Tax Bulletin*

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Finance Bill 2006

We are pleased to provide you with our first Quarterly Tax Bulletin for the New Year 2006 and to extend to you and your families our best wishes for a happy and prosperous New Year.

As has been widely reported the economy is on the boil and daily we see concerns being expressed with terms used such as ‘overheating’, ‘inflation’ and even ‘full employment’.

Positive financial results are anticipated in most quarters and consequently the reduction in tax rates across the board at both the individual and corporate level will be well received.

The Finance Bill 2006 which will enact into law the various budgetary measures announced in the 2005/06 Budget has today been presented to Parliament and is expected to be enacted into law within the next week.

This Bulletin is therefore focused primarily on those fiscal measures that are included in that Bill and the earlier Finance Act 2005.

Finance Bill 2006

Fiscal Measures Proposed - 2005/06

A brief summary of the fiscal measures announced in the 2005/06 Budget is set out below as an aide memoire.

Tax Rates

- *Petroleum Profits Tax* 50%
- *Unemployment Levy* 5%
- *Corporation Tax*
  - ⇒ *Petrochemicals* 35%
  - ⇒ *Other* 25%
  - ⇒ *Insurance (Life)* 15%
  - ⇒ *Individuals* 25%
  - ⇒ *ESOP Withdrawals*
    - ~ *pre retirement* 25%
    - ~ *post retirement* Nil

Personal Allowances

- *Resident taxpayers (all)* $60,000
- *Mortgage Interest* Nil
- *First Time Homeowner* Nil
- *Credit Union Shares* Nil

Benefits in Kind (subject to PAYE)

- *Employer provided loans at preferred interest rate*
- *Employer owned housing – market rent*
- *Employer provided vehicles: -*
  - ⇒ *Owned* 50% of W&T
  - ⇒ *Leased* 50% of rental

Incentives/Allowances

- *No tax holidays for new investment projects;*
- *Approved Property Development status to be removed;*
- *Uplift (50%) for sponsorship of sport, culture and arts to be removed;*
- *Uplift (100%) for additional workers to be removed;*
- *Uplift for training and re-training of employees to be removed.*

New Fiscal Measures

- *Expenditure incurred in generating exempt income to be non-deductible;*

Finance Bill 2006

New Fiscal Measurers *(Cont'd)*

- *Deduction for bad debts to be based on Central Bank prudential criteria;*
- *Interest on related party debt to be subject to thin capitalisation rules;*
- *Close company legislation to be abolished;*

FINANCE BILL 2006

Detailed Measures

Details of the principal measures included in the Finance Bill 2006 are set out below together with a brief commentary where appropriate.

The majority of these measures were announced in the budget that was presented in Parliament in late 2005 and in the main are effective as of January 1, 2006.

Petroleum Taxation (PPT/SPT)

The amendments contained in the Finance Act 2005 have been made effective January 1, 2005. These included: -

- *PPT to be paid quarterly based on estimate of the tax payable for the year;*
- *Capital Allowances for PPT purposes to be claimed when assets first put into use save where expenditure incurred in exploration operations when capital allowances are to commence from the date the expenditure is incurred;*
- *Failure to claim the annual wear and tear allowance when due may result in the BIR notionally reducing the tax written down value of the asset by the amount of the allowance not claimed;*
- *Definition of management charges expanded to include head office expenses and other shared costs. The deductible limit increased from 1% to 2%;*
- *Abandonment and decommissioning costs to be deducted only when incurred;*
- *New definition of deepwater and deepwater block introduced;*
- *Capital allowance introduced for exploration wells in a deepwater block based on 140% of the cost of the exploration expenditure;*

Finance Bill 2006

Petroleum Taxation (PPT/SPT) *(Cont'd)*

- *SPT changed to a quarterly tax payable on the actual gross income for the quarter on or before the 15th day of month following;*
- *Companies have been given until 30th April 2006 to re-file their SPT Returns for the four (4) quarters of 2005 on this amended basis, and pay any additional SPT without penalty;*
- *Allowances deductible in computing gross income subject to SPT removed except for Royalty;*
- *New table of SPT rates introduced with a higher price threshold and some widening of the bands.*
- *Any contract involving the sale, exchange, transfer or other disposition of natural gas for export shall be submitted to the Board of Inland Revenue for examination to determine that the value of the transaction is the fair market value.*
- *The Board of Inland Revenue may submit the contract to the Minister for determination of the fair market value where it is of the view that the method used will not arrive at fair market value.*

Comment

The above measures are generally consistent with those previously announced by Government as part of the reform of the Energy Tax Regime.

