BUDGET DEBATE 2015

REVENUE

In December 2013, this Parliament passed the Fiscal Incentives Legislation and the Customs Tariff Resolution 2013 and the Stamp Duty Order 2013. Together, this body of legislation represents perhaps the most far-reaching tax reform undertaken in Jamaica in more than two decades.

Prior to this, Jamaica's taxation landscape had been defined by a system of sector specific incentives. The basic problem with those arrangements was that:

- First of all they created huge differences in the tax treatment between sectors that benefitted from an incentive proposal and those that did not. We may call this inter-sector inequity.

- Secondly, there was also the problem of intra-sector inequity which was caused when certain entities within a sector benefitted from tax breaks to the disadvantage of those within the same sector which did not likewise benefit.

- Over time this created distortions in the economy since capital flowed disproportionately to those sectors and entities that had the advantage of specific tax incentives and not to other sectors and entities which, as a consequence, failed to grow.

- What is more, a culture of tax avoidance became prevalent. We still struggle with the belief today, that productive activity should not incur any tax responsibilities. This is obviously an untenable situation, since all of these productive sectors could not exist unless the state provided security services, health services, infrastructure, port services, etc. These have to be paid for.

- As a consequence of this, however, the tax burden over the years was disproportionately placed on certain sectors, like the PAYE worker who had to carry a disproportionate share of the burden while others were relieved of all responsibilities.

- Not surprisingly, the overall record of growth in investment has told a tale of relative under-achievement compared with the efforts made for investor promotion through tax incentives, and has led to an economy over-dependent on a few sectors such as tourism and mining.

With the 2014 tax reforms, sector specific incentives have been replaced by broad-based benefits applicable to all businesses with a reduced effective rate of corporate income tax, and more attractive customs rates applied to all productive inputs.

What is more, the old time-bound incentives have been largely replaced by perpetual eligibility so that all firms within the economy are on a level playing field facing lower and more competitive tax rates.
Perhaps the most striking evidence of the benefit of this revised incentive regime has been the re-invigoration of the small hotel segment of the tourism sector. A large

proportion of these hoteliers had ceased to benefit from the tourism incentives and thus was not able to refurbish and renovate their properties. In addition to providing for lower effective rates, the new tax-arrangement also provided for specific performance-based tax credits which were available to all corporate taxpayers. I am referring here specifically to the Employee Tax Credit (ETC) which is available to investors based on the size of their statutory deductions, which means that the greater their employment and wages, the greater the deduction available to them. There are also more generous capital depreciation allowances which are greater, the larger the level of investment and economic activity undertaken.

Basic Principles Underlying Tax Policy
I would like to remind the House that our basic principle guiding our tax policy involves creating equity across sectors by:

- Relieving the burden on the most vulnerable; and
- Satisfying the Revenue needs implicit in our economic programme

Members should also recall that our basic commitment is to a balanced budget and a 71/2 percent primary surplus target, as well as to long term objectives of broadening the tax base and reducing the rate of taxation.

What is the Overall Tax Need?
This year's Budget has in it substantial increases in Non-Debt Expenditure – increases not restricted to "recurrent" expenditure.

$8B	Health
$5B	Education – to ensure we continue our effort to end the Shift-System
$3.1 B	For roads, etc
$4B	For PATH, School Feeding and other Social Protection
$5.1B	Transport, Works and Housing (for providing housing as well as road repairs)

- It also meets our obligations to end wage-restraint
- And to repay principal on the NDX Bonds which together with our intention to retire some of our external debt - $100B.

When the budgeted expenditures for 2015/16 are compared to passive projections for total revenues there is a revenue gap of approximately $22.7B if we are to attain the 7.5% primary surplus target. This in the absence of any further policy or administrative actions.

Tax Compliance efforts are expected to provide $12.3B this year.
And as I have said our compliance efforts for 2015/16 are not based simply on exhortation. There are specific legislative and administrative issues and tasks to be implemented:

a) Amendments to Property Tax Act
b) New Transfer Tax Legislation

c) Withholding taxes on payments statutorily due

Successful implementation of these targeted compliance activities leaves a revenue gap of $10.4 B.

