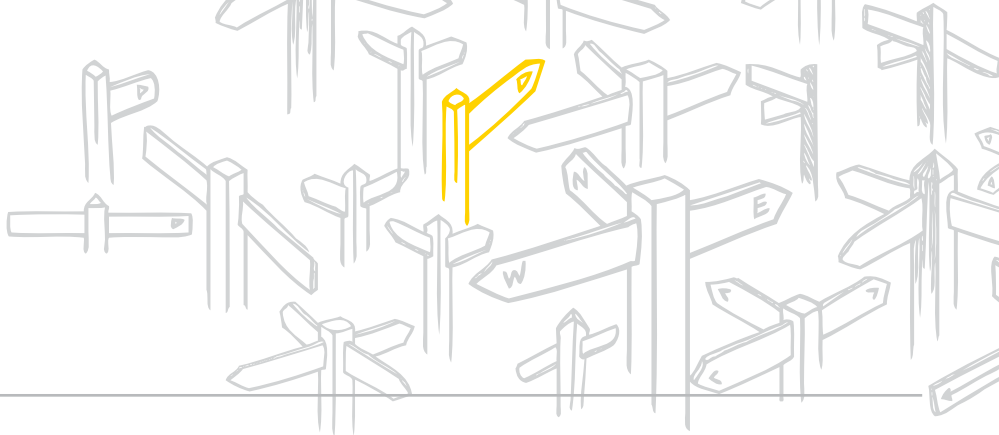


Focus on Barbados Budget 2011



Executive summary



Barbados: Stuck at the crossroads

The Honourable Minister of Finance Christopher Sinckler presented his Financial Statement and Budgetary Proposal for 2011 on 16 August 2011. Mirroring the style of his inaugural presentation, the Minister spoke of fiscal pressures across the globe and measures introduced in the United States and Britain, where the changes implemented by Governments have resulted in “hobbled” economic recovery. In comparison, the Minister spoke of the signs of economic turnaround in Barbados.

Real growth in GDP for the first half of the year was estimated at 2.1% as at June, compared to negative 1% for the same period in 2010. The growth in GDP was driven primarily by tourism and secondarily by construction and other non-tradable sectors.

The recent winter season saw a turnaround with increased tourist arrivals of approximately 5%. However, the fall in actual spending by tourists meant that there has been no real growth in the foreign exchange reserves. Given that the global economic climate continues to be subdued, one can expect no significant real future growth in our foreign exchange reserves resulting from tourism. The Government may have to consider alternative measures to shore up the foreign currency reserves to maintain the 20 weeks of import cover, which is well over the 12 week threshold deemed desirable under prudent standards. Unemployment fell to 10% as at June 2011, which was down from 10.5% as at December 2010.

The international business sector saw an increase of 4% in the total number of international business companies operating in Barbados between January and May of 2011. The Minister has committed to improving the sector by working with the Barbados International Business Association (“BIBA”), Invest Barbados and updating related legislation in light of fierce competition by other offshore jurisdictions resulting from the introduction of Tax Information Exchange Agreements. The reaping of benefits from these initiatives will take time. Immediate action is necessary.

There were two real choices for the Minister - raise taxes or decrease expenditure. Last year, taxes were raised but it did not yield the desired result. This year, taxes were raised on the middle class yet again by virtue of the inability to set-off losses from business income against income from employment. There were no substantive measures tabled which would result in decreased expenditures.

Based on the Central Bank’s press release on the Barbados economy as at June 2011, both direct and indirect tax receipts have declined based on the April to May receipts for 2011, when compared to the same period in 2010. The Value Added Tax (“VAT”) rate increase from 15% to 17.5% in November 2010 was expected to result in increased VAT receipts, but receipts for April to May of 2011 have declined by just over 2%, which suggests that business recovery may be lagging.