The variation of the effective date of the Finance Act 2005 from 1/1/04 to 1/1/05 will be welcomed by both the upstream and downstream producers as the earlier effective date had severe adverse financial reporting consequences for many companies in the Sector.

There will however continue to be serious concern in the following areas: -

- *Deepwater operations where an uplift (140%) has been provided in respect of exploration expenditures. This uplift will of course only benefit those producers who attain production and would thus seem to be insufficient to offset the additional costs and related risks associated with this activity;*

Finance Bill 2006

Petroleum Taxation (PPT/SPT)
(Cont'd)

- *Natural gas sales since all contracts whether or not involving related parties will be subject to review and determination on the basis of an assessed fair market value. Third party sales should not be subject to such 'interference' as is the case currently with crude oil sales;*

- *The measures contain little or no incentives/reliefs for the smaller land producers who will continue to be assessed at substantially the same rates of tax as the major producers..*

Corporation Tax

Tax Rate

With effect from January 1, 2006 the rate of corporation tax is reduced from 30% to 25%.

There has been no change to the tax rate (35%) currently applying to petrochemical companies and for long term insurance companies (15%).

Removal of Allowances

With effect from January 1, 2006 a corporation can no longer claim the following in computing its chargeable profit:-

- *Uplift for sponsorship of sports, arts & culture, training, audio, visual or video productions.*

- *Employment allowance uplift on additional employee costs has also been removed as has the apprenticeship allowance.*

Companies will continue to be allowed a deduction for the actual expenditure incurred on these items in the income year.

Approved property development company status has effectively been withdrawn by the repeal of that Section of the Corporation Tax Act. The deduction of 15% of capital expenditure is therefore removed.

Comment

The removal of these allowances reflects Government's view that the current business environment no longer requires this range of incentives in order to prosper.

Finance Bill 2006

Corporation Tax - Comment
(Cont'd)

This is particularly the case in the areas of employment, where Government maintains that we are nearing full employment and construction, where there is a very definite boom in effect.

Changes to Computation of Capital Allowances

With effect from January 1, 2006, the tax depreciable limit for motor vehicles of $100,000 has been removed. This is a welcome measure particularly since the current average cost of a motor vehicle in a corporate fleet exceeds $100,000.

With effect from January 1, 2006 the restriction to cost on the disposal proceeds used in the computation of the balancing allowance or charge of plant and machinery has been removed.

This appears to be an introduction of capital gains legislation "through the back door" as proceeds in excess of original cost will now fall to be taxed whereas in the past they were sheltered from tax.

The Income Tax (In Aid of Industry) Act which now applies generally to manufacturers has been amended to: -

(a) Require the Initial Allowance to be claimed in the year the asset is first put into use rather than when the expenditure is incurred; and

(b) Allow the BIR to notionally reduce the tax written down value of an asset where no annual wear and tear allowance has been claimed.

Comment

Based on the above it would appear that the Initial Allowance claim has been recognised as an optional claim and will not expose the tax-payer to a notional write down of the asset where it is not claimed.

Exempt Interest Now Taxable

With effect from January 1, 2006 companies in receipt of interest on loans granted in respect of the following activities will no longer be exempt from Corporation Tax: -

- *Low cost housing;*
- *Approved tourism projects;*
- *Approved small companies;*

Finance Bill 2006

Corporation Tax — Exempt Interest Now Taxable *(Cont'd)*

- *Approved agricultural holdings;*
- *Small business sector;*
- *Construction of houses where loans granted by an approved mortgage company (S42(2) d and e).*

Approved Small Company

Approved Regional Development Co

Approved Activity Company

With effect from January 1, 2006, the 25% tax credit granted to these specific companies will be replaced with a full corporation tax exemption for a period of five years.

