

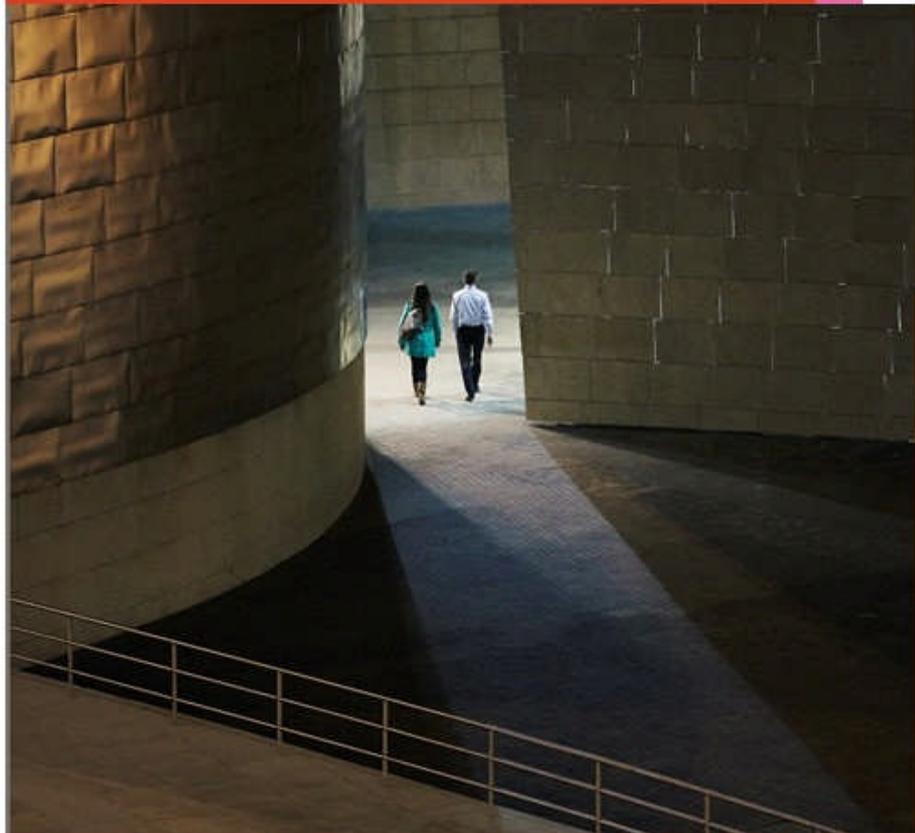
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# *Tax News*

Is there light at the  
end of the tunnel?

Barbados Budget

May 30, 2017



**pwc**

# *Is there light at the end of the tunnel?*

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Last night Minister of Finance, the Hon. Christopher Sinckler delivered his long anticipated budget address to the nation. In his opening remarks, the Minister acknowledged that despite some progress in facing down many challenges, including the recent growth in the tourism sector, the state of the economy was not yet where it should be in order to maintain the quality of life and standard of living that Barbadians have come to expect. He noted that immediate actions were therefore needed to maintain the balance between the social fabric of our society and effective fiscal prudence.

In August 2016 the Executive Board of the International Monetary Fund (IMF) concluded its Article IV consultation with Barbados. While welcoming the pickup in economic growth led by the tourism sector and the improvement in the external position, the Directors stressed that continued fiscal adjustment and public sector reforms were necessary to bring public debt down, preserve external sustainability, and improve investor sentiment. They also underscored the need for actions to eliminate impediments to stronger long-term growth and to bolster competitiveness.

The Board stressed that stronger efforts were needed to reform state-owned enterprises through better governance, consideration of user fees and potential divestment and consolidation of public entities, calling for swift action to eliminate government arrears.

Finally it was emphasised that the continued financing of the fiscal deficit by the Central Bank of Barbados (CBB) is inconsistent with maintenance of the exchange rate anchor.

Yesterday's budget measures sought to address each of these areas and in particular the fiscal deficit, which Minister Sinckler noted was now "public enemy number one".

## **Fiscal deficit**

In setting the context for the fiscal adjustment the Minister observed that, if at any point in time, the cost of providing critical public goods and services exceeded the capacity of the Government to finance them, then the options would be to reduce the level of services or to raise the revenue to meet the required cost.

He went on to say that while it was recognised that urgent attention is required to the structural changes in our economic and social systems, such change should only be done after widespread consultation with all Barbadians. As such, while the current budget would only address the short-term fiscal and financial challenges necessary to maintain monetary and economic stability, the medium- and longer-term adjustments would be reflected in a comprehensive **National Fiscal, Economic and Social Development Restructuring and Enhancement Programme**. The programme is to be issued in the next few months and the intention is to have it available for extensive consultation with the public prior to implementation by the Government.

