MINISTRY OF NATIONAL SECURITY

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**OPENING REMARKS BY:**

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**MINISTER OF STATE**

**THE MINISTRY OF NATIONAL SECURITY**

**On**

# THE VALUE ADDED TAX BILL, 2014

**BEFORE THE SENATE**

**MONDAY, 1st SEPTEMBER, 2014**

## ***Introduction***

I wish at this time to open the debate in the Senate on the Value Added Tax Bill 2014.

I trust that Honorable Senators appreciate that this Bill represents a landmark moment in the history of our nation. Following many years of study and discussion, we are finally moving to bring our system of taxation up to the proper and appropriate standards of the 21st century.

I will, in these opening remarks, make observations on a number of vitally important matters in respect of the Bill that I hope will serve to promote an enlightened and effective discussion of the Bill.

I will, specifically, touch on the following issues:

1. Setting the new VAT and tax reform within the context of the Government's overarching national development plan;

2. Outlining the concerted efforts to reform and modernize the administration of the major, existing taxes in order to enhance revenue collections performance;
3. Reviewing the many initiatives that the Government has launched to better contain and control public expenditure;
4. Expanding on the key elements of the VAT policy and administrative framework that is featured in the VAT Bill; and
5. Elaborating on the complementary reductions that have been announced for various tariff and excise rates.

## ***The Government's National Development Plan***

The VAT Bill before us is about the introduction of a new tax on consumption in The Bahamas. However, it is critically important to properly situate this initiative in the broader context of the Government's overall plan for national development. The plan, appropriately so, is about much more than tax reform and the introduction of a new source of taxation.

This plan offers new and innovative solutions for the wide range of economic and social challenges facing the nation. To that end, the Government has charted a course of change with the specific goals and targeted actions that it will implement over the full course of its mandate. The plan is multi-faceted and it is targeted to fighting crime and bolstering national security, strengthening the economy and creating jobs, enhancing health and education and social development generally as well as promoting the further development of our Family Islands.

We fully recognize that the challenges that confront us are numerous and complex. The plan of action is commensurate with those challenges and the Government is steadfastly committed to its full implementation for the sake of a better life and future for all Bahamians.

The achievement of those objectives clearly rests on stronger economic growth going forward. To that end, the plan encompasses a variety of measures including strengthening our key tourism industry; promoting additional foreign direct investment across the country, and particularly in Grand Bahama and the Family Islands; exploring avenues for further diversifying our economy, especially in the agricultural area through science and technology to improve our competitiveness in food production. We are also committed to further diversifying our financial services sector; the further development and expansion of our yachting and shipping registries; expanding our investments in education; and strengthening national training through the National Training Agency to establish a competency based training and job placement system that is flexible and responsive to the requirements of the workplace.

The Government has focused attention on these and the other major areas of its change and growth agenda and will persist in planning and further developing initiatives that will get our economy growing more strongly in the years ahead.

From the outset, it has been clear that the plan could not simply be fueled by spending more money. The finances of the Government need to be returned to a position of sustainability if we are to strengthen confidence in the Bahamas as an attractive and secure place for investment, not only by foreigners but by Bahamian entrepreneurs as well. If confidence is eroded by lax fiscal policies, we all bear the consequences: credit downgrades and higher interest rates for the Government and Bahamian businesses and citizens, as well as the potential for further downgrades and higher interest rates if we fail to act decisively and stop mortgaging the future to support today's spending.

The Government has therefore been clear that it will implement priority initiatives within its plan to the extent that it can do so in a fiscally responsible manner. We have also stressed that we will strive to reform and rebuild the basic structure of the public finances such that, over time, we return them to a self-sustaining basis with no need for annual deficit financing and borrowing.

At the same time, by putting the burden of government debt on a downward path back to more desirable and appropriate levels, we will recreate the fiscal room necessary to finance the full complement of our national development plan, including economic renewal and stronger job creation. Seen in this light, fiscal reform is at the heart of the Government's plan for national economic and social development. In turn, tax reform is a critical component of fiscal reform. These reforms are critically necessary to allow the Government to follow through in making its national development plan a reality.

For the sake of complete transparency, accountability and credibility, the details of the fiscal reform strategy have been set out in the form of a Medium-Term Fiscal Consolidation Plan through 2016/17. The plan consists of four key parts: growing the economy; restraining expenditure; enhancing revenue administration; and securing new sources of revenue.