REVENUE MEASURES

On this basis, the following revenue measures are being proposed, bearing in mind both our revenue needs and our commitments to protect the most vulnerable.

Threshold on Personal Income Tax

Over the past three years, we raised the threshold for personal income tax. Members may recall that this past January the Personal Income Tax (PIT) threshold was increased to $557,232.00. The workers whose wages are below this level pay no income tax; and at this level a little more than 13,900 persons were brought below the threshold and would have been relieved from income tax. This brings the share of employees who is free from income tax to 36.6 per cent or (119,469 persons).

It is proposed that in **January 2016**, the personal threshold should increase from $557,232 to $592,800 per annum, thereby providing further relief to PAYE tax payers. Mr. Speaker, for all PAYE persons this will mean an additional $35,568 per year of tax free income but the impact in terms of lower effective tax rates will be greater for the lower income PAYE tax payers. The proposed increase in the threshold would relieve another 9,000 persons (approximately) from income tax and bring the total number free of tax to the 129,000 mark.

The revenue loss from this adjustment is $644M

Removal of Duties on Racehorse Breeding Stock

In order to facilitate continued viability of the Racehorse Industry, especially in the context of the government's intention to privatize Caymanas Park Limited and to bolster the quality of the tourism product, a number of changes are being proposed. The category of Horses which presently attracts a tariff of 40 per cent will be subject to a lower tariff of 5 per cent. This category previously attracted a tariff of 40 per cent. This will result in a **minimal revenue loss for the fiscal year of approximately $1M** and will help to stabilize conditions in the sector and support the divestment exercise. **The effective date for this measure is April 1, 2015.**

Increase in the Special Consumption Tax (SCT) on Cigarettes

Jamaica has a commitment under Article 6 of the Framework Convention on Tobacco Control (FCTC) to reduce local tobacco consumption. At the same time we are mindful that the illicit trade in cigarettes continues and we are addressing this. In that regard we are proposing that the Special Consumption Tax be increased from $10.50 per stick to $12 per stick **effective March 13, 2015.**

We expect that these new rates will **yield an additional $488M in revenue. These receipts will be directed to the National Health Fund.**

Adjustment to the Asset Tax of the Insurance Sector

Mr. Speaker, the House will recall that as part of the revenue measures announced last year, the Asset Tax Rate applicable to entities supervised by the Bank of Jamaica (BOJ) and the Financial Services Commission (FSC) was increased. At that time, I gave a commitment that the measure "was for a period of no more than a year and therefore the rate would revert to the standard rate as of March 2015".

After consultations with the Life Insurance Sector and appropriate due diligence by the Ministry with respect to the data and forecasts, we are proposing that for the Life Insurance Sector:

1) The 1.0 per cent Asset Tax rate be reduced to 0.25 per cent;
2) The Gross Premium Tax and the Net Investment Income Tax be removed; and
3) A Corporate Income Tax (on total income) will now be levied at the standard rate of twenty five per cent

These changes will be **applicable to the year of assessment 2015**. This revised tax structure is one that we believe allows the sector to be more flexible with respect to its business development and business model; facilitate greater growth in the sector and over time a greater increase in revenues. For this year, however, the **measure is calculated to be revenue neutral.**

There remains the issue of the application of the Asset Tax to other financial institutions. This will remain in force during the current year. We are mindful that the Asset Tax as presently structured for other institutions needs to be reviewed and this we are proposing to do in the 2016-17 financial year as part of a broader review of the financial sector.

Environmental Levy

There currently exists an environmental levy of 0.5 per cent of the c.i.f. value of goods imported with certain exemptions for government, diplomats, international organisations, passengers and most importantly on CARICOM imports.

Given our obligations under WTO rules, concerns have been raised about the impartiality of the application of the levy because of the exclusion of domestic goods and the failure to apply the levy to CARICOM imports. Since the levy is charged on non-CARICOM imports of productive inputs, but not applied to CARICOM imports of finished goods into the domestic markets, we are putting our domestic producers at a disadvantage *vis-à-vis* their CARICOM counterparts who are exporting to Jamaica.

