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SECURING THE REVENUE TARGET OF 25% OF GDP

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I. Introduction

In the 2021 Fiscal Strategy Report, the Government presented an updated medium term fiscal outlook reflecting its "vision, policies and plans for a new direction – for a better way forward. We have been clear that we believe the country needs big and transformative change."

If the Government is to be successful in achieving this new direction and securing better economic outcomes for all Bahamians, specifically in terms of jobs and standard of living, it is undeniable that it must as a priority restore the fiscal health of the nation. Running never-ending deficits, one piling up on top of another, to the point that the amount of debt owed by the Government exceeds the size of the domestic economy is a prescription for fiscal and economic calamity. This fiscal insanity must end and the Government that was elected last September is doggedly determined to do just that as a vital foundation for its transformative Blueprint for Change.

Through its revised fiscal framework, the Government has explicitly set out its plan to steadily reduce the annual deficit to the point where it is expected to be eliminated completely in 2024/25. In so doing, the Government will set the burden of public dent on a downward path toward the attainment, by 2030/31, of the long-term objective of 50 per cent of GDP mandated by the Fiscal Responsibility Act. The keystone elements of this plan are threefold, namely:

» to constrain the growth of Recurrent Expenditure such that it does not exceed 20 per cent of GDP through the medium-term;

» to maintain Capital Expenditure at an annual level of 3.5 per cent of GDP through which critical public infrastructure can be provided; and

» to modernize existing revenue systems and, if necessary, further enhance the revenue base such that Recurrent Revenue attains a level of 25 per cent of GDP by 2025/26.

II. Rationale for the 25 per cent Target

With these various ratios having been established, the question naturally arises as to the reason for their selection. The first part of the answer is that they are decidedly not arbitrary nor are they unreasonable. Effective governance in a modern society necessitates the provision by Government of vital programmes and services to its citizenry in areas such as security, health care, education and social assistance. The extent to which these are provided by Government around the world depends on a number of complex factors including the country's level of development, cultural differences, standards of living and wealth levels, among others. Based on data for 2019 (the year prior to the pandemic) Government expenditure in the Euro area averages 47 per cent of GDP while in the U.S. the ratio is under 36 per cent. Within this region, the ratios vary widely from the low to mid 30 per cent range in Trinidad and Tobago, Belize, Jamaica and St. Kitts and Nevis to 27 per cent in Barbados, 25 per cent in St. Lucia and 22 per cent in Grenada. In The Bahamas, total Government expenditure stands at 27.6 per cent of GDP in 2021/22 and is projected at 23.5 per cent of GDP through the medium-term (20 per cent for Recurrent Expenditure and 3.5 per cent for Capital Expenditure).

It may be gleaned from the data above that the Government Expenditure ratio in this country is not excessive on an international scale; nor is the ratio of 27.6 per cent in the current fiscal year (more on this below). The fundamental fiscal problem in The Bahamas is that Government Revenue, at 20.2 per cent of GDP in 2021/22, comes nowhere close to being adequate to sensibly finance Government spending. That is not to say that public expenditure is immune from review and assessment. Indeed, as is explained in the Fiscal Strategy Report, the Government is determined to implement targeted reforms to enhance the effectiveness and efficiency of public spending.

At an aggregate level, then, we face a structural imbalance between spending and revenue amounting to some 7.4 percentage points of GDP. Such a gap is clearly untenable and, if allowed to persist, could well lead to dire and painful consequences.

How best to address this fiscal conundrum? One option would be to simply raise the amount of revenue collected from Bahamians to the full extent needed to finance the current level of Government spending. That would entail a roughly 37 per cent increase in the tax take which, in and of itself, would evidently be highly counter-productive to the Government's critical objective of significantly bolstering the rate of economic growth and job creation.

An alternative solution would be to simply shred Government spending to the point that it matches the current level of revenue. It is evident that such an approach would readily have severe and deleterious effects on Bahamian society, in terms of access to vital Government programmes and services such as health care and education, to name only two. As was highlighted above, the current and prospective levels of Government expenditure in this country are nowhere near to being excessive internationally.

