Tax news

Barbados Budget
March 2019

Back from the brink

In a bold and far reaching Budget speech, The Honorable Prime Minister Mia Mottley outlined her plans to build on those measures already taken during the first 10 months of her administration. Many of the announced measures have been pro-growth, primarily geared towards boosting private consumption and investment, with some participation from Government through public/private sector partnerships. Under the banner "Stay the Course" her speech focused on the key areas of stabilisation, growth and transformation.

The measures that this Government has already taken have boosted confidence in the economy, created a sense of hope in the population and gone some way towards restoring Barbados' international reputation. In a relatively short period much has been achieved. The country's international reserves have risen by $400 million to $1.1 billion or 15 weeks of import cover, and following the successful local restructuring of Government of Barbados debt, the debt to GDP ratio has fallen from 170% to 125%. The Government has also improved the country's fiscal position and implemented a number of its key manifesto commitments including:

- a 5% pay increase for public sector workers;
- an increase in the non-contributory pension; and
- the payment of tuition fees for Barbadian students attending the University of the West Indies.

Barbadians will also be relieved to know that there is now a plan to settle corporation tax and VAT arrears dating back to 2011. Commencing 1 May 2019, those debts will be settled through immediate payments up to $10,000, while those in excess of that threshold amount will be paid over a 42-month period.

With the objective of stabilising the economy well advanced, the Prime Minister has turned her attention to growth and transformation. Cautioning Barbadians that transformation cannot be achieved overnight, she sees her budget as the first step towards the fulfillment of her vision for a 'fit for purpose' Barbados by 2025.

The Budget outlined a number of tax measures designed to reduce the level of direct taxes on individuals while increasing indirect taxes and broadening the tax base, and included a number of other transformative measures that we expect will be welcomed by individuals and businesses alike. The establishment of a self-financing commercial court, the promise of new legislation focused on arbitration and alternative dispute resolution and the establishment of three temporary additional criminal courts will go a long way towards restoring public confidence in our justice system, both at home and internationally.

A plan to improve the efficiency of Government departments including digitisation in some areas, if achieved, will likely impact the country's overall productivity, as many productive hours are lost each year by workers queuing in Government departments. The outsourcing of the management of CAIPO and a commitment to improve the speed of approval of town planning applications will be welcomed by the private sector and demonstrates that this Government is willing to take measures which are critical to ensuring Barbados remains internationally competitive.

The international business sector was also assured that the Government is in active negotiations with the EU to have Barbados removed from its blacklist.

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Back from the brink (cont'd)

While making it clear that she saw the Government as an enabler of growth primarily through investing in its citizens, the Prime Minister nonetheless also announced a number of measures and innovations expected to drive economic growth. Projects with a value of $2 billion dollars were announced which, when completed, are expected to create 1,500 new hotel rooms and 3,000 new jobs.

Government is also keen to stimulate a broad base of local investment in the economy and working in conjunction with the Financial Services Commission and the Barbados Stock Exchange (BSE), will be developing a regulatory regime and introducing new investment vehicles for Barbadians. This includes a promise to list minority interests in assets such as the Hilton Hotel on the BSE. These initiatives are welcomed given the limited opportunities for meaningful local equity investments coupled with the fact that bank interest rates are at historic lows.

Other initiatives, including a commitment for Barbados to be carbon neutral by 2030 and for a medical cannabis programme, demonstrate a refreshing vision for a twenty first century Barbados.

A number of the measures that the Government plans to implement to raise indirect taxes may prove to be controversial. The increase in bus fares and commercial water rates are likely to be unpopular measures. Nonetheless in our view the Budget builds on the Government's achievements over the last 10 months. Given the number of measures outlined, it's clear that there will be no pause for breath in the effort to transform and rebuild the country.

Like the Prime Minister, we recognise that the road to recovery is going to be a long one and that there will be bumps along the way. However, every successful organisation and country needs a clear vision which its people both understand and can believe in. In our view this Budget sets out such a vision. We have set out below a more detailed analysis of some of the measures announced and we have reviewed the country's recent economic performance in our Appendix.

