

Tax News

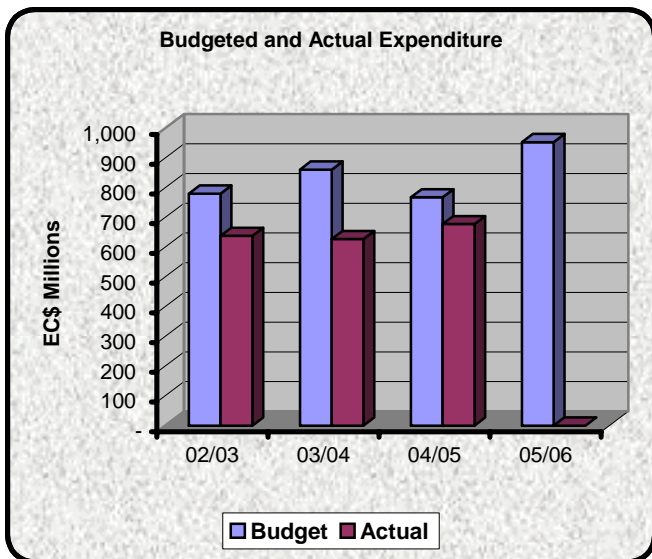
2005/2006 Budget Address



**Billion Dollar Baby (almost)**

**“Developing a World Class Destination and enhancing Human Resource Capacity”**

On April 19, 2005, Prime Minister and Minister for Finance, Economic Affairs, International Financial Services, and Information, the Honourable Dr. Kenny D. Anthony, presented an EC\$954.1 million Appropriation Bill to Parliament for fiscal year 2005/2006. The total planned budgetary outlay is 24.1% higher than the budgeted expenditure and 40.7% higher than the actual expenditure for 2004/2005. No new taxes are planned to finance the increased expenditure.



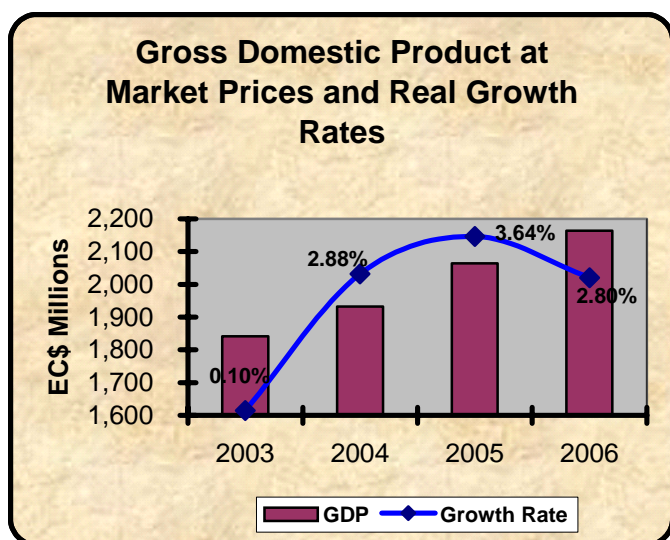
**BUDGET HIGHLIGHTS**

- ❑ Economic growth of 3.6% in 2004/2005 and expected growth of 2.8% in 2005/2006.
- ❑ EC\$336 million of public sector capital investments in Cricket World Cup facilities, road infrastructure, water supply, disaster mitigation, national hospitals, seaports and airports, security equipment and information technology.
- ❑ Over EC\$1.8 billion in new large-scale private sector developments in hotel resorts, apartments and condominiums proposed over the next 3 - 5 years.
- ❑ New incentives to assist “Bed and Breakfast” accommodation for the Cricket World Cup, renovate business properties, encourage the use of energy saving devices, and support agri-business development in the non-banana sub-sector.
- ❑ Investments in the Social Sector for disaster mitigation, housing relocation, increases in pension payments to Government pensioners, increases in public assistance and increased allocations to homes for the elderly.

