value of the minimum lease payments to the cash price of the non-current asset at the inception of the lease term. This is the interest charge of "first choice" that should be used for tax purposes.

- Where it proves difficult to ascertain the implicit interest rate (IIR), the lessee's incremental borrowing rate (IBR) would be acceptable to the Commissioner General, TAJ.

Overview

In Brief - Changes to the Taxation of Finance Leases

Income Tax continued

- The IBR is defined as the rate of interest that the lessee would have to pay on a similar lease, or, if that is not determinable, the rate that the lessee would incur at the inception of the lease to borrow over a similar term, and with a similar security.

- The income tax implications for operating and finance leases are illustrated in detail on page 7.

GCT:

- The GCT treatment of operating leases remains unchanged, with the lease payment subject to GCT for the lessor and the lessee entitled to an input tax credit within the provisions of the GCT Act (Regulation 14).

- Determining the output tax and input tax credits for finance leases, however, has become more complex. If the arrangement is classified as a finance lease, the GCT treatment will depend on whether the asset is purchased in the name of the lessee or the lessor.

GCT continued

- Assets purchased in the name of the lessee are indicative of loan arrangements. Consequently, the lease payment shall be treated as an exempt supply in accordance with the Third Schedule of the GCT Act.

- Where the asset is purchased in the name of the lessor, the arrangement shall be treated as an outright sale of the asset. GCT shall be accounted for on the 'cost' of the asset, which is determined as the aggregate of the minimum lease payments required from the lessee over the term of the contract.

- The detailed tax implications of the position taken by TAJ are illustrated on page 8.

Impact of Changes at a Glance:

Income Tax

Income Tax Impact - Leases (Effective 1 January 2023)

	Operating Lease	Finance Lease
Lease Payment (Finance Fee)	Lessor: Full lease fee subject to income tax Lessee: Full lease fee is a tax deductible expense	Lessor: Interest accruing on lease fee is subject to income tax* Lessee: Interest arising on lease fee is tax-deductible
Capital Allowances (where eligible)	Lessor: Claim capital allowances Lessee: No capital allowances	Lessor: No capital allowances Lessee: Claim capital allowances
Capital Allowances - basis of qualifying expenditure	Capital expenditure incurred to purchase, alter or improve the asset*	Capital expenditure incurred to purchase (expressed as aggregate minimum lease payments less interest); or to alter or improve the asset*
Capital Allowances - initial/investment allowance	Building: when first brought into use Plant and Machinery: when incurred	Building: when first brought into use Plant and Machinery: when incurred
Capital Allowances - annual allowance	When first brought into use	When first brought into use
Capital Allowances - cancellation of lease (lessee's books)	N/A	No balancing allowance is available upon termination
Sale and Lease-Back	Lessor claims capital allowances	Lessee (former owner) continues to claim capital allowances

* computed in accordance with the provisions of the First Schedule to the ITA

Impact of Changes at a Glance:

GCT

GCT Impact - Leases (Effective 1 January 2023)

	Lessor	**Lessee**	**Vendor**
Operating Leases	Entire lease fee charged by lessor subject to GCT	GCT charges recoverable as input tax (where eligible) by lessee*	N/A
Finance Leases: *Asset Purchased in Lessee's Name* *(Treated as Loan)*	Interest to be accounted for on GCT return as exempt supply	GCT on cost** of non-current asset recoverable as input tax by lessee (where eligible)	Output tax on supply of asset to lessee to be accounted for by vendor of the asset
Finance Leases: *Asset Purchased in Lessor's Name* *(Treated as Sale)*	Lessor to account for output tax*** on 'sale', when the asset is made available to lessee Periodic finance lease fee and lump sum lease payments treated as exempt from GCT GCT on cost** of non-current asset recoverable as input tax by lessor	GCT charges incurred recoverable as input tax by lessee*	N/A

* Input tax claims subject to the provisions of the GCT Regulations
** Cost of asset shall not exceed a third-party cash price
*** Value of output tax based on aggregate minimum lease payments required from the lessee over the contractual term or the third party cash price

Comments on Changes to Treatment of Leases

General

- TAJ has indicated that IFRS 16 shall not be adopted for tax purposes and that the superseded standard -IAS 17, shall be used in considering lease contracts for income tax and GCT purposes. This raises potential challenges for taxpayers that have prepared accounts in accordance with applicable accounting standards and they may face challenges in maintaining separate accounts for tax purposes. Where systems changes have been made to accommodate the application of IFRS 16, this may lead to additional expenditure for larger taxpayers.

