

Focus on Barbados Budget

2015



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Executive summary



We aren't there yet.

The deficit may be down but structural challenges remain.

On Monday evening, the Honourable Christopher Sinckler, Minister of Finance, opened his remarks to the Barbados House of Assembly by first highlighting progress on key features of the Barbados Homegrown Fiscal Stabilization and Economic Revitalization Programme.

The Minister then revealed budget measures that will raise BDS\$200 million in additional taxes and excise duties in the full fiscal year.

Building upon initiatives first unveiled in August 2013, Minister Sinckler outlined key features of the Government's medium term agenda. These are:

- ▶ Continued stabilization and growth of foreign exchange reserves;
- ▶ Invigoration of economic growth to 2.5 - 3.0% of GDP per year;
- ▶ Reduction of the fiscal deficit to no greater than the rate of growth in GDP by 2017 and to balance by 2020.

On behalf of the Government, Minister Sinckler took credit for the following achievements:

- ▶ At the end of March 2015, foreign exchange reserves amounted to BDS\$1,135 million, equal to 16.1 weeks' worth of the import of goods and services;
- ▶ At the end of March, 2015, the fiscal deficit has fallen to 6.6% of GDP, compared with 11.8% at the end of March, 2014;
- ▶ The Barbados Tourism Authority had been restructured into Barbados Tourism Marketing Inc and Barbados Tourism Product Authority;
- ▶ The rate of VAT applicable to the hotel sector had been reduced to 7.5%;

- ▶ Airlift out of key source markets had been increased;
- ▶ Other significant developments were underway in tourism, energy including renewables, international business services, agriculture, telecommunications and housing.

The Minister then unveiled an array of measures aimed at boosting Government revenues. The most significant measure that will affect business is the removal of Group Relief and the reduction of the carry forward period for tax losses from nine years down to seven years.

Minister Sinckler anticipates this will increase annual receipts by BDS\$15 million. However, the measure is unlikely to be popular with the business community, and the reductions in trade registration fees, which he also announced, are unlikely to soften the reaction.

The Minister also set out changes that will impact the ordinary taxpayer. These include:

- ▶ An increase in land tax rates designed to raise BDS\$44 million;
- ▶ A new excise on mobile telephone usage designed to raise BDS\$32.7 million;
- ▶ The removal of certain income tax deductions and a reduction of the income tax rates for a net increase in revenues of BDS\$9 million;
- ▶ The removal of certain food items from exemption from VAT, plus the imposition of VAT on betting and gambling, all of which are designed to raise BDS\$40 million in total;
- ▶ An excise on sweetened drinks.

However, the effects of this last measure are partly offset by subsidies offered to milk producers, which will lower the cost of fresh milk to consumers. These combined measures may help the nation's fight against non-communicable diseases, an issue the Minister remarked on at some length.

The Minister also announced a somewhat puzzling measure to retain the fuel cess levied on Barbados National Oil Company Limited ("BNOC") products so that these funds may be diverted to Queen Elizabeth Hospital ("QEH") to help it meet its liabilities. While it is an unorthodox measure, the QEH will no doubt welcome it.

Executive summary cont'd

Minister Sinckler also referred to the need to reform the public sector, and introduced steps towards a Performance Monitoring Framework for state-owned enterprises. The Minister described this as a “phased-in approach”. However, we believe this issue is one that requires swift and radical reform.

In summary, the Minister defined the challenges facing the Government and focused on measures designed to raise taxes and lower the deficit. However, there was less clarity as to how Government intends to deal with the underlying structural issues that continue to affect the cost and efficiency of public services.

