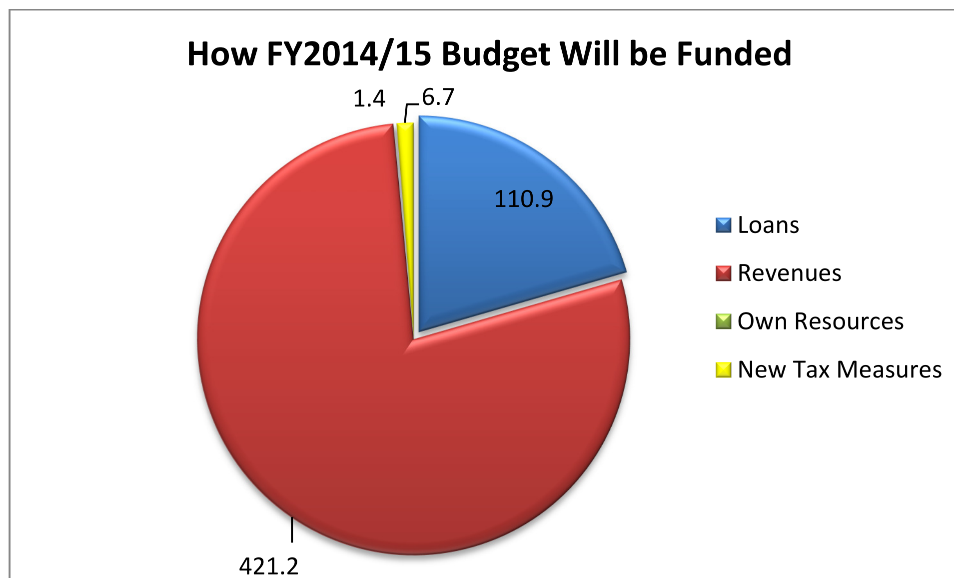
The Tax Issue

In its efforts to adhere to the fiscal discipline entrenched in the 4- year long extended fund agreement, the government has budgeted expenditure of $540.1Bn in FY2014/15. This represents a 1.5% decline in real terms on last year's expenditure if we consider projected inflation of 9.4%. Of this amount, $233Bn (or 43%) will be used for debt servicing, while the balance will be earmarked for spending on wages, programmes and capital expenditure. Cutting infrastructural spending to meet the fiscal target has often been a practice of the government and this year was no different. And while many continue to take issue with the sustainability of this practice because of the adverse impact on economic growth; the government continues to find space to reduce capital expenditure (this year by roughly 8.7% to $33.93Bn). The fact that economic growth has picked up in the last two quarters has made cutting this expenditure item a little less difficult. However the risk inherent in this approach is that growth is being driven mainly by the impact of recovery in key industries. As soon as this effect dissipates, the economy is likely to return to its lacklustre growth levels in the absence of well needed stimulus.

On April 17th, the Minister of Finance outlined how the government plans to fund the $540.1Bn expenditure for the current year. With expectation that revenues will grow to $421.2Bn, the $118.9Bn financing gap is expected to be funded by loan receipts and a $6.7Bn tax package. The breakdown is shown in the pie chart below:



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About revenues

The government has done well over the last few years in meeting budgeted expenditure, but has hardly ever met its projected revenues (this may be because it has greater control over expenditure but revenue collection depends on the actions of taxpayers). Revenues have fallen behind budget in four of the last five years. The one thing that is clear is that they have been very poor forecasters, a flaw that IMF officials called out in the last review. That said, it is becoming increasingly important that the government increase the accuracy of its forecasts given that the stakes are higher, the targets are ramping up and there is very little room for error. We hope this year's tax revenue forecast contains an appropriate contingency and incorporates the impact of a cut back in consumer spending given the recent tax measures. In addition, the government must weigh the impact of offsetting receipts. For example, the increase in asset taxes will lead to a decline in PAYE receipts as the financial sector trims cost to maintain or improve efficiency. This could result in the revenue outturn being less than expected.

About Taxes

The government is expected to implement a $6.7Bn tax package through implementation of the following measures:

Description of Revenue Measures	Revenue Impact (Billion $)
Modification of the alcohol regime to unify the specific SCT on all alcoholic beverages	$0.844
Increase in age limit of second sale on which GCT will be applicable (from 8 to 10 years)	$0.026
Levy on withdrawals from deposit-taking institutions and encashments from securities dealers	$2.250
Increase in premium tax for regionalized and non-regionalized Life Assurance companies (up to 5.5%)	$0.276
Investment tax for insurance companies (up to 20%)	$0.701
Increase in Asset Tax	$1.788
Modification of duty regime for specified motor vehicles	$0.250
Redirecting of portion of SCT from the Road Maintenance Fund to Central Government	$1.200
Increased Annual General Personal Income Tax Threshold ($557,232)	($0.650)
TOTAL	$6.685

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Levy Rates on Withdrawals from Deposit Taking Institutions and Securities Dealers	
Value of Transaction	**Levy Rate**
Less than One (1) Million Dollars (<$1,000,000)	0.100%
One (1) Million to Five (5) Million Dollars ($1,000,00≥Transaction<$5,000,000)	0.090%
Greater than Five (5) Million – Less than Twenty (20) Million Dollars ($5,000,000≥Transaction<$20,000,000)	0.075%
Greater than Twenty (20) Million Dollars	0.050%

Of note, 75.0% of the new tax yield (including the transaction tax) is from the financial sector which means that the government is obviously targeting measures which it has the highest potential to collect. This will minimize the risk of evasion and shortfall given that these regulated institutions usually pay over their government obligations. The withdrawal levy has drawn the most attention. Despite the minister's attempt to explain why the withdrawal levy is the best solution at this time, he has come under pressure from all angles. Of note, this tax measure has the highest expected yield (about 33% of expected new taxes). Usually when there is such strong resistance on a particular tax measure, the government would review and implement an alternative. Let's say the government considers a review. We believe that it would have to be replaced by another high yielding measure such as the progressive income tax on individuals above a certain income level. This was implemented in FY2009/10 year for a duration of 15 months from which the government sought to raise $1.32Bn. The alternative approach is to demonstrate the political will that the international lenders (including the IMF) love but voters hate (election due in less than two years). We think that the government will be inclined to review that levy.

Implications of recent tax measures

Undoubtedly, there are positive and negative implications of the recent tax measures. The positives are:

- Help to set Jamaica on the right path to reduce its debt over time- this has positive implications for long term growth
- Nod of approval from international investors- A sustained reduction in the fiscal deficit signals that the country's financial risk is declining which is viewed favourably by prospective lenders. This will allow the government to access funds at cheaper cost and boost foreign investment
- Passing IMF Test- Meeting revenue and fiscal targets will facilitate continued assistance from the fund and other multi-laterals

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On the other hand:

- Higher taxes on the financial sector will result in increased unemployment for the sector as companies trim cost to counter the effect. In addition, the likelihood of industry consolidation has increased as the prospects for smaller outfits will weaken in light of lower revenues and higher costs . This also has implications for PAYE receipts.
- There is the possibility of the government further increasing these taxes in the near future if revenues underperform. The government has shown a tendency to continually target high yielding tax measures. These include SCT on alcoholic beverages, cigarettes and now financial institutions. There is the possibility that the latter will be called upon again to stem any decline in revenues going forward.

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