

Tax News

July 7, 2008

“Our brother’s keeper” - a budget of restraint

Overview

Prime Minister and Minister of Finance The Right Honourable David Thompson delivered his first financial statement and budgetary proposals as Prime Minister in a presentation lasting approximately 3 ¼ hours on July 7, 2008.

He stressed that international developments greatly influenced Barbados’ economic fortunes and that the outlook for the next year was not good for the developed countries, and by extension Barbados, with oil prices reaching record highs almost on a weekly basis and corresponding increases in prices of other commodities creating cost-push inflation. He projected the moving average rate of inflation to be about 7.9% by year-end, dictated by these trends, and that this relatively high inflation would persist through the first six months of 2009.

The Prime Minister also stated that growth in the local economy, reflecting the deceleration in the global economy, declined to 1.8% during the first half of 2008 and he predicted an outturn of between 2.0% and 2.5% for the year.

The Minister saw the current major issues affecting Barbados as:

- the anticipated slow rate of growth in tradable sectors, particularly tourism;
- vulnerability in food and energy with resulting pressure on growth of the economy and the impact of inflation on the poor;
- high national debt and an already high fiscal deficit; and
- pent-up unsatisfied demand for housing by lower and lower middle income families.

The budgetary proposals were presented with these in mind and reflected fiscal restraint. The Prime Minister has clearly recognised that although his party may have won the election by promising to reduce the cost of living, this is much easier said than done.

The Prime Minister's presentation is not a "honeymoon" budget. It reflects a subdued analysis of the global economy and its impact on that of Barbados. With the price of oil predicted to reach US\$200 per barrel by year end, he warns Barbadians to be prepared for tough times ahead.

The Prime Minister's proposals anticipate a net revenue gain of \$22 million, as set out in the attached Appendix A, with the most significant measures being:

- increased taxes on insurance premiums;
- increased licence fees for insurance companies and financial institutions;
- increased highway revenue;
- increased liquor licence fees;
- increased racing services registration fees;
- increased gaming licence fees for slot machines and video lottery terminals;
- a revenue tax on gambling;
- a withholding tax on gambling winnings;
- increased excise taxes on alcohol and tobacco products;
- increased Town and Country Planning fees;
- increased ad valorem environmental levies;
- increased environmental levies on cars;
- a mobile phone subscription fee for education and training;
- refunds of VAT on lower income housing;
- increased reverse tax credits;
- increased pensions for disabled persons;

- increased non-contributory old age pensions;
- increased welfare grants;
- increased vacation camps for children;
- expansion of school bus scheme;
- increased marketing budget of BTA;
- restoration of credit union allowance;
- increased retro-fitting allowance to cover energy conservation and alternative energy;
- incentives for agriculture; and
- a seed capital fund.

International business sector

The Prime Minister re-emphasized the need to focus on activities and incentives which will serve to fuel growth in the international business sector and make Barbados a more attractive location for regional headquarter companies. To this end he broadly stated the following as necessary areas of focus:

- continued development of the country's network of double taxation treaties via the negotiation of additional treaties, particularly with Latin American and Asian countries;
- tax benefits;
- improved immigration arrangements for the sector's senior and professional staff;
- the relaxation of exchange controls on capital transactions;
- dispute settlement arrangements;
- health facilities; and
- education and skills availability.

Comments

The international business sector is one of the country's key foreign exchange earners, contributing more than 55% of Barbados' corporate tax revenue.

While the Prime Minister has recognised the key impact of health facilities and skills availability on the prospects of the international business sector there was a disappointing absence of specific initiatives in his presentation beyond the continued development of the critical tax treaty network.

The removal of exchange controls on capital transactions would definitely make Barbados a more attractive holding company location for regional companies, as well as international entities that are unable to utilise Barbados' international business legislation. However, in order for Barbados to truly become a holding company jurisdiction of choice, we believe that the removal of property transfer tax and stamp duty on the transfer of shares of such entities would also be necessary.

VAT

The Prime Minister proposed the removal of VAT from building materials on low-income houses with a value up to \$150,000 for first time home-owners who reside in their homes, and whose gross family income is below \$42,000.

Administratively, the Government will seek to provide this concession through refunding VAT included in the cost of acquisition of such owner-occupied dwelling houses, whether the houses are built by their owners or purchased.

