Final Report

Of the

Tax Policy Review Committee

To

The Government of Jamaica

November 30th 2004

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Introduction

Jamaica has not undertaken any comprehensive review of its system of taxation in nearly twenty years. In particular, the last such review was undertaken prior to trade and foreign exchange liberalization and at a time when its economy was substantially different to what it is today. While the system has performed reasonably well since that time, there is now a clear sense that changes in the world economy over the past 20 years, and Jamaica's place in such an economy, demand that we undertake a detailed examination of the tax system in order to ensure that it is consistent with our current economic objectives. Furthermore, in the period since the last such reform, successive governments have introduced several piece-meal changes to the system without sufficient emphasis on the internal consistency of the system as a whole.

The criteria that the committee has used in measuring the efficacy of the current tax structure as well as any proposed reforms are as follows:

- Revenue performance
- Distribution of tax burden
- Coverage of the tax base (horizontal equity, fairness)
- Economic incentives, competitiveness, and growth effects
- Administrative efficiency and compliance costs

The committee's terms of reference did not include a detailed examination of administrative structures and procedures. However, in the course of our examination a number of administrative weaknesses were highlighted and **Appendix A** identifies these issues and makes summary recommendations for corrective action. The committee's deliberations, and this report, have otherwise focused exclusively on tax policy and tax structure.

We first set out below the committee's agreed terms of reference, membership, and meeting schedule followed by a description of our work programme and methodology.

We begin the main body of this report with a review of Jamaica's economic performance record in order to place the task of tax reform in context. Next we review a number of policy issues highlighted in our terms of reference followed by an identification of specific problems in the current tax system. Finally, we set out a proposed package of reforms for consideration by Government.

The reform package presented should not be considered simply as a "menu" of reform options from which preferred positions may be selected.

Rather, the committee wishes to emphasise that in making its recommendations, the impacts in terms of economic effects, burden distribution, equity etc. have been measured based upon the outcome of the recommended package as a whole and given the interaction of all proposed measures. Any changes which government in its wisdom may deem appropriate should therefore be measured in the same light if the hoped-for internal consistency of the tax system is to be preserved.

Terms of Reference

The following were the terms of reference agreed between the Ministry of Finance and the Committee:

1. Examine each of the main sources of tax revenue (Personal Income Tax, Payroll Taxes, Transfer Taxes and Stamp Duties, Corporate Income Tax, Tariffs and Taxes on International Trade, GCT, Property Tax) and assess, in the light of Government's fiscal strategy and international experience, their impact at current rates on:

    (a) Incentives for work, investment and economic growth in general;
    (b) Poverty and the equitable distribution of the tax burden
    (c) Revenue mobilization.

2. The review should focus on the following issues:

    (a) Revenue responsiveness to economic growth and inflation;
    (b) Changes in resource allocation in response to tax changes (e.g. the ratio of debt to equity investment, work effort, consumption of imports vs. local goods);
    (c) The impact of tax on the competitiveness of key sectors;
    (d) Constraints imposed by tax legislation;
    (e) The distribution of the tax burden – progressive, proportional or regressive?
    (f) The balance between direct and indirect taxes;
    (g) Stability of the system;
    (h) Possible over-reliance on particular taxes;
    (i) The impact of current policies and rates on compliance levels.

3. Examine the levels of incentives, exemptions, concessions, waivers etc to ascertain whether these can be simplified and tailored to meet the developmental goals of the Government.

4. Where significant, the inefficiencies and/or inequities are to be identified. The review should recommend alternate tax structure/rates designed to address these weaknesses.

Committee Membership

The following persons were appointed by the Minister of Finance to serve on the Tax Policy Review Committee:

Mr. Joseph M. Matalon – Businessman (Chairman)

Ms. Elizabeth Ann Jones-Kerr – Accountant (KPMG)

Mr. Eric Crawford – Accountant (PricewaterhouseCoopers)

Ms. Ethlyn Norton-Coke – Accountant/Attorney at Law (Deloitte)

Mr. Wilfred Baghaloo – Accountant (PricewaterhouseCoopers)

Mr. Mark Golding – Attorney at law (Hart, Muirhead, Fatta)

Ms. Velma Blake – DFS Tax – Ministry of Finance

Dr. Wesley Hughes – Director General PIOJ

Ms. Effie Crooks – Accountant (Crooks, Jackson, Burnett)

Mr. Derek Brooks – Businessman

Mr. Lloyd Goodleigh – Trade Unionist

Ms. Allison Peart – Accountant (Ernst & Young)

Committee Meeting Schedule

The committee held a total of 15 formal meetings on the following dates:

July 17th 2003, October 7th 2003, January 29, 2004, February 19th 2004, April 26th 2004, May 27th 2004, June 21st 2004, June 23rd 2004, June 25th 2004, August 16th 2004, August 17th 2004, October 12th & 13th 2004, November 19th 2004, November 26, 2004.