Quite obviously, simple solutions are to be eschewed. The sensible way forward is through a combination of spending restraint and revenue enhancement, and this is the cornerstone of the Government's medium-term fiscal strategy. On one hand, the plan is not to cut the level of recurrent spending but rather to constrain its rate of growth such that its ratio to GDP declines over time to a more sustainable level of 20 per cent. Reforms and enhanced efficiencies in Government operations will contribute to this goal; reallocations will also be implemented to align spending to core Government priorities as set out in the Blueprint for Change. These focused actions on recurrent spending will also facilitate a much-needed, sustained boost in Capital Expenditure to 3.5 per cent of GDP. The latter will be critical in underpinning the stronger long-term growth of our economy.

The enhancement of the revenue yield to 25 per cent of GDP that is proposed as an integral part of the Government's medium-term fiscal strategy may thus be seen as being the appropriate counterbalance to the ratios of spending set out above. At 25 per cent, the yield of the revenue system will be sufficient to fully finance both Recurrent and Capital Expenditure while also leading to the gradual elimination of the annual deficit. Fiscal headroom will also be provided through which the Government can deal with unforeseen eventualities.

While vital within the context of the Government's fiscal strategy, a revenue to GDP revenue ratio of 25 per cent is not unreasonable in and of itself or when viewed internationally. Within the advanced G7 nations, the revenue ratio amounts to some 36 per cent; in the Euro area it averages roughly 46 per cent. Latin American and Caribbean countries post an average ratio of 27 per cent with regional rates of 30-31 per cent in Jamaica, Barbados and Belize.

III. Achieving the Revenue Target

From the discussion above, it may be seen that achieving the 25 per cent revenue to GDP target by 2025/26 will necessitate an increase in the ratio of some 4.8 percentage points, over the next four fiscal years, from its level of 20.2 per cent in 2021/22. As outlined in the Fiscal Strategy Report, the improvement is projected to be gradual and steady, moving to 21.5 per cent in 2022/23, 23 per cent in 2023/24, 24.5 percent in 2024/25 and 25 percent in 2025/26.

The proposed revenue enhancement measures advanced below to secure the achievement of the 25 per cent revenue target bring into focus possible opportunities for revenue generation in the short, medium and longer terms, and were guided by the following principles:

1. to increase the predictability in the tax system;
2. to promote voluntary compliance by simplifying and decreasing the compliance burden for taxpayers;
3. to align with international commitments;
4. to align with the National Environmental Policy of The Bahamas; and
5. to support low and middle income taxpayers in The Bahamas.

As for the various options that are available to secure the attainment of the objective, the Government has been clear that its priority is to avoid, to the extent possible, increasing the burden of taxation on Bahamians. Moreover, the Government is of the view that it would be desirable to implement reductions in customs tariffs going forward, especially in respect of capital goods. Accordingly, in order to lighten the burden of taxes, emphasis is being placed on measures that will significantly improve collections of existing taxes, especially in the areas of real property tax, VAT, Customs duties and excise taxes. It has long been acknowledged that important gaps do exist between the amount of taxes that should be paid and the amount actually collected in the above areas. And beside the gaps in recurring annual collections, the tax debt owed to Inland Revenue in respect of Business Licence, VAT and real property tax is estimated at some $840 million.

These gaps and arrears can be bridged through actions to improve the operational efficiency of the major tax agencies, facilitate compliance by taxpayers and reduce outright tax evasion and non-compliance. Concrete action beyond the vague promises of the past is urgently required and the Government is determined to do so. To that end, the existing tax laws will be reviewed to determine opportunities for modernization and simplification of tax legislation, having regard to efficiency, fairness and stability of taxes, and to achieve conformity with best practices.

As well, a comprehensive review of the Government's tax concessions regime will be conducted with a view to reducing the quantum of revenue foregone across sectors and in line with international standards. Such as review will also include the introduction of a monitoring and evaluation framework to ensure value for money.

As a key measure to improve revenue collections, the Ministry of Finance has re-established the Revenue Policy Committee comprising heads of revenue collection agencies across Government. While the committee is paying attention to reducing areas of revenue leakage, it is also identifying and reviewing, for the sake of prudent advance planning, potential new sources of revenue. To that end, a review of the existing tax regime will be launched to develop a road map of tax system reform recommendations that would also introduce greater progressivity, fairness and stability to the government's revenue system over the medium-term horizon.

