



# **VARIATION IN TAX POLICIES EFFECTS ON REGIONAL TAX HARMONISATION**

**Sabina Walcott-Denny, Commissioner  
Inland Revenue Department (Barbados)**

=====

## **INTRODUCTION**

Countries are sovereign nations and have the right to tax individuals and entities that come under their jurisdiction.

There are no international standards that have been developed in relation to taxation. This certainly leads to variation in tax policies and would have some effect on regional tax harmonisation.

Countries have fashioned their tax policies according to their circumstance. Some countries prefer high tax rates in order that they could offer citizens significant social benefits. Other countries concentrate on lower rates.

The policy in relation to what should be taxed also varies. Taxes on income, expenditure, consumption and property are some of the taxes that are used to collect revenue. Even within these various taxes one could detect different rules.

How and the extent to which such variation in tax policies affect regional tax harmonisation could be determined after analysis and discussion of the various tax policies in some of the countries in CARICOM.

## **VARIATION IN TAX POLICIES**

### THE GOAL

The overall goal of most countries is to obtain long-term growth which enables a high standard of living for its citizens. It is known that capital formation is the key determinant to such growth. This capital is attracted mainly through investments. It could be from citizens or from abroad.

### CHALLENGES

Taxation policy is not an independent policy but it must fit into the overall economic policy of the country. A policy that is beneficial to one country could be detrimental to another. For example, can all countries have strict thin capitalization rules? This rule consists of a high percentage of investment capital in the form of equity capital instead of loan capital.



Surely not many would consider it to be wise for a developing country to refuse a company from carrying out a major important development, if it proposes to do so through loan capital.

Ideally it would be preferred that companies investing in a country do so with equity capital. This means that owners get rewarded after the payment of taxes.

Some countries need the investment and have taken the decision to forego taxes on interest. They have very low withholding tax so that they could encourage investments.

The overall challenge is to balance possible revenue loss from taxation with social and economic development gains.

### VARIATION IN TYPES OF TAXES

Countries in CARICOM obtain Government revenue through various taxes such as income tax, corporation tax, Value Added Tax (VAT), sales tax and fees. Some countries use a combination such as income tax, corporation tax and VAT. Other countries may have only income tax or fees.

### DIFFERENCES IN CORPORATION TAX SYSTEMS

Most CARICOM countries levy corporation tax. In the calculation of this tax, generally income, expenses, allowances, deductions and credits are taken into consideration to arrive at the taxable income and tax payable.

On examination of CARICOM countries several differences would be detected. What is included as income may vary. For example, some countries include dividends from foreign sources.

In relation to expenses some items that are classified as expenses in one jurisdiction may not be classified as such in another – for example, interest.

Usually capital allowances are deducted from income to arrive at taxable income. However it should be noted that the amount deductible may vary from item to item in different countries.

### VARIATION IN POLICIES OF SOME ITEMS

The following are some of the policies that exist in various CARICOM countries:

#### INTEREST - DEDUCTION

Policy A - paid on capital, only to banks and certain financial institutions.

Policy B - paid on capital – must be paid within two years with



respect to arm's length transaction and one year for non-arm's length.

Policy C - can be interest paid on any money borrowed that was used on capital employed in acquiring the income.

#### PENSIONS - DEDUCTION

Policy A - not mentioned in the legislation.

Policy B - Contributions paid to registered retirement plan deductible, however with limits.

- Lump sum contribution for past years is deductible over a period of not less than 10 years.

Policy C - contributions paid on an approved plan with no limits on deduction.

#### PREMIUM TAX

Policy A - Life Insurance – premium tax of 3% on both residence and non-residence companies - taxed net of Commission (for agent).

Policy B - 5% Life Insurance – of gross direct premium income of resident and foreign life insurance companies.

Policy C - Only on property insurance premiums payable in respect of local risk.

#### SOME INTEREST WITHHOLDING TAX RATES

0%  
15%  
20%  
25%  
33 $\frac{1}{3}$ %

#### EXPLORATION AND RESEARCH - DEDUCTION

- **Expenses incurred prior to commencement of business:**

Policy A - no provision made for any deduction specifically.