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Let's talk!

01 Personal tax - change in income tax rates

Overview of measure:

The Prime Minister proposed that effective 1 July 2019, the bands and income tax rates will be as follows:

- taxable income up to $50,000 – 12.5%
- taxable income in excess of $50,000 – 33.5%

From 1 January 2020, the bands and income tax rates will be as follows:

- taxable income up to $50,000 – 12.5%
- taxable income in excess of $50,000 – 28.5%

PwC commentary:

Since the reduction in the corporate tax rates, many people were concerned about the current rate of taxation for individuals. The relief proposed by way of reduction in the tax rates effective 1 July 2019 and again on 1 January 2020 would be welcomed by taxpayers who have seen a reduction in allowances available over the years.

The following table shows the changes in the net take home pay of two individuals earning $75,000 and $125,000 per annum.

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01 Personal tax - change in income tax rates (cont'd)

	2019 before	2019 after	2020	2019 before	2019 after	2020
Annual salary	75,000.00	75,000.00	75,000.00	125,000.00	125,000.00	125,000.00
Income taxes payable	(10,625.00)	(8,437.50)	(6,250.00)	(30,625.00)	(21,562.50)	(20,500.00)
Net take home pay	64,375.00	66,562.50	68,750.00	94,375.00	103,437.50	104,500.00
Average tax rate	14.17%	11.25%	8.33%	24.50%	17.25%	16.40%
Increase in net take home pay		2,187.50	4,375.00		9,062.50	10,125.00

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02 Personal tax - reverse tax credit

Overview of measure:

The Prime Minister proposed, starting from income year 2018, to pay the reverse tax credit to individuals earning between $18,001 and $25,000. Once an individual submits their income tax return for the income year 2018 and their income is within the gross income bracket mentioned, that individual will qualify for this credit for the first time. It has been proposed that the credit would be paid by September.

PwC commentary:

The reverse tax credit was previously only available to individuals who earned less than $18,000 annually, but not more than $1,500 monthly. The inclusion of those persons earning between $18,001 and $25,000 will cost the Government $9 million, but will be welcomed by those in this bracket who will receive additional income in their hands. The extension of the credit to these individuals will also go some way to compensating them for possible increases in goods and services, such as water rates and bus fares.

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03 Personal tax - compensatory income credit

Overview of measure:

The Prime Minister indicated that the personal allowance will remain unchanged at $25,000. However, she advised that the Government was introducing a Compensatory Income Credit (CIC), for individuals who earn above $25,000 but below $35,000 per year. The CIC will provide a credit of up to $1,250 and will be accessible after the filing of the income tax return for income year 2019.

PwC commentary:

The Prime Minister advised that income tax for these persons would continue to be deducted on a monthly basis. Individuals would therefore be unable to see an immediate benefit. However, they will receive a refund of income taxes paid through a lump sum refund in 2020. It can be seen as a saving mechanism for some individuals, or as the Prime Minister facetiously said as a Government “meeting turn”.

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04 Personal tax - foreign currency earnings credit

Overview of measure:

The Prime Minister proposed to change the scale applicable to the foreign currency earnings tax credit such that the minimum effective tax rate would be approximately 10%. The changes in the scale will be as follows:

Foreign earnings as a percentage of total earnings	Current rebate of income tax, expressed as a percentage of income tax on foreign earnings	Proposed rebate for balance of 2019, of income tax, expressed as a percentage of income tax on foreign earnings	Proposed rebate effective January 2020, of income tax, expressed as a percentage of income tax on foreign earnings
20% and under	35%	26%	24%
Over 20% but under 41%	45%	34%	31%
41% but under 61%	64%	48%	45%
61% but under 81%	79%	59%	55%
81% and over	93%	70%	65%

PwC commentary:

The reduction in the foreign currency tax credit will result in an increase in the tax payable on the income earned by individuals from sources outside Barbados, which is transferred through the banking system. An individual whose income is earned only from foreign sources will, from 2020, pay income tax at approximately 10%, an increase of 7.2% from their current effective tax rate of 2.8%.