To further secure the closing of revenue gaps, reduce arrears and enhance compliance, the Government has re-established and fully resourced the Revenue Enhancement Unit (REU) with the ultimate goal of building a world-class tax compliance organization. The REU has been tasked with adopting, testing and refining best practices that can be scaled to Inland Revenue, Customs and other Government entities. In the area of Business Licence and VAT, the REU seeks to introduce efficient desk and entity audits, as well as arrears collection and enforcement. For real property tax, it will accelerate the impact of the 2022 re-assessments, identify unregistered properties, target re-assessments of high-potential Family Island properties and identify mis-categorized properties. For Customs, the REU will focus on world-class best practice such as risk-based inspections of air freight and containers, analytics-based post-clearance audits and enhance client service. To date, a one-time $500 million revenue boost has been identified from just six selected initiatives. Over time, the activities of the REU are expected to yield an ongoing annual revenue increase of some $200 million.

The broad outlines of other specific measures that are being pursued to enhance revenues from existing taxes are set out in the 2021 Fiscal Strategy Report. For example, as part of the project to improve the collection of real property tax, Tyler Technologies has completed the update of the real property tax roll and assessment of New Providence properties, thereby identifying an additional $100 million in RPT revenue. Similar work is commencing on other islands and is expected to secure additional revenues.

As well, consideration could be given to require that property taxes be included in the amortization schedules of all mortgages, through both negotiated agreements with financial institutions and legislation. The revenue impact could be significant by securing the collection of RPT revenues and eliminating opportunities for non-payment by mortgage holders.

An in-depth analytical assessment of the real property tax system was undertaken a few years ago but its main conclusions generally remain valid today. The study found significant gaps in the system in the areas of coverage, valuation and collection with the implication that RPT revenues could readily be boosted to 2 per cent of GDP. That would represent a 0.6 percentage point improvement from the ratio of 1.4 per cent in 2021/22. Based on the successes to date of the Tyler work, it may be well within the realm of the possible to do even better than 2 per cent of GDP over the next four years.

In the area of the Value Added Tax, a number of reform measures present themselves for consideration. For one, as is done in many other countries and as is recommended in line with best practice, Inland Revenue could explore the establishment of a Large Taxpayer Unit (LTU) to effect better control of, and service to, those taxpayers who contribute the majority of tax revenues. Establishing a LTU would (1) stabilize the collection of a large portion of national revenue collections, bringing predictability to revenue planning, (2) enhance compliance and improve service to taxpayers that provide the vast majority revenues, (3) make more efficient use of limited resources and (4) compensate for weaknesses in tax administration capacity. As models for such a Unit already exist abroad, its creation would not be overly complex and could be finalized within 12 months. If properly done, the revenue implications could potentially be quite significant.

The creation of an LTU will also provide a timely opportunity to strengthen and stabilize the structure of Inland Revenue. The Department is the second largest revenue collection agency in the Bahamas and, even though it plays a vital role in the collection of the country's revenue, its staffing challenges were unfortunately ignored by the previous administration. The department has 214 employees of which only 52 are permanent and 49 are seconded from other departments; 54 per cent of the officers are on contract, the vast majority of which have expired. The last person to hold the post of Controller of the Department retired in 2017; since that time no one has either been appointed to the post or chosen to act in the capacity of Controller. There have also been no appointments (even on an acting basis) to the posts of Deputy or Assistant Controller. Since 2017, the Department has also experienced a very high turnover of staff resulting in the suspension of critical functions such as audits. Bahamian taxpayers have consequently experienced delays in the processing of Business Licence applications, VAT refunds and the resolution of real property tax matters.

An important part of the modernization and improvement of the tax system must indeed be the continuous upgrading of the administrative capacity of the DIR. Since its establishment in 2014, the legislation underpinning the structure of the Department has not yet been brought forward for consideration and approval. Stabilizing the structure of DIR would only be moderately complex as far as implementation is concerned. It would require various legislative and administrative actions, including legislation to finalize, stabilize and consolidate authorizations within the DIR, as well as legislative or policy decisions to strengthen and stabilize the staffing situation. These actions would be expected to result in significant improvements in operational efficiency, predictability and public confidence. In turn, significant revenue impacts could be expected.

Other measures to further strengthen VAT collections could include the establishment of VAT withholding agents and the introduction of electronic fiscal devices (EFDs). As for the former option, legislation would be needed to appoint certain purchasers of goods and services as "VAT Withholding Agents" who would be required to withhold the VAT amount when paying invoices from standard rate vendors and remit that VAT directly to the Government on behalf of the vendor. With the option of EFDs, these could be mandated for use by VAT registrants who conduct significant portions of their sales in cash, or where sales suppression is difficult to detect. Such devices are point-of-sale attachments that ensure that receipts are issued for all transactions and that sales/VAT information is securely transmitted to the DIR.

