Handle with Care

Budget Analysis 2017/18

Barbados

Deloitte's Perspectives

It is a long established idiom that tax is a function of economics and a country's economic conditions can determine and influence the level and incidence of taxation in a country. The Barbados economy has been in limbo for the past eight (8) years, constituted by minimal to zero growth, growing fiscal deficits, high debt repayment obligations, economic downgrades, not to mention increasing levels of taxation. Government's obligations continue to be significant – social services are under pressure, with health care and roads deteriorating and there has also been the introduction of fees for university education, which has been hitherto free. Given this sachet of challenges, government continues to face the dilemma of 'to tax or not to tax'. This year's budgetary proposals presented the opportunity for the Minister of Finance to find the right balance to a delicate situation, one which must be 'Handled with Care'.

The Minister noted that there was a loss in tax revenue resulting from International Business Companies ("IBC") moving to other jurisdictions as a result of changing legislation to allow exempt surplus from countries with Tax Information Exchange Agreements. Subsequent to that, there has been a global tax reset, with the advent of the OECD's Base Erosion and Profit Shifting ("BEPS") initiative. Companies are now forced to move back to a tax location to avoid hybrid mismatches and Barbados being a low tax jurisdiction have benefited from this reset in 2016. It is therefore expected that much of the tax revenue lost from the exodus of the Canadian entities would be recouped from the taxation of International Society Restricted Liabilities ("ISRLs") emanating from US based entities.

The Minister has recognized the negative impact that the backlog of Value Added Tax ("VAT") refunds has on various businesses and has pledged to have the matter corrected. The Minister has however not made a commitment to a time frame for when refunds would be made and this would continue to be a concern for most businesses especially those claiming refunds on zero rated supplies and overpayments. In some instances these refunds are in excess of thousands of dollars and can be viewed as financing the treasury. They have reduced central government's cost of debt by re-profiling the debt held by statutory corporations – such as National Insurance Scheme ("NIS"); and Central Bank of Barbados ("CBB") would hold the majority of this exposure. We anticipate that this would include the terming out of treasury bills to more palatable rates and reducing the interest rates on short and medium term instruments to a level that is more manageable by Government. The unknown however is the impact that this measure will have on these entities to deliver on their respective socioeconomic mandates…but this adjustment could be viewed favourably by the ratings agencies.

The Minister estimates that the budgetary proposals would account for $542 million in additional revenue and he has revised the deficit to BD$537.6 million and reckons that these measures would lead to a small fiscal surplus of BD$4.4 million and reduce borrowing from the CBB by BD$640 million. Furthermore, the Minister announced an approved across the board 10 % cut in the existing approved Estimates of Expenditure for the financial year 2017/2018. Whilst no specific details were given he stated that an additional $82 million reduction in total expenditure this financial year is expected.

As with most fiscal measures, timing is of the essence. Over the past few years, there has been elevated volatility in Gross Domestic Product ("GDP"), commodity prices and exchange rates. And the ongoing financial and economic crisis will serve as a reminder to the Minister that Barbados' recovery will not be easily accomplished as there are hardly any shock absorbers left. The remaining pillars of our economic foundation, especially tourism and international business still have ability to improve, but as noted before, must be carefully dealt with.

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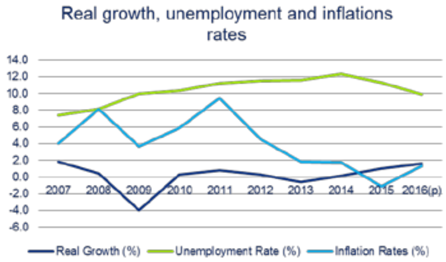
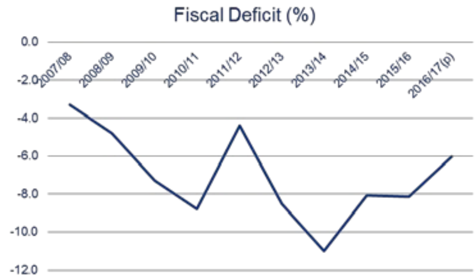
Barbados Economic Review

After sluggish or no growth in recent years, the Barbados economy experienced modest growth in the first quarter of 2017. This is due to the improved performance of the tourism sector over the last three years.

Since 2014, there has been a related decline in unemployment rates, which continued into 2016. Inflation rates remain low, trending at an average rate of 1.3% at the end of December 2016. This represents an increase from the drop of 1.1% in the previous year and is attributed to increased non-alcoholic beverage and food prices.

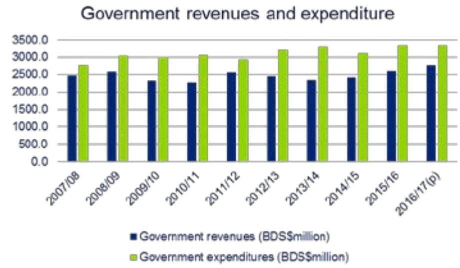


According to CBB data, growth within the construction sector has improved over the past few years and was recorded at almost 2% for the first quarter of 2017 due to commercial project activity, including Sandals Royal which is expected to open by the end of 2017. This was accompanied by moderate improvements in performance within the agricultural and manufacturing sectors.