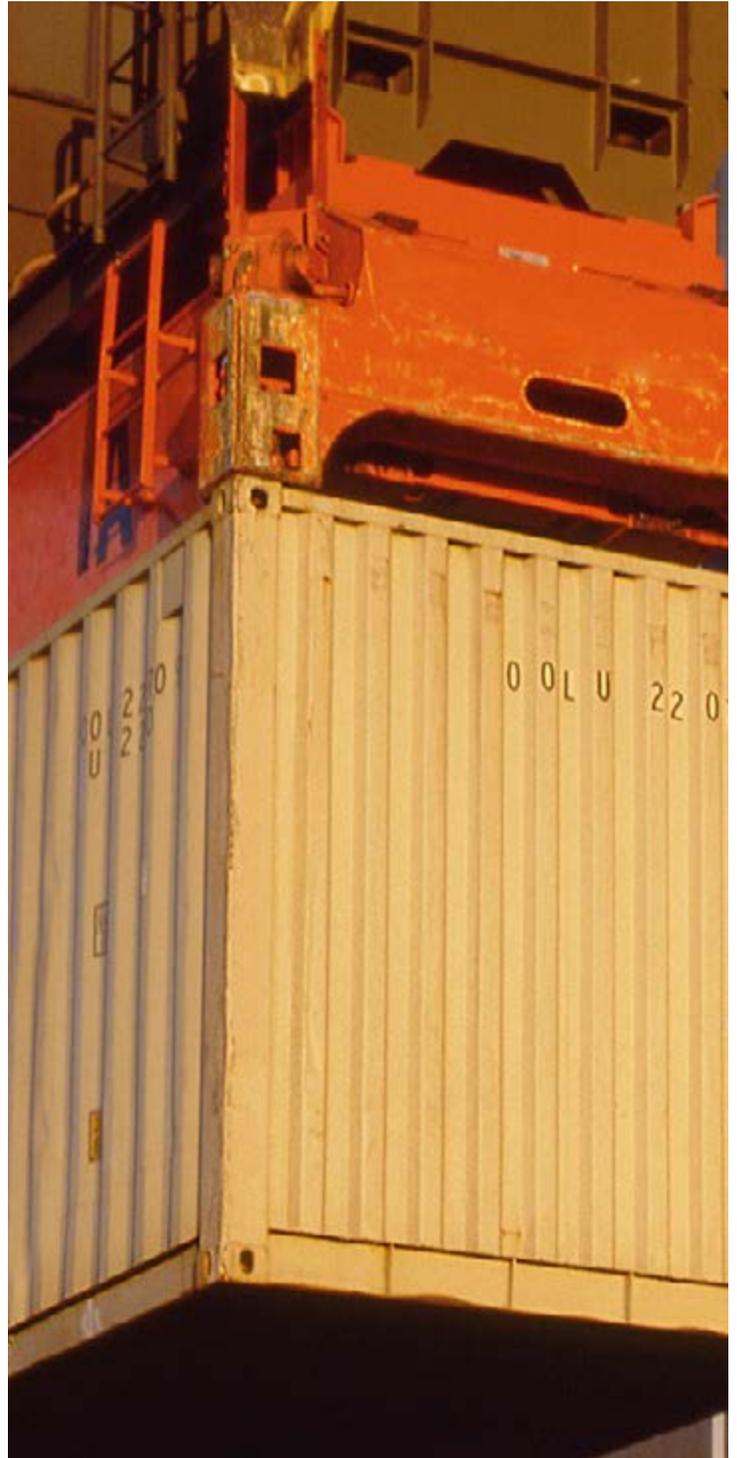
Interest group insight

Barbados Chamber of Commerce and Industry (“BCCI”)

BCCI notes that they were disheartened to see the removal of Group tax relief measures and the shortening of the life of tax losses by two years. This will pose a significant burden for some of the more diversified groups domiciled in Barbados.

Institute of Chartered Accountants of Barbados (“ICAB”)