## REVIEW OF ECONOMIC PERFORMANCE IN 2004

The Prime Minister presented an aggressive plan to develop the country and its people to take advantage of the opportunities presented by the hosting of the Cricket World Cup in 2007. This plan will be facilitated by the good economic performance in 2004 and the significant inflows of foreign direct investment that are projected. The challenge, as usual, will be Government's capacity to carry out the plan and, its efficiency in undertaking the expenditure. It will require improvement of the fiscal position of Central Government and the containment of public debt to more prudent levels.

Based on the leading economic indicators for 2004, and the growth of 3.6% in Gross Domestic Product, the Prime Minister declared that the Saint Lucia economy has fully recovered from the recessionary conditions of prior years. Tourism led the way, and most of the growth came from the expansion in hotels and restaurants, government services, wholesale and retail trade, communications, banking and insurance and agriculture

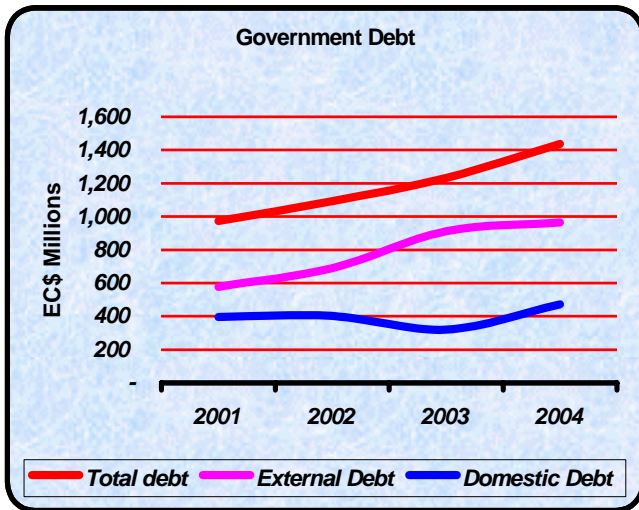


*There has been real economic growth over the last two years, and further growth of 2.8% has been conservatively estimated for the coming year. Most of the leading economic indicators were good, and best ever results were achieved in many sectors. We have benefited from favorable economic factors in our main tourism markets and natural events that adversely affected our competitors. Some of these trends are expected to continue in 2005, but our economy remains open and vulnerable to shocks, and future growth may be threatened by the continued volatility of fuel prices.*

Some of the highlights in domestic sectoral developments in 2004 included:

- A 15.8% increase in total visitor arrivals to 813,681, the highest level ever. Improvements were experienced in stay-over arrivals (7.7%), cruise ship visitor arrivals (22.4%), yacht visitor arrivals (6.2%), average occupancy rates and overall earnings (17.1%) which now stands at \$879.3 million or 71% of the exports of goods and services.
- A 24.6% growth in Banana exports to 42,326 tonnes and a 24.7% increase in export earnings to \$54.3 million. Growth was also experienced in fish landings (5%), egg and pork production, but the production of chicken declined (28.7%) and the production (4,854 tonnes) and value (\$9.8 million) of non-traditional crops declined by 15% and 11.7% respectively.
- The value of manufacturing output (80% of which came from food and beverages, electrical products and paper and paperboard) increased by 6% but this sector recorded an overall reduction in value added.

- Government current revenues increased by 12.3%, due to higher than expected tax revenues, and current expenditure increased by only 1.7% due to a 4.4% decrease in wages and salaries. These changes generated a current account surplus of \$69.4 million (3.3% of GDP), but lower than expected grants resulted in an overall deficit of \$93.2 that had to be financed by new borrowing.



*Although government guaranteed debt and non-guaranteed debt declined by \$236 million, the total outstanding liabilities of the public sector increased by 16.7% to \$1,438 million or 69.6% of GDP. External debt increased by 6% and domestic debt increased by 53.4% due to refinancing to reduce servicing costs. Debt service was lower but the interest component was higher. Debt service to current revenue improved 5.4 points to 19.7%, but is still higher than the desired benchmark of 15%.*

