



**Impact of the Economic Partnership Agreement on
Tax Systems in CARICOM**

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I. Introduction

In December 2007, negotiators representing CARIFORUM (fourteen CARICOM member states and the Dominican Republic) and the European Commission (EC) signed the Economic Partnership Agreement or EPA. The EPA negotiations concluded only a few days prior to the expiration of the WTO waiver granting preferential access to the Caribbean states in the EU market. It is expected that the EPA will enter into force by summer 2008, after legal scrutiny by both Caribbean and EC officials and ratification in the various national and regional bodies.

As a full trade and development agreement, rather than just a traditional free trade agreement or FTA, the EPA addresses a number of areas outside the traditional goods-only agreement, such as services, investment, government procurement, intellectual property, and taxation. The primary challenge for Caribbean tax administrators will be to understand and implement the significant number of areas within the EPA text touching upon tax issues. **While the EPA deals only with indirect taxes and the remit of COTA is centered on direct taxes, the fiscal implications will no doubt place adjustment pressures on CARICOM tax systems.**

Caribbean tax administrators already face, without the EPA, significant challenges within their own countries. Given the narrow production base of many CARICOM states, fiscal policy is a key stimulus to economic growth and well-being in the Caribbean. As recent levels of economic growth have remained stagnant in many CARICOM states, tax administrators in the region have been faced with the difficult task of maintaining fiscal balances while not increasing the (in many cases) already high tax burden on Caribbean citizens and businesses. The provisions of the EPA, while in some cases providing support to these efforts, adds another layer of complexity and challenge to the tax reform picture in the region.

This note addresses the various sections of the EPA text dealing with taxation¹ and address the scope, potential impact and policy issues arising from the EPA. The sections of the EPA text on taxation can be grouped into five categories, each of which will be addressed in turn:

- (a) Provisions on development cooperation/funding;

¹ These sections are listed as Annex I to this paper. The full EPA text can be downloaded at <http://www.crnmm.org>.

- (b) Provisions on the elimination of taxes;
- (c) Provisions on the application of taxes; and
- (d) Provisions on bilateral cooperation and dialogue on tax issues.

II. Provisions on Development Cooperation

The EPA addresses development cooperation in the area of tax administration in two articles (8 and 22). In these two articles, the Parties agree that development cooperation “shall be primarily focused on ... the provision of assistance for capacity and institution building for fiscal reform in order to strengthen tax administration and improve the collection of tax revenues with a view to shifting dependence from tariffs and other duties and charges to other forms of indirect taxation”.

The immediate implication for tax administrators in CARICOM is that both national governments and regional bodies can draw upon European Development Fund (EDF) support to implement tax reform programs. **However, Caribbean negotiators did not seek EU assistance for direct taxation, only indirect.** While the EPA text does not specifically earmark development cooperation funds, the European Commission has set aside 165 million Euros specifically for EPA implementation, part of the approximately 1.5 billion Euros of EC assistance earmarked for the Caribbean over the initial stage of EPA implementation.² The EPA text does not specify *a priori* the share to be allocated towards tax reform, although its status as the second of seven cooperation priorities – above private sector development, economic diversification, R&D and infrastructure development – points to the level of concern on both the Caribbean and European sides of the negotiating table.

The EPA provisions of course do not exist in a vacuum, and need to be considered in light of current efforts within CARICOM states to reform tax regimes. These efforts include programs funded by the EC, by individual countries (e.g. CIDA, UK DFID, USAID), by various non-governmental donors (e.g. IDB), by the various regional bodies (e.g. the CARICOM and OECS Secretariats) and more importantly by the CARICOM member states, based on existing strategies and legislation. This support covers a wide range of areas, including reform of taxation management and public expenditure, regulation of credit unions, upgrading facilities, human resources development and new management and computer packages.

