

Jamaica Budget 2010/11

No new taxes but tax evaders beware!

8 April 2010



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Introduction

The Hon. Audley Shaw, Minister of Finance and the Public Service today (8 April 2010) delivered his 2010/11 Budget Presentation in Parliament.

This is the Government's first Budget since a US\$1.27 billion Standby Agreement for Jamaica was approved by the International Monetary Fund (IMF) on 4 February 2010. Following an initial disbursement upon approval, subsequent drawdown of funds under this Agreement is conditional on the attainment of agreed specific quarterly performance targets.

No New Taxes

It was generally recognised that the public could not be asked to bear the burden of further taxation following the implementation of three separate tax packages during 2009/10 in an effort to address the deteriorating fiscal situation.

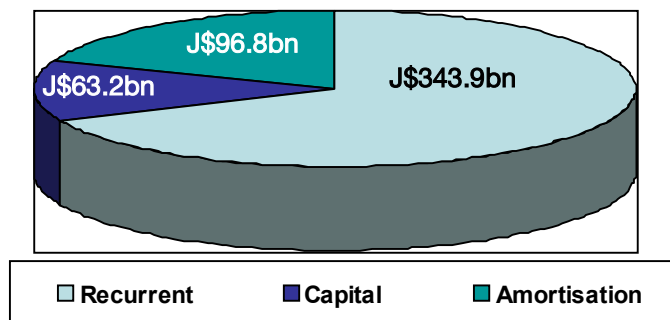
The Government therefore gave repeated indications that there would be "no new taxes" in this year's Budget with the exception of property tax. It was announced last week that property tax would increase from 0.5% to 0.75% (imposed on the value of unimproved land) with effect from 1 April 2010.

The Minister confirmed today that there would be no new taxes imposed in 2010/11 (other than the property tax increase already announced).

Financing the 2010/11 Budget:

Minister Shaw indicated that the Government projects to incur expenditure of J\$503.9 billion in 2010/11. This is made up as follows:

2010/11 Expenditure Estimates:



The Minister further indicated that the Government proposed to fund the above expenditure from projected revenues and grants of J\$326.3 billion (see below) with the balance to be funded by way of additional borrowing (approximately J\$177 billion).

The following table highlights projected revenues and grants for the 2010/11 fiscal year.

2010/11 Projected Revenues & Grants:

| | J\$ billion |
|--------------------------|---------------------|
| Projected Revenues - Tax | 287.2 |
| - Non-Tax | 20.1 |
| Bauxite Levy | 0.7 |
| Capital Revenue | 2.7 |
| Grants | 15.6 |
| Total | <u>326.3</u> |

Fiscal Deficit as % of GDP—where are we?

The country's fiscal deficit as a percentage of Gross Domestic Product (GDP) is regarded as an important indicator of Jamaica's ability to control and manage its national finances. Balancing the budget is therefore a critical

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milestone that must be achieved in order to improve the country’s financial health.

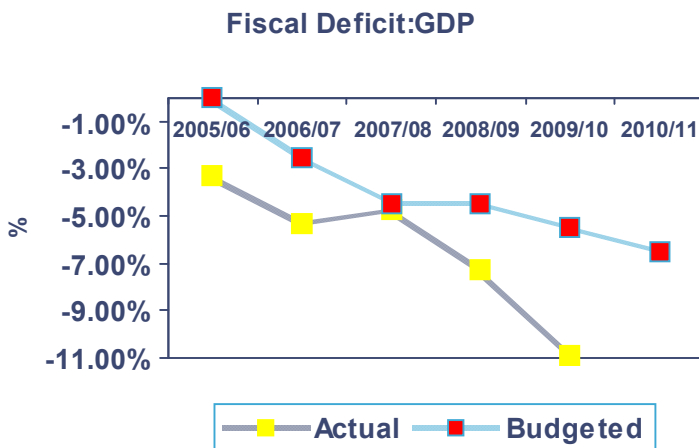
A fiscal deficit of 5.5% of GDP was programmed for 2009/10 as a step towards a sustained reduction in this key ratio over the medium-term. This compares with an actual out-turn of 7.3% for 2008/09.