- Marginal growth was recorded in construction, due to the reduction in public sector construction activity, but private sector construction remained buoyant, as evidenced by imports of construction materials (\$75.9) and credit disbursed by financial institutions (\$180.4 million) to the private construction sector.
- Liquidity in the financial and monetary sector improved as growth in deposits (10.7%) outpaced loans and advances. The loans to deposit ratio improved to 80.7% and the stock of monetary liabilities in the domestic economy increased by 10.5%. Savings deposits and prime lending rates remained unchanged, but mortgage rates declined slightly.
- Petroleum import prices increased by 32% over the period, and led to a 23% decline in consumption tax revenues from diesel and unleaded gasoline in spite of the price increases passed on to local consumers in June 2004. The prices of LPG and Kerosene are now being subsidised by Government.
- The merchandise trade deficit narrowed to \$773 million (37% of GDP) as exports doubled to \$250 million while imports increased by 6.8% to \$1 billion. As a result of the surplus on the services account, the current account deficit narrowed to \$295 million (14% of GDP). The overall surplus on the balance of payments more than doubled to \$70 million.
- Inflation increased slightly to 1.4% due to higher food and oil prices.

## REVENUE AND EXPENDITURE ESTIMATES FOR 2005/2006

Expressed in EC\$ 000's	2005/2006 BUDGET	2004/2005 ACTUAL	2004/2005 BUDGET
<b>EXPENDITURE</b>			
Recurrent expenditure	557.1	482.7	508.1
Capital expenditure	335.7	163.4	221.6
Debt amortisation	61.3	32.1	38.9
<b>TOTAL EXPENDITURE</b>	<b>954.1</b>	<b>678.2</b>	<b>768.6</b>
<b>FINANCING</b>			
Current revenue	597.6	552.0	500.1
Capital revenue	1.0	0.9	2.7
Grants	76.8	-	73.0
Debt Financing	278.7	125.3	192.8
<b>TOTAL FINANCING</b>	<b>954.1</b>	<b>678.2</b>	<b>768.6</b>
<b>CURRENT ACCOUNT SURPLUS</b>	<b>40.5</b>	<b>69.3</b>	<b>(8.0)</b>

Total expenditure of \$954.1 million is 24.1% higher than budgeted expenditure in 2004/2005 and 40.7 % higher than actual expenditure for that period. This is largely due to the planned expenditure on capital investments, which is 51.5% higher than the estimates for 2004/2005 and twice as high as the actual expenditure for that period. This is in keeping with Government's stated intent to make the required capital investments to host the Cricket World Cup in 2007 and take advantage of the opportunities that our presence on the world stage in 2007 will provide.

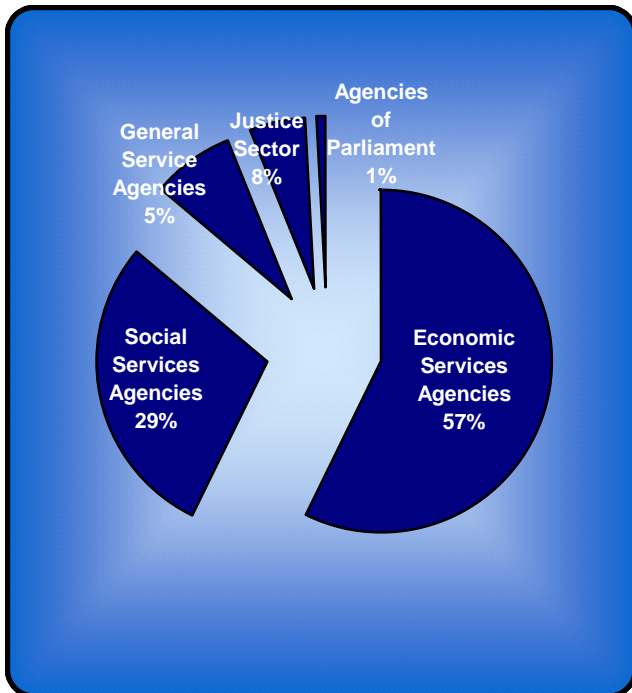
Recurrent expenditure is 9.7% higher than the estimates for 2004/2005 but 15.4% higher than the actual expenditure for that period. This is a reflection of planned or required increases in expenditure on the social services agencies, preparations for the Cricket World Cup,

increases in debt service and retiring benefits. The overall increase is in excess of the expected growth in GDP for the coming year and will amount to 25.7% of projected GDP compared with 23.4% in 2004/2005.