Group Loss Relief

No changes have been made to the current 25% restriction on group loss relief claims.

Management Charges

The definition of Management Charges contained in the Income and Corporation Tax Acts has been expanded to include Head Office Charges and Other Shared Costs and the limitation increased from 1% to 2%.

Comment

Having regard to existing legal precedent this measure is likely to be highly contentious since all head office allocations are likely to be considered by the BIR to be management charges subject to the 2% limitation. We are not necessarily in agreement with this interpretation.

Withholding Tax

There has been no change in the standard rate of withholding tax of 20% on gross payments. This rate may however be varied by double taxation treaty.

Income Tax

With effect from January 1, 2006, the following changes have been made: -

(1) The income tax scale rate is re placed by a flat rate of 25%;

(2) The personal allowance has been increased to $60,000 for all resident individuals regardless of age;

(3) The $18k deduction for mort gage interest has been removed;

Finance Bill 2006

Income Tax *(Cont'd)*

(4) The $10k deduction for first-time homeowners has been retained save in respect of home purchases after 1/1/06;

(5) The $10k deduction for credit union investments has been removed;

(6) Child maintenance allowance of $1,200 has been removed.

Comment

Based on the above, from 2006 onwards resident individuals will generally be allowed only the personal allowance ($60,000), the tertiary education allowance for approved extra regional institutions and a deduction for approved pension/deferred annuity contributions ($12,000) in computing taxable income.

Changes to Benefits In Kind

Employee Loans

With effect from January 1, 2006, an employee is assessable on the difference between the 'Repo' rate of interest due on a loan granted by an employer and the actual interest charged on that loan.

The Central bank 'repo' rate of interest as at the December 31 of the year immediately prior to the year of income will be the applicable rate for a year of income.

Note that where an employee loan is written off, that portion that has been written off shall also be treated as taxable benefit in kind save where the loan is proved not to be recoverable.

Comment

This measure could result in severe financial hardship for employees with existing loans and related financial obligations who are now faced with an unanticipated tax bill.

Private Motor Vehicles and Other Equipment Provided for Private Use

Owned

Where a company purchases a private motor vehicle and/or other equipment (for example, cell phones or laptops) on or after January 1, 2006, that will be used by an employee both for corporate and private use, the assessable monthly benefit will be 50% of the annual wear and tear allowance applicable to that private motor vehicle and/or other equipment.

Finance Bill 2006

Income Tax — Changes to Benefits in Kind *(Cont'd)*

It is assumed that the initial allowance claim available to manufacturers generally is not to be taken into account in the computation of the taxable benefit, but this is yet to be confirmed.

There has been no change to the current monthly assessable benefit of 1% of the cost of the private motor vehicle and/or other equipment purchased before January 1, 2006 that continue to be used for company and private purposes by an employee.

Leased

Where a company leases a private motor vehicle and/or other equipment on or after January 1, 2006, that will be used by an employee both for company and private use, the assessable monthly benefit will be 50% of the lease rental for that private motor vehicle and/or other equipment.

There has been no change to the current monthly assessable benefit of 33 1/3% of the lease rental for private motor vehicles and/or other equipment leased before January 1, 2006 that continue to be used for company and private purposes by an employee.

Employer Owned Accommodation

With effect from January 1, 2006, the assessable benefit on employees enjoying employer owned housing increases from the annual rateable value to the fair rental value of that property. The process for establishing fair market value has not been prescribed and could thus create uncertainty in an area where the cost of non-compliance is very severe.

Pension Funds

- *With effect from October 1, 2005*

  Refund of pension contributions and surrender of annuities pre retirement will be taxed at the flat rate of 25%.