  It has been established in the courts (primarily in the United Kingdom) that financial statements prepared on the basis of generally accepted accounting principles (GAAP) should be accepted by tax authorities in determining accounting profits for income tax purposes. By choosing to rely on a superseded standard and without corresponding amendments to the ITA to support this position, TAJ may be setting a precedent that is contrary to current tax practice.

Income Tax

- TAJ has indicated that its preferred method for determining the interest rate to be used for the initial measurement of finance leases is the implicit interest rate in the lease. This rate is usually driven by the lessor's inputs, such as costs and profit assumptions, and may not be readily available to the lessee. TAJ has also indicated that in cases where it is difficult to ascertain the implicit interest rate, the lessee's incremental borrowing rate would be accepted. The various approaches suggested for determining the interest rate may require further clarity.

General Consumption Tax

- It is expected that traditional financing fees, including late payment charges/interest, would continue to attract GCT. Where the lease payments (rather than the interest portion only) are to be treated as exempt for GCT, however, this could skew the eligible input tax ratio that is available to the lessor.

- There are multiple methodologies for determining the value of the taxable supply where an asset is purchased in the lessor's name under a finance lease contract. For instance, where the lease arrangement is classified as a finance lease, and the interest rate implicit in the aggregate minimum payments cannot be readily determined, a third-party cash price is recommended. This adds an additional layer of complexity to determining the value of the supply for the taxpayer.

Amendments to the Special Economic Zone Act

Treatment of Intellectual Property Activities

- The SEZA has been amended to include a definition of "intellectual property activities". These are classified as "excluded activities" and are ineligible for SEZ approval.

- Intellectual property activities are defined as "*any activities relating to the right to use, any copyright of literary, artistic, or scientific work, including cinematograph films, and films or tapes for radio and television broadcasting, or any patent, trademark, design or model, plan or secret formula or process, for the use of or the right to use industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience*".

Treatment of dividends:

- Dividend income derived from shares held by the developer or an occupant is no longer subject to tax at the rate of 0%.

- Dividend income from shares held in the developer or occupant is now taxable at the rate of 0%; subject to 0% withholding tax.

Phone services:

- The rate of tax on the supply of telephone services to the zone is 0%.

Non-Zone related activities

- A developer or an occupant is required to establish a separate company to carry on activities outside of zone related activities.

'Economic Substance Rules'

- A developer or an occupant is now required to have 'substantial activities' which are the core income generating activities (CIGAs) of a developer or occupant of the Zone. CIGAs:
  - may vary according to the specific qualifying activity, but shall mainly consist of those significant functions that drive the business value;
  - must be carried out by an adequate number of qualified employees;
  - must generate operating expenses which are adequate, necessary and relevant in accordance with the size and nature of the operations;
  - may be outsourced to related and unrelated parties if the parties are situated in Jamaica and the outsourced activities are performed within Jamaica.

  This is subject to the terms of the licence agreement and the approval from the SEZ Authority.

Let’s Talk

Brian J. Denning

Partner and CARICOM Tax Leader
Direct line: 1 876 932 8423
brian.denning@pwc.com

Kimblian T. Batson

Partner
Direct line: 1 876 932 8378
kimblian.t.batson@pwc.com

Viveen A. Morrison

Director
Direct line: 1 876 932 8336
viveen.morrison@pwc.com

Amanda Layne

Director
Direct line: +1 246 266 8036
amanda.layne@pwc.com

Colette A. Guthrie

Senior Manager
Direct line: 1 876 932 8331
colette.a.guthrie@pwc.com

Lana Nehme

Senior Manager
Direct line: 1 876 932 8349
lana.nehme@pwc.com

Tamara Sinclair

Manager
Direct line: 1 876 932 7314
tamara.sinclair@pwc.com

Kerishe M. Higgins

Manager
Direct line: 1 876 932 7241
kerishe.higgins@pwc.com

Karen McHugh

Manager
Direct line: 1 876 922 6230
karen.mchugh@pwc.com

Collette Sharp

Manager
Direct line: 1 876 932 7255
collette.sharp@pwc.com

Marsha Wilson Maxwell

Manager
Direct line: 1 876 932 7430
marsha.wilson.maxwell@pwc.com

pwc.com/jm