Policy B - if incurred after the granting of a licence may be accumulated and deducted in any future accounting periods.

Policy C - must be capitalised as part of cost for plant and machinery to be deductible.

• **Post Trading Expenses:**

Policy A - deducted if established as revenue expenses (wholly and exclusively).

Policy B - initial and annual capital allowances allowed on expenditure on mines and wells.

Policy C - scientific research expenditures (not of capital nature) deducted as an expense.

DIVIDENDS – WITHHOLDING RATES

Several withholding tax rates are presently used within the Community.

33 $\frac{1}{3}$ %  
15%  
12 $\frac{1}{2}$ %

CAPITAL ALLOWANCES

Policy A – straight line method used – can claim initial allowances, investment allowances, annual allowances and manufacturing allowances.

Policy B – reducing balance method used – can claim initial allowances and annual allowances.

Policy C – can claim initial allowances, annual allowances, special annual allowances.

LOSSES

Policy A – can be carried forward indefinitely with no restrictions on set-off except against income from employment or profession.

Policy B – can be carried forward for 9 years with no restrictions on



set-off except rental of residential property.

Policy C – can be carried forward for 6 years with restriction on set-off to 50% of taxable income.

## **EFFECTS OF TAX HARMONISATION**

### TAX HARMONISATION

What is tax harmonisation? Could there ever be total tax harmonisation? Which group of countries has attempted such and what have been the results?

There is no consensus on the technical definition of tax harmonisation.

Wikipedia states, “Tax harmonisation refers to the process of making tax identical or at least similar in a region”.

BNET Business Dictionary states, “The enactment of taxation laws in different jurisdiction such as neighboring countries..... that are consistent with one another”.

For some, tax harmonisation is stipulating a defined range of rates while for others it is concentrating on particular tax structures.

For CARICOM, with respect to corporation taxes, tax harmonisation is a specific structure for specified items.

### WHY TAX HARMONISATION

Some countries within the region have different resources, different difficulties, different levels of stability, education and social services. Indeed there exists a measure of inequality.

The purpose of harmonising taxation structures and systems of CARICOM is to make Member States compatible with the regional integration objective. The countries are moving to a single market and single economy. It means viewing this region as one market and one economy. There is the need for the environment to encourage investment. There is also the need to achieve the balance that would enhance the overall Community.

Presently each country has different rules, methods and rates to determine tax liability. It would be easier for investors if there were similar rules in the region. Also some persons believe that tax policies should be neutral and not contribute to the determination of where an investment is made.

A major plus towards harmonisation is that most Member States have similar tax structures, based on a model of the United Kingdom system. There is similarity in many concepts and definitions such as business profits, permanent establishment and residence.



## EUROPEAN UNION (EU)

The European Union has some measure of tax harmonisation in respect of VAT. Countries are required to have a VAT rate of no lower than 15%.

With regards to corporate tax, there is a proposal to have a Common Consolidated Corporate tax base for multinational corporations. It would not involve tax rates. Apportionment by a formula is being advocated.

## EFFECTS OF CARICOM DOUBLE TAXATION TREATY (CDTA)

A multilateral treaty encompassing all CARICOM countries exists. As the treaty is multilateral, instead of just being bilateral, it offers better opportunities for tax harmonisation.

Usually countries sign bilateral treaties with other countries. However, the provisions given to country A could differ from that given to country B. This is not so within CARICOM. The provisions given by Barbados to Jamaica, Trinidad, St. Lucia, St. Vincent and other CARICOM countries are similar. It means that a company or individual from St. Vincent would be treated by Barbados in the same manner as those in other CARICOM countries.

The treaty is source-based. Article 5 of CDTA on Tax Jurisdiction states, *“Irrespective of the nationality or State of resident of a person, income of whatever nature accruing to or derived by such person shall be taxable only by the Member State in which the income arises, except for the cases specified in this Agreement.”* It means generally that the country where the income is earned has the sole right to tax.

Under Article 8 business profits are taxed where the business activity is undertaken. As a result losses by a branch in one jurisdiction cannot be set off against profits in another jurisdiction. This prevents “big” corporations from utilizing losses in one country against business profits in another, just because of structure – if it were a subsidiary no losses could be claimed. Interest, royalties, management fees are taxed in the source state and the rate of tax cannot exceed 15%. These policies encourage investment, trade and business in the community.