Comments

This commitment is partially in keeping with the contents of the Democratic Labour Party's December 2007 manifesto, in which it was proposed that VAT be removed from building materials on houses valued up to \$400,000. If administered effectively, the proposed concession is likely to represent real tax relief for low income earners and could significantly lower the cost of such housing.

Energy

The Government has indicated its desire to take a lead in moving Barbados away from dependence upon imported fossil fuels and towards energy independence by encouraging the generation of renewable energies and the sale of electricity into the national grid. Steps will include:

- assisting solar water heater manufacturers to ensure that as many Barbadian made solar products are used in Barbadian hotels, restaurants and luxury houses as possible;
- automatically exempting various renewable energy equipment, such as wind turbines, from customs duties;
- reviewing its own buildings and fleets of vehicles with the goal of energy conservation in mind;
- examining alternative energy projects for government installations;
- upgrading the grid to cope with the anticipated new sources of electricity;
- commencing work on the waste energy complex at Vacluse, expected to provide between 6 and 8 megawatts of power to the grid;
- instructing Barbados Light & Power to purchase renewable electricity at a predetermined price; and

- amending the offshore petroleum legislation to provide a requirement for local content, to protect the value of Barbados' carried interest and to provide adequate dispute settlement arrangements.

The pricing of petroleum will now automatically reflect cost movements, with the price set by the Ministry of Trade on a monthly basis without reference to Cabinet (using a Cabinet approved pricing formula).

The current allowance for an energy audit of \$2,000, subsumed within the existing Home Improvement allowance of \$10,000, will be replaced with a new and separate allowance.

The Energy Conservation and Renewable Energy Deduction will be an allowance of \$5,000 per year (for a maximum of five years) to cover the cost of an energy audit and 50% of the cost of retro-fitting a residence or installing a system to produce electricity from sources other than fossil fuels. This allowance will apply equally to businesses and individuals.

Comments

Given speculation that the price of oil could reach US\$200 a barrel by the end of 2008, any initiatives that help Barbados to move away from a dependence on foreign oil will be welcomed by Barbadians.

The move to energy independence is certainly ambitious and highly desirable. The incentives proposed should encourage many in Barbados to consider how they might contribute to a sustainable energy environment through tax-effective investment in renewable energy systems. This can be seen as an opportunity for any renewable energy producer and the guarantee of a market and price for energy

created may well encourage investment in this field.

Manufacturing and productivity

Efforts to boost local manufacturing include commitments to:

- develop the indigenous pottery industry through targeted assistance and incentives;
- assist the growth of a premium sea-island cotton brand through joint venture and franchise arrangements; and
- incentivise local hotels and shops to use locally made furniture.

Concurrently, the Government has made greater productivity a key aspiration. The Prime Minister cited the example of factories that are only operated for 25% of the available time and encouraged the adoption of new technology by Barbadian industries.

More specifically it was noted that in future preferential tax treatment will be given to productivity related bonuses and Government itself will open a dialogue with employee organisations to try and aid productivity.

Comments

The Government has indicated that it will be pursuing a unified development strategy, whereby growth in one sector can trigger growth in others. We look forward to concrete proposals in this regard.

As the Prime Minister says, "The importance of improving productivity is appreciated by everyone". However, increasing productivity is likely to take more than tax concessions on bonuses, welcome as these are.

Indications by the Prime Minister that the Government may attempt to introduce the concept of performance related pay to public workers is noteworthy. This concept is not currently widespread in Barbados and we will be interested to note the reaction of the Trade Unions to such proposals. Any initiatives in this regard must be commended.

Tourism

The Government has embarked on restructuring its marketing programme to concentrate on markets from which the more price resilient of our tourists are attracted, and on those markets which are critical to maintaining airlift. Such restructuring efforts will cost up to \$10 million.