² See “EU Increases by 25% the 10th EDF Allocation for the Caribbean Regional Programme”, European Commission Delegation to Barbados and the Eastern Caribbean”, available at <http://www.delbrb.ec.europa.eu/en/index.htm>

While the scope of this note does not permit a full evaluation of the effectiveness of support given by the EC or other regional donors, the key challenges for CARICOM tax administrators in the EPA are:

- (a) To ensure that applications for EDF funding under the 10th EDF are submitted at the earliest stage possible (via the EDF National and Regional Authorizing Officers), given the bureaucratic lags in accessing EU funds; and
- (b) To ensure that the objectives and deliverables of EDF-funded programs are consistent with national tax reform programs and strategies already in place, i.e. to ensure adequate effectiveness and ownership of donor-funded programs.

III. Provisions on the Elimination of Taxes

Perhaps the most controversial elements of the EPA are those articles relating to the elimination of certain trade taxes. At the outset, it is worth noting two important points. First, **the EPA deals exclusively with trade-related taxes, and does not address direct/internal taxes unless they are applied in a discriminatory manner on imported goods (i.e. vis-à-vis domestically produced goods)**. However, the fiscal losses arising from trade-related taxes will no doubt place pressures on other forms of taxation to recoup fiscal losses.

This brings us to the second point – i.e. that fiscal losses arising from the EPA, as a percentage of government revenue, are not likely to be significant, for three reasons. First, no CARICOM state apart from Suriname imports more than 15% of their total imports from European Union sources. Second, most of the products sensitive for revenue purposes are protected under the EPA. Third, trading patterns within the region have seen a historical shift away from Europe towards sources in Asia and Western Hemispheric sources. The EPA is unlikely to halt this shift, given that Europe remains a relatively high-cost producer for most goods and that the EPA excludes most goods in (a) which trade diversion is likely to occur and (b) where the EC maintains export or domestic subsidy programs.

Nonetheless, CARICOM states – and Ministries of Finance in particular – will face fiscal challenges arising from the EPA, as there will be an undoubted fiscal impact as trade taxes on certain products are phased out within the 25-year implementation period of the EPA. Given that the EPA goods schedules run over a thousand pages, this note will not attempt to specify which products will face elimination of trade taxes, rather given a general overview of the phase-out envisioned under the EPA.

Article 14 of the EPA sets out a three-year phase-out schedule for all **export duties** from CARIFORUM to the EC market, in Annex I to the agreement. In the current version of the text, export duties for products from only two states

(Guyana and Suriname) are listed in the Annex, although Article 14 refers to all CARIFORUM states.

Article 16, dealing with **customs duties** on EC-originating products into CARIFORUM market, is the primary source of concern for most Caribbean states. In this Article, the EPA provides for:

- (a) A **maximum tariff** applicable only to products to be liberalized under the EPA. This implies that, while there is no ‘standstill’ clause to the EPA, CARICOM states cannot increase import duties above this maximum rate for these goods.
- (b) **Zero-binding**, i.e. for any good which a CARICOM state currently applies a zero rate for imports from the EU, that state cannot impose a non-zero rate in the future.
- (c) **Phased elimination** of import duties over a specific period of time for most goods. The phase-out schedules – ranging from 5 to 25 years – vary from product to product, with a three-year moratorium (i.e. no cuts occur until 2011).
- (d) **Elimination of other duties and charges** (ODCs) on EC-originating imports, within ten years of entry-into-force (i.e. 2018) with a seven-year grace period.

The impact of these provisions will vary across CARICOM. Table 1 below estimates, based on 2002-2004 averages, the US\$ amount of import duties that will be lost from tariff cuts in the EPA. While the impact from the loss of import duties is less than 1% of total government revenue across most CARICOM States (except Barbados, Guyana and Suriname), the table does not account for the loss of other duties and charges, which is expected to increase the expected revenue impact from the EPA.