This measure will impact high net worth individuals who currently choose to be tax resident in Barbados, and one has to hope that this increase in their potential income tax liability will not force them to leave these shores.

The effective date for the change in the rate was not made clear. The relevant legislation will need to clarify whether “balance of 2019” takes effect as at the date of the Prime Minister’s presentation or on some other date.

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05 Corporate tax

Overview of measures:

The Prime Minister noted that in order to simplify the current tax system, the following measures will be implemented with immediate effect:

Withholding taxes

The Prime Minister reaffirmed the decision to eliminate withholding taxes on payments made to non-resident persons, which include interest, management fees and royalties, but not dividends. Dividends derived from domestic sources and paid to non-resident persons remain subject to withholding tax.

In addition, the Prime Minister advised that the rate of withholding tax on dividends and interest payments made to resident persons will increase from 12.5% to 15%.

Branch profit tax

In order to bring the withholding tax treatment of branch profits in line with that of dividends, branch profits paid out of income earned outside of Barbados will no longer be subject to branch profits tax in Barbados.

In addition to the new measures announced today, the Prime Minister reaffirmed her Government's commitment to implement the following anti-avoidance rules:

Thin capitalisation rule: The Prime Minister noted that companies are typically capitalised through a combination of debt and equity, which may result in the reduction of their taxable income, as interest payments are deductible for tax purposes whereas dividends are not. She also indicated that in order to avoid potential abuse, a thin capitalisation rule of 1.5 to 1 will be introduced from 1 September 2019. Interest payable on outstanding debts due to non-resident related parties that own more than 10% of the company will be deductible to the extent that the total amount of the debt does not exceed one and a half times the equity of the company. Any portion of interest that exceeds this ratio will no longer be deductible.

Transfer pricing: The Prime Minister has reaffirmed Barbados' commitment to the OECD by announcing the Government's intention to introduce transfer pricing rules in the near future. She also indicated that this measure is aimed at targeting controlled transactions between related entities.

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05 Corporate tax (cont'd)

PwC commentary:

The exemption from withholding taxes and branch profits tax, as proposed by the Prime Minister, will be attractive to multinational enterprises and foreign investors seeking business opportunities and tax efficiency. This is likely to result in the expansion of our international financial sector, as well as employment for local professionals.

The implementation of transfer pricing rules and a thin capitalisation regime, both anti-avoidance measures, are in line with Barbados' commitment to comply with the minimum standards required by the OECD to enhance transparency. The satisfaction of these standards remains vital as Barbados seeks to defend and grow its international financial services sector.

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06 VAT - zero rated to exempted

Overview of measure:

The Government has made the decision to significantly reduce the number of zero rated supplies and treat them as exempt supplies in order to alleviate the burden of excessive VAT refunds. To this end, the villa sector and the supply of water from the Barbados Water Authority will be removed from the zero rated list and will be considered an exempt supply from 1 April 2019. The export of certain services has also been transferred to exempt supplies.

The Prime Minister also announced that the zero rated ‘basket of goods’ would be reviewed and many items would be transferred to exempt supplies.

PwC commentary:

While this move will not directly generate revenue for the Treasury, increasing the list of items that are exempt supplies will significantly reduce the burden on the Government to pay VAT refunds due to the previous mismatch of input VAT versus output VAT. For entities making both exempt and taxable supplies, this will make the process of completing their VAT returns somewhat complicated, as input VAT that does not directly relate to one type of supply or the other will have to be pro-rated.

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07 VAT - room levy and accommodation

Overview of measure:

In an effort to broaden the tax base and maintain the integrity of the VAT system, the Prime Minister announced that VAT on accommodation will be increased to 10%, effective 1 January 2020.