Significant revenue shortfalls combined with higher than anticipated domestic interest payments as a result of the Jamaica Debt Exchange (JDX) resulted in a revision of the fiscal deficit target to 8.7% of GDP in September 2009. Under the aegis of the IMF Stand-By Agreement, a further revision of this key fiscal target was made to 9.6% of GDP.

Based on provisional data for 2009/10, central Government operations generated a fiscal deficit of J\$120.6 billion or 10.9% of GDP.

For 2010/11, Minister Shaw stated that the Government is targeting a fiscal deficit of 6.5%.

The following table highlights the programmed fiscal deficit as a % of GDP as well as the actual outturn for each fiscal year since 2005/06.



Strengthening Tax Compliance & Enforcement Capabilities:

In reminding Parliament that there would be no new taxes this year, Minister Shaw proceeded to outline a series of proposed legislative amendments and other initiatives with a view to enhancing tax compliance and the enforcement capabilities of the Jamaica Tax Administration. The Minister appealed to those taxpayers who are in arrears or under-reporting their taxes to stop doing so and “pay their fair share—no more, no less”.

Although the precise implementation date remains outstanding, the Minister indicated that the proposed legislative and other initiatives are intended to support the tax authorities in intensifying their enforcement actions against delinquent taxpayers in the 2010/11 fiscal year.

The following proposed amendments/ initiatives were outlined by the Minister.

Imposition of GCT on Imported Services:

While the GCT Act imposes GCT on the importation of both goods and services, the Act historically lacked an effective mechanism to assess and collect GCT on services provided by non-resident service providers. In 2003 a legislative mechanism was introduced to remedy this but it was not enforced at the time due to a number of legal and administrative issues.

Section 23B of the GCT Act provides that a recipient of imported services will be deemed to be a GCT registered taxpayer who has supplied the imported services thereby making him liable to account for GCT thereon.

It is important to note that GCT on imported

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services is separate and apart from any withholding tax obligations which one may have to comply with when making the payments overseas.

Subsequent to the Minister's 2009/10 Budget Presentation on 23 April 2009, the Ministry of Finance indicated that this mechanism (Section 23B) would be enforced with effect from 1 July 2009. Notwithstanding this, the legal and administrative issues noted above have remained an impediment to the enforcement of same by TAAD.

In an effort to address this matter, Minister Shaw announced today in his 2010/11 Budget Presentation that the Government is contemplating further amendment to the GCT Act to strengthen the imported services GCT regime.

This will include:

- clarifying what is meant by the term 'imported services';
- specifying exemptions from the regime;
- setting a threshold (presumably a dollar value level of imported services) above which GCT will be charged thereon.

This clarification will undoubtedly be needed in order for taxpayers to properly comply with such a regime as well as for TAAD to administer same.

There are however a number of other matters which will need to be addressed in any legislative amendment to be implemented including:

1. Who will be subject to the regime? (e.g. all recipients of imported services (which

would be impractical) or only business recipients). The current legislation makes no such distinction.

2. Specific provisions to ensure that input tax credits will be claimable where imported services are used in connection with a taxable activity. The current legislation is deficient in this respect.
3. How and when are these matters be reported? (e.g. will existing GCT Returns be re-designed to accommodate same).

The assessment and collection of GCT on imported services is a significant modification to our existing GCT regime. It also represents a departure from the familiar concept of GCT being imposed on the supplier of services to making the recipient of such services accountable for GCT thereon.

If you have not already done so, it will be important that you review your business operations with a view to assessing the likely impact that the enforcement of GCT on imported services will have on your business. This will be particularly important where you are engaged in an activity that is exempt from GCT.

Generally speaking GCT applies to all services (unless specifically exempted). The term "services" is broadly defined for GCT purposes and would include many payments made overseas including service fees, lease rentals, royalties, license fees, insurance etc.

As the legislation to define the meaning of imported services (as well as associated exemptions) is yet to be promulgated, you may also wish to consider making representations to the Ministry of Finance in the event of any special or inequitable

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circumstances you identify which might otherwise prejudice your business operations.

