

EDITOR'S NOTE: The present is a short summary of the document submitted to the Turks and Caicos Islands Government on June 5th. Any questions should be directed to Sonia Monnier, sm@bishopslegal.com

OBJECT – GREEN PAPER COMMENTS - VAT

1. INTRODUCTION – GENERAL

a. Enforcement

If the TCIG is unable to provide **neutral and competent auditors** and neutral parties to help businesses comply with the VAT administration, then this tax is doomed to failure even before it has started its existence.

b. Education

Massive education and transparency are needed. When we say education, we mean conferences for industry sectors, specific training, etc.

2. INTRODUCTION – GREEN PAPER

a. Abrogation of the Hotel and Restaurant (Taxation) Ordinance (“HRT”)

The GP says: “VAT will replace the Hotel/Restaurant Accommodation Tax only for those businesses qualifying for registration.” (Our emphasis).

We would like to suggest the complete abrogation of the HRT in order to minimise the logistics and to simplify the process while minimizing the financial aspects and the human resources involved in the process. A way to do that, while maintaining the amount of revenue for the Government, would be by applying the new VAT to everyone that is currently subject to the HRT.

3. VAT OVERVIEW

a. Special Treatment for exporters

We totally agree with the carrying forward system for all taxpayers except for exporters. Exporters should be treated differently. For example, they can provide the VAT unit documentation showing evidence of their status of exporter and then have special treatment to obtain their refunds, let's say in 2 periods instead of 3.

4. MAIN FEATURES OF VAT

a. Registration

i. Tax Identification Number ("TIN")

The GP says: "Every registrant will be issued a Certificate of Registration containing the Trading Name of the Establishment, Registration or (TIN) Tax Identification Number (issued by the VAT Unit) and Date of Registration."

We strongly recommend that you also implement a system that will allow registrants to verify (**online and easily**) the TIN provided by their suppliers on invoices. Firstly, to prevent fraud by traders who could charge the VAT without a proper account and secondly, to prevent fraud in the input tax credits refunds. Once again, this control system should be easily accessible via the website of the VAT Unit.

b. Taxable Supplies

The GP says: "The time of supply of goods and services occurs on the earliest of the date on which:

- An invoice for the supply is issued by the supplier;
- All or part of the payment for the supply is received;
- The earliest of the date on which the goods are delivered or made available;
- The performance of the service is complete."

This is when the supply of goods or the performance of a service will be deemed to be made. We would like to put in perspective a very subtle, but important, nuance. This

should not be considered as the time or moment as when the tax is payable, deemed to be paid, etc.

A distinction must be made between the time when the tax is payable versus when the supply is made. Generally speaking, the tax is payable when the consideration is due and not when the supply is made.

c. Zero-rated supplies

The GP says: “Zero rates are intended for the benefit of the final consumer.” We agree with the fact that non-residents should not have to pay the TCI VAT when that non-resident received a good or a service (or enjoy the benefit of it) if he is located outside the TCI when he receives the good or service. If not, then the VAT would be payable. For example, when a tourist is visiting the TCI, he must pay the VAT on all goods and services acquired in the TCI and should not be entitled to a refund of any kind.

i. Basic food

The GP mentions: “Exempt supplies (..) some examples include (...) Basic food items e.g. rice, flour, sugar, milk, eggs, etc.”. With all due respect, **we recommend instead that Basic Food to be treated as a zero-rated supply.** The reason is quite simple, companies claim their ITC on imports and that will reduce their cost of acquisition of such goods. This cost reduction should be reflected in a reduction of the purchasing price of goods by consumers. In fact, presently, goods are taxed at a rate of 36%. If those items are zero-rated, that means that most of the population of the TCI will directly benefit from a reduction of 13%¹ on the price paid by the supplier on importation. Again, information and education for businesses and the population will be the key to success.