The committee's meetings on October 12th & 13th took the shape of a two day retreat during which we also benefited from the presence and views of a number of tax administrators:

Mr. Clive Nicholas, Director General Tax
Ms. Vinette Keene, Commissioner TAAD
Mr. Paul Lai, MOF
Mr. Ainsley Powell, TAAD

Mr. Norris Miller, TAAD
Mr. Oronde Small, MOF
Mr. Andrew Stephenson, MOF
Mr. Theodore Mitchell, MOF

Methodology and Work Programme

The committee members agreed early on that in order to fulfill its Terms of Reference, a significant body of technical analysis would be required on which to base its recommendations. Since this work was neither within the scope of the technical competence nor the available time resources of committee members, it was agreed to recommend that GOJ engage the services of consultants to perform this work. The job of the committee would then be to review this body of background work as well as the various reform options analysed in order to arrive at a consensus for a package of comprehensive reform recommendations to Government.

GOJ ultimately accepted this recommendation and a letter of engagement and contractual terms were negotiated with the Andrew Young School of Policy Studies at Georgia State University (GSU) in the USA.

Professor Roy Bahl, Dean of the Andrew Young School, who had previously managed the Tax Structure Examination Project in Jamaica during the 1980's and early 1990's, which advised the government, and several tax Reform Committees during that period, led the technical team while Professor Sally Wallace served as Co-Director of the Project. A number of the other technical team members were also involved in the earlier studies of tax reform in Jamaica, providing a level of familiarity with our environment which has proved invaluable during the course of their work.

A total of 10 staff papers were produced by GSU for review and comment both by the committee and representatives of relevant government departments and agencies. The deliberations of the committee have been largely informed by these staff papers (which are incorporated herein by reference) and this report also borrows liberally from their text without any consistent pattern of attribution.

The title and authorship of each of the staff papers is as follows:

Individual Tax Analyses

The Land Value Tax in Jamaica: An Analysis and Options for Reform by David L. Sjoquist (Staff Paper #1)

Property Transfer Tax and Stamp Duty by Roy Bahl (Staff Paper #2)

Corporate Income Tax and Tax Incentives by Mark Rider (Staff Paper #3)

Taxation Issues in the Jamaican External Trade Sector by Felix K. Rioja and Keith E. Maskus (Staff Paper #4). A supplement to this paper was also issued.

The Jamaican Individual Income Tax by Sally Wallace and James Alm (Staff Paper #5)

Payroll Taxes and Contributions by Sally Wallace and James Alm (Staff Paper #6)

Taxing Consumption in Jamaica: The GCT & The SCT by Kelly D. Edmiston and Richard Bird (Staff Paper #7)

Additional Analyses

Taxation and Economic Efficiency in Jamaica by Miles K. Light (Staff Paper #8)

Tax Burden in Jamaica by Dillon Alleyne (UWI), James Alm, Roy Bahl, Sally Wallace (Staff Paper #9)

Comprehensive Tax Reform: Final Report by Roy Bahl & Sally Wallace (Staff Paper #10)

Acknowledgements

The committee wishes to acknowledge the very significant contribution of the technical team, and in particular of Drs. Roy Bahl and Sally Wallace to its deliberations. They diligently attempted to answer all of our questions and helped us to remain true to the tenets of “good” tax policy.

We also wish to acknowledge the hard work of Mr. Paul Lai of the Ministry of Finance who played an important coordinating role among the committee, GOJ and the technical team. Our thanks also to those members of the tax administration who participated actively during the committee’s retreat.

Our thanks to Fiscal Services who were extremely cooperative in providing much of the data on which our analysis has been based.

Thanks also to those members of the public and civil society who made submissions to the committee on a wide range of tax policy matters.

Finally, our thanks to Ms. Cristina Matalon, ICD Group Company Secretary, who acted in a voluntary capacity as recording secretary to the committee, and to Ms. Valerie Hamilton, assistant to Mr. Joseph M. Matalon who worked diligently on the various drafts of this report.

Jamaica's Economic Performance

Staff Paper #10 presents a good analysis of Jamaica's past economic performance, which we summarise here.