Computing Input Tax Credits:

Where a GCT-registered taxpayer is engaged in the making of both taxable and exempt supplies, then the GCT Act and Regulations prescribes that he may claim such input credits as are attributable to the making of taxable supplies. The law does not however prescribe a specific method for making such a determination or apportionment although in practice the turnover or 'sales mix' basis is used.

The Minister indicated in his Presentation today that Cabinet is considering an amendment to standardise the method of computing input tax credits in this situation (presumably by prescribing the apportionment methodology to be used).

While such a move will generally simplify the regime for both the taxpayer and TAAD, care needs to be taken in our view not to preclude taxpayers from using both direct attribution as well as other apportionment methodologies to the extent that they more accurately reflect the underlying cost drivers involved. In some instances, the turnover basis may not equitably allocate costs between various specific activities. The amended law could therefore permit taxpayers to make an election should they seek to use an approach other than the standard method prescribed.

Enhancement of GCT Penalty Regime:

It is proposed to amend the General Consumption Tax (GCT) Act & Regulations in order to increase (or impose) fines and penalties in respect of the following offences:

| GCT Offence | Current Penalty | Proposed Penalty |
|-----------------------------------------------------------------|----------------------------------------------|---------------------------------------------------------|
| Failure to apply for GCT Registration | J\$5,000 (Individual) J\$10,000 (Company) | J\$100,000 |
| Failure to file a GCT Return | J\$1,000 (Individual) J\$2,000 (Company) | J\$10,000 |
| Failure to display a GCT Certificate of Registration | No Penalty | J\$50,000 fine or imprisoned for up to 3 months or both |
| Failure to issue a tax invoice | No Penalty | J\$500,000 fine or imprisoned for 12 months |
| Failure to supply books and records | No Penalty | J\$500,000 fine or imprisoned for 12 months |
| Failure to return a GCT Certificate (i.e. upon de-registration) | No Penalty | J\$500,000 fine or imprisoned for 12 months |

The Minister also suggested that the statutory period within which a GCT Return should be filed may be reduced.

Reduction in interest rate charged on overdue GCT payable:

With a view to encouraging those who have outstanding amounts to come forward voluntarily, the Minister indicated that it is the intention of the Government to reduce the interest rate charged for the late payment of GCT from 2.5% to 1.5% per month. This is a welcome move as the current interest rate charged acts as a deterrent to those who may otherwise be willing to declare their tax and come into the tax net while penalising those generally compliant taxpayers in the event of errors inadvertently made.

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No mention was made of any corresponding reduction in penalties which currently stand at 15% for failing to pay GCT or file a GCT Return by its due date.

Reduction in interest rate charged on overdue Income Tax payable:

The Minister announced that an amendment to the Income Tax Act has been proposed with a view to reducing the rate of interest charged on overdue income tax payable from 40% to 20% per annum. This reduction (along with the GCT interest rate reduction noted above) is also to be welcomed.

The 40% rate of interest on income tax overdue is clearly in excess of market lending rates and has resulted in taxpayers being pursued for outstanding balances which are a significant multiple of the tax overdue. This has hindered taxpayers in trying to regularise their tax position, impaired the ability of the tax authorities to bring closure to matters and acted as a deterrent to those who may otherwise be willing to declare their income and come within the system.

No reduction was announced in respect of income tax penalties.

TCC Clearance for Professional Registration:

Minister Shaw indicated that the Government is currently re-visiting a proposal whereby a Tax Compliance Certificate (TCC) would be required by professionals in order to register with their relevant statutory body in order to practice in Jamaica. Such registrations are normally required to be maintained on an annual basis.

If implemented, this would impact a variety of professionals including doctors, lawyers,

architects and accountants.

Introduction of a Flat Tax:

One of the perennial challenges that tax authorities face across the globe is to assess and collect tax from hard-to-tax (HTT) sectors.

In this vein, the Minister announced that Cabinet intends to examine a proposal to introduce a flat tax for small business operators in certain fields. The Minister further indicated that this proposed change will apply to artisans such as plumbers, electricians, masons, painters as well as transport operators.

The precise mechanics as to how such a flat tax will be implemented as well as what legislative provisions will be needed will be developed in conjunction with the tax authorities.