Secondly, we must point out that in a lot of taxation systems, Basic Foods are generally subject to specific treatment for several reasons, economically speaking and also depending of which taxation system is used, i.e.: sales tax versus VAT.

We have not conducted a thorough study of all the tax systems of the Caribbean, but let's just say that Belize, Barbados, St-Vincent and Grenadines and St-Kitts and Nevis,

¹ Assuming an actual 36% on importation for those goods.

are treating Basic Food in their VAT system as a zero-rated supply. Moreover, St-Kitts and Nevis (which is the closest comparable example to TCI²) treats as zero-rated flour, sugar, milk (not condensed, chocolate, etc.), rice etc. Their VAT system applies that the zero-rated status depending on the product itself and the circumstances of the sale.

d. Exempt Imports

i. Personal Exemption

The GP says: “The personal effects of a passenger, carried in his or her baggage or on his or her person which he or she might reasonably be expected to carry with him or her for his or her own regular private use, which are so declared and passed as such by a Customs Officer at the port of entry and which in the case of a passenger 18 years old or older may include:

- Goods not exceeding \$400 in value
- 2 liters of Wines (less than 25% by Volume), 1 liter of spirits, manufactured tobacco (includes 200 cigarettes, 50 cigars, 100 cigarillos, 250 grams of smoking tobacco) 50 grams of perfume or 0.25 litres of toilet water.”

We believe that everyone should be entitled to this \$400.00 exemption regardless of their age. This should be included in the legislation. On the other hand, it makes perfect sense that the “18 years and older” criteria would be applicable for tobacco, etc.

ii. Implements, instruments and tools of profession, etc.

The GP says: “Implements, instruments and tools of profession, trade, occupation or employment of a passenger”. If we understand correctly that would be applicable above the \$400,00. This is good and refreshing! The definition of what constitutes a profession, trade, occupation or employment should be broad enough. We also think that this should be applicable to registrants and non-registrants, in particular to cover the employment part of the exemption. Nevertheless, we do believe that a threshold should be applicable in order to avoid fraud, black market trading or massive importation for non-registered persons of equipment and / or goods for resale under the guise of the exemption.

² With an estimated population of 54,000 people on July 1, 2009.

iii. Flat Rate or Combined Rate – Duty and VAT

May we suggest a FLAT RATE of the VAT on imports? By example a combined rate of 30% or 33%. Then only 10% (which would be the portion of the VAT) would be refundable as an ITC. This would greatly simplify the administration and might even allow the repeal of the Customs Duty Ordinance in large part. Why administer two parallel systems on imports, when one would achieve the same revenue objectives? The benefits will be one administration, lower costs and it will be generally more flexible.

e. Input Tax Credit

i. Allocation method

We would like to point out the particular situation of businesses with mixed activities, i.e. taxable and exempt supply. Have you considered a way to help those businesses to comply in the simplest way? A way to help them would be to allow an allocation method based on outputs (i.e. revenues).

ii. Quick Method of Accounting (Small Businesses)

The quick method of accounting (“QMA”) is for very small businesses. It is an alternative method of calculating the net amount of tax to be paid without having to account for VAT on the majority of sales and VAT paid or payable on most purchases. Small businesses could be those registered businesses which can reasonably expect that their sales will not exceed the threshold of \$ 250,000 (for example) at the beginning of their second year of operation.

When using the QMA, businesses charge VAT on their taxable sales in the usual way. However, rather than actually account for the VAT charged on sales they make in the ordinary course of their business operations and claim credits for input tax on purchases related, businesses that use the QMA simply pay a fixed percentage (prescribed) of their total sales (including VAT) for the reporting period. These percentages, which vary depending on the nature of the business, are usually designed to equal the actual amount of VAT collected less the input recoverable (if rapid method was not used) for a typical firm size type.

As an example, in the GST system the rates are as follows:

- Sales of goods: The rate for is 2.5% of total sales;
- Services (for example auto repairs, hairdressers, lawyers): the rate is 5%.