Dividends are taxed in the source state and the rate is zero %. This is definitely to encourage inter-regional investment.

The Caribbean Community (CARICOM) has achieved what many regions have not and should be commended. It stands out in the world for its multilateral treaty and source-based principle.



## **CARICOM PROPOSED ARTICLES FOR PROTOCOL ON HARMONISATION OF CORPORATE TAXATION STRUCTURES**

In addition to the CDTA further work has been done by CARICOM in an effort to harmonise taxation policies. The goal is to harmonise some elements of corporation tax.

The legal draft of the proposed Articles for the protocol on Harmonisation of Corporation Tax Structures deals with ten elements.

### CAPITAL ALLOWANCES – ARTICLE 1

- Capital Allowance on a pooled basis
- Buildings have two pools – 1% and 2%,
- Plant and machinery – four pools 10%, 25%, 50% and 100%

### INTEREST – ARTICLE II

- Deduction of interest on a loan for acquisition of capital to be used in or for the production of chargeable or assessable income
- Add back if interest not paid within two years for arm's length transaction and one year for non-arm's length.

### LOSSES – ARTICLE III

- Allows carry forward of losses indefinitely.
- Can be off-set from income of other sources.
- Restricted to 50% of tax payable before allowances of the loss brought forward.

### PENSIONS – ARTICLE IV

- Allows deduction for contribution to an approved pension fund.

### INSURANCE PREMIUM TAX – ARTICLE V

- Allows for on insurance premiums at x% - No rate given.
- Tax is on gross premium income.

### MINIMUM CORPORATION TAX – ARTICLE VI

- Determined by individual member state.
- Allows tax of x% on gross receipts.



- Tax may be used as a credit.
- Not refundable and cannot be carried forward to future liability.

#### MERGERS AND SPLITTERS – ARTICLE VII

- Losses not allowed where there is a
  - change of more than 50% of underlying ownership or control of company; and
  - tax avoidance possible or a change in nature of business

#### DISPOSAL AND ACQUISITION OF ASSETS – ARTICLE VIII

- Non-arm's length disposal or acquisition of assets deemed to be at market value
- Arm's length transaction – use written down value

#### AGREEMENTS FOR EXTRA-REGIONAL FINANCING WITH IMPLICATIONS FOR WITHHOLDINGS TAXES – ARTICLE IX

- Allows withholding taxes on interest payment to a non-regional financial institution.
- Rate between 0 – 20%

#### EXPLORATION AND RESEARCH EXPENSES – ARTICLE X

- Expenses prior to commencement of business written off over a period of five years or more.
- Expenses during the operation of business treated as revenue expense.

#### **POINTS TO NOTE**

- The CDTA has brought a measure of harmonisation of treatment of entities and individuals within the community doing business in another member state.



- The tax dividend rate of zero in the CDTA encourages investment through equity within the community. It is somewhat similar to the EU parent/subsidiary directive.
- No community including the EU and CARICOM has advanced the harmonisation of rates.
- Without the harmonisation of rates it is possible for a country to adjust its rate to compensate for losses as a result of other harmonisation structures.
- It should however be noted that tax rates are more visible than other tax elements. Usually investors are first attracted by rates. This factor would contribute to the country not raising the tax rate beyond what is considered competitive.
- Harmonisation of the tax structure is a laudable goal by member states of CARICOM. However, implementation of specific measures may prove to be a challenge for some states as a result of cost constraints in the form of revenue loss or simply reluctance to change some prevailing laws and practices.
- Several factors beside taxation affect investment decisions. Infrastructure, skilled labour, knowledge workers, stability, crime rate and the health system are some factors used in making such decisions.

## **CONCLUSION**

Countries are sovereign nations and do have the authority to make policies independently. However, with the globalization of trade and investment more and more countries are forming trading groups. Such alliances recognise the need to encourage trade and investments through the principle of “single market and economy”.

For CARICOM the objective is to move from wide variation in tax policies to some degree of regional tax harmonisation through structures. This is a work in progress.