The main areas of focus of the proposed programme would be:

- boosting foreign exchange earnings through creating more attractive conditions for foreign direct investment;
- reducing the cost of doing business in critical sectors (agriculture, manufacturing and tourism) and finding mechanisms to capitalize emerging sectors;
- instituting a Competitiveness Commission and Operational Unit to improve output and efficiencies in key agencies;
- implementing a new national energy policy to accelerate the use of alternative energy;
- public financial management reform including a new Financial Management and Audit (SOEs) Act to govern the financial affairs of government statutory boards and enterprises;
- State Owned Entity reform, including mergers, operational consolidation and divestment;
- completing the tax policy reform and tax administration upgrade project including the final transition of Customs into the Barbados Revenue Authority (BRA) and the implementation of a single taxpayer IT system;
- debt growth stabilisation and reduction through fiscal reform and debt management enhancement including debt profiling; and
- social sector reform in critical areas such as health, education, sanitation, social care services and environmental protection.

## Financing and foreign reserves

The Minister noted that Government was likely to encounter further financing and foreign exchange challenges in the coming year.

The Government has committed to reducing its reliance on CBB financing and the commercial banks have reduced their holdings of government paper – despite the increase in the mandatory securities reserve. The Government is also facing financing pressures from meeting the debt obligations of some of its SOEs such as the Barbados Agricultural Management Company (BAMC).

In respect of net international reserves, these have steadily declined over the past seven years, thus limiting Government's ability to meet its external debt service requirements while retaining a contingency for unexpected demands and unexpected external shocks. Government has increased its borrowing from the multilateral agencies (as an alternative to the international capital market). However, after successfully securing these concessional flows, administrative and other unforeseen delays have limited the timely disbursement of the foreign exchange flows into the economy.

## Budgetary proposals - Revenue

### National Social Responsibility Levy

The National Social Responsibility Levy (NSRL) was introduced on September 1, 2016. It was imposed on goods imported into Barbados and on domestically manufactured goods. Effective July 1 the rate will increase from 2% to 10 %.

### Commission on Foreign Exchange Transactions

Effective July 1, a commission rate of 2% is to be charged on the sales of all foreign currency. This will extend to all wire transfers, credit card transactions, and over the counter sales of foreign currencies.

### Excise tax on gasoline and diesel

Effective June 1 the excise tax on gasoline will be increased by 25 cents per litre from \$0.74 to \$0.99 and on diesel by \$0.24 from \$0.20 to \$0.44.

## Budgetary proposals – Divestment of Assets

The Minister noted that the proposed sale of the Barbados National Terminal Company Ltd. (BNTCL) is now awaiting final regulatory approval from the Fair Trading Commission (FTC) of Barbados.

It is expected that this should take effect during the current financial year and is expected boost foreign reserves by \$100m and revenue by \$70m.

He also announced Government's intention to divest the Hilton Hotel at Needham's Point which is owned by a company in which the Government of Barbados is majority shareholder. It is estimated that Government would receive \$100m for its interest in the Hilton.

## Budgetary proposals - Expenditures

### Debt profiling

A significant proportion of government securities is held by the CBB and the National Insurance Scheme (NIS). The Minister noted that the two agencies were exploring a possible swap programme that would result in a possible \$70m reduction in interest costs to Government.

### Across the board reduction

The Minister reported that Cabinet has approved an across the board 10% cut in the existing approved Estimates of Expenditure for the financial year 2017-2018. It is estimated that this will yield an additional \$82m in savings.

The budgetary proposals in total account for an additional \$542 million, as a result of increased revenues, expenditure savings and divestment proceeds. Therefore with the revised deficit of \$537.6 million, the new measures should effectively lead to a small fiscal surplus of \$4.4 million.

## Our view

We compliment the Minister for delivering a budget that addresses the fiscal deficit, foreign reserves and financing of Government's operations. However we have the following observations:

- there was limited focus on growth initiatives;
- the proposed 2% commission on foreign exchange transactions may send the wrong signal to the market around the effective value of the Barbados dollar;
- a more broad-based policy signal to divestment of state-owned assets was expected;
- there were very limited details on proposed expenditure reductions; and
- there were no proposals to implement measures to improve business facilitation.

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## ***Budgetary proposals in summary***

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### ***National social responsibility levy***

The Minister announced that with effect from July 1, 2017 the rate for the National Social Responsibility Levy (NSRL) will increase from 2% to 10%. It is anticipated that this will result in increased revenue of \$291 million for a full financial year and \$218 million for the remaining nine months of the current fiscal year. The NSRL was introduced on September 1, 2016 and was imposed on goods imported into Barbados and on domestically manufactured goods. The NSRL is expected to generate \$186 million and additional VAT \$32 million.

#### ***Comments***

The levy was designed to finance the increased cost of health care on the island and to assist with maintaining a clean environment, which is critical not only to Barbadians, but for the survival of our tourism industry. The levy is a preferred method of revenue generation because it exempts critical sectors, is charged predominantly at the port on imports, and compounds the VAT for additional coverage. It can also have a dampening effect on imports, by shifting consumption patterns more towards domestic consumption and production, hence reducing the demand for foreign exchange.

The increase in the levy should assist Government in meeting some of its stated objectives, including a reduction in the demand for foreign exchange and a narrowing of the fiscal deficit. The expected reduction in demand for foreign goods should result in increased local production giving rise to higher levels of employment.