The increase in the level of debt amortisation for the coming year is due to the requirement to increase the provisioning for sinking fund contributions to meet future debt retirement obligations, due to low returns on the existing sinking funds.

To finance the budget, total recurrent revenues are projected to increase by 9.2% over the budgeted revenues for 2004/2005 but are 1.1% lower than the actual revenues in 2004/2005 due to concerns over consumption tax on oil imports. For the first time, Government is allocating excess revenue of \$51.4 million from the actual current account surplus carried over from 2004/2005.

Without this allocation, there would actually be a current account deficit of \$11 million rather than the budgeted surplus of \$40.4 million (2% of GDP).



*The largest increase in the allocation of expenditure is to the Economic Service Agencies for the Cricket World Cup, road, water and other public infrastructure investments, higher debt servicing and increased retiring benefits. All other allocations are in line with budgets in prior years, and reflect Government's balanced approach to the allocation of public expenditure. Allocations to other agencies and sectors are marginally lower as a percentage of the pie, but have all increased in absolute amounts over the prior years budgeted amounts. Sharing the pie remains a difficult balancing act.*

It is assumed that this excess revenue represents available facilities and would not require new borrowings. There are no new taxes or revenue measures in the budget, but Corporation tax rates will decline from 32% to 30% in line with tax reform proposals made in prior years.

It is assumed that the expected decrease in corporation tax revenues from reduced rates will be compensated for by increased direct and indirect tax revenue from economic growth, new economic activity and the broader implementation of the property tax regime implemented in prior years.

Grant funding is expected to provide \$76.8 million, of which \$61.1 million is expected from the European Union. The expected grant funding of \$73 million in the 2004/2005 estimates did not materialise due to unexpected changes in the system of disbursements that have since been rectified. There are still substantial untapped resources available from the European Union.

Financing is also provided by \$22 million of bond funding carried over from previous fiscal years. It is assumed that this excess represents available funds from bond funding not required in 2004/2005. The overall deficit after allocation of excess revenues and bond funding from prior years, but before debt amortisation of \$61.3 million, is \$217.4 million (10% of GDP) compared with an actual overall deficit of \$93.2 million in 2004/2005. This is financed by new bond funding of \$188.4 million and other loan funds of \$68.3 million from the CDB, the World Bank, the Kuwaiti Fund and the Agence Francaise de Development.

*Debt financing is projected to increase by 33.3% over the 2004/2005 estimates and will be twice as high as the actual debt disbursements in that period. While there are few options available to finance the required capital investments for the Cricket World Cup and other economic services, this rapid increase in debt will require careful management in the years ahead. Government will have to ensure that they collect the expected increases in revenues from the Cricket World Cup and new economic activity, and will have to implement tax reforms as early as possible in the coming year to stabilise and broaden their revenue base.*

## NEW PRIVATE SECTOR DEVELOPMENTS

The Prime Minister listed an impressive array of new and proposed developments in tourism, many of which have already started, or have committed funds for the purchase of property in Saint Lucia. Most of these investments involve inflows of foreign direct investment, either as loan capital from foreign banks or equity from foreign investors, but the local private sector is heavily involved in many of these projects, through joint ventures and sole investments.

Some of the investments listed (Discovery at Marigot Bay, Coco Resorts) are nearing completion and many (Choc Bay Marina, Sapphire Cove, Praslin Bay, Beaches, The Landings) have not finalised their project proposals or commenced construction. The Prime Minister cautioned that many of the developments were still in the proposal stage, but noted that if they were all completed, they would represent a cumulative investment of over EC\$1.8 billion or 142% of our annual GDP.

Many of these investments were encouraged and accelerated by the special incentives that were enacted in 2004 to increase the number of hotel rooms in time for the Cricket World Cup in 2007. While these incentives have been effective in attracting new investments, most of the developments have been based on a long-term feasibility that is not dependent on revenues from the World Cup in 2007. It is an indication that Saint Lucia is being increasingly viewed as a destination that has long-term prospects for good returns on investment.