Table 4: Loss of Import Duty Revenue on EU Imports
(US\$ using 2002-4 averages)

	<i>Annual Loss of Import Duties by Liberalization Phase (cumulative)</i>					<i>Annual Loss as Share of Current Gov't Revenue</i>
	<i>2013</i>	<i>2018</i>	<i>2023</i>	<i>2028</i>	<i>2033</i>	
	Antigua & Barbuda	73,963	131,423	573,282	586,309	
Bahamas	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

	<i>Annual Loss of Import Duties by Liberalization Phase (cumulative)</i>					<i>Annual Loss as Share of Current Gov't Revenue</i>
	<i>2013</i>	<i>2018</i>	<i>2023</i>	<i>2028</i>	<i>2033</i>	
	Barbados	702,574	2,743,169	15,396,111	16,188,607	
Belize	26,260	110,921	485,825	504,110	556,911	0.3%
Dominica	15,826	46,323	235,826	257,976	272,159	0.3%
Grenada	53,547	125,302	584,769	630,657	674,468	0.6%
Guyana	523,280	1,432,733	3,726,726	4,038,462	4,201,193	2.9%
Haiti	13	60,122	303,284	381,439	603,998	0.1%
Jamaica	40,791	175,358	7,976,852	8,211,928	8,697,666	0.6%
St Kitts & Nevis	12,714	40,696	333,088	341,631	380,062	0.3%
St Lucia	4551	78,109	1,400,674	1,448,679	1,611,681	0.5%
St Vincent & Grenadines	25,175	77,109	338,330	359,571	397,595	0.3%
Suriname	860,421	2,997,264	9,483,000	10,658,242	11,677,797	2.5%
Trinidad & Tobago.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: CRNM estimates based on data provided by CARICOM Member States

With respect to other duties and charges (ODCs) to be removed over a ten-year period (with a seven-year moratorium), duties provided under the Customs tariff are not covered by ODCs, only collections applicable only with respect to imports. VAT and Consumption Tax, where they are collected in a non-discriminatory manner, that is, on local production, regional imports and third country imports, are not considered as ODCs. As a result, a number of the collections within CARICOM are considered as ODCs - the names vary across the region (e.g. stamp duty, customs surcharge, etc) – and are slated in the EPA for removal on EU-originating imports.

While the EPA will undoubtedly remove some sources of trade-related government revenue in the near future, two important points bear mentioning. First, the removal of other duties and charges (ODCs) does not include consumption taxes, which alongside import duties generates the largest amount of revenue on traded items. Second, the implementation of the EPA tariff phase-outs has been deliberately timed over a 25-year period, with the bulk of liberalization occurring within the first 15 years (i.e. by 2023). In many cases, this

exceeds the time-frame envisioned by many CARICOM States' own tax reform plans wherein many states plan to move towards internal taxes (e.g. VAT) and lessen their own reliance on border taxes for government revenue. While many CARICOM States remain dependent on border taxes for overall government revenue, it is unlikely that the EPA in and of itself will either significantly alter fiscal balances or force CARICOM States to adopt measures which are not already in the legislative pipeline. It will, however, place significant pressure on CARICOM states to honor the deadlines for their agreed programs of fiscal reforms.

IV. Provisions on the Application of Taxes

Article 27 of the EPA specifies so-called “national treatment” with respect to taxation of imports from the EU. More specifically, it states that “originating imports shall not be subject, either directly or indirectly, to... internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products.” **Thus CARICOM States cannot apply taxes or charges inside the border in a discriminatory way to imported goods, i.e. differently than those applied on domestically-produced goods.** This article applies exclusively to internal taxes such as Value-Added Taxes (VAT) or General Sales Tax (GST).

Similar provisions exist in Article 13, which specifies that fees levied on the importation or exportation of goods between the Caribbean and EC markets “shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection for domestic products or a taxation of imports or exports for fiscal purposes.”

V. Provisions on Cooperation and Dialogue on Tax Issues

The final provisions of the EPA concerning taxes (Article 226, 236 and 237) deal with bilateral cooperation on tax issues. In these articles, CARICOM member states are committed to “agree to foster dialogue, transparency and to share best practices in the area of tax policy and administration” as well as “to prevent and fight against illegal, fraudulent and corrupt activities, money laundering and terrorist financing.”

It is worth noting at the outset that these provisions do not include any undertaking for CARICOM states to harmonize tax systems or prevent so-called “harmful tax” competition. The EC negotiators, at the outset of the EPA, had tabled a proposal whereby taxation issues would be included in the EPA's chapter on Good Governance issues, including language whereby both regions recognized the potentially negative impact arising from tax havens and committing both parties to information-sharing to combat possible tax evasion. This proposal was strongly resisted by Caribbean negotiators and the final

language, committing Caribbean states to fostering transparency and dialogue, was deemed an acceptable compromise by both sides.