The room rate levy will also increase by 75% from 1 April 2019, ranging from $8.75 for apartments to $35 per bedroom, per night for hotels in the luxury class.

PwC commentary:

The VAT on accommodations will not be doubled, as was announced by the Prime Minister in her mini-budget of 11 June 2018. The reduction of the increase should be welcomed by the tourism sector, although it will still be viewed as making Barbados a more expensive destination. The proposed increase is expected to generate income of approximately $27 million annually.

While the introduction of the room rate levy was not met with enthusiasm by the sector, the increased rates are expected to generate additional revenues of $15 million annually. Both proposals will likely be considered as having a negative impact on the competitiveness of the sector.

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08 VAT - online transactions

Overview of measure:

The Prime Minister advised that the legislation necessary to allow for the collection of VAT from e-commerce transactions has been passed and will take effect from 1 May 2019. The success of this implementation will be dependent on assistance from the payment processors of online transactions. The Prime Minister has provided reassurances that VAT will only be charged on goods which will be consumed in Barbados and no double taxation will occur.

PwC commentary:

We understand that an efficiently designed VAT system is the preferred tax for raising revenue for Governments, as it is directly correlated to consumption. However, the implementation with respect to engaging the foreign payment processors is not quite clear and some preliminary teething problems can be expected. We hope that the Barbados Revenue Authority will issue concise guidance on this in the near future.

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09 Land tax

Overview of measure:

The Prime Minister announced the following land tax rates which are to be in effect from tax year 2019/20:

Land	Land tax rate
On the improved value of each parcel of land on which there is a dwelling house that is used exclusively for residential purposes:	
On first $150,000	0
On amounts between $150,000 and $450,000	0.10% of the improved value
On amounts between $450,000 and $850,000	0.70% of the improved value
On amounts exceeding $850,000	1% of the improved value capped at $100,000
On the improved value of each parcel of land on which there is a building other than a residence	0.95% of the improved value
On the site value of each parcel of unimproved land	0.80% of the site value up to 4,000 sq.ft.; 1% on excess

There have been no changes to the residential rates on property values of up to $450,000. Similarly, the rates on unimproved land of 4,000 sq. ft. and less have also remained unchanged. However, residential property values in excess of $450,000 will attract a higher rate of tax. Where residential property values exceed $850,000, the taxes due will not exceed $100,000.

The Prime Minister has proposed that land tax bills will be issued at the end of May 2019 instead of September 2019, to allow residential taxpayers to make provision for the new rates.

PwC commentary:

The increase in land tax rates for the upcoming fiscal year is the first in a few years, and is aimed at supporting the Government's new strategy to tax assets as opposed to income. Given the reduction in corporate tax rates, as well as the upcoming reduction in the personal income tax rates, these increases are expected to partially mitigate the loss in revenue from corporate and personal taxes.

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10 Exchange controls - gradual liberalisation

Overview of measures:

The Prime Minister remains adamant that the Barbados dollar will remain pegged at 2:1 with the US dollar. In noting that exchange controls were originally designed to ensure that the country retained sufficient reserves to defend the established fixed rate peg, she emphasised that in an era of expanded global trade and liberalisation, its has become urgent to liberalise the country's exchange controls.

A gradual approach is being adopted, with the following initial targeted measures:

- effective 1 July 2019, all Barbadians will be allowed to maintain foreign currency bank accounts to hold funds earned locally or abroad;
- reduction of the surrender requirement of 70% of foreign exchange brought into Barbados, potentially to be reduced to 50%;
- foreign currency proceeds from the sale of assets will be allowed to be repatriated in foreign currency or kept locally in a foreign currency account;
- annual limit on personal travel facilities will increase from $7,500 to $20,000; and
- the 2.5% foreign exchange fee will be capped at $100,000.