- *With effect from January 1, 2006*

  ⇒ *Tax has been removed on the transfer of contributions to another approved plan.*

  ⇒ *The limit allowed for commutation has been increased from a pension of $65 per month to include a pension of up to $500 per month;*

Finance Bill 2006

Income Tax — Changes to Benefits in Kind *(Cont'd)*

⇒ *Removal of the tax exemption on funds with drawn from a pension plan to facilitate the purchase of property for a first time home owner.*

⇒ *The limit allowed for employer provided deferred annuity plans is varied to the greater of 1/3 of the chargeable income of the employee or 20% of the emolument income.*

⇒ *Income earned on an immediate annuity purchased on or after January 1, 2006 by a T&T resident individual is now exempt from Income Tax for all resident taxpayers.*

⇒ *Exemption was previously limited to taxpayers over 60 years of age.*

⇒ *Withdrawal of contributions and/or premiums pre-retirement are no longer tax exempt.*

Measures announced in the Budget Speech that have not been included in the Finance Bill 2006

The following measures were announced in the Budget Speech but were not included in the Finance Bill 2006. Taxpayers should not assume that these measures have been abandoned as it is expected that there will be a supplementary Finance Bill during 2006 and these measures may thus be included therein.

Taxpayers should therefore be reviewing their current operations to determine whether any changes should be made in order to avoid the potential negative impact if any of these measures are introduced.

(1) Introduction of Thin Capitalisation Rules Where Related Party Debt/Equity Exceeds a 3:1 Ratio.

The impact of this measure if introduced will result in the restriction on the deductibility of interest in computing chargeable profits.

Finance Bill 2006

Measures announced in the Budget Speech <u>that have not been included</u> in the Finance Bill 2006 *(Cont'd)*

(2) <u>Abolishing Close Company Legislation</u>

The removal of this legislation is not expected to have a material impact on taxpayers as these provisions are generally very leniently applied by the Board.

(3) <u>Expenditure Incurred on Production of Exempt Income to be Disallowed</u>.

If brought into effect this measure will adversely impact corporations that generate exempt income in the course of their operations whether from Caricom sources or other routine transactions as well as Group Holding Companies that generate exempt income in the form of dividends or interest.

(4) Bad Debt claims to be allowed as deductions for tax purposes only where based on specific Central Bank guidelines.

(5) Wear & Tear Allowance to be introduced for patents and scientific research expenditure.

Value Added Tax

No changes to the current rates of 0% and 15%. It should be noted that despite the lengthy list of proposed changes to the Zero Rated Schedule the only items that have been included in the zero-rated listing with effect from September 28, 2005 are the following:-

(1) Paper or paperboard used for writing, printing or other graphic purposes (Tariff No 4823.90.30);

(2) Puzzles (Tariff No 9503.60.00)

(3) Non-prohibited Magazines (Tariff No 4902.90.00)

Trinidad & Tobago Free Zones Act

With effect <u>from January 1, 2006</u>, the income tax, corporation tax, business levy or any other tax or levy exemptions granted in respect of sales receipts, profits or gains of the approved enterprise will not be extended to newly approved enterprises operating in the Free Zone.

The Land and Buildings Taxes exemption remains in effect.

Tourism Development Act

With effect from January 1, 2006, interest received on approved tourism development projects will no longer be exempt from corporation tax.

Update on Finance Act, 2005

Measures to be Introduced Retroactively

In our Second Tax Bulletin issued on August 10, 2005, we advised that certain changes to the Petroleum Profits Tax, Supplemental Petroleum Profits Tax and Income Tax (In Aid of Industry) Act were to take effect on January 1, 2004.

Given the negative impact not only on our petroleum producers but also on the manufacturing sector, representations were made to the Honourable Minister of Finance and good sense has prevailed with the amendments to these Acts taking effect on January 1, 2005 and not January 1, 2004 ◆

This Bulletin is intended to provide a general guide to the subject matter and should not be regarded as a basis for determining your liability to tax in specific circumstances.

We recommend that you should seek specific advice on any potential issue that is of interest to you before acting thereon. With respect to further advice on these highlights you may wish to contact: -

- *Peter R Inglefield,*
- *Allyson West,*
- *Susan Morgan, or*
- *Deborah Ragoonath-Rajkumar*

Caveat

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