# Pre-Budget Tax News August 2014

As a prelude to the much anticipated 2015 Budget this newsletter addresses some of the topical issues in T&T including -

- 1. Does FDI = Growth?
- 2. The Benefits & Burdens of CSME
- 3. The Oil & Gas Challenge

## <u>Does FDI = Growth?</u>

Foreign Direct Investment (FDI) is a direct investment into production or business of a country by a company, either by buying a company in the target country or by expanding operations of an existing business in that country. FDI is essential for the development of the Caribbean territories and often leads to competition for such investment. Relative to their size, these economies receive relatively high levels of FDI, which means that a high percentage of the economic activity in those jurisdictions is conducted by multinationals. The ratio of FDI inflows to GDP in 2013 was 7% for the Caribbean, with some countries above 10% according to the FDI in the Caribbean Report issued by ECLAC (2014). In Jamaica, Guyana and Belize a majority of FDI is directed to market seeking services such as banking and telecommunications. In Trinidad and Tobago (T&T) there is a clear dominance of the energy industry.

# "T&T received inflows of US\$1.713 billion in 2013"

Among CARICOM countries, T&T is both the main recipient and contributor of FDI. T&T received inflows of US\$1.713 billion in 2013, compared with a 2012 figure of US\$2.453 billion, which was amongst the highest ever recorded in the country according to the 2013 ECLAC Report. That Report stated that companies in T&T have capitalized on their

larger size to expand into other territories in the region. Some examples are Republic Bank, the Guardian Group, the Massy Group and Ansa McAL. Compared to other Caribbean territories, T&T per capita income is relatively high, with stable inflation and exchange rates and relatively more developed financial markets. InvesTT reported that based on UNCTAD's (United Conference Trade on Development) World Investment Report 2014 for the Caribbean, Central America and South America Region, T&T achieved second tier group status of US\$1.0 to US\$4.9 billion, with the Dominican Republic, the Bahamas and Honduras in 2013. T&T also accounts for the highest level of CARICOM inflows owing to its relatively large energy industry.

Most activities of the multinationals in T&T took place in the oil and gas exploration sector -2013 ECLAC Report. The Government continued selling oil and gas exploration rights and several companies committed significant investments in the sector. bp plans to spend some US\$5 billion in five years, while BHP will spend US\$1 billion and Range Resources will US\$100 million. France's commit divested US\$473 million worth of assets to the National Gas Company in 2013 and Repsol of Spain sold its holdings to Anglo-Dutch Shell. Beyond oil and gas exploration Mitsubishi Gas Chemical signed an agreement committing to US\$850 million to a petrochemical complex.

# "Banking is one of the most active sectors in the Caribbean"

Banking is one of the most active sectors in the Caribbean with several multinationals in the regional market (2014 ECLAC Report). The three largest banks in CARICOM are all controlled by Canadian banks. Canadian Imperial Bank of Commerce (CIBC) is the largest bank in the region. Royal Bank of Canada (RBC) participated in one of the largest M&As of recent years when it took over RBTT Financial Holdings in 2008 for US\$2,235 operations RBC million. has in jurisdictions including T&T. The third Canadian bank active in the Caribbean is Scotiabank.

Since 1970 Scotiabank has expanded its active presence in most Caribbean jurisdictions.

Multinationals are also actively involved in telecommunications in the region. Digicel of Ireland began operations in 2001 in Jamaica and has expanded aggressively, operating in more than 20 jurisdictions in the Caribbean. Cable & Wireless of the UK operates in 14 jurisdictions in the Caribbean. In 2011 Cable & Wireless purchased 51% of Bahamas Telecom for US\$210 million and announced large investment projects in the Bahamas, Barbados and Jamaica. Although a relatively new telecommunications player, Columbus Communications, originally from Canada, has made significant inroads during its short history, with a market presence in virtually every country in the region. Its long-term strategy is to enable its operating subsidiaries to revolutionize the telecommunications industry.

## "The United States used to be most important investor in the region..."

The United States used to be most important investor in the region, but more recently other players, such as Canada and China, are also taking a keen interest. In recent years there has been a strong inflow of Chinese investments. InvesTT in a news release stated that with the recent establishment of the Trinidad and Tobago Embassy in Beijing and the signing of MOUs in air services, energy and energy-related matters by both countries, T&T has set the stage to increase its foreign direct investment through securing Chinese investments in this country's non-energy sectors. While the focus of the recent Trade Mission to China was the promotion of investment opportunities in the non-energy sectors of clean technology, creative industries. downstream energy, tourism. manufacturing, agribusiness and maritime, particular emphasis was placed on promoting identified hotel and tourism opportunities as well as the establishment of a combined solar park consisting of four plants producing polysilicon, metallurgical silicon, float glass and solar photovoltaics.