Through this plan, and in combination with actions to strengthen economic growth, the Government is fundamentally and, in a balanced way, reforming the structure of both Recurrent and Capital Expenditure as well as the structure of Government Revenues. This will allow the Government to:

- eliminate the unsustainable imbalance between Recurrent Expenditure and Revenue by 2015/16;
- significantly reduce the GFS Deficit and set it on course to complete elimination; and
- arrest the growth in the Government Debt burden and move it onto a steady downward path to more prudent and sustainable levels.

***Reform and Modernization of Major Existing Taxes***

The Government's actions on the revenue front begin with measures to improve the collection of existing taxes in line with what is rightfully due to the Government. Our revenue system is seriously deficient and the Government is moving to remedy this situation through a number of targeted reform and modernization measures.

***Customs Operations***

For one thing, the Government has been pursuing an aggressive plan of action in respect of Customs, to bring its practices and procedures up to best international standards.

***Business Process Re-engineering***

In the area of business process re-engineering, the final Inception report has been prepared and monthly reports have commenced. A cloud-based project management software has been set up to monitor activities, timelines and milestones.

***Enforcement***

As for enforcement, the consultants conducted their first mission and are developing preliminary findings for the "As Is" reports. This work should conclude by September 12, 2014.

***Customs Network Infrastructure***

The final report assessing the Customs Network has been reviewed. As well, the Terms of Reference for the new Customs Network have received approval from the IDB, which is providing financial support. Work is underway on the RFP to solicit bids for the new customs network inclusive of IP phones, Network Topology, Network Equipment, Installation, Maintenance, Warranty and Standardization.

***Mobile Communications Equipment***

The procurement of some of the mobile communications instruments, such as handheld radios, Wifi solutions in port zone and PDA's, is underway.

***Marine Unit***

Mobilization of the Marine Unit is proceeding with the RBDF guiding the procurement of the boats and maintenance management.

***K9 Unit***

Mobilization of the K9 Unit has been agreed and the RBPF/HMP will guide the procurement of the canines and maintenance management.

***Portable Scanners***

Customs is proceeding with the procurement of portable scanners and has identified several Family Island sites for deployment.

***Human Resources Consultancy***

The RFP for the HR consultancy is in development and bids will be solicited with a view to engaging a firm.

***Training Sites Renovation***

Customs is proceeding with the training sites renovation. They have identified several training sites for key Customs Operations on the Family Islands.

***Audit***

In the audit area, proposals are being reviewed and evaluated.

***<u>Modernization of the Real Property Tax System</u>***

As for progress being made on the modernization of the Real Property Tax system, concerted efforts are being focused on the following major initiatives in the Property Tax Unit of the Department of Inland Revenue:

- Introduction of a new Property Tax Management and CAMA System that will enable the RPT Unit to improve the coverage ratio of the tax system, provide accurate tax information, manage arrears and collections and lead to an overall enhancement in the efficiency of the department; the Government recently signed the contract with Tyler

Technologies with respect to replacing the Real Property Tax System;

- Development and implementation of a General Re-assessment of properties on the register in the Fall of 2014, in order to get property values up to date, by either indexing or trending existing valuations to achieve better horizontal equity;
- Implementation of an Arrears Action Plan utilizing private collectors to assist with the collection of outstanding property taxes;
- Delivery of an effective programme of Taxpayer Education to inform taxpayers on the various aspects of the Real Property Tax; and
- Amendments to the Property Tax Legislation to ensure that it is in line with best practices.

***Enhanced Containment and Control of Public Expenditure***

As for the containment and control of public expenditure, the Government has taken numerous concrete actions to restrain the growth of spending and make that spending more efficient and effective. The overall framework for strengthened public financial management is taking place within the scope of the new Financial Administration and Audit Act. The Ministry of Finance is, in a determined fashion, enforcing strict expenditure discipline and accountability across all Government Ministries, Department and public corporations.

In this regard, the Government is committed to a fundamental review of its operations and its expenditure and revenue control mechanisms, seeking to instill best practices wherever feasible. The Ministry of Finance, in particular, is being restructured and strengthened to enhance its capacity to more effectively monitor the operations and expenditures of Government Ministries, Departments and public corporations. Higher levels of accountability and transparency are critical.