Executive summary cont'd

The key fiscal measures outlined by the Minister are as follows:

- ▶ Land Tax - An increase in the tax bands, while maintaining the current rate structure, against the backdrop of a recent revaluation of properties in Barbados
- ▶ Employment income and business losses - effectively a potential increase in the tax burden for the middle class
- ▶ Occupational Pension Benefits Act - correction of anomalies
- ▶ Penalties and Interest for late filings - an amnesty period to encourage payment of overdue taxes
- ▶ International Business - revamping of legislation
- ▶ Manufacturing - tax rebates for "green" investments
- ▶ Agriculture - tax rebates for "green" investments and lower cost loans

Lower tax receipts, a lagging business recovery, a budget which does not highlight any major reductions in Government expenditure and a Gross Central Government Debt to GDP ratio of 103% (see table below) as at June 2011 threatens to derail the Government's medium-term growth strategy.

Financial Year	Debt Outstanding (BDS\$ Million)	Debt-GDP Ratio	% Change (Debt-GDP Ratio)
2005	4,987.3	68%	N/A
2006	5,482.7	71%	4%
2007	6,229.4	77%	9%
2008	6,658.9	84%	8%
2009	7,517.4	97%	16%
*2010	8,393.3	102%	6%
**2011	8,738.6	103%	1%

* Figures included are provisional

** Figures included are provisional and are up to June 2011

Two years ago on the same occasion, we wrote, *"The opinions of the economists on the length of the global crisis are varied and the budget proposals seem to adopt a "wait and see" approach. The question now to be answered is, "in the absence of significant measures in this year's budgetary proposal, are those previously presented sufficient to weather the global economic storm?"*

The question remains unanswered ...

Budget commentary



Land tax

The Minister of Finance proposed changes to the bands for the application of land tax as follows:

Existing bands		Proposed bands		Change in improved value
Rates	Improved value	Rates	Improved value	
0% on first	\$150,000	0% on first	\$190,000	\$40,000
0.10% on next	250,000	0.10% on next	310,000	60,000
0.45% on next	600,000	0.45% on next	750,000	150,000
0.75% on excess over	\$1,000,000	0.75% on excess over	\$1,250,000	\$250,000

Comment

The expansion of the land tax bands is a welcomed change given the recent land tax valuations which have resulted in marked increases in the improved values of properties on the island. However, it is interesting to note the magnitude of the savings. The table below shows the net savings in the land tax liability of BDS\$360 per annum for a residential property with an original improved value of BDS\$540,000 which was increased in the recent valuation to BDS\$600,000. However, in cash terms, homeowners will have a small reduction in their land tax in 2011 of \$30 when compared to 2010. It is clear to us that this rate change is a response to the public outcry to the increased valuations in a stagnant real estate market.

Rates	Before	After	Rates	After	Increase in improved value
Improved value	\$540,000	\$620,000		\$650,000	15%
Tax on first \$150,000	-	-	Tax on first \$190,000	-	
Tax on next \$250,000 @ 0.10%	\$250.00	\$250.00	Tax on next \$310,000 @ 0.10%	\$310.00	
Tax on the next \$600,000 @ 0.45%	\$630.00	\$990.00	Tax on the next \$750,000 @ 0.45%	\$540.00	
Total land tax	\$880.00	\$1,240.00		\$850.00	
Increase in land tax without change in bands				\$360.00	
Reduction in tax resulting from change in bands				(\$30.00)	



Budget commentary *cont'd*

Employment income and business losses

Under the present income tax rules, losses arising from business income can be offset against other sources of income, including employment income. The Minister proposed to amend the Income Tax Act to prevent the offsetting of business losses against other sources of income.

Comment

To illustrate the impact of this measure, assume that a taxpayer earns \$80,000 in employment income, has incurred a loss of \$8,000 from operating a small farm and claims the basic personal deduction of \$25,000 per annum. The table below shows that the total taxes paid under the existing tax rules would be \$12,820. However, without the ability to offset the business loss as proposed, the taxpayer must pay an additional \$2,800 in income taxes per annum.