PwC commentary:

The approach to the liberalisation of these controls is prudent and timely. Improvements in investor confidence generated in recent months must be bolstered by the ability to sensibly conduct business in a recovering economy seeking to regain, and indeed grow, its position in global marketplace.

The ability of Barbadians to secure and retain foreign currency within the local banking system is long overdue and should have an almost immediate positive impact.

The Prime Minister referenced the now common practice of structuring transactions outside of Barbados to avoid the impact of the existing controls. The other immediate measures are intended to address this issue, encouraging investment into and through Barbados, as a result allowing the country to benefit from tax receipts from these transactions.

We believe that these measures are vital to maintaining improved investor confidence, support growth and channel foreign savings currently off-island into the economy for further productive use.

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Appendix

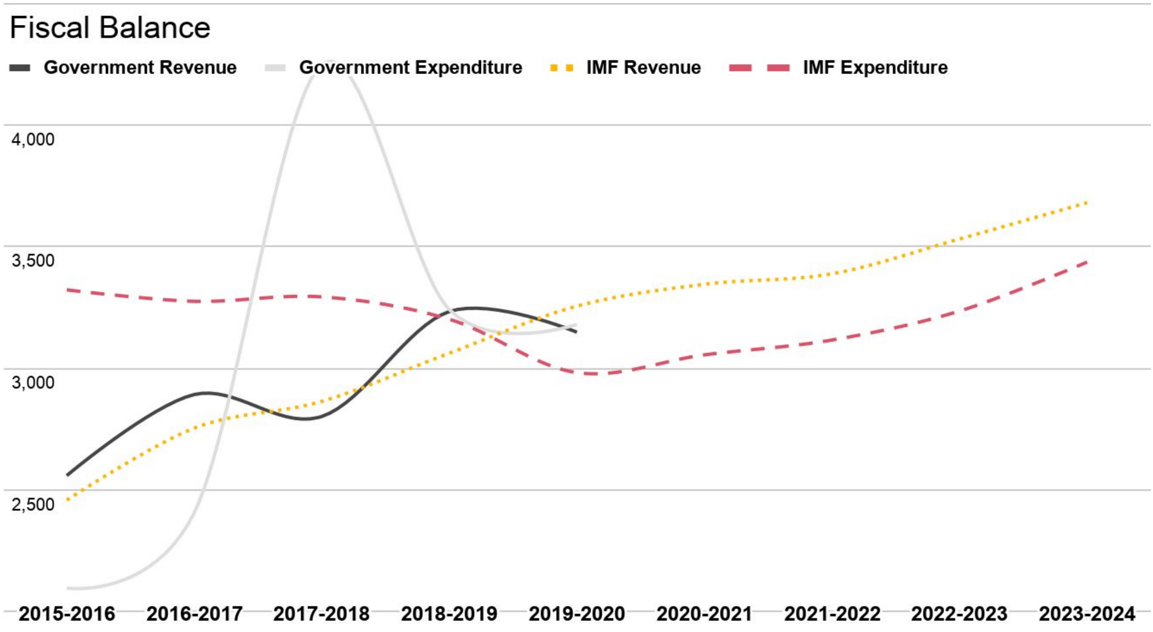
Economic overview

Economic overview

The Barbados economy faced a very challenging year in 2018, as the Government entered into an Extended Fund Facility (EFF) with the International Monetary Fund (IMF), and suspended commercial external debt payments. Overall, economic activity was sluggish with the economy contracting by approximately 0.6%. However, Government was able to successfully complete the restructuring of their domestic debt, which led to savings and enhanced the outlook for fiscal and debt sustainability over the medium-term. Overall, most of the economic drivers were impacted by the stabilisation measures.

Economic sectors:

- Real economic activity contracted by an estimated 0.6% in 2018 from a recent high of 2.5% in 2016.
- Manufacturing output was weak despite increases in poultry and sugar production which were principally consumed domestically.
- Tourism output slowed to an estimated 0.6% albeit, having an increase in long-stay arrivals by 2.8% over the prior year.
- Construction fell by approximately 7.0% due to low levels of infrastructural development in both the public and private sector.