As regards public corporations, the Ministry of Finance is exerting more direct oversight of their financial affairs to ensure that they strive for greater levels of efficiency and effectiveness and that they are subject to greater accountability to the Government. This will allow the budgeting process to be more comprehensively informed by the budgets of public corporations, such that a truly comprehensive approach to fiscal discipline is achieved. The Government has asked subsidy dependent corporations to better align their expenditure plans with the resources that are available.

In addition, the Government's planning function is being strengthened such that new investments and projects are reviewed in an economically and financially sound and effective manner. The Government is also introducing new Public Sector Procurement procedures which impose greater controls and greater efficiency on public spending for goods and services for all public entities including public corporations.

As well, the approach to the management of government debt has been strengthened with the establishment of a Debt Management Committee comprising representatives of Finance, the Treasury and the Central Bank. Through this committee, a new debt management policy framework has been developed to minimize the financing costs of Government debt while also minimizing risk.

Through these actions, Recurrent Expenditure will be allowed to grow in dollar terms through the medium- term to allow the financing of new and emerging priorities such as the hiring of doctors and other staff for the new mini-hospitals. However, the plan does signal the Government's commitment to a reduction in Recurrent Expenditure relative to the size of the economy; this will require the setting of clear spending priorities going forward.

Capital Expenditure over the last few years has been at exceptionally high levels relative to historical trends. That has reflected important investments in public infrastructure that will underpin more buoyant economic growth in the coming years. However, due to the fiscal exigencies, the Medium-Term plan calls for these expenditures to be returned to their more traditional level of 3% of GDP. Given emerging requirements, this will require strict prioritization and timely profiling on the part of the Government.

***Key Policy and Administrative Elements of the VAT Bill***

Before getting into the details of the VAT Bill, I will take a few moments to provide some background information on the context in which our Government's VAT proposal has been developed.

As many have acknowledged, our tax structure is clearly outdated and inadequate for the needs of a modern Government. Taxes and duties on international trade, in the form of import and export duties, excise taxes, stamp duties and tourism taxes, constitute some 60 percent of total Government Recurrent Revenues. Unlike most countries, we do not impose personal or corporate income taxes, nor do we have a broad-based consumption tax.

In essence, the Government's revenue base is excessively narrow and suited to another era when the economy was far less complex. The economy of today is, as in most advanced societies, heavily oriented to the provision of services but our tax structure is simply out of tune with that reality. By predominantly focusing on goods, our tax system is also decidedly unfair as the burden of taxes is not shared equitably by citizens of varying means.

Reform of the tax system and its administrative apparatus have been talked about in this country for a number of years but follow-up has been sporadic and unfocused. The time has come for decisive action.

The proposals for a fundamental reform of our tax structure, including the introduction of a Value Added Tax, which appeared in the White Paper of last year are another important element of the Government's programme of change. When fully implemented, they will result in stronger growth of our economy and more job opportunities for our citizens. A reformed tax system will provide for more equitable taxation. Just as importantly, the new tax structure will secure adequate revenues for the effective administration of Government and the pursuit of key economic and social objectives.

VAT has been under review and discussion in The Bahamas for a very long time and across administrations. In the process, we have benefited from the experience of numerous other nations around the world that have adopted a VAT over the past decades, as well as from an extensive international academic literature on the benefits and key desirable features of a VAT. Senior staff and advisors at the Ministry of Finance have also honed our VAT proposal on the basis of in-house research and visits to other nations in the region.

After carefully considering the vast amount of information at its disposal and the range of potential new revenue options, the Government decided that a VAT is the most suitable option to enhance the revenue yield of the tax system. Having said that, it is important to also stress that the Government is fully mindful of the potential effect on lower income Bahamians and is committed to mitigating the impact of VAT on the most needy in society, through the financial enhancement of its various social assistance programmes. This is a practice that has been adopted in other countries that have introduced a VAT and it is one that we believe is most appropriate in the Bahamian context.

The other revenue enhancement options that were considered as a central element of tax reform include:

- an income tax;
- payroll taxes; and

- a sales tax.

Income taxes are in general application around the world and they do generate significant sums of money for governments. However, as taxes on income, their yield is subject to the usual impacts of the economic cycle on employment and profits. As such, they represent a less stable source of revenue than a VAT over the cycle.