	Existing	Proposed
Employment Income	\$ 80,000	\$ 80,000
Business loss	(8,000)	-
Assessable Income	72,000	80,000
Personal allowance	(25,000)	(25,000)
Taxable income	47,000	55,000
Tax at 20% of \$24,200	4,840	4,840
Tax at 35% on balance	7,980	10,780
Total taxes	12,820	15,620
Additional tax due		\$ 2,800

While this measure is in line with the tax legislation of many other territories, including some of our Caribbean neighbours, it will raise the tax burden borne by the middle class, which is already facing an increased tax bill owing to the removal of the tax free allowances for travel and entertainment, as well as, the removal of the allowances for investments in credit unions and mutual funds.

The Occupational Pension Benefits Act 2003 (the "OPB Act")

The OPB Act was proclaimed on February 2011 at the same time that the Regulations were issued and became effective. With the introduction of this Act, the Income Tax Regulations were repealed. Prior to repeal, the Regulations provided that not more than 25% of the pension benefits payable could be paid in the form of a tax-free lump sum to a pensioner. The Minister proposed to re-instate the repealed Income Tax Regulation with effect from 15 February 2011.

Budget commentary *cont'd*



Comment

The reinstatement of the repealed Income Tax Regulation retroactively to 15 February 2011 will remove the uncertainty being faced by persons retiring during 2011 as to the tax treatment of lump sum payments.

However, the tax treatment of the special payments to fund solvency deficiencies for pension plans which are required under the Act is unclear. The current income tax legislation only provides for the deduction for tax purposes of special contributions for past service costs arising on the initial introduction of a pension plan. It is hoped that the planned review of the domestic tax regime will deal with the tax treatment of such special payments.

Penalties and interest for late filing

- ▶ In 2009, the Government granted relief to employers and self-employed persons by way of a waiver of 50% of the total penalty and interest owed in respect of National Insurance, Income Tax, Land Tax and Value Added Tax. The waiver was scheduled to come to an end in December 2009. The waiver was then extended in the 2010 Budgetary Proposals to 1 December 2011. This waiver has now been further extended so that 100% of outstanding penalties and interest will be waived if 80% of the amount due is paid in full by a one-off cash payment. This waiver will end on 31 December 2011.
- ▶ The late filing penalty of BDS\$100 for failure to file corporation or personal tax returns has been increased to BDS\$500 for all taxpayers. However, individuals who have failed to file personal tax returns for any period prior to income year 2007 would also benefit from the conditional amnesty. Consequently, where 80% of the taxes due are paid by way of a one-off cash payment, all penalties and interest due, apart from the BDS\$500 penalty for each late filing, will be waived.

Comment

This measure appears two-fold. First, it is aimed at encouraging taxpayers to bear their portion of the tax burden by filing and paying their taxes. This will encourage the inclusion of more taxpayers in the system. To be the most effective, a campaign alerting taxpayers to the amnesty should be mounted. However, this measure is also aimed at satisfying international organizations, such as the Organisation for Economic Cooperation and Development (OECD), that Barbados qualifies to be on the list of countries that has been found to have implemented the internationally agreed standard for the exchange of tax information on the basis that there is general compliance in the filing of tax returns. Given the objectives and, more importantly, the negative effect of the failure to meet the objectives, it is hoped that this measure will have the desired effect.



Budget commentary *cont'd*

International business

International business legislation

The Government is seeking to introduce the following legislation:

- ▶ Amendments to the Society with Restricted Liabilities Act to effect merger between these entities;
- ▶ Enactment of Foundation legislation which would put Barbados on competitive footing with Panama, Malta and the Bahamas;
- ▶ Amendments to the Companies Act and if necessary the Securities Act;
- ▶ Amendments to the International Corporate and Trust Providers, Companies Act and the finalization and laying of the accompany regulations;
- ▶ Amendments to the Companies Act to allow for the incorporation of companies with Chinese names along with an English equivalent in order to attract more businesses from Asia;
- ▶ Enactment of Private Trust Company Legislation.