These articles further commit Caribbean states to “take the necessary legislative and administrative measures to comply with international standards”. In terms of actual standards, the text itself only specifies the United Nations Convention against Corruption, the United Nations Convention on Transnational Organized Crime and its Protocols and the United Nations Convention for the Suppression of Terrorist Financing. Given the priority placed on this area by the European Commission, this commitment is a likely area where Caribbean tax authorities can obtain EC funding to implement compliance programs with agree international standards.

VI. Conclusion

The Economic Partnership Agreement, like any negotiated text, contains both challenges and opportunities for Caribbean states. The balance is all the more marked for CARICOM tax authorities. On one hand, they can use the EPA to provide important momentum for national tax reform strategies and a forum to share best practices with their European counterparts, who have significant experience in constructing national tax regimes in the context of a regional construct. On the other hand, tax authorities will be placed under pressure from elected officials to maintain fiscal balances in the face of tariff cuts and implement revenue-replacement measures in time to match the phasing-out schedules envisioned under the EPA.

Annex I: EPA Articles on Taxation

Cooperation Priorities (Article 8)	<p>Development cooperation provided for in Article 7 shall be primarily focused on the following areas as further articulated in the individual Chapters of this Agreement:</p> <p>(ii) The provision of assistance for capacity and institution building for fiscal reform in order to strengthen tax administration and improve the collection of tax revenues with a view to shifting dependence from tariffs and other duties and charges to other forms of indirect taxation;</p>
Definition of Customs Duties (Article 11)	<p>A customs duty includes any duty or charge of any kind, including any form of surtax or surcharge, imposed in connection with the importation or exportation of goods, but does not include any:</p> <p>(a) internal taxes or other internal charges imposed in accordance with Article 27;</p> <p>(b) antidumping, countervailing or safeguard measures applied in accordance with Chapter 2 of this Title;</p> <p>(c) fees or other charges imposed in accordance with Article 13.</p>
Fees and other charges (Article 13)	<p>Fees and other charges referred to in Article 11 shall be limited in amount to the approximate cost of services rendered and shall not represent an indirect protection for domestic products or a taxation of imports or exports for fiscal purposes. They shall not exceed the real value of the service rendered. Fees and charges shall not be imposed for consular services.</p>
Elimination of Customs duties on originating exports (Article 14)	<p>(a) Customs duties on exports shall not be applicable to goods originating in the CARIFORUM States and imported into the EC Party and vice versa.</p> <p>(b) Notwithstanding the above, the Signatory CARIFORUM States included in Annex 1 shall eliminate the customs duties on exports set down in that Annex within three years of signature of this Agreement.</p>
Customs duties on imports of products originating in the CARIFORUM States (Article 15)	<p>Products originating in the CARIFORUM States shall be imported into the EC Party free of customs duties except for the products indicated, and under the conditions defined, in Annex 2.</p>
Customs duties on imports of products originating in the EC	<p>(a) Products originating in the EC Party shall, on their importation into the CARIFORUM States, not be subject to customs duties higher than those indicated in Annex 3.</p>