The personal income tax can also be tailored to be quite progressive which, as may be seen in some countries, involves the imposition of somewhat steep tax rates on higher levels of income. In some cases, marginal tax rates well in excess of 50 per cent are applied. That can be problematic in a nation such as ours.

With an exemption for a basic level of income, higher tax rates are also needed to generate the desired levels of Government revenues.

Research has found that income taxes are clearly more detrimental to economic growth than a VAT. The OECD (Organization for Economic Cooperation and Development) has reviewed over 90 studies in this area and concluded that the principal drawback of the personal income tax is that it acts as a disincentive to work effort, innovation and entrepreneurship. It also discourages saving as interest income, dividends and capital gains are subject to tax. Likewise, the corporate income tax on profits discourages investment and innovation.

The study produced a ranking of tax instruments in terms of their growth "friendliness". Property taxes and consumption taxes such as VAT are the most growth friendly. Personal income taxes are significantly inferior while corporate income taxes have the most negative effects on GDP per capita.

These negative effects, of course, grow in magnitude with the degree of progressivity of the income tax. As such, it is clear that the income tax works at cross-purposes to one of the major goals of tax reform, i.e. promoting a stronger economy and job creation.

A VAT, as a tax on consumption, does not deter work effort and entrepreneurship, nor does it discourage investment and innovation. It also encourages savings which, in turn, supports enhanced investment in the domestic economy

The imposition of tax on income can also lead to an onerous compliance burden for individual taxpayers. Employers, for their part, must withhold income taxes from the monthly wages and salaries of employees and then remit these to the government. Individuals must then file an annual tax return, declaring income from all sources and submitting all receipts required to support claims for whatever deductions are permitted. Private sector enterprises must do the same in respect of corporate income taxes.

As for a payroll tax, as its name suggests, it is simply a tax on an employer's total payroll.  Such a tax represents the major source of revenue in some countries but relatively high rates of tax on employment must be imposed in order to generate significant revenues.

As such, the main drawback of a payroll tax is that it represents a clear impediment to employment creation.

Payroll taxes also discriminate between income from employment and income from investments and profits.

Being based only on employment, payroll taxes are also highly cyclical, which is undesirable from a public policy perspective.

The Sales Tax, as its name implies, is a tax imposed at the final point of sale.  While relatively simple to administer, a Sales Tax suffers from important drawbacks.

For one thing, experience abroad has shown that, as a single stage tax, a Sales Tax is susceptible to significant evasion. In contrast, the VAT system has built-in mechanisms to encourage compliance. VAT is collected and remitted at each stage of the production and distribution chain. VAT paid at each stage is credited against VAT owing at the next stage, and only the difference is remitted. A VAT registrant expects the buyers of his product to claim credits for VAT paid to him, thereby discouraging him from attempting to hide VAT receipts. With a sales tax system, buyers may seek to avoid the payment of tax and sellers may be tempted to acquiesce in order to complete a sale. Such a transaction is easy to conceal to the detriment of Government coffers.

As well, as a single stage tax, a Sales Tax results in the cascading of the tax burden, whereby tax imposed at one stage of the production and distribution process, is subject to Sales Tax at a later stage (i.e. Sales Tax is charged on Sales Tax).

A VAT avoids this problem of tax cascading. With the crediting that is permitted under VAT, there is no "tax on tax" effect; when every registered business adds its markup to its cost of production to determine its selling price, it will not include the VAT that it paid on the materials and supplies that it bought because it will get a credit for that VAT when it files its VAT return. VAT will therefore not be charged nor paid on VAT.

Finally, under a Sales Tax regime, exporters are disadvantaged as their selling prices include Sales Tax paid on the materials and supplies that they purchase.

The phenomenal success of VAT around the globe reflects the fact that every country needs a tax on mass consumption to adequately finance government programmes and services. More importantly, experience has shown that the VAT is the least distorting consumption tax and it is the tax that can be administered most effectively. In other words, VAT is the most economically efficient way to collect tax revenues and the cost of doing so is generally lower than for other forms of taxation.

According to an IMF tax policy mission that visited this country in March of this year, revenue yields from VAT generally outperform other types of taxes and this has been demonstrated in several Caribbean countries. For example, following VAT introduction, indirect tax revenue increased by at least 3 per cent of GDP in Antigua and Barbuda, Belize, Dominica and St. Vincent and the Grenadines. In the case of St. Kitts and Nevis, the increase was on the order of 6 per cent of GDP, on the basis of a VAT imposed at a rate of 17 per cent.