Comment

The introduction of the above legislation will increase Barbados' attractiveness as a jurisdiction for conducting international business. However, Government still needs to address, as a matter of urgency, the issues relating to the long delays in the drafting and enactment of legislation which could severely hinder our efforts in achieving a competitive advantage vis-a-vis other international business centres.

Multi-year license

The Minister has announced that the Ministry of Finance has invited the Attorney General's Office to work alongside the International Business Unit to devise a multi-year license in one go with an appropriate discount to do so.

Comment

This proposal is welcomed. However, Government will need to put in place the necessary mechanisms to ensure that the relevant due diligence procedures continue to be conducted with respect to international business entities that are granted the multi-year licence so as to ensure that Barbados continues to adhere to international regulatory standards.

Budget commentary *cont'd*



Rate structure

Government, through the appropriate agencies and in conjunction with BIBA, will review the entire rate structure with a view to looking at areas that might be in need of intervention. This will ensure that Barbados as a jurisdiction remains relevant while not unduly affecting our revenue intake.

Comment

This proposal is welcomed.

Tourism

- ▶ With effect from tax year 2011/2012, hotels and stand alone restaurants that qualify as approved tourism products will be allowed to pay their land tax bills during the last quarter of the fiscal year i.e. January to March, while continuing to qualify for prompt payment discounts.
- ▶ Effective income year 2012, the taxes applicable under the Tax on Remittances Act on the remittance of premiums to non-registered insurers by local businesses offering tours and attractions to cruise visitors will be removed.
- ▶ The Value Added Tax Act will be amended to allow for the supply of timeshare properties to be treated as zero rated supplies. This would allow for the recovery of input VAT on the purchase of local goods by entities that are in the business of selling timeshare properties.

Comment

At present, the payment of land tax is due at a time when the cash flow of hotels and restaurants is at its lowest. The proposal to make payments between January to March would assist the cash flow of such operations. However, it is recommended that this benefit be accessible not only by hotels and restaurants but any activity that benefits from the provisions under the Tourism Development Act.

The removal of the tax on remittances would provide some relief for those businesses, as it is perceived that they would have borne the burden of this tax thereby ensuring that the foreign insurers receive the full amount of the premium. The amendment of the VAT Act to allow for the recovery of input VAT in respect of the sale of timeshare properties is a good step as it allows for a rectification of an anomaly in the legislation where the intent was evidently based on the provisions of the Tourism Development Act.



Budget commentary *cont'd*

Manufacturing

- ▶ Effective 2012/2013, approved manufacturers who can certify exports of BDS\$100,000 or more in a calendar year will be entitled to a 50% rebate of land tax which will be based on the tax demanded and not on the improved or site values of the properties.
- ▶ Effective 2012/2013, entities certified by the Division of Energy as being engaged in the production of solar energy or solar energy equipment will also qualify for the 50% rebate of land tax.
- ▶ Duty free concessions offered to the hotel and manufacturing sector on the importation of electric water heaters will be removed.
- ▶ Effective 1 September 2011, all parts imported into Barbados for the assembly of personal computers will be free of import duties and VAT.

Comment

While the above rebates may go some way in assisting the struggling manufacturing sector, in view of the high cost of doing business in Barbados, it is unlikely that this alone will serve to stimulate this ailing sector. One wonders whether the removal of the concession on electric water heaters will significantly impact the level of foreign exchange reserves, as suggested. It is also left to be seen whether the removal of import duties and VAT on computer parts will reduce the unemployment rate as hoped.