Note: 2015 to 2018 actuals, 2019-2020 estimates, 2021-2024 projections
Source: Budget Estimates,International Monetary Fund

Fiscal balance:

- The public finances improved significantly due to the reduction in interest rates both externally via the suspension of external commercial debt payments and domestically via lower rates on Government securities.
- Total revenue was below target by $56m as higher-than-anticipated corporate and property tax returns were offset by lower income tax and VAT collections.

Economic overview

Inflation and employment

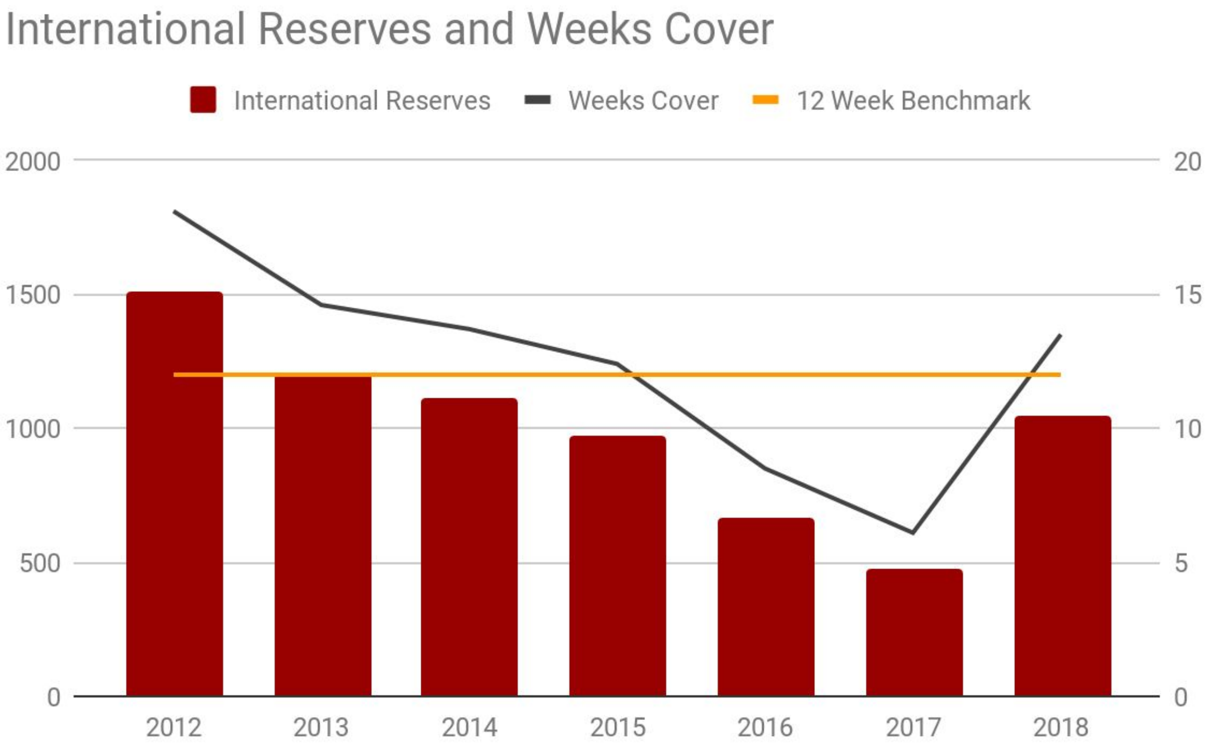
- While the unemployment rate stood at 9.2% as at September 2018 down from 10.2% for the same period, recent public sector layoffs within the last quarter of 2018 will lead to a hike in the unemployment rate.
- With the elimination of the National Social Responsibility Levy (NSRL) and the stabilisation of international fuel prices, the inflation rate has declined.