The difference in rates between goods and services can be explained by the amounts of inputs needed. In fact, a supplier of goods has, generally speaking, more goods to purchase (more inputs) than a supplier of service.

f. Returns

We would like to suggest different production timing for small businesses. In fact, depending of the “threshold amount” a registrant would be allowed to calculate its payment or refund of VAT on a monthly or quarterly basis.

i. Non-compliance

We believe that a proper way to administer a VAT system is to ensure that the administration acts promptly against non-compliance. The VAT system will impose a burden on taxpayers, they will have to apply for registration and charge VAT on taxable supply. Also, they will have to issue invoices, keep books and records, file returns and pay promptly liabilities as the case may be. In return, the administration must act promptly against non-compliance. This implies prompt processing of returns, prompt payments, prompt identification of non-compliance (non-filers, delinquencies, false return) so that the taxpayers who duly comply will be encouraged to do so.

g. Refund

The GP says: “Further excesses will be carried forward consecutively for a maximum of three months and if after three months excess credit remains, that person may then apply for a refund or may ask that the amount be applied to another tax type where a liability exists”.

We believe that one step of getting good results for the compliance with the VAT system, a good public opinion and appearance of transparency **is to pay VAT refunds on time.**

You want to keep the TCI VAT system as simple as possible... On that particular point, isn't the purpose defeated by requesting a person to apply (or may we say "re-apply") for a refund after three months of excess credit with another form, and inevitably more delays when that same person already duly produced 3 declarations?

Again, the integration of all departments is a colossal task for a country as small as TCI, for many reasons. But the taxpayer is entitled to expect that the government will tell him clearly and unambiguously why he cannot obtain a refund of the VAT that he paid with his own funds, particularly given the very recent history of businesses not being able to obtain timely refunds from TCIG. Our earlier suggestions regarding the simplification/abrogation of the HRT and the Customs Duty would go a long way towards this.

h. Objections & Appeals

Have you considered the possibility of establishing an administrative tribunal perhaps similar to the Labour Tribunal to deal with VAT issues, Stamp Duty and Customs Duty? Under the current proposal, the first independent person (i.e. not government and not registrant) to intervene in the proceedings will be an already overburdened Supreme Court! Taxation in general, and VAT in particular, is a complex specialized field and many countries use administrative tribunals to deal with them. With the size of the TCI economy, the amount of actual litigation will probably be minor and could be dealt with by a small team in the "TCI Tax Court".

5. SECTOR CONSIDERATIONS

a. Tourism

First of all, as we said previously, we insist on the fact that every business which could be subject to the HRT would have to register for the VAT regardless of the threshold of

the business, allowing for the complete repeal of the HRT and the inherent simplification this would bring about.

Moreover, one particularity of the TCI economy is that many of the condos in the tourist resorts are rented “hotel style” (and therefore taxable under the VAT) but many others are rented long term to residents (and presumably not subject to VAT). This local distinction should be addressed clearly in the legislation, to avoid confusion.

i. Regarding the application of the STRATA MODEL (or Condo-Hotel) Acting as Agent:

Our suggestion is to apply the Agency system in the Strata Model. This will result in greatly simplifying the administration of the VAT for these entities, avoiding the risk of double taxation and, since it has non-residents involved in the chain of taxation (collection and remittance), ensure that the applicable tax is duly delivered to the tax authorities. Informally, this is what currently happens with the HRT on the revenue side, so the implementation will be fairly easy for the hotel industry.

b. Financial Sector

We believe it may be extremely difficult to monitor that all financial transactions were properly subject to tax. To this regard, the GP says: “Domestic Financial services other than those rendered for a fee/commission” will be exempt. We understand that, the financial institutions would have to, under the provisions of the GP, deal with exempt and taxable supplies. Since all financial institutions, particularly banks, are required to produce some form of financial statements, we suggest a compensatory tax which would apply as a simple percentage on one entry of their financial statements and /or general ledger instead of keeping track of all transactions at the ATM. Of course, the countervailing charge for this is that financial services will be zero-rated to offset the financial burden of the compensatory tax on financial institutions.