Whilst seeking to preserve the East Coast from Pico Tenerife to Skeetes Bay as a national park, and considering legislation to prohibit the purchase of much of this land by foreigners, the Prime Minister has restated his commitment to developing those areas where he perceives tourism development not to be in conflict with the aspirations of Barbadians. In so doing, the following proposals have been made:

- the Tourism Development Act is to be amended to:
 - provide a gradation of concessions to be granted to tourism related investments on the basis of the local value added that accrues to Barbados from those tourism related investments;
 - increase the time period for concessions as linkages by tourism entities to the rest of the community are deepened;
 - make the rental pool conditionality optional, and to possibly limit the concessions available to property owners who do not wish to have their

properties listed as short-term accommodations;

- continued support has been pledged to those hotels forming part of the “Small Hotels group” by the Enterprise Growth Fund;
- from income year 2008, the granting of an additional income tax concession of up to 5 years over and above the original and normal concession, if 25% of the investment is owned by Barbadians in blocks of not more than \$100,000 per shareholder; and
- taxi operators will now be allowed to purchase gasoline powered motor vehicles duty-free.

The Government lists a number of developments which it is seeking to facilitate, namely the:

- establishment of a number of marinas to attract yachts;
- construction of a number of jetties in fishing villages to encourage the development of the boating industry;
- further expansion of the airport and cooperative marketing strategies with airlines to establish Barbados as a major regional airport hub for the Caribbean and South and Central America;
- development of theme park type entertainment;
- construction of a terminal for private jets in the north of the island;
- building of a new cruise ship pier and facility in the north of the island to reduce congestion at the Bridgetown Port; and
- investment in a regional ferry service.

Expansion of the duty-free selling regime

It is proposed that the current duty-free regime be expanded and updated in keeping with the marketing strategy to attract regional visitors by making shopping in Barbados more competitive.

The proposal speaks primarily to the phasing out of the duty drawback scheme.

Effective September 1, 2008 new market entrants will, upon application to the Comptroller of Customs and the provision of appropriate bond coverage, be permitted to take delivery of imported goods which they are offering for duty-free sale to tourists, without the payment of upfront relevant duties and taxes.

Any retailer who passes the necessary due diligence checks of the Ministry of Finance will be permitted to retail goods free of import duties and excise taxes, where the retailer has posted a bond for 30% of the estimated quarterly duties, that the retailer and Customs agree would most likely be otherwise payable on the goods to be sold free of duty.

The bond would reduce by 5% per year on satisfactory reporting, and finally to 5% of the duty that would otherwise be payable.

Comments

The Government recognises the need to effect changes within the Tourism Development Act, and is seeking to tailor the existing legislation to accommodate certain niche markets.

Incentives for local ownership participation in tourism related projects are always welcome. All will await with interest further details of the various development projects which were referred to during the presentation.

The phasing out of the duty drawback scheme reflects Government's commitment to reducing unnecessary administrative roadblocks to conducting business in Barbados. This will be a very welcome cash flow boost to retailers.

Real estate

The Prime Minister reported that his Government is examining proposals by the private sector to construct new real estate off the coasts of Barbados by utilising modern land-reclamation methods to construct offshore islands and marinas.

Efforts are also underway to improve the much criticised planning process, with professional town planners in private practice being hired to assist with the backlog of applications and certain Ministerial powers being delegated to the Chief Town Planner.

Comments

The idea of a few new islands off the coast of Barbados is certainly fascinating and not entirely improbable given what is now being achieved in Dubai. Many Barbadians will be keen to hear more of this.

However we consider it unlikely that any such developments will ease pressure on land prices in Barbados, as the cost of any such developments will be huge. Most Barbadians will be disappointed to learn of plans to pursue "environmentally friendly" developments for the East Coast given the risk of losing what may be considered our last significant area of unspoilt natural beauty.

We are encouraged by any attempt to improve the planning mechanisms currently in place.

Although no mention was made of land tax rates, we are still hopeful that the land tax bands will be expanded when the new valuations are issued to offset the impact of anticipated increases in property valuations.

Revenue raising measures

Government has announced the following revenue raising measures.

Insurance

With effect from January 1, 2009, Government has proposed that the premium tax will increase by one percentage point wherever the premium tax now applies.

The premium tax rates will now be as follows:

	Resident life insurance companies	Foreign life insurance companies
New business written for the income year	6%	6%
Renewal business	4%	6%

Resident and foreign general insurance companies will pay 4.75% of the gross direct premium in respect of property insurance business and 4% of the gross direct premium for other general insurance business.

License fees for insurance companies will be increased from \$5,000 to \$20,000 per annum.