Government debt

- Policy-based loans of $350 million from the International Development Bank (IDB) and Caribbean Development Bank (CDB) during the last quarter of the year contributed to the overall reduction in Central Bank financing by approximately $242 million.
- As at December 2018, the gross public sector debt stood at 126.9% of Gross Domestic Product (GDP).

Foreign exchange reserves

- International reserves increased by $576.3 million to $1.05 billion at the end of 2018 which is equivalent to approximately 13.5 weeks of import cover.
- In total, there were $470 million from international financial institutions earmarked as policy and project loans which elevated the foreign exchange holdings.



Note: 2015 to 2018 actuals, 2019-2020 estimates, 2021-2024 projections
Source: Budget Estimates,International Monetary Fund

13.5 weeks of import cover

Economic overview

BERT

The Barbados Economic Recovery Plan (BERT), a joint development between the International Monetary Fund (IMF) and the Barbados Government, seeks to transform public finances and the economy of Barbados towards sustainable and inclusive growth.

The core elements of the BERT plan are:

1. An ambitious fiscal consolidation strategy with an aim to broaden the tax base, streamline expenditure and reform the public sector, specifically the State-Owned Enterprises (SOEs); and
2. A comprehensive debt restructuring plan which directly addresses the Government's growing debt burden.

Medium-term macroeconomic framework

The Government expects to achieve debt sustainability through two primary measures – attaining a primary fiscal surplus of 6 percent of GDP by FY2019/20, and completing a debt restructuring exercise aimed at reducing interest payments and postponing principal repayments.

IMF Structural Benchmarks			
Benchmark	**Passed by House and Senate**	**Partially implemented**	**Implemented**
Parliament to adopt a revised Financial Management and Audit (FMA) Act	X		
New Town & Country Planning Legislation	X		
Government to table a revised FMA to establish permanent binding budget calendar and approval process	X		
Launch of a training and outplacement programme for restructuring of SOEs		X	
Submission of quarterly reports by all SOEs			X
Establishment of Sandbox regime for regulation for fintech start-ups			X
Update of accounts and commencement of audit for the Large Taxpayer Unit			X

Source: BERT MC

Economic overview

IMF performance benchmark

Under the EFF arrangement, a number of quantitative and structural benchmarks should be achieved. By the end of December 2018, Government was able to attain the following:

Quantitative performance criteria benchmarks			
Performance Criteria (BDS$ millions)	**Target**	**Actual**	**Achieved**
Fiscal targets:			
Floor on the CG primary balance	257	348	X
Non-accumulation of CG external debt arrears	0	0	X
Ceiling on CG transfers and grants to public Institutions	495	486	X
Ceiling on public debt	13,679	12,828	X
Monetary targets:			
Ceiling on net domestic assets of the CBB	1,977	1,763	X
Floor on net international reserves	531	830	X

Source: BERT MC

Although revenue collection was below the target, reductions in expenditure more than compensated, allowing for the primary balance minimum target to be exceeded.

Revenue collection

- Total revenue for the period April to December 2018 was $2.022 billion versus a projected $2.078 billion intake. While exceeding the same period prior year total of $1.987 billion by $ 35 million the 2018 total revenue fell $56 million - 2.7% - short of target.
- Direct tax revenue was $730 million versus a $750 million targeted. While gross direct tax collections exceeded forecasts, higher-than-planned tax refunds drove $20 million shortfall.
- At $1.2 billion, the indirect tax revenue was $36 million or 3% less than the target, largely due of lower-than-expected intake from VAT, excise tax and duties.

Expenditure control

- As at December 2018, total expenditure was $1.9 billion, approximately $175 million or 8.1% below the budgeted level, and $362 million or 15.4% less than the prior-year period.
- The savings were spread across several expense categories, with less spent than originally planned on goods and services ($46 million), interest ($55 million), transfers ($38 million), and capital expenditure ($25 million).
- It should be noted that the saving on interest expense has no impact on the primary balance.

Let’s talk!

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