# "...integrate FDI into its wider development strategy"

The 2014 ECLAC Report recommends that in order to attract FDI and increase the capacity of these countries to grow and develop, the Caribbean needs to integrate FDI into its wider development strategy. The region needs to rethink its industrial policy in order to promote the sectors and activities that can best advance its development. For example, the Caribbean needs to explore the scope for negotiating technology transfer. The current promotion policies need to be reassessed. The focus on financial incentives offered by governments, while undoubtedly appealing. may distract from other key issues such as improvement in the overall business climate by improving infrastructure, addressing safety and ease of doing business and promoting education. This way, governments can stimulate both domestic and foreign investment alike. A final recommendation that can help to stimulate growth in the region is to continue its path towards integration. Reducing trade and investment barriers between different economies in the Caribbean may act as a further multinationals inducement to seeking investment opportunities.

# The Benefits and Burdens of the CSME

The year 2014 marks 25 years since the Heads of Government first conceived the idea to transform the Common Market into a Single Market and Economy in a bid to deepen regional integration. After a lengthy gestation period, the Heads of Government gave birth to the Caribbean Single Market and Economy (CSME) in the Revised Treaty of Chaguaramas (RTC) in 2001. The CSME comprises fourteen states1 creating a framework which facilitates inter-regional trade. Local businesses seeking to access regional markets need to understand the rights to which they are entitled flowing from the CSME. This article seeks to briefly highlight these rights and the potential role the CSME plays in interregional economic growth.

In seeking to create a single market, the RTC provides for the removal of key barriers to trade both of a tariff nature or otherwise while also proscribing discriminatory measures based on nationality. The key "freedoms" enshrined in Chapter 3 of the RTC include:

- ✓ The freedom of establishment the right of an entity of one Member State to establish itself and operate in another Member State;
- ✓ The free movement of capital within the CSME;
- ✓ The free provision of goods and services by a national/company of one Member State to a customer in another Member State; and
- ✓ The free movement of skilled nationals between Member States.

"Far from being an abstract right, these rights have considerable practical value for local businesses.." Far from being an abstract right, these rights have considerable practical value for local businesses seeking access to regional (CSME)

markets. Local businesses therefore cannot, on the sole basis of nationality, be prevented from establishing themselves in another CSME territory or providing goods and services to other CSME Member States. As evidenced by the penetration of a number of regional brands (such as Guardian, Sagicor, GraceKennedy), there is scope for businesses to expand beyond national territories. It is now more than a decade since the implementation of the CSME and very rarely would there be a demonstrable case of a discriminatory measure existing in a Member State's laws. However, our local businesses need to be vigilant for measures or practices in a Member State which, in effect, serve to discriminate against foreign businesses. Such measures constitute veiled threats to the viability of interregional trade. The free movement of skilled labour is a welcome start to full and free movement of persons. As business leaders continue to lament the shortage of unskilled labour, one wonders if there may be scope for a revision of the immigration/free movement of persons policies within the CSME.

Likewise, our T&T government needs to ensure that it is putting in place the necessary framework (both on a legislative footing as well as in practice) to ensure that our CSME partners have equal access to the T&T market. In this respect, an oft-cited issue is the T&T Customs Authority. Importers bemoan the woefully inadequate system where excessive costs (through overtime payments) and delays in the clearance of goods prejudice businesses. While this affects T&T businesses, the status quo impedes market access to manufacturers/exporters other in **CSME** jurisdictions. The Government would be welladvised to make the necessary investment in revamping the Customs Authority which should benefit local manufacturers, our CSME partners and the local consumer.

As evidenced in the recent CCJ decision

"..the Caribbean Court of Justice stands willing to protect the rights of Community nationals..."

<sup>&</sup>lt;sup>1</sup> Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Suriname and Trinidad and Tobago.

involving Jamaican national, Ms Shanique Myrie, the Caribbean Court of Justice stands willing to protect the rights of Community nationals provided for in the RTC. It is reassuring that the many Governments have begun to show the necessary further political will to drive regional cooperation. For example, in Barbados, following the rebranding exercise by the Massy Group (and the public perception of a "takeover" by T&T business interest), it is heartening that the Barbadian Industry Minister, The Hon Donville Inniss, sought to dissuade the Barbadian public from such a nationalist perspective which indeed has no place in a Single Market.

The CSME has much potential to facilitate the exponential growth of local and regional businesses. While these rights enjoyed by CSME nationals (including companies) are not unfettered, local businesses trading within the Single Market should stand prepared to assert their rights in respect of the CSME "freedoms". Knowledge of the extent of such rights is but the first step.

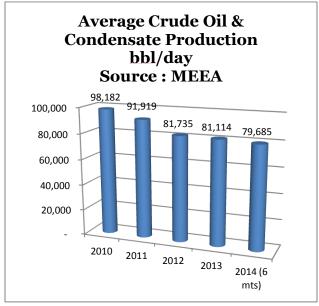
## The Oil & Gas Challenge

Achieving the balance between acquiring for T&T a fair share of the wealth accruing from the extraction of the hydrocarbons while at the same time encouraging investors to ensure optimal economic recovery of the resources is a constant challenge.