Financial institutions

License fees will be increased with effect from January 1, 2009 as follows:

Local – main branch (per bank)	\$250,000
Local – other branches (per branch)	\$20,000
Local – ATM's (per ATM other than at a branch)	\$1,000
International banks (per bank)	\$100,000
Trust companies (per company)	\$100,000

Highway revenue

Faced with escalating costs of the ABC project and the ongoing maintenance of the island's roads, Government has increased fees in most

areas dealing with the use of the island's highways. Increased licence fees will be borne by owners of private cars, motor cycles, commercial vehicles, articulated vehicles and trailers. Ancillary fees including permits, number plates, regulation fees, vehicle examinations and international driving licenses have also increased.

Liquor licences and professional fees

Effective September 1, 2008, fees with respect to the selling of alcoholic beverages will be increased as follows:

Licence	Current rate	Proposed rate
General wholesale licence	\$5,000	\$10,000
Wholesale	\$2,500	\$5,000
Retail	\$350	\$1,000
Hotels	\$1,000 - \$10,000	\$1,500 - \$15,000
Restaurant licence	\$350	\$1,000
Occasional licence	\$50	\$100
Members club	\$200	\$500
Proprietary club	\$2,500	\$5,000
Druggist licence	\$100	\$750

The Prime Minister has increased the fees to be collected under the Trade and Business and Registration Act. These fees have not been increased since the early 1980's and he has indicated that the fees no longer bear any relationship to the individuals' or organizations' earning capacities. Fee increases have been levied on many professionals with effect from January 1, 2009. Accountants, actuaries, architects, attorneys-at-law, dental practitioners, engineers, land surveyors and quantity surveyors will pay an annual registration fee of \$2,500 each. Chiropractors, chiropodists, dental hygienists, dental technicians, draughtsmen, embalmers, funeral directors, optometrists, podiatrists and professional promoters will now pay an annual registration fee of \$750. Fees in other trades and categories have increased.

Betting and gaming

The licence fee on gaming machines including video lottery terminals will be increased from \$10,000 to \$15,000.

It is proposed that the tax on lotteries or sweepstakes will be increased to 20 cents in every dollar and the tax on lotteries operated by an approved sporting organization to 13 cents in every dollar. For daily lotteries the rate of tax will increase from 12% to 20% and those operated by an approved sporting organization from 3% to 11%.

With effect from January 1, 2009, racing service and amusement arcade registration fees will be increased by 200%.

It is also proposed that the annual registration fees for pool betting businesses will be increased from \$300 to \$1,000.

Withholding tax on winnings

With effect from October 1, 2008 all jackpots and all pay-outs of over \$1,000 will be subject to a withholding tax of 25%. The tax will be collected by the owners of the gaming establishments and paid to the treasury within 15 days of the end of the month during which the money was won.

Excise tax

With immediate effect the excise tax payable on alcoholic beverages will be increased by 50%. The excise tax payable on manufactured tobacco will be increased by 100% and the duty-free allowance currently granted to persons travelling to Barbados will be removed with respect to manufactured tobacco.

Environmental levy

The existing treatment in respect of the environmental levy has violated the revised Treaty of Chaguaramas. Government has therefore decided to apply the levy to local products in addition to imports. Manufacturers who export their goods will now qualify for a rebate of the levy on the goods exported.

The existing levy on used cars and new cars has been equalized to have a common rate. The existing rate of \$4,000 for used cars and \$300 for new cars has been adjusted and the new rate is \$1,500 for new and used cars.

The ad valorem rates of the environmental levy have been increased from 1.5 and 2 per cent to 2 and 3 per cent respectively.

Town and country planning fees

Government has decided to increase the fees charged by the Town and Country Development Planning Office for applications for planning permission and various other consents and certificates. These fees have not been specified in the presentation but will seek to bring a level of equity where larger and more complex applications carry a higher associated fee.

These fee adjustments are expected to yield additional annual revenue of \$500,000 and will be published before implementation.

Mobile phone subscription for education and training

Government proposes to collect a monthly subscription of \$4 on each post and pre-paid mobile phone in use. These funds will be used to continue Government's funding of education which comprises approximately 20% of the national budget.