The public launch of the VAT process began with the release of the White Paper on Tax Reform early in 2013. While there has been some evolution of the proposed framework since then, the fundamentals of how the VAT would operate in the Bahamas are still broadly in keeping with how the tax operates in countries around world. The objective is to keep the VAT administratively simple.

Public discussions began around the White Paper in both New Providence and the Family Islands. These then intensified to include the business community, churches, school, community and civic groups, and audiences within the public sector. From the private sector the Ministry of Finance also enlisted key business groups and the Christian Council to form part of an Advisory Committee for VAT implementation, to ensure that alongside one on consultations, the views of industry were being constantly channeled to the Government.

Following the release of the White Paper, the Ministry of Finance engaged in the process of drafting the VAT legislation and regulations, which formed the basis of more in-depth consultations upon their release last November.

With the release of the draft VAT legislation the Ministry of Finance received significant feedback from private stakeholder groups. In addition, there has been increasing outreach to the Family Islands.

The full range of these meetings and discussions has led to significant clarifications and in many cases positive responses to the proposals put forward by stakeholders.

As well, both the IMF and the IDB have provided invaluable technical assistance. The IMF brought regional and international experience to bear in helping us to cover all of the necessary bases in the draft VAT legislation. The IMF through Its Caribbean Regional Technical Assistance Centre (CARTA) also provided training to help build capacity for VAT administration.

The IDB has made a substantial contribution with the economic study on the impact of the VAT. Following the IDB's work, the IMF concluded a mission and issued a draft report to the Ministry of Finance on the revenue potential from VAT. On the basis of this revenue modeling work, the Ministry of Finance has been able to undertake sensitivity analysis on assumptions in respect of the VAT rate, exemptions and the efficiency of tax collections.

The government also commissioned Compass Lexecon to undertake an additional study on the desirability and suitable structure of a VAT. As well, early this year, the Government co-operated with the Chamber of Commerce's Coalition for Responsible Taxation in respect of the study on fiscal policy options that it commissioned to Oxford Economics.

The Compass Lexecon study concluded that a VAT is by far the superior new tax policy instrument for The Bahamas. A VAT provides the best combination of revenue generation, enforceability, efficiency, fairness and compatibility with economic growth. On the latter point this study concurs with the literature that VAT is a much better choice relative to personal and corporate income taxes and payroll taxes.

However, in light of the current state of the economy, the study recommended a VAT rate below 15 per cent, in the range of 5 to 10 per cent in combination with other fiscal reforms to meet the Government's fiscal targets.

The key findings of the Oxford Economics study are that, if we are to meet our deficit objective by the end of our current mandate, it is critical that we succeed on all revenue enhancement initiatives, including reform of property tax and Customs operations.

The study also finds that meeting our deficit target by 2017 will also be more likely to be achieved with a VAT rather than a payroll tax. As well, implementing VAT at a significantly lower rate, while desirable and feasible, will nonetheless require a much tighter approach to exemptions.

These studies have provided the Government with invaluable input into its thinking on the most appropriate approach to fiscal consolidation in general and, more specifically, on the parameters of a VAT policy framework suitable in the Bahamian context.

As the Minister of Finance stressed in the May Budget Communication, deliberations on VAT have also been most usefully instructed by the advice received from the team of New Zealand VAT experts that visited our country. These experts had discussions with a wide range of stakeholders as well as with officials and Ministers. Through this process, they outlined what had made the introduction of VAT in their country so successful and offered observations and recommendations on our proposal to introduce VAT in The Bahamas. As these inputs have proven critical to the evolution of the VAT proposal, I will review them again briefly at this juncture.

The success of the New Zealand VAT, and there are important lessons for us here, was very largely due to:

- an extensive education programme aimed at both the business sector and the wider public, with the programme largely driven by respected members of the private sector;
- a Government commitment to minimize the compliance costs involved with the new tax, particularly by having virtually no exemptions; and

- a Government commitment to offset the effect of VAT on the cost of living by reducing income taxes and, for families not paying income tax, introducing a form of negative income tax or cash transfer system.