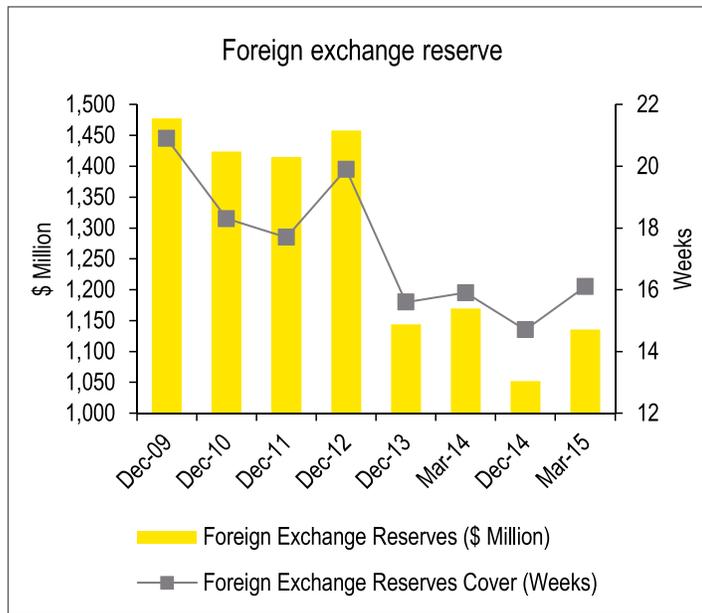
ICAB was pleased that Government proposed to raise the VAT filing threshold to BDS\$200,000 as this measure would ease some of the administrative burden on the Barbados Revenue Authority and small businesses and should hopefully reduce the processing time for tax administration.



Economic overview



This budget was delivered against the positive backdrop of an increase in long-stay tourism arrivals of 11.5% in the first three months of the year, compared with the same period in 2014. In addition, foreign exchange reserves appeared to be making a modest recovery subsequent to their downward trajectory in 2013.



Source: Central Bank of Barbados Economic Review March 2015

At the end of March 2015, reserves were BDS\$1,135 million or 16.1 weeks of imports, up from BDS\$1,052 million or 14.7 weeks of imports at the end of December 2014. In comparison, at the end of March 2014, the total reserves were 15.9 weeks of imports and BDS\$1,170 million in absolute dollars.

This would suggest a reduction in absolute reserves in March 2015 in comparison to March 2014. One would have to assume that a lower rate of consumption led to the increase in weeks' import cover.

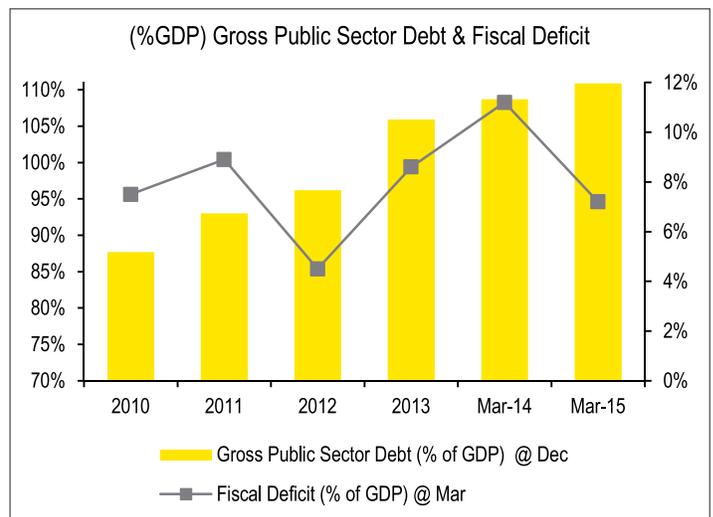
Barbados' fiscal deficit of 6.6% at the end of March 2015 is encouraging. This reduction was the first since 2012 and was attributed to the implementation of Government's various cost-cutting measures.

However, unemployment peaked at 12.7% at March 2015 in comparison to 11.7% at March 2014.

At 111%, gross debt-to-GDP continues to trend negatively and has increased each year since 2010. On 2 June 2014, Moody's Investor Services downgraded Barbados debt from Ba3 to B3 and Standard & Poor's from BB- to B on 19 December 2014.

In response the Minister spoke to debt management initiatives, the restriction of the deficit to projected GDP growth to curb any further increases in the debt, and the introduction of the low cost debt via CAF - Development Fund of Latin America.

Whilst the measures will hopefully reduce the cost of funding for new money and arrest the increase in debt, there were no specific measures identified for immediate reduction of principal.



Source: Central Bank of Barbados Economic Review March 2015



Budget commentary

Corporation tax

The Minister announced his intention to amend the Income Tax Act to remove the Group relief provisions and reduce the carry forward period for tax losses from nine years to seven years.