As well, the Government is continuing, through data collection agreements, to exploit the use of big data techniques to detect tax evasion and avoidance. For instance, the Government already collects data on AirBnB rentals which facilitates the identification of properties collecting revenue but not paying taxes. To further build on this initiative, Inland Revenue has engaged an international firm to provide data on a variety of online transactions such as AirBnB and other short-term rentals and Amazon among others. A collaborative working group is to be established between Inland Revenue and the Bahamas Investment Authority whose objective will be to close revenue leakages in the areas of RPT, vacation rental fees, etc. associated with the short-term rental market.

In the area of Customs, efforts are continuing to monitor and expand the Customs Electronic Single Window, "Click2Clear", launched in September 2019, to ensure the effective and efficient collection and maximization of Customs revenue over the medium-term.

The many proactive measures outlined above are anticipated to generate significant incremental revenues in both the near term and over the medium-term horizon. As such, the Government believes that, by solidifying existing revenue operations, enhancing taxpayer compliance and closing important revenue gaps, the annual revenue forecasts set out in the 2021 Fiscal Strategy Report can reasonably be expected to be well within reach, along with the overarching 2025/26 objective of attaining a 25 per cent revenue to GDP target.

Having said this, however, it is evident that international developments in recent times have brought the matter of a corporate income tax (CIT) to the fore in this country. Indeed, an agreement was concluded in 2021 by 133 jurisdictions, including The Bahamas, on a reform of such taxation internationally that features a global minimum tax of at least 15 percent, determined on a jurisdiction-by-jurisdiction basis. The goal is to ensure that the profits of multinationals with global turnover exceeding 750 million euros are subject to the minimum effective tax rate. Such a measure could be a significant source of revenue for The Bahamas and could avoid corporate profits of MNEs in the country being taxed elsewhere. As well, not imposing a corporate income tax could pose reputational risks on the country that could jeopardize the buoyancy of future prospects for the economy.

As a CIT would be a complex undertaking with important economic and fiscal ramifications, the Government has engaged Deloitte to conduct an in-depth study of the impact of imposing the proposed global minimum corporate income tax in The Bahamas. A key element of the work will be developing a comprehensive understanding of the associated risks and potential impacts of various corporate tax policies. It is proposed that the work develop a risk-assessment framework with a focus on the most vulnerable parts of the economy and an explicit commentary on the potential risks and benefits. This exercise will be vital in determining the appropriate corporate tax policy for The Bahamas. At this stage, the Government is seeking to understand the potential risks and impacts rather than the approach to implementation of a corporate tax in The Bahamas. To this end, for each defined policy option, the study will provide only the headline points to consider in respect of possible implementation.

The main objectives of the engagement are:

- in light of the current domestic and international environment, examine the options for a corporate tax policy in The Bahamas and highlight the most important design features;
- undertake quantitative economic impact analysis to understand the potential revenues that could be generated from a change in tax policy, the potential fiscal cost to local and international businesses and the potential economic impact (employment, investment, output); and
- provide a qualitative risk-assessment of policy options, with a clear examination of the potential positive and negative outcomes across sectors of the economy and for international companies operating in The Bahamas. In particular, the risk-assessment will consider the response of international organizations (e.g. OECD, G7) to the various policy options. This exercise will be vital in supporting the Government in determining the appropriate tax policy for The Bahamas due to the implications for direct investment into the country.

Needless to say, the imposition of a corporate income tax would necessitate a significant reform of Business Licence fees, very likely including the elimination of the turnover-based annual fee for the vast majority of Bahamian businesses. As such, the net annual revenue gain from a new CIT would most certainly be significantly reduced.

Environmental taxes are another area that are prime candidates for review and reform. It is well-established that the core environmental objectives of The Bahamas include measures on adaptation, mitigation and public health, with plans to reduce greenhouse gas emissions by 30 per cent below business-as-usual levels by 2030. To that end, excise taxes are highly effective policy tools to achieve reductions in emissions and correct for the negative social effects of fossil fuel use, such as global warming, local air pollution and road damage.