It was noted that for the 2016/2017 financial year, there have been improvements in the fiscal deficit as a percentage of GDP compared to previous years, as a result of increased tax revenues, as well as restraint of non-interest expenditure.

It is also expected that there will be an improvement in the deficit once the scheduled divestment of assets is complete.



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National Social Responsibility Levy

The Minister announced that effective 1 July 2017 the National Social Responsibility Levy ("NSRL") will be increased from 2% to 10%.

The NSRL was implemented on 1 September 2016 with the expectation of raising additional annual revenues of $142.1 million to assist with meeting the rising social costs in Barbados. The proposal to move the rate from 2% to 10 % is expected to increase revenue from this measure to $291 million for a full financial year and $218 million for the remaining nine months of the current fiscal year. Furthermore, the expected break down in the contributions is projected to be NSRL $186 million and VAT $32 million.

Comment: The increase is expected to be fully borne by customers, as it is unlikely given current economic conditions that this increase will be absorbed by businesses. It is our view that the general population will be significantly impacted by this measure. The Minister highlighted in his presentation options such as:

- reducing VAT to 15% whilst eliminating exempt and zero supplies
- increase vat to 22%

However, these suggestions were disregarded given that the Minister considered that they would have adversely affected the Barbados population as a whole. It is our view that the impact of increasing the NSRL would have a more compounded effect than first envisioned. This is rationalized by the increase of the Levy by 8% plus an additional 17. 5% VAT on that increase, plus the 2% commission on the sale of foreign exchange.

The Minister conceded that the NSRL had early implementation challenges. Indeed there has been much confusion on how the calculation should be done. The Minister noted that the levy can have a dampening effect on imports which would in turn reduce the demand for foreign exchange. There is however a clear paradox. Given that the levy is also on locally manufactured products, it means that the cost of these products would also increase and may not necessarily become an attractive alternative to imported products.

Commission on Foreign Currency Transactions

It was proposed effective 1 July 2017 to implement a commission of 2% on all foreign exchange sales by authorized dealers. The Minister noted that the aim is to reduce the demand for consumption goods.

Comment: This is an interesting measure in that it could be construed as a de facto devaluation of the Barbados dollar. The purchase of foreign exchange will become more expensive and it has an ability to affect the cost of overseas education and imports among other things. It is possible that this measure could lead to the development of an alternative market for foreign currency. The Minister stated that this measure would be implemented on all foreign currency sales. However, it was unclear if it would also be applicable to international business companies with Barbados bank accounts.

Excise Tax

The excise tax on gasoline and diesel fuel will increase by 25c / litre and 24 c/ litre respectively. This will increase the retail prices of gasoline and diesel as follows:

	From	To
Gasoline	3.00	3.05
Diesel	2.15	2.25

The increase will take effect on the 1 July 2017.

Comment: This measure sends confusing signals given the fact that it does not cohere to the Government's stated objectives to reduce imports and encourage local production and manufacturing. The measure will increase the underlining cost of production on most local goods and services (transportation costs). It will also affect those agriculture and manufacturing sectors as well as general consumers.

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Tax Amnesty

The Government has extended the tax amnesty to run from 1 Jun 2017 to 30 November 2017 on VAT and Land Tax. This initiative will assist Government with paying the numerous tax refunds owed to taxpayers.

Comment: This measure was one of the few measures that both taxpayers and Government benefitted. Taxpayers now have more time to seek to become tax compliant with the BRA through payments towards outstanding obligations without attracting penalty and interest on taxes owed to the BRA. It should be noted that the amnesty was only extended on VAT and Land tax and it would need to be clarified whether the penalties and interest on income tax and corporation tax will also be waived.

Tax Administration

It has been proposed that a special tax forces along with a competent tax firm be engaged to provide recommendations on how to widen the establish a national tax administration registration initiative

The initiative is aimed principally at ensuring all of those persons who are operating businesses, are self-employed, sole traders or professionals and artisans are registered with the BRA and brought into the tax net.

Comment: The Minister's initiative to improve the tax administration is a welcomed one, as the economic conditions demand that the tax base be widened, rather than rely only on increasing tax rates. Overtime, the BRA has come under much pressure for its management of the island's tax affairs. There is a school of thought that the BRA would benefit from improved human and technical resources to effectively manage in this global tax environment. Certainly the need to interpret and implement international tax rules and solve tax disputes is already a significant one. The additional responsibility of expanding the tax net will add to the ongoing challenge.

Divestment of State Assets

The Government intends to divest some of the state owned assets to raise revenue to service its debts. It has been proposed that Hilton Hotel at Needham will be sold.

Comment: Privatization is always a useful tool in raising Government revenue. Given the depressed nature of the real estate market, it is uncertain that the amount of revenue expected will match the market value. It should be noted that while the Government expects to receive BD$100 million from this sale it is a matter of conjecture.

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