c. Real Property

i. Long-term residential lease (principal residence)

First, the terms used in the GP imply that the long-term residential lease will be exempt. The GP says that would be exempt: “A supply of an accommodation in a dwelling under a lease or rental.” There is actually no tax applicable on long-term renting and this must remain so. ***From an economic standpoint, the main expenses of a person are food and rent. If we treat the first category as zero-rated and the second as exempt, the budget of low income families will be only minimally affected by the introduction of VAT.***

ii. Land transactions

The GP says: “Land transactions are expected only to be subject to VAT where they are not subject to Stamp Duty”. Moreover, the GP says: “A supply of land for dwelling (...) where the supply is subject to Stamp Duty” will be exempt.

This is very broad and seems, with all due respect, meaningless in the context of the consistency of laws. What do you mean exactly? It is our understanding the Stamp Duty ordinance covers almost every transaction of land that may arise in the TCI. Does “not subject to Stamp Duty will be subject to VAT”, mean if exempt under the *Stamp Duty Ordinance*, then will be subject to VAT? Or simply not subject? In other words, we have not been able to identify a land transaction which would not be subject to the Stamp Duty Ordinance (though duty may not be payable) other than the “renting” of real property, which is comprehensively treated elsewhere.

iii. New construction of dwelling

We would also like to submit a different treatment for sale of new dwellings. We believe these should be taxable under the VAT and a refund should be made available to the purchaser, refund that will be equal to the difference of the VAT and the Stamp Duty that would otherwise be calculated on the total amount of the consideration. The idea behind that is to prevent new construction of residential property containing a portion of VAT that used residential buildings do not have where there was no-VAT component in their construction costs. In other words, during the construction of a new property, several suppliers will pay the VAT on different inputs in order to perform their services or to

provide certain goods and they will not be able to recover the input tax as they carry out an exempt supply. As such, you mention in the GP that the supply by way of sale of a real property for dwelling that is subject to Stamp Duty will constitute an exempt supply. Moreover, the Stamp Duty (if the supply is not taxable under the VAT system) will be applicable on a consideration which will be unduly inflated by the cost of the tax included in the costs charged by different suppliers. The idea behind the refund is to put all buildings on the same footing from a tax perspective and avoid double or even triple taxation under some distortions that may occur between two different taxation systems i.e. Stamp Duty versus VAT.

iv. Manufacturer

We believe that some relief measures should be considered for (the very few) businesses that qualify as local manufacturers. A local manufacturer could be defined as a business where substantially all necessary inputs, to provide products or services, resources are from TCI.

You are aware that local manufacturers are faced with operating costs well above their closest competitors who only have to import the products. TCI manufacturers face very high production costs. It is essential that these industries benefit from special treatment in order to reduce their operating costs and allowing them to remain competitive in a market such as TCI.

6. ECONOMIC IMPACT

The GP says: “With the introduction of VAT, prices in the economy will increase for some goods and services while others will reduce or remain the same.”

This statement is quite true in a theoretical framework without distortion parameters. However, our experience tends to show that too often, this cost reduction, production or distribution due to the VAT, is simply reflected in an increase in the supplier's profit margin. We must develop a way to raise public awareness of the effects of VAT on different goods and services and so discourage some suppliers who will see the

introduction of VAT as a great way to generate additional profits. Clearly the public, quite legitimately in our opinion, fears this greatly.

7. CONCLUSION

We are of the opinion that VAT might help the TCI. However, there are many technical elements which we feel must be reconsidered, as well as local particularities to take into account. If the implementation is taking those into consideration, then this could result as a positive change for the TCI. That being said, even if we firmly believe in that regime, we are not entirely convinced, given the history of the TCI, whether or not it is the best alternative for this country at this moment. Only time will tell...

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