As for a VAT in The Bahamas, the New Zealand experts recommended that:

- while the Ministry of Finance VAT Implementation Team could likely cope with implementation as early as October 1, they are more likely to require time beyond then if there are design and implementation changes made in response to the draft legislation upon tabling.
- Moving to a single rate of VAT, other than zero for exports, with very limited exemptions would enormously reduce the compliance costs of the private sector and the enforcement costs for the public sector. This would also permit a potentially large reduction in the single rate of VAT, almost

certainly to 10 per cent and quite possibly to below that figure.

- While the above approach would minimize compliance costs and allow a lower rate, it could also have negative effects on the well-being of low-income households. It would thus be vital to introduce mechanisms to protect such households. The team estimated that our proposed reforms to social assistance programmes appear to provide a suitable delivery mechanism for such assistance.

The impact of VAT structure and simplicity/complexity on private sector compliance costs is indeed critical. The issue has been documented in a study undertaken by Price Waterhouse Coopers on the basis of data collected by the World Bank as part of its Paying Taxes 2010 project. The study concluded that it is very important to streamline the compliance burden and reduce the time needed by business to comply if a VAT system is to work efficiently. The key underlying findings are that:

- Where electronic filing and payment is available and is used, the average time to comply with VAT is some 30 per cent lower;
- The frequency of returns is also important; where bi-monthly or quarterly returns are available, compliance time falls by some 35 per cent;
- The requirement to submit invoices and other documentation with VAT returns increases the time required to comply by a factor of 2; and
- Prompt refunds tend to reduce the time required by businesses to comply.

The VAT administrative framework that is in development for this country features a number of measures that will ease the compliance burden on business. There will, for instance, be electronic filing and payment; three options for filing frequency based on the size of a business; no invoices and supporting documentation will need to be filed with VAT returns but merely retained for audit purposes; and refund procedures have been accelerated.

The New Zealand mission has also brought the spotlight back to exemptions, an area on which we had a significant private sector lobby. Exemptions when they are socially motivated are intended to reduce the burden of consumption taxes on persons with lower incomes. The points that the mission reinforced however, are the following:

- The first is that it is a costlier method of trying to help the poor, because more revenue is sacrificed in the process to those who are not poor. Take food for example. While a low-income family spends a higher proportion of its income on food, a high-income family spends much more on food in absolute terms. So exempting food from VAT would provide a much larger dollar benefit to a high-income family than to a low-income family. Having the means to provide direct assistance to low-income families is thus a far more efficient mechanism than exempting necessities from VAT.

- Studies done in New Zealand at the time of VAT introduction showed that the bottom 20 per cent of households spent up to 29 per cent of their budgets on food while the top 20 per cent spent up to 10 per cent. However, upper income households spent twice as much on food as low-income households. For every $100 spent on food, the least well-off spent $6.50 while the most well-off spent $12. Thus taxing all food made more than sufficient additional revenue available to redistribute and supplement the incomes of the poor.
- In addition, as the Ministry of Finance has emphasized in its education campaign, VAT-exempt items can still experience a price increase under a VAT as sellers will not be able to claim credits for VAT paid on inputs. The New Zealand mission stressed that this increases the justification for limiting the list of items that are exempted from VAT, because it gives the businesses that are affected by such changes the opportunity

to participate fully in claiming credits for VAT paid on their operating inputs. It also allows such businesses to be more transparent in undertaking the adjustments to explicitly include VAT in their prices.

- The case of electricity is instructive in this regard. As it will not be exempt, BEC will be able to claim credit for all VAT paid on its inputs which, for electricity, are significant as they represent fully 82.5 per cent of gross output. That suggests that value-added in the electricity sector is only 17.5 per cent of gross output. BEC will then add 7.5 per cent VAT to its bills. However, were electricity to be exempt, BEC would not charge consumers the 7.5 per cent VAT but, as VAT on its inputs would not be creditable, it would pass on the equivalent of 6.2 per cent of VAT in the form of higher electricity prices. BEC's commercial customers would be particular hard hit as they would face higher electricity prices and would have no input VAT to claim as a credit. Their own selling prices, and the VAT that they charge, would also be higher. This clearly illustrates how tax cascading can result from VAT exemption.

As was explained in the Budget Communication, the government has accepted the New Zealand recommendation to enlist the private sector in the public education campaign. A three person Task Force will oversee this process and will be tasked to assist in explaining the VAT to the business community and the wider public.