However, the increase in the rate of the levy from 2% to 10% is significant and would result in an increase in the cost of living to the consumer and, by extension, to the rate of inflation. Since the levy is an indirect imposition it would be considered to be a regressive method of taxation, as it also places more burden on the most vulnerable in the society. Measures may be required to ease the burden on the

most vulnerable, in an already challenging environment.

Although the levy has been implemented since September 2016 and is currently being paid on imports and domestic manufactured output, the bill to enact it has not yet been legislated.

In its current form the bill includes no exemption from this levy for entities licensed to carry on international business, despite the fact that these entities are exempt from custom duties on the importation of most plant, machinery, spare parts and raw materials.



### ***Commission on the sale of foreign currency***

The Minister has proposed the imposition of a commission on foreign currency transactions executed by authorised dealers at the rate of 2%, payable to the CBB. This commission is expected to commence on July 1 and will be levied on transactions such as “wire transfers, credit card transactions and over the counter sale of foreign currencies”.

## Comments

This measure is intended to dampen demand for imported goods and reduce the outflow of foreign exchange. It is likely to cause an increase in the rate of inflation.

While this measure will be viewed negatively by many businesses and consumers alike, it is a move in the right direction by the Government to increase and stabilise the foreign currency reserves. These reserves are at a perilously low level of approximately 11 weeks of import cover.

This charge is not unlike the 1% fee imposed on similar transactions in the 1990's. Further clarification will, however, be required as to the exact mechanism for the collection and remittance of the commission to the CBB.



## Excise taxes

The Minister has proposed that excise tax on gasoline and diesel fuels be increased effective June 1, 2017. The excise tax on gasoline will be increased by \$0.25 from \$0.74 to \$0.99 per litre, while that on diesel will be increased by \$0.24 from \$0.20 to \$0.44 per litre.

## Comments

This increase in fuel prices will result in Barbadians paying \$3.05 per litre for gasoline and \$2.25 per litre for diesel. This measure is directly related to the Government's strategy to reduce its fiscal deficit and is not related to an increase in the price of fuel on the international market.



## Extension of tax amnesty

The Minister has proposed yet another tax amnesty to be applied for the period June to November 30, 2017. This amnesty will, however, only benefit taxpayers who have arrears of land tax and value added tax. The Minister has proposed that all penalties and interest on these taxes be waived and that the proceeds thereof be directly applied to the payment of tax refunds owed to taxpayers.

## Comments

Another tax amnesty will be welcomed by taxpayers who have experienced difficulty in clearing their arrears of VAT and land tax. The Minister did not indicate a time frame for the payment of outstanding principal, nor did he give a cut off period on the calculation of the penalties and interest. However, he stated that the programme will mirror that of the previous tax amnesty and that the rules governing its implementation will be published by the BRA in due course. We also hope that the funds collected will be used expeditiously by the Barbados Revenue Authority to issue income tax refunds to tax payers as promised.



## VAT factoring

The Minister has proposed that the Barbados Revenue Authority (BRA), the Ministry of Finance and Economic Affairs, the Treasury and the CBB meet to design a simple but effective VAT factoring program. The Minister indicated that the details of the program would be revealed shortly and that he hopes for commencement before October this year.

## Comments

The delay in the payment of VAT refunds has negatively impacted the cash flow, profitability and sustainability of many businesses. If this type of program is formalised, the current obligation to pay VAT refunds owed to taxpayers would be assigned to third parties. These third parties would be responsible for the refunding of VAT to taxpayers in place of the Government.

Given the current economic climate, it may be difficult to encourage financial institutions to enter into this type of arrangement, since it requires future compensation by Government and such institutions may not want to take on more Government debt. On the other hand, some businesses across Barbados would benefit greatly from this initiative if it could be implemented successfully.

The CBB currently has a similar program called the Value Added Tax Receivables Liquidity Facility, which is for the purpose of guaranteeing settlement of refunds owed by the BRA to small businesses. However, the number of steps involved in the current process have made it difficult to use and as such its effectiveness has been limited.



## *Debt re-profiling*

The Minister advised that debt service costs are the fastest growing item in the Government's expenditure budget. He stated that any intensive fiscal consolidation program should therefore include mechanisms to lower interest costs over the short, medium and longer terms.

The Government has commenced the process of fully examining its portfolio of short and longer term security instruments in order to determine where and how profiling of the interest on some of its securities may be achieved. The Minister further stated that discussions had commenced between the NIS and the CBB, the two Government entities owning significant portions of Government securities, with the goal of a possible swap program. Such a program would see these Government related entities reissuing some existing securities in their portfolios at lower interest rates as agreed to by the parties.

### **Comments**

This measure is expected to result in savings of \$70 million on interest expense, part of which is earmarked to assist with the liquidation of outstanding arrears to NIS. Should the initiative be successful, the resulting savings would be welcomed, however, the question arises as to whether these gains will be enough to significantly reduce the large debt owed to the NIS.

## Let's talk

If you have any further questions in connection with the above or would like to explore how these budget pronouncements may impact your business or personal arrangements, please feel free to contact any member of our specialist tax team listed below or your usual PwC contact.



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