New economy

The Minister expounded the virtues of a new economy which would introduce new areas of economic activity in the form of foreign currency and employment generation. To this end, the Minister stated that the new economy would be built around:

- ▶ Increasing Barbados' GDP growth through the building of new sectors such as alternative energy, cultural industries, logistics and sports and health tourism;
- ▶ Creating new employment opportunities by building an expanded domestic entrepreneurial base, consisting of properly funded and equipped small businesses; and
- ▶ Shifting Barbados' reliance on advanced economies to Brazil, China and India.

In this regard, the Minister stated that he would be proposing to Cabinet an implementable blueprint which would triple Barbados' GDP value added over the next 15 years.

Comment

While we commend the Government for considering the diversification of the Barbados economy, it appears that such plans will be slow to come to fruition. It is believed that more immediate action is required.

Budget commentary *cont'd*



Agriculture

- ▶ With immediate effect, a rebate of up to BDS\$5,000 is to be provided to poultry and animal farmers who retrofit their livestock housing with the use of solar energy.
- ▶ An Organic Matter Programme is to be established to facilitate the provision of financial assistance for the purchase of three mulch compostors, three row mulchers, two transplanters and two mulch lifters. Partial waivers of duties will also be considered in respect of similar equipment.
- ▶ The Agricultural Development Fund will be recapitalized to facilitate loans to the agricultural sector. The interest rate on such loans will be reduced from 6.5% to 5%.

Comment

The cost of retrofitting for the use of solar energy appears to be significant. While some assistance is welcomed, a cash strapped farmer may not be encouraged to retrofit his livestock housing. We are certain that the assistance rendered to the fruit and vegetable growers will be appreciated.

Energy

Energy costs mitigation assistance

The Minister in his presentation proposed to offer some level of relief by way of a one-off “energy grant” to vulnerable groups such as the elderly, disabled and unemployed indigent. The grant funding will be provided through the Welfare Department. It is proposed that the initiative will commence 1 October 2011 and will go to a maximum of \$5 million.

Comment

The Government must be lauded for this initiative which will help to alleviate the burden associated with rising energy costs. However, it is not clear whether the grant funding will be provided as a one-off payment per annum and how the quantum of the grant for persons will be determined.

Alternative energy

The Minister of Finance announced that Government is seeking to implement a paradigm shift in the move to renewable energy and energy efficiency within the context of the establishment of a green economy.

He stated that within the next few weeks, draft renewable energy and energy efficient policies will be submitted to the Cabinet along with proposals for the amendment of the relevant legislation. He noted that it is Government’s intention to have draft legislation in respect of the renewable energy policy within the next few months to facilitate the generation of electricity by renewable energy systems and the sale of electricity to the grid.



Budget commentary *cont'd*

Comments

The Minister must be commended for this initiative which is long overdue. We look forward to the speedy enactment of the enabling legislation.

Allowance for energy audits, renewable energy and energy efficient retrofits

The Minister proposed that with effect from the current tax year, the energy conservation and renewable energy allowance will be increased from BDS\$5,000 to BDS\$10,000 per year for individuals and BDS\$25,000 per year for registered small businesses. The allowance will also be made available to lessees of properties once it is proven that approval was obtained from the owner of the property.

In addition, businesses whose filings with the Inland Revenue Department and VAT Division and whose compliance with NIS and Land Tax are up to date or who have in place arrangements to settle their arrears will be allowed to write off 150% of conversion to alternate energy over a five (5) year period.

Comments

These incentives will encourage more persons to install energy saving devices in their homes and businesses, thereby reducing their energy costs.

The Barbados Income Tax Act currently provides that businesses are entitled to an annual allowance of 20% of capital expenditure incurred for the purpose of an energy audit and the retrofitting of a building or the installing of a system to produce electricity from sources other than fossil fuels. The proposed increase in the annual allowance from 20% to 150% would greatly assist small business manufacturers in the reduction of their energy cost which is a major factor in their cost of production. It is hoped that the savings realized by such businesses will be passed on to consumers in the form of lower prices.

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