Also significant is the fact that many of these investments are in projects that cater to the upscale and high net worth traveller and investor, and is biased towards the construction and sale of condominiums, apartments and luxury homes that can also be operated as a resort complex. There are a number of additional private sector developments in Cap Estate that were not mentioned in the budget address, but are also in the planning or implementation stage.

The Government has indicated its intention to establish a special Fast Track Unit with additional staffing to expedite approvals and facilitate efficient collaboration between the Ministries of Government and the referral agencies.

*The greatest cause for concern with these new private sector investments is whether the country has the capacity to accommodate the increased level of construction activity during the next 3 – 5 years, and whether the Government can provide, upgrade and maintain the critical infrastructure that will be required for these investments and the increased visitor arrivals that are anticipated before, during and after the Cricket World Cup. The acceleration of activity could also result in increased construction costs and shortages in materials and labour that will affect the timing and viability of these investments.*

## NEW INCENTIVES AND CONCESSIONS

The Prime Minister announced a package of new incentives to assist “Bed and Breakfast” accommodation for the Cricket World Cup, renovate business properties, encourage the use of energy saving devices, and support agri-business development in the non-banana sub-sector.

### ➤ *Incentives for Bed and Breakfast accommodation*

These incentives are being provided to assist persons who wish to expand or renovate an existing property to provide bed and breakfast accommodation for between 2 and five persons in time for the Cricket World Cup in 2007.

An approved Bed and Breakfast Accommodation Project will qualify for the following incentives:

- 1) 100% waiver of Duty and Consumption Tax on materials and fittings imported or bought locally for the expansion or renovation of the property.
- 2) An income tax holiday of 5 years on the rental income from the property.
- 3) A 50% reduction in Property Tax for a period of 5 years in respect of the property or the entire property on which the project forms a part.
- 4) A tax credit of up to 3% for financial institutions providing finance for the project, based on the amount loaned (1% for loans of \$300,000 and under, 2% for loans between \$300,000 and \$600,000 and 3% for loans above \$600,000)

For projects to qualify, they must be inspected in advance of approval, meet minimum standards established by the Ministry of Tourism, and be made available during the Cricket World Cup.

*While there will be a need for this type of accommodation during the Cricket World Cup, owners will need assistance to market their properties and the Ministry of Tourism will be strained to provide the inspections, approvals and monitoring of these projects. Government should have provided a more flexible package of concessions to include other ventures and activities that can be executed by local investors for the Cricket World Cup.*

### ➤ *Promotion of energy-saving devices*

In a bid to assist energy conscious consumers and conserve energy usage in a projected period of high oil prices, Government will reduce Consumption Taxes on energy-saving devices commencing on August 1, 2005 and for income years 2005 to 2007 will allow a deduction of up to \$6,500 for the purchase and installation of a new solar water heating system.

*This is a good but inadequate response to the anticipated problem of high electricity and petroleum prices as a result of the continuing high prices of imported oil. As this trend is likely to continue for the medium term, and may become more severe in the years ahead, Government needs to establish a strong energy policy that will promote, practice and reward conservation, alternative energy and the use of energy-saving devices.*

*Concessions should be available to businesses as well as individuals in the promotion of these policies, which should also target the use of more fuel-efficient vehicles, lighting devices, air conditioners and allow the private generation of energy using alternative energy sources.*

➤ ***The restoration of incentives to businesses to renovate properties***

Effective May 1, 2005 businesses will be exempted from duties and exemption taxes on building materials used in repairing, rehabilitating and renovating places of business in all of the major towns and villages in Saint Lucia. The incentives will terminate on January 31, 2007. Applications with a supporting bill of quantities should be forwarded through the Office of Private Sector Relations.

***These concessions operated in prior years, and have been requested by the private sector. A more effective procedure for the approval and refund of duties will be required to assist local retailers to provide and recover the savings without undue delays.***

➤ ***Incentives Regime for Agriculture***

A new incentives regime will be provided to support agri-business development, encourage youth participation in agriculture programmes and promote sustainable land management. The regime will also focus on groupings, associations and cooperatives to encourage the pooling of resources to produce greater economies of scale. Concessions will include the 100% waiver of import duty and consumption tax on generic materials and supplies for registered cooperatives and partial exemptions for individual farmers.