<p>party (Article 16)</p>	<p>(b) Products originating in the EC Party shall, on their importation into the CARIFORUM States, be exempt from all customs duties within the meaning of Article 11 other than those listed in Annex 3.</p> <p>(c) For a period of ten years after the signature of this Agreement, the CARIFORUM States may continue to apply any such customs duties within the meaning of Article 11 other than those listed in Annex 3 to any imported product originating in the EC Party, provided that these duties were applicable to this product on the date of signature of this Agreement, and that the same duties are imposed on the like product imported from all other countries.</p> <p>(d) The Signatory CARIFORUM States shall not be required to begin a phased elimination of the customs duties other than those listed in Annex 3 and referred to in paragraph 2 in the seven years subsequent to the signature of this Agreement. This process shall be accompanied by the support of the necessary fiscal reforms as provided for under Article 22.</p> <p>(e) With a view to ensuring transparency, such duties shall be notified to the CARIFORUM-EC Trade and Development Committee within six months from the date of signature of this Agreement. Their elimination shall also be notified promptly to the CARIFORUM-EC Trade and Development Committee.</p> <p>(f) In the event of serious difficulties in respect of imports of a given product, the schedule of customs duty reductions and eliminations may be reviewed by the CARIFORUM-EC Trade and Development Committee by common accord with a view to possibly modifying the time schedule for reduction or elimination. Any such modification shall not lead to the time periods in the schedule for which the review has been requested being extended in respect of the product concerned beyond the maximum transitional period for duty reduction or elimination for that product as provided for in Annex 3. If the CARIFORUM-EC Trade and Development Committee has not taken a decision within thirty days of an application to review the timetable, the CARIFORUM States may suspend the timetable provisionally for a period that may not exceed one year.</p>
<p>Cooperation (article 22)</p>	<p>(a) The Parties recognize the importance of cooperation in order to strengthen tax administration and improve the collection of tax revenues.</p> <p>(b) Subject to the provisions of Article 7, the Parties agree to cooperate, including by facilitating support, in the following areas:</p> <p>(i) technical assistance in the area of fiscal reform with a view to shifting dependence from tariff</p>

	<p>and other duties and charges to other forms of indirect taxation; and</p> <p>(ii) capacity and institution building in regard to the measures outlined in (a) above.</p>
<p>National Treatment on internal taxation and regulation (Article 27)</p>	<p>(a) Originating imports shall not be subject, either directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, the Parties and the Signatory CARIFORUM States shall not otherwise apply internal taxes or other internal charges so as to afford protection to like domestic products.</p> <p>(b) Originating imports shall be accorded treatment no less favourable than that accorded to like domestic products in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.</p> <p>(c) No Party or Signatory CARIFORUM State shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no Party or Signatory CARIFORUM State shall otherwise apply internal quantitative regulations so as to afford protection to domestic production.</p> <p>(d) The provisions of this Article shall not prevent the payment of subsidies exclusively to national producers, including payments to national producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products.</p> <p>(e) The provisions of this Article shall not apply to laws, regulations, procedures or practices governing public procurement, which shall be subject exclusively to the provisions of Chapter 3 of Title IV.</p> <p>6. The provisions of this Article shall be without prejudice to the provisions of Article 23.</p>
<p>Taxation (Article 226)</p>	<p>(a) Nothing in this Agreement or in any arrangement adopted under this Agreement shall be construed to prevent the EC Party or a Signatory CARIFORUM State from distinguishing, in the application of the relevant provisions of their fiscal legislation, between taxpayers who are not in the same situation, in particular with regard to their place of residence or with regard to the place where their capital is</p>

	<p>invested.</p> <p>(b) Nothing in this Agreement or in any arrangement adopted under this Agreement shall be construed to prevent the adoption or enforcement of any measure aimed at preventing the avoidance or evasion of taxes pursuant to the tax provisions of agreements to avoid double taxation or other tax arrangements or domestic fiscal legislation.</p> <p>(c) Nothing in this Agreement shall affect the rights and obligations of the EC Party or a Signatory CARIFORUM State under any tax convention. In the event of any inconsistency between this Agreement and any such convention, that convention shall prevail to the extent of the inconsistency.</p>
Dialogue on Finance Issues (Article 236)	The Parties and the Signatory CARIFORUM States agree to foster dialogue, transparency and to share best practices in the area of tax policy and administration.
Collaboration in the fight against illegal financial activities (Article 237)	The EC Party and the Signatory CARIFORUM States are committed to prevent and fight against illegal, fraudulent and corrupt activities, money laundering and terrorist financing and shall take the necessary legislative and administrative measures to comply with international standards, including those laid down in the United Nations Convention against Corruption, the United Nations Convention on Transnational Organised Crime and its Protocols and the United Nations Convention for the Suppression of Terrorist Financing. The EC Party and the Signatory CARIFORUM States agree to exchange information and cooperate in these areas.