The ability to implement a feasible flat tax regime will in our view depend on several key factors including the ability of the tax authorities to identify people engaged in these activities, assess the flat tax and enforce collection. Many people engaged in these activities operate on an informal basis. It will therefore be critical to find or create a point at which they are compelled to come out of the shadows to facilitate identification and assessment/collection of tax (whether flat tax or otherwise).

This approach can also be considered across the board for small businesses generally. It is also important that the flat tax is set at an amount which is meaningful and viable to collect (in cost:benefit terms). Consideration should also be given as to whether the flat tax chargeable will be in lieu of compliance with all other taxes (or just specific taxes) and

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whether the flat tax is refundable if a taxpayer can demonstrate that they would have been liable to less or no tax if they file under the full tax system.

Reform of the Tax Administration:

The Minister indicated that Cabinet has approved a submission which paves the way for the transformation of the Jamaica Tax Administration. In due course, this will result in the formation of a Single Domestic Tax Administration Department (which will embrace the current Taxpayer Audit and Assessment Department (TAAD), the Taxpayer Administration Services Department (TASD) and the Inland Revenue Department) i.e. with Jamaica Customs also being distinct and separate.

Technical Assistance:

With a view to strengthening the capabilities of the Jamaica Tax Administration, Minister Shaw indicated that assistance has been obtained from the United States (US) Treasury including the services of three former IRS agents.

The Caribbean Technical Assistance Centre (CARTAC) and the International Monetary Fund (IMF) are also providing assistance to develop the Tax Administration's auditing and compliance capabilities and techniques.

Revenue Protection Division:

The Minister announced that corruption has been unearthed in several areas within Taxation and Customs. He further stated that the country was losing billions of dollars through these corrupt practices. In an effort to deal with this, additional resources have been allocated to the Revenue Protection

Division (RPD) to strengthen and enlarge its capacity to detect and prosecute tax officials as well as their co-conspirators in the private sector.

Conclusion:

The ability of the Government to see the 2010/11 fiscal year through without the need for a Supplementary Budget will depend in part on the ability of the Jamaica Tax Administration to realise revenue targets set. This will not be without challenge in an economy that contracted by an estimated 2.3% in the 2009/10 fiscal year. Reductions in exports, falling real incomes, increased unemployment and reduced remittance flows have all contributed to this contraction.

Against this backdrop, it will be critical that the series of administrative initiatives announced by the Minister in his Budget Presentation today are both speedily and properly implemented if any meaningful compliance dividend is to be realized within 2010/11. The country cannot afford to miss its quarterly performance targets over the coming fiscal year.

Finally we would also submit that more comprehensive tax administrative reform is required in order to enhance the efficiency and effectiveness of our tax system realise the compliance dividend potential. This dividend can also provide some much needed fiscal space to implement urgent tax policy reform in order to rehabilitate our tax regime and make it internationally competitive in the twenty-first century.

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

Your PricewaterhouseCoopers Tax Team:

Eric A. Crawford, Head of Tax Services

Direct Line: 1 876 932 8323

Email: eric.crawford@jm.pwc.com

Brian J. Denning, Partner

Direct Line: 1 876 932 8423

Email: brian.denning@jm.pwc.com

Viveen A. Morrison, Director

Direct Line: 1 876 932 8336

Email: viveen.morrison@jm.pwc.com

Dionnie A. Headley, Manager

Direct Line: 1 876 932 8434

Email: dionnie.a.headley@jm.pwc.com

Paul A. Cobourne, Manager

Direct Line: 1 876 932 8350

Email: paul.cobourne@jm.pwc.com

Kimblian T. Batson, Manager

Direct Line: 1 876 922 6230 (ext. 6021)

Email: kimblian.t.batson@jm.pwc.com

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Office Locations:

Kingston:

Scotiabank Centre
Corner of Duke & Port Royal Street
Kingston

Tel: 1 876 922 6230

Fax: 1 876 922 7581

Montego Bay:

Advantage General Building
32 Market Street
Montego Bay
St. James

Tel: 1 876 952 5065

Fax: 1 876 952 1273

<http://www.pwc.com/jm>

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