Group relief is a mechanism that allows Company X to apply its tax loss against the taxable income of Company Y so that the group suffers tax on the same amount of profit as if it had operated as divisions instead of as separate companies.

This regime saves the group cash tax and administrative costs. Its removal will result in increased cash flow requirements for Barbadian groups since, from 2015, Barbadian companies that generate taxable income within a group, will have to put aside cash to fund their tax payments. Loss making companies within the group could run the risk of their carry forward losses expiring before they can be used; this risk is heightened by the proposed reduction of the carry forward period from nine to seven years. Groups will therefore have to employ other methods to mitigate these risks.

Reduced tax loss carry forward periods are not new. Indeed, Barbados' tax rules in the 1980s saw tax loss carry forward periods of five years and seven years before settling on nine years. Many of our Caricom partners have loss carry forward periods that are lower than nine years.

No details were provided as to how this reduction will be implemented. We expect that losses incurred before 2015 would retain their nine year carry forward attribute, while tax losses generated in 2015 and beyond would have the seven year carry forward period.

We encourage the Barbados Revenue Authority to issue communications explaining how these measures will be implemented.

Income tax

The Minister proposed that from income year 2015, only the following deductions will be allowed along with the existing personal allowances (personal allowance of BDS\$25,000 or BDS\$40,000 [for pensioners], spouse allowance of BDS\$3,000 and child allowance of BDS\$1,000):

1. Contributions to trade unions and statutory associations;
2. Donations to charities including the church; and
3. Energy audit retrofits.

The foreign currency earnings allowance and the foreign tax credit will remain.

The harsh impact caused by removing these allowances and deductions is likely to cause an unfavorable response from the working class of Barbados. Essentially, this proposal will cause more of the income earned by individuals to be subject to tax.

The removal of the home allowance of BDS\$10,000 is likely to raise questions on the lack of encouragement to own a property as many middle class persons used this deduction as a means of affording their own home.

Additionally, we believe that many questions will be posed about the removal of the BDS\$10,000 tax deduction for planning and saving for the future using a registered retirement plan. This is extremely relevant in the context of the depletion of funds in the National Insurance Scheme.

In an attempt to soften the blow, the Minister has proposed a reduction of the higher personal tax rate of 35% down to 33.5% and the lower band of 17.5% down to 16%. However, as can be seen in the calculation below, the overall impact of this reduction in rates is negligible in comparison to the increased taxation resulting from the removal of allowances.

It is interesting to note that these measures are also expected to result in a reduction of 60% of the total tax refunds processed by the Barbados Revenue Department.

Budget commentary cont'd

Personal Tax Changes										
		2014				Proposed 2015				Increase/ (Decrease)
Employment Income										
Salary		75,000.00				75,000.00				
Total Income From Employment		75,000.00				75,000.00				0.00
Allowances										
Personal allowance		(25,000.00)				(25,000.00)				
Child allowance- 2		(2,000.00)				(2,000.00)				
Spouse allowance		(3,000.00)				(3,000.00)				
		(30,000.00)				(30,000.00)				
Assessable Income		\$45,000.00				\$45,000.00				0.00
Deductions										
Donations to Registered and Exempt charities		(5,000.00)				(5,000.00)				
Home Improvement		(10,000.00)								
Approved provident or Superannuation Fund Contribution		(3,500.00)								
Registered Retirement Savings Plan Contributions		(3,250.00)								
		(\$21,750.00)				(5,000.00)				
Taxable Income		23,250.00				40,000.00				16,750.00
Total Tax Payable										
		Rate				Rate				
	First	35,000.00	17.5%	\$4,068.75	First	35,000.00	16.0%	5,600.00		
	Excess		35%	\$0.00	Excess	5,000.00	33.5%	1,675.00		
Annual Taxes Payable		4,068.75				7,275.00				3,206.25



Budget commentary cont'd

VAT

The Minister has announced several changes to the Value Added Tax ("VAT") regime, some of which were recommended by the International Monetary Fund in their August 2014 report.