The option of setting excise taxes on road gasoline and diesel, for instance, at socially optimal levels could be adopted at some point, not only for the sake of the related social benefits but also as a means of further enhancing the revenue yield of the revenue system.

Finally, the various user fees that the Government currently charges for the many services that it provides to Bahamians are deemed to be sorely inadequate relative to the costs of providing those services. A detailed examination of these fees is to be undertaken to ensure that they more closely align with the costs of providing the services. This will further contribute to the attainment of the Government's core revenue target through the medium-term.

An overview of the major revenue enhancement initiatives set out above is presented in the Annex to this paper, including an assessment of their complexity, the timeline for their implementation, whether legislation would be required, along with an estimate of the potential revenue impact of each measure.

OVERVIEW OF MAJOR REVENUE ENHANCEMENT INITIATIVES

REVENUE INITIATIVE	COMPLEXITY	TIMELINE	LEGISLATION	REVENUE IMPACT
Re-establishment of the Revenue Policy Committee (Heads of revenue collection agencies): » Focus on eliminating leakage/gaps » Review of tax system/recommendations for reform over medium-term (enhanced stability, fairness, progressivity)	Low	Immediate and ongoing	No (potentially longer term)	High
Re-establishment of fully resourced Revenue Enhancement Unit (REU): » build a world-class tax compliance organization » adopt/test/refine best practices for DIR, Customs, other Government entities	Low	Immediate and ongoing	Yes	More than $500M one-time boost and $200M ongoing annual increase
Structural stabilization of the Department of Inland Revenue (DIR) to significantly improve operational efficiency, predictability and public confidence: » finalize/stabilize/consolidate authorizations with DIR » strengthen and stabilize the staffing situation	Moderate	12 months	Yes	High
Establishment of a Large Taxpayer Unit (LTU) in DIR, based on best international practice for better service to, and control of, taxpayers who contribute the majority of tax revenues	Moderate	12 months	Possibly	High
Mandating Electronic Fiscal Devices (EFDs): » for use by VAT registrants who conduct significant portions of their sales in cash, or where sales suppression is difficult to detect » point-of-sale attachments ensuring that receipts are issued and that VAT information is securely transmitted to DIR	Moderate graduated requiring acquisition of EFDs and training	Dependent on procurement of EFDs and training required	Yes	Moderate
Establish VAT Withholding Agents: appoint certain purchasers of goods and services as VAT Withholding Agents who would be required to withhold the VAT amount when paying invoices	Low (new forms required)	6-12 months	Yes	Moderate
Update of Real Property Tax rolls and assessments by Tyler Technologies: » accelerate input of 2022 re-assessments » identify unregistered properties » target re-assessments of high-potential properties	Moderate	Ongoing	Possibly	High ($100M in NP; work beginning on other islands)
Include RPT in Mortgage Amortization Schedules through negotiated agreements with financial institutions and legislation	Low to moderate	12 months	Yes	High

OVERVIEW OF MAJOR REVENUE ENHANCEMENT INITIATIVES CONT'D

REVENUE INITIATIVE	COMPLEXITY	TIMELINE	LEGISLATION	REVENUE IMPACT
Continue to monitor and expand the **Customs Single Window** "Click2Clear" and: » strengthen risk-based inspection of air freight, containers » enhance analytics-based post-clearance audits » improve service to clients	Moderate to high	Ongoing	Possibly	High
Exploit Big Data Techniques through data collection agreements to detect tax avoidance and evasion (e.g. AirBnB rentals, other online transactions)	Moderate	Ongoing	Possibly	High
Excise taxes on Fossil Fuels: Implement socially optimal tax levels to reduce emissions in line with Government's environmental objectives	Low	Phased over medium-term	Yes	Moderate
Review of Tax Concessions Regime to ensure value for money and in line with international standards by » reducing the volume of concessions being granted » review the concessions being granted under e.g. MyGateway Portal	Low	12 months	Possibly	Moderate to high
Detailed Assessment of Government User Fees to ensure they more closely align with the costs of providing the services	Low	12 months	Possibly	High (potentially $90M the coming year)
An in-depth study of options for a Corporate Income Tax (CIT) by Deloitte in light of 2021 international agreement by 133 nations featuring a global minimum tax of at least 15%; would necessitate significant, concomitant reform of Business Licence regime	High	Study completed by end-May	Yes (if CIT introduced and BL reformed)	Likely moderate on a net basis

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