The Government has now deliberated on VAT for well over a year. There have been consultations with the private sector. The Government has had the benefit of in-depth studies of VAT in the Bahamian context. Accordingly, the VAT policy and administrative framework that is presented in the VAT Bill has been duly shaped to reflect the very best advice that the Government has had at its disposal.

I will now briefly review the key features of the Bill.

There will be one single VAT rate across the board (other than the zero rate for exports) that has been substantially reduced to 7.5 per cent from the originally proposed 15 per cent. The lower VAT rate is deemed to be desirable from both an economic and social perspective. Of course, a lower rate will yield somewhat less revenue than we had originally expected. As such, across-the-board reductions in tariffs and excises will not feasible. There will, however, be selective reductions in certain areas.

Along with the significantly reduced VAT rate, the list of exemptions has been pared substantially. Specifically, no goods will be exempted. As for services, the list of exemptions has been tightened to include only the following:

- Financial services, i.e. credit and deposit/savings products. This covers all forms of lending and savings products issued by banks, insurance companies and other financial institutions. For insurance, the products affected are, in particular, life policies and annuities. Exemptions on non-

  life insurance and annuities are to be preserved until June 30, 2015.
  - The sale or rental of a dwelling.
  - Education services, specifically explicit tuition-funded courses in pre-school, primary and secondary school; and in programs of study leading to the award of graduate or undergraduate degrees at the tertiary level.
  - The sale of vacant land; the stamp tax on transfers remains in place.
- A lease of land to the extent that such land is principally used, or intended for use, for accommodation as a dwelling which is erected or to be erected on such land.
- Any services by a ministry, department, statutory body, agency, local government council, or other entity of Government, in connection with a taxable activity where the consideration for such services is —
  - (a) nominal in amount; or
  - (b) not intended to recover the cost of such goods or services.

- Services rendered by a daycare business, including the provision of after-school care.
- Services provided directly by a facility to persons in need of care, being persons who are —
  - aged;
  - indigent;
  - infirm;
  - disabled;
  - handicapped.
- Health care, specifically for public services provided to “public patients” receiving free care at public facilities including children of school age or younger, the indigent, aged, government employees and other persons identified by the Minister of Health.
- Religious services by an institution of religious worship.
- Services by a recognized charity to the extent that such services relate directly to the charitable function of the charity.
- Games of chance, gambling and lotteries.

A regime of VAT-inclusive, rather than VAT-exclusive, pricing is now being proposed. This is to simplify price comparisons by consumers, especially when navigating between VAT registrants and non-registrants. The price consumers see will always be the price they pay.

The registration threshold for VAT will now be universal at turnover of $100,00 per year. As well, we will allow group registration for related groups of companies, which will use a single VAT account and file a consolidated VAT return. This will eliminate the need to recognize input and output taxes on intra-group transactions.

There will be three filing periods for VAT which will be specified in the VAT rules rather than the Bill. Businesses with annual taxable sales exceeding $5 million will file monthly. Businesses below that threshold and with taxable sales exceeding $400,000 will be allowed to file quarterly. Other registrants would be allowed to file on a semi-annual basis and use more simplified cash accounting methods when compiling their VAT returns. This cash rather than accrual basis of accounting among small registrants would also eliminate working capital concerns over the treatment of bad debts.

A simplified VAT return using a “flat rate scheme” is proposed for businesses with turnover below $400,000. VAT due to Government would be calculated either as a fixed percentage of cash sales, with no need to account separately for input taxes paid; or the business would be allowed to calculate both input and output taxes on the basis of cash receipts or cash payments.

As well, businesses that qualify, including those that currently enjoy fiscal incentives on imports (such as tourism and manufacturing firms), may be allowed to defer payment of VAT until the return for the respective period is filed. At the time of filing, such VAT registrants would be required to report the deferred taxes. They would simultaneously claim any allowable input tax credit, and any cash flow impact of paying VAT would be minimized.

We will also implement less complex procedures for tax credits against bad debts. The simplified method relieves small business firms of the need for accrual accounting for VAT, and correspondingly all complications relating to bad debts. Large firms that must continue to use accrual accounting would face fewer hurdles when claiming credits for bad debts. These credits would be allowed when bad debts are recognized, as opposed to when collection efforts are exhausted.