Over the past five years Trinidad and Tobago has seen a decline in the production of crude oil and condensate which has attracted the attention of the Minister of Energy who has given a commitment to do the needful to facilitate the improvement of the levels of production.

In spite of this decline we have seen buoyant levels of revenue due to prices remaining in the US\$100 per barrel range however our fortunes could have been much improved had we been able to be successful in the effort to achieve production levels of 100+ barrels per day – the stated target.

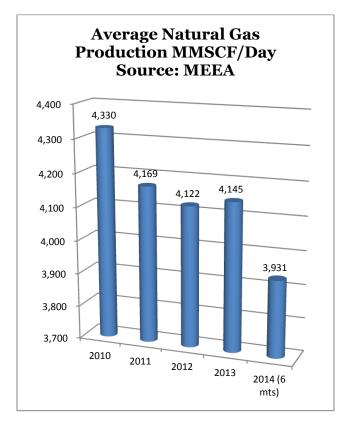
Since 2010 when crude oil and condensate production dipped below the 100,000 bbl/d it has continued to decline from approximately 98,000 bbl/d in 2010 down to 81,000 bbl/d in 2013 and further to an average of 79,685 for the first six months of 2014 according to the website of the Ministry of Energy and Energy Affairs (see Chart 1 below).



Almost simultaneously there has been a decline in natural gas production from approximately 4300 mmscf/day in 2010 down to

approximately 4100 mmscf/day in 2013 and a daily average of 3,931 mmscf/day for the first six months of 2014.

(See Chart 2 below)



These declines have occurred in spite of the tinkering with the fiscal regime with the objective of making it more competitive and attractive while ensuring that T&T gets its fair share from the resources.

Some of the tax measures introduced include redefinition of deep water, introduction of 35% tax rate for activity in deep water, investment tax credits and sustainability incentives aimed at stimulating production in mature and small oil fields on land and in marine areas, encouragement of exploration generally and specifically in deeper horizons both on and offshore. Changes to the SPT regime were also introduced along with write off of 100% of exploration costs in the year of expenditure and changes to the capital allowances regime that facilitate faster recovery of capital expenditure on development activity.

There have been some positives resulting perhaps from the changes made including BP proceeding with development of the Juniper field, the response to bid rounds particularly the 2012 deep water bid round.

The question for potential investors remains however "Is there confidence in T&T as a good source of crude oil or gas in commercial quantities?'

What else can be done / what should we look forward to in Budget 2015 in order to continue the process of enabling a competitive business environment and stimulating investment in the sector?

Are we maintaining our global competitiveness in the sector?

What about the "new" fiscal regime for the sector to encourage exploration and development and lead ultimately to the elusive increase in crude oil production?

While the estimates vary there is consensus about the heavy oil resources, so will there be measures to encourage activity in this area?

In spite of our robust hydrocarbon base will there be some more focus and initiatives regarding renewable energy which has the potential to assist in dealing with the fuel subsidy issue.

The question raised in the Business Express Opinion of June 25, 2014 is therefore worth considering:

## "Has Trinidad and Tobago hit the "peak oil" barrier?

Has Trinidad and Tobago hit the "peak oil" barrier; the point at which production goes into decline and when wells yield less and less oil?"

As stated then, this is not a doomsday prediction but rather it may be a call to revise expectations or to think outside the box in looking for solutions. We look forward to Budget 2015.

### Our PwC Tax Team

Allyson West, Tax Partner

Telephone: 1-868-299-0700, Ext 1030 Email: <u>allyson.west@tt.pwc.com</u>

Brian E Jones, Senior Manager

Telephone: 1-868-299-0700, Ext 1012 Email: <u>brian.ellison.jones@tt.pwc.com</u>

Walter Rochester, Senior Manager

Telephone: 1-868-299-0700, Ext 1024 Email: walter.rochester@tt.pwc.com

Rosalind Alexander, Senior Manager

Telephone: 1-868-299-0700, Ext 1001 Email: rosalind.alexander@tt.pwc.com Keith Robinson, Director

Telephone: 1-868-299-0700, Ext 1023 Email: keith.robinson@tt.pwc.com

Karen Hackett, Senior Manager

Telephone: 1-868-299-0700, Ext 1035 Email: karen.hackett@tt.pwc.com

Fanny Ursulet-Headley, Senior Manager

Telephone: 1-868-299-0700, Ext 1028

Email: fanny.ursulet-headley@tt.pwc.com

## Office Locations:

#### Port of Spain:

11-13 Victoria Avenue Port of Spain Trinidad

Telephone: 1-868-299-0700 Fax: 1-868-623-6025

#### San Fernando:

NEM Building 19/21 Independence Avenue, San Fernando Trinidad

Telephone: 1-868-299-0700, Ext 5200

Fax: 1-868-657-4993

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