Zero-rated food items

The most notable change to the VAT regime was the removal of several food items from the zero-rated basket of goods. As a result of this proposed change, VAT will now apply to many of the previously VAT-free goods at the rate of 17.5%.

While the removal of some of the items can be justified, we expect that consumers will be concerned by the removal of several significant items such as:

- ▶ baby formula;
- ▶ frozen flying fish fillets;
- ▶ certain categories of pork and parboiled rice;
- ▶ certain fruits and vegetables.

Registration threshold

In addition, the VAT registration threshold will be increased from BDS\$80,000 to BDS\$200,000. As a result, many of the small businesses in Barbados will no longer meet the requirements for VAT registration and the overall number of registrants should be reduced.

The intent of this change is to make the overall administration of the regime easier.

However, persons who are not VAT registered may not reclaim any VAT that they may incur in their operations. These small businesses will not bear this VAT and will likely pass this cost on to consumers.

It also remains to be seen whether current registrants who do not meet the new threshold will be automatically de-registered or will be given the choice as to their registration status.

Gambling

The Minister announced that betting and gaming services will no longer be VAT exempt. Therefore VAT at the rate of 17.5% will now apply to all bets, as well as, lottery and instant money tickets.

While this change may curb consumer spending on betting and gaming services, persons offering these services will now be able to reclaim any VAT that they incur in their operations.



Budget commentary *cont'd*

Increase in land tax rates

The Minister proposed a variation in the residential land tax bands. In addition to these changes, commercial property will be subject to an increased rate of 0.70% of improved value from 2015.

The table below shows the changes to the land tax bands with respect to residential property with an improved value of BDS\$500,000 since 2010.

Description	Tax Rate	2010
Property value		\$ 500,000
Tax on Property up to \$150,000	0%	\$ -
Tax on next \$250,000	0.10%	\$ 250
Tax on the next \$600,000	0.45%	\$ 450
> \$1,000,000	0.75%	
	Total Tax Liability	\$ 700
Description	Tax Rate	2011 - 2014
Property value		\$ 500,000
Tax on Property up to \$190,000	0%	\$ -
Tax on next \$310,000	0.10%	\$ 310
Tax on the next \$750,000	0.45%	\$ -
> \$1,250,000	0.75%	
	Total Tax Liability	\$ 310
Description	Tax Rate	2015 (Proposed)
Property value		\$ 500,000
Tax on Property up to \$150,000	0%	\$ -
Tax on next \$300,000	0.10%	\$ 300
Tax on the next \$550,000	0.45%	\$ 225
> \$1,000,000	0.75%	
	Total Tax Liability	\$ 525

The effect for residential land owners is that property values exceeding BDS\$150,000 but not exceeding BDS\$190,000 will be subject to land tax for the first time since 2010.

Although the actual tax rates have not changed, the shift in the bands for 2015 will result in a land tax increase for residential land owners. The Minister has not indicated whether the land tax cap of BDS\$60,000 will remain in force.

These changes, together with the increase in the commercial land tax rate, will yield additional Government revenues of BDS\$44 million. The Minister anticipates that this will not be any more burdensome upon the taxpayer given the abolition of the Municipal Solid Waste Tax.

Excise on mobile minutes

The Minister proposed an excise duty on mobile airtime minutes - a suggestion also featured in the International Monetary Fund ("IMF") Tax Reform Roadmap for Barbados. The proposed excise rate is BDS\$0.03 per minute.

Statistics from the Telecommunications Unit show that about 1.1 billion mobile minutes were consumed in Barbados last year. On these figures, a BDS\$0.03 per minute excise duty is expected to produce about BDS\$33 million in revenue on an annual basis.

An airtime excise can present logistical challenges. For instance, policy makers would need to decide who will pay the excise, or whether the tax will be suffered by both the caller and recipient of the call. They will further need to determine whether the tax will apply to promotional or "free" minutes, or to calls related to other network services (such as calls to check voicemail, obtain customer service, check balances, or toll free calls).