Waivers of import duties, consumption and excise taxes will also be available on a wide range of items and inputs used in agricultural production and processing, including vehicles, refrigerated trucks and farm equipment. Similar concessions will be available for the livestock and fisheries sub-sectors. Concessions will only be provided to qualified projects and farmers who meet the required standards and practices, and can provide evidence that the concessions granted were used for the specified purposes.

***These are useful and important incentives that can promote agricultural diversification and good agricultural practices, but it will require good public education and targeted assistance to ensure that farmers can access the incentives and comply with the conditions. The private sector and agricultural associations should be utilised and rewarded to provide technical assistance and help in the creation of cooperatives.***

The Budget included a wide range of investments in the Social Sector to address issues of social protection and social vulnerability. They include capital and current expenditure, directly and through enabling agencies, to assist and empower those affected by disasters and disadvantaged by poverty and economic hardships.

Some of the investments mentioned in the budget included:

- Landslide risk reduction and housing relocation
- Relocation of fire victims
- Increases in pension payments to Government pensioners
- A 37.5% - 41% increase in public assistance to incapacitated persons
- Increased allocations to homes for the elderly
- A textbook rental program for needy students
- Continued progress towards the implementation of Universal Health Care

*These are all essential investments that need to be continued until our society has matured sufficiently and can provide the support and assistance to most of this sector through properly organized and funded voluntary, religious and non-governmental organizations to implement such programmes*

Other important programmes, investments and initiatives included the increase of information technology in the public service and the justice sector, the introduction of machine readable passports (by November 1, 2005) and improved border control systems, a three-pronged strategy for the improvement of water supply and the eventual privatisation of WASCO and the initiation of a National Export Development Strategy.

Some of the more glaring omissions in the budget were the introduction of measures that would effectively deal with the following issues:

- Income tax reform, particularly the research that is urgently required to determine if, how or when we should introduce a broad transactions-based system of tax (VAT), given that most other countries in the region have made progress in this area.
- Improvements in the justice sector that would deal with the backlog in the courts and antiquated legislation that constrains the timely enforcement of loan security.
- Public sector reform and productivity enhancement that would improve the efficiency and delivery of public services and provide compensation incentives for better performance.
- Integrated planning within the Public Sector and improvements in the timing and delivery of economic information that would enhance transparency and accountability.
- Measures that would reduce or rebalance utility charges and other costs that are biased against the most productive sectors.

## CONCLUSION

The budget establishes a plan to exploit the opportunities provided by the Cricket World Cup in 2007 and use the investments that are required of Saint Lucia to accelerate economic growth and development in 2005/2006. It assumes that the improved performance of the economy in 2004, and the expected continuation of most of the positive trends will justify the calculated risks of significant increases in recurrent and capital expenditure, and it projects that we will have the capacity and funding to meet these targets.

There are no new revenue measures to fund this ambitious plan, and there is no mention of tax reform measures that could have provided the base for more stable tax revenues in the medium term. The reliance on additional debt in the short-term requires a clear and consistent strategy as to how this debt will be serviced and amortised in the long-term, and annual budgets do not provide either assurance or the information as to how this will be accomplished.

Government should seek to ensure that both the level and the rate of growth in public debt is fundamentally sustainable and can be serviced under a wide range of circumstances while meeting cost and risk objectives. The strategy to reduce excessive levels of debt must be credible and sustainable, and there should be a separate agency to advise on long-term debt management policy and arrangements, which should be publicly disclosed and explained.

The Cricket World Cup and the impressive array of existing and proposed private sector developments will create a unique window of opportunity for Saint Lucia to accelerate economic growth and improve living standards in the years ahead, but these opportunities will place an enormous strain on our available resources and capacities, and will require huge

The improvements in project management skills and efficiency in both the Public and Private sectors. This budget confirms our commitment to meet these challenges and provides some measures for us to take advantage of the opportunities.

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