In light of these anomalies and the need to protect this revenue source, we are proposing that an environmental levy be placed on domestic production to mirror the environmental levy on imports.

It is proposed that a 0.5 per cent environmental levy be applied to all qualifying imports of goods as exists currently, **but now including CARICOM imports,** and to domestic supplies of goods, excluding the services sector, charitable organizations, exempt organizations, International Organizations, and Mining.

For the domestic component of the tax, the following will apply:

- The total value of supplies sold quarterly is to be used as the tax base;

- The Environmental Levy imposed at the ports will be treated as a tax credit against quarterly payments to Tax Administration Jamaica (TAJ) or the domestic levy. Hence amounts paid at the port are treated as advance payment against quarterly environmental levy obligation on actual supplies.
- Net payment obligations are to be remitted quarterly (same as income tax obligations) using a payment advice.
- Quarterly instalments would be due one month after the end of each quarter, e.g. March quarter would be due last working day in April.
- Environmental Levy is to be treated as an expense on taxpayers' annual income tax return.

This measure is estimated to yield approximately $962M and is effective April 1, 2015.

Petroleum Cess
Mr. Speaker, we all know that there have been substantial changes in the global oil markets in the last six to nine months. By and large for a country like Jamaica:

i) It has been beneficial to our Balance of Payments and has resulted in sisgnificant savings on the country's oil bill Consumers have also benefitted from the lower prices with positive effect for the economy as a whole

Tracking of petroleum prices at one corporate area gas station shows the following:

Date	**E10 87**	**E 10 90**	**Diesel**
June 4, 2014	129.1	132.8	131.9
December 30, 2014	104.9	107.7	105.5
March 10, 2015	109.5	112.5	106.2
Avg. June-Dec. 2014			
Avg. Dec-Mar 2015	117.0	120.25	118.7
	107.2	110.2	105.85

However, in terms of the national economy, there are risks:

Firstly, there is the risk that in the context of lowered oil prices we relax our efforts to become less dependent on oil for our energy needs. We have made this error before. That is the reason why after the oil price shocks of the 1970s we are still dependent on oil for 90 per cent of our energy needs.

Secondly, there is the risk that oil prices move again sharply upwards. This would have a profoundly negative effect on our balance of payments and on the economy generally. Accordingly, the government has taken the decision to purchase a hedge in the market against the risk of a sharp increase in the price of oil. This is like an "insurance premium". We pay the financial institution for a hedge contract for a specific volume of oil. If the price of oil moves above the contracted price, Jamaica will receive a payment. This payment will allow us to stabilize the price to consumer and would also assist in compensating for balance of payment losses.

Thirdly, there is the risk to the revenues. For FY 2014/15 lower oil prices are estimated to have resulted in a loss of approximately $2-$2.50 in terms of the total SCT per litre of petroleum products.

In order to pay for the hedge and compensate for the lost revenues, we are proposing that **effective March 18, 2015** an additional specific SCT of J$7 (approximately US 6 cents) per litre will be imposed on petrol. **This measure should yield revenues of J$6.4B.**

While there will obviously be a price effect from this measure, the specific effect on pump prices cannot be known at this point. **As I indicated, the movement in relation to the cost of the hedge and the additional revenue recovery represent US 6 cents per litre.** If for example, there were to be a continued movement downwards in the price of oil per barrel on the world market we could continue to see the downward movement in the actual price of fuel at the pump. However, we now also would have the protection against an upward price movement in the future, and we would preserve our ability to meet our expenditure in health, security, education and all the things included in the budget.

I would finally make the point that I would hope, and expect, that market companies and individual retailers do not use the opportunity to change their margins to the disadvantage of the public and the economy.