As well, we have reduced the timeline for the payment of VAT refunds. Administrative procedures in the VAT Bill would allow businesses that file monthly returns to request refunds within two months of the period in which the net credits arise. Previously, wait times could extend up to 6 months. VAT registrants that sell zero-rated supplies and are always expected to be in a net credit position would not be subject to such waits. Such refund claims would be allowed at the same time as the VAT returns for the relevant tax period. Registrants that are allowed to file their returns on a less frequent basis would be able to claim refunds at the time of filing.

We are also providing an additional week to file VAT returns. Businesses will have up to 28 days after the end of each tax period to file their returns.

***Tariff and Excise Rate Reductions***

It is evident that a lower VAT rate will yield somewhat less revenue than we had originally expected. As such, across-the-board reductions in tariffs and excises will not feasible. There will, however, be selective reductions in certain areas, as seen in the amendments to the Tariff and Excise Acts that were tabled at the same time as the VAT Bill. Though not exhaustive, the following list is indicative of the areas in which the reductions are primarily focused:

- building materials, such as wood and wood strips, plywood, veneered panels, builders' joinery and carpentry of wood, PVC lumber and composite wood, shingles and shakes, Portland cement;

- articles of apparel, clothing and footwear
- various food items such as turkey, dairy products, soybean milk, vegetables, fruits and nuts, fruit juices
- instruments and appliances used in medical, surgical, dental or veterinary sciences
- refrigerators, freezers, stoves and ranges, instantaneous gas water heaters, tableware and kitchenware and
- selected so-called tourist items such as jewellery, watches and clocks, cameras and trunks, suitcases and briefcases.

As has been stressed in the past, this is the first round of tariff and excise cuts that is, at this time, compatible with the revenue targets that the Government is seeking to meet with its programme of tax reform. As the Government garners hard evidence on actual revenue collections in the first part of 2015, it will be in a better position to assess the extent of additional reductions that might be feasible going forward.

** In debating an important reform measure as VAT, Madam President, it is never appropriate to speak half-truths to advance one's cause. I mention this in the context of this debate as one of the groups leading the campaign against VAT published, (have employees adorned in VAT t-shirts), and several of their stores continue to have displayed posters showing a basket of grocery items stating that under VAT, they will increase by 15%.

Madam President, this poster is clearly inflammatory and was factually incorrect from publication. At no time has this government proposed any tax which would have resulted in the increases described in that poster. That group has access to some of the best and brightest, yet they circulate flyers knowing the contents to be misleading.

Madam President such tactics are simply inexcusable.

But whilst on the topic of groceries and VAT, I believe that at some point, the legislature will have to look at the issue of price control and price gouging in The Bahamas.

Madam President, as I go around town, I am amazed by the number of persons who have asked me if retailers have began charging VAT already. Persons are asking these questions as they feel as though prices are increasing.

I too have experienced this and I cannot fathom fully why this is occurring.  Over the years, we have consistently reduced duty on most food products and many of them are near zero.  Then the CEO of AML Foods speaking at a Store Opening in 2013 provided the answer.

The Chairman of AML Foods stated that:

**“by forcing all food stores to sell the bread basket items below cost, it means that we must charge much more for healthier non-price controlled items," he said, "thereby putting out of reach the very food groups our people need to eat."**

Madam President by “Below Cost” they are referring to the fixed margin which grocers are allowed to make on bread basket items which they advise is around 18.5%.  According to them, this margin is not enough and Supermarkets are subsequently forced to boost the prices on other items to make up the price controlled items to increase profit.

So essentially, the grocers are saying that since you control how much I can charge for these items, I would charge what I like on the rest of the store.  But the issue isn’t phrased as one of competition or unfair or unethical business practice but one of Government Taxation.

Madam President, providing food for one’s family is a basic human need. If retailers believe that reforms are required to enable them to reduce the costs, this government is always willing to listen.

It is however difficult, politically and otherwise to seek to reform a system when the industry partner whilst obeying the letter of the price control laws- do not obey the spirit.

These retailers who benefit from both their protected market positions and low duty tariffs must not abuse the positions of trust which the Bahamian public holds in them by either:

1) Selling substandard products
2) Using the strength of their market position to price gouge
3) Using unequal pricing for the same product on the same island
4) Failing to remove goods expired goods from shelves

***Conclusion***

We firmly believe that the VAT Bill sets out a solid, world-class policy and administrative framework for a Bahamian VAT that will be successful in moving our nation to a system of taxation that is both economically efficient and adequate to serve the needs of modern governance.