It is anticipated that everyone will benefit from an improved, high-quality education system.

Comments

The revenue raising measures announced by the Prime Minister were aimed at ensuring that the Government is able to meet its commitments for expenditure in what is an extremely volatile global environment. With a projected continuation of the slow down in the world economy and a downward revision in the rate of growth of the Barbados economy, it was no surprise that Government has adopted a restrained approach to raising revenue.

Some of the revenue measures introduced which affect tobacco, liquor and betting are targeted to impact discretionary expenditure. However, experience has shown that the demand for these items is relatively inelastic and there is thus a high probability that the anticipated revenue will in fact be realized.

Whether directly or indirectly, these increased costs will impact the consumer. As the revenue measures result in reduced disposable income, this can lead to a further slowing down of the economy.

Apart from the increased tax revenues, it is difficult to understand the benefits to Barbados of increasing the number of gaming machines allowed on the island.

Agriculture

The Prime Minister in his presentation indicated that “Land use is at the heart of our agricultural policy”. To achieve balanced development and protection of our people with food security being a major consideration, the following were proposed:

- an Agricultural Protection Bill to protect large areas of agricultural land and requiring approval of Parliament for the change of use of land of over 100 acres;
- guaranteed loans totaling \$15 million to BAMC and BADC to provide an additional 10 acres for various agricultural activities;
- farmers entitled to concessions will receive them up front when they purchase items, rather than having to wait on a rebate;
- a rebate of 50%, up to a maximum of \$7,500 per farm per annum, of the cost of cleaning, drainage and refurbishment of existing wells on farms, will be granted to registered farmers;
- Government will guarantee a loan for the financing of a \$16 million project for Drainage and Irrigation Water Storage conducted at the River Plantation by the BADMC;
- an increase in the annual subvention to the 4H organization from \$100,000 to \$200,000 per annum;
- provision of a one-off grant of \$100,000 to the Barbados Agricultural Society to support the establishment of a wholesale market and an increase in the subvention to \$200,000 annually;
- provision of duty-free concessions to fish farming and on importation of equipment and facilities for storage and marketing of local agricultural and fisheries products;
- an increase in the threshold of the rebate of the cost of an approved security system from \$5,000 to \$10,000;
- the acquisition of a crane, a hydraulic trailer and boat jacks to assist fishermen in hauling boats;
- a rebate of 50% up to a maximum of \$3,000 per registered farmer per year will be granted towards the purchase and application of rat bait or other approved rodent extermination and control devices;

- provision of \$1,000,000 to facilitate the cotton industry's pursuit of investment opportunities and for payment of seed cotton; and
- provision of funding of a feasibility study and the commercialisation of cassava production with \$400,000.

Comments

Government has embarked on a number of schemes and incentives to revitalise the agricultural sector, and to stimulate increased food production.

Barbadians will readily appreciate the value of any initiatives which increase the domestic production of food and reduce the requirement for large amounts of foreign exchange to be expended on imported food supplies.

The following tables have been extracted from the Minister's budgetary proposals:

Revenue gains	\$ M
Increase in tax on insurance premiums	6.6
License fees for insurance companies	4.8
Banking license fees	4.9
Highway revenue	46.0
Liquor licences	1.0
Racing Services registration fees	0.6
Gaming licences - slots	1.9
Gaming licenses - video lottery machines	5.2
Revenue tax on gambling	4.4
Withholding tax on gambling winnings	8.7
Excise tax on alcohol and tobacco products	1.5
Town and Country Planning fees	0.5
Environmental levy - cars	1.5
Environmental levy – ad valorem	3.5
Mobile phone subscription fee for education and training	13.9

Revenue losses	
VAT on lower income housing - existing rate of increase of housing	7.1
VAT on lower income housing -additional rate of increase of housing	11.0
Increase in reverse tax credit	7.5
Increase in pension for disabled	3.0
Increase in non-contributory old age pension	8.0
Increase in welfare grants	0.2
Increase in vacation camps for children	5.0
Expansion of school bus scheme	11.0
Increase in marketing budget of BTA	10.0
Restoration of credit union allowance	2.5
Increase in retrofitting allowance to cover energy conservation and alternative energy	5.0
Incentives for agriculture	8.0
Seed capital fund	0.5

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