Conversion of the 1.0 per cent Petroleum Cess to a specific SCT of $2 per litre

Mr. Speaker, we are proposing that the current 1 per cent Petroleum Cess paid by Petrojam to the Petroleum Corporation of Jamaica (PCJ), be replaced by a specific SCT of J$2.00 per litre on specified petroleum products. The base of the proposed J$2.00 SCT would be all petroleum products with the exceptions of Crude Oil, Jet Fuel, Bunker C Fuel and Fuel used by the Jamaica Public Service Company for energy generation, the Independent Power Providers as regulated by the Office of the Utilities Regulation and the Bauxite Industry.

There are several things to note Mr. Speaker,

- Currently the entire proceeds of the Petroleum Cess (the yield from which was approximately US$16.4M in fiscal year 2013/2014) is used by the PCJ to defray the administrative costs associated with the operational components of the Petro Caribe Agreement, as well as to support the Government of Jamaica's energy strategy and programmes. Part of the proceeds from the new $2.00 SCT levy will be distributed to the PCJ for continued use in these areas. However, a portion of the flows will be retained in the Consolidated Fund. Transfers to the PCJ have already been factored into the expenditures estimates.

- The replacement of the ad valorem cess with a specific SCT is viewed as a more appropriate fiscal structure given its purpose. In particular, the specific SCT insulates the fiscal proceeds from the impact of a fall petroleum prices, while reducing the proportionate burden when prices rise.

This structure guarantees minimum revenues for the policy objectives while also ensuring that revenues do not rise without limit in support of these policy objectives.

- The replacement of the 1.0 per cent cess with a specific SCT **will not affect electricity prices as the fuel base for these purposes are specifically exempt from the application of the levy.**

- Finally, the conversion of the cess into a specific SCT **will not affect Petrojam's reference billing prices for petroleum products (on impact) since the SCT replaces a cess which, de facto, was being recovered by Petrojam through its billing prices.**

This measure, to be effective March 18, 2015, is projected to yield gross revenues of approximately $1.8B.

Rationalization of Outdated Selected User Fees and Fees, Fines and Penalties in respect of Excises

Mr. Speaker, we have also taken a look at a range of user fees and charges, including in relation to excises, and have proposed adjustments to bring these more into line with current realities. These areas have been itemized and are presented in a Ministry Paper on the revenue measures which has been tabled. So in the interest of time, I will not elaborate on these here. Suffice it to say, for revenue estimation purposes we are only receiving approximately **$500 M in additional revenues from these sources. The effective date is April 1, 2015.**

Bauxite Levy Regime

There have been positives in the international environment, among them the increase in the price of bauxite and alumina. While we understand the reasons in the past, which both Administrations have had to engage in to discount or relieve production companies of the requirements under the Bauxite Levy Act, the interim regime in respect of the Bauxite Levy which was negotiated in 2008/9 came to an end last December. **The full levy is now due and we expect all the companies to adhere to the law – both in letter and spirit.**

Re-introduction of the GCT at the standard rate on monthly residential electricity consumption above 350kwh

Mr. Speaker, the Government is proposing that GCT be charged at the standard rate on residential customer usage of electricity above 350 kwh.

Mr. Speaker, the reality is that this tax represents one of the most efficient and equitable tax instruments as it is easily collectable, has a high compliance rate and customers whose usage falls below the 350kwh threshold would not be required to pay the applicable GCT. Based on data on current consumption levels, approximately 6.4 per cent of the current residential customer base will be affected by this tax. The other 93.7 per cent would be below the threshold. We believe, therefore, that the tax is one that will be borne substantially by the higher income consumers.

The estimated revenue yield during Fiscal Year 2015/16 from this measure is $807 M. The effective date is April 1, 2015.

CONCLUSION

The revenues and the expenditure budget is aimed to continue the efforts at fixing the basic foundation of the Jamaican economy. The margins this year, as in previous years, are very tight and there is little room for manoeuvre. Reduction in revenues will have to be compensated for by cuts in expenditure. The expenditure budget for its part is tailored to meet obligations to the Jamaican people for better social protection, the education system, health care and to facilitate the provision of necessary infrastructure and services to facilitate growth in the economy.

Sacrifices have been made by the Jamaican people in order to keep the industry going during the difficult years; now that that sector in the world economy is moving to a brighter day, we are determined that the Jamaican people should share some of this benefit.