In addition, policy makers need to consider the practical and transparency challenges for both operators and consumers. One suggestion is for the tax to be charged on a per-second basis to reflect the manner in which mobile minutes are currently billed. We note, however, that there may also be different challenges in applying the excise tax in prepaid and postpaid scenarios.



Budget commentary *cont'd*



In light of the above, we encourage the tax authorities to consult with the existing mobile operators who are likely to have the most valuable insight for implementing this proposed tax.

We also note that it is typical for excise duties to be included in the value of a supply on which VAT is charged. The Minister did not address the increased VAT revenue directly, but the IMF Tax Reform Roadmap specifically noted this.

We project that the additional VAT revenue on the airtime excise tax to be BDS\$0.00525 per minute, or BDS\$5.7 million in additional annual VAT revenue.

Fuel cess

The Minister proposed the transfer of fuel cess revenues to pay down the QEH arrears due to suppliers.

This cess on all fuel products sold by the BNOC raised in excess of BDS\$35 million dollars annually over the past 5 years.

It is the Government's intention to permit the company to continue to collect the cess on fuels for at least one more year.

We understand that this proposal would allow for the QEH's suppliers to finally recover arrears due to them. However, use of taxes from the sale of petroleum products is no doubt an unconventional method to settle the QEH's debts.

Excise on sweetened beverages

Citing the escalating incidence of diabetes and other non-communicable diseases in the country, the Minister has proposed a new excise tax on sweetened beverages. These include carbonated soft drinks, sweetened juices, and sports drinks, regardless of whether these drinks are imported or produced locally.

This excise tax will be levied at the rate of 10% of the value of the item before VAT, resulting in an after-VAT increase of 11.75% on the price of such beverages. However, beverages containing natural sugars only, such as 100% natural fruit juice, coconut water, and plain or evaporated milk will not be subject to the excise tax.

Budget commentary *cont'd*

The Minister is hopeful that this additional tax will help to reduce the consumption of sweetened beverages in the island, by encouraging consumers to choose healthier alternatives while producing additional tax revenue for the Government.

While admirable, the success of this measure will depend on healthy alternatives being available at a cheaper cost. In the absence of cheaper and healthier alternatives, the consumption of sweetened beverages may only be marginally affected by this tax.

Tipping fees

The Minister proposed to keep the controversial Tipping fee in place. The fee is to be set at BDS\$40 per load for all categories of waste tipped at the Waste Treatment Facility inclusive of municipal solid waste, rock and soil/construction and demolition waste, green waste and coconuts.

Liquid waste delivered to be handled by the Sanitation Service Authority will also be subject to the tipping fee of BDS\$40.

It is interesting that the Tipping fee has been changed from the much debated BDS\$25 per tonne to a more palatable BDS\$40 per load. A load may consist of several tonnes of waste. Therefore, there has been a considerable reduction to the possible fees faced by a waste hauler on a given day.

The Minister took care to indicate that all Waste Haulers who intend to tip waste at the appropriate facilities must register and be licensed by the Sanitation Service Authority. Moreover, as has been the case with many proposals in this presentation, a tax clearance must be obtained from the Barbados Revenue Authority to enable registration and licensing.

It remains to be seen whether this adjustment to the Tipping fee will meet the requests of the Waste Haulers who have voiced extreme protest against the imposition of the fee.

Professional licences and tax clearance certificates

Professionals in Barbados who must obtain annual licences under the Profession, Trade, and Business Registration Act will now be required to produce a valid tax clearance certificate from the Barbados Revenue Authority before their licence is renewed.

This measure seeks to ensure that persons who are liable to pay tax do so. However, this measure is likely to result in a burdensome volume of requests for tax clearance certificates in the weeks before the renewal deadline.

Given the penalties associated with the late renewal of professional licences, the proper resources must be put in place to allow the Barbados Revenue Authority to issue these tax clearance certificates in a timely manner.

In addition, professional licences are renewed in January each year while personal tax returns are filed at the end of April. Therefore an issue arises in respect of the timing of these tax clearance certificates, since a professional renewing their license in 2016 will not be able to obtain a clearance certificate for the previous income year until after their return has been filed in April 2016.



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