Except for very recent improving economic news, (a key contributor to which has been the aggressive fiscal adjustment programme followed by GOJ), we have performed poorly over the last 20 years and our economy has been repeatedly shocked by external events: oil price hikes, U.S. recession, and natural disasters. There has been little growth in GDP, and GDP per capita was lower at the end of the nineties than it was at the beginning (MOF, IMF, World Bank).

Paradoxically, while the unemployment rate has remained in the 15% range, the percentage of the population living below the poverty line has declined markedly in recent years, which phenomenon the World Bank (2003), has attributed to a combination of factors including measurement error, falling food prices, low inflation, increased remittances and rising real wages.

Some commentators are also cautious about the economy's long run prospects given certain inhibiting factors – the evidence points to an economy which is not internationally competitive, to slow growth in productivity, and to continuing problems with the fiscal balance which will require the continued generation of significant primary surpluses in the medium term.

The International Trade Sector

As demonstrated in Table 1, the external trade sector in recent years (and for most of the 1990's) has been characterised by relatively weak export growth, and a steady though moderate increase in the value of imports, resulting in a deteriorating trade balance which is only partially offset by the positive services balance. The negative income balance reflects Jamaica's status as a recipient of significant foreign direct investment with few remaining controls on the

Table 1: Jamaica's Aggregate External Trade in Goods and Services (US$ million)

Year	Merchandise Imports, cif	Merchandise Exports, fob	Trade Balance	Services Balance	Income Balance	Current Transfers	Current Account Balance
2001	2,572.8	1,234.0	-1,338.8	338.8	-346.4	704.8	-641.6
2002	2,634.9	1,110.5	-1,524.4	195.4	-476.3	907.6	-897.7
2003	2,761.2	1,132.1	-1,629.1	350.3	-489.3	917.8	-850.3

Source: Reported in Maskus and Rioja (2004).
Note: these data are reported according to IMF conventions for national account statistics. Source: Bank of Jamaica, *Statistical Digest*.

movement of capital. Current net transfers in the form of remittances, from Jamaicans or persons of Jamaican descent residing abroad, have been an increasingly important factor in moderating the overall current account deficit, which in 2003/4 ran out at approximately US$800 million.

Economic Competitiveness

The apparently weak competitive position of the Jamaican economy is often cited in relevant literature as the main contributor to our weak export performance, and indeed the relatively weak growth performance of the economy as a whole. Among the factors cited as contributing to this circumstance are:

-Overvalued real exchange rates
-High relative real labour costs and low relative productivity,
-High relative real interest rates,
-High relative energy costs,
-High relative cost of security/crime and violence

This conclusion is borne out by reference to the latest FDI (Foreign Direct Investment) Potential Index published by UNCTAD which ranks Jamaica 78th out of 140 countries (and below such countries as Costa Rica, El Salvador, Dominican Republic, and Trinidad & Tobago) in terms of comparative advantage.

On the other hand, the FDI Performance Index also published by UNCTAD, which ranks countries by the volume of FDI actually received relative to the economy's size, places Jamaica 23rd out of 140 countries. This ranking places Jamaica ahead of the countries already cited in reference to the FDI Potential Index, and in fact Jamaica enjoyed the highest ranking among Caribbean countries. While these data indicate that Jamaica has performed relatively well in attracting FDI during 1999 – 2001, of concern is the fact that over the decade of the 1990's as a whole, Jamaica actually performed less well than the Caribbean average, and perhaps more in keeping with its lower FDI Potential Index ranking.

Fiscal Balance

Perhaps the most challenging feature of Jamaica's current economic environment (and indeed the most significant constraint on any tax reform effort) is the country's debt level relative to GDP, which is amongst the highest in the world. The massive injection of public resources that resulted from the financial crisis of the nineties, as well as growth in non-interest current expenditures generally, have been reflected in a Debt to GDP ratio which reached 143% in 2003/4. Perhaps even more relevant to our terms of reference, and as demonstrated elsewhere in this report, a significant level of tax expenditures (i.e. losses in tax revenue due to tax preferences of whatever nature) have also served to narrow the tax base. Also, while tax administration has undoubtedly improved in recent years, there remains a significant rate of non-compliance.

Implications for Tax Reform

The analysis of Jamaica's economic performance in the previous sections describes a very challenging environment in which to make proposals for comprehensive tax reform.

Clearly central to the GOJ's economic programme are its objectives for deficit and debt reduction. The IMF (2004) identifies a "gap" of 1.7 percent of GDP beyond 2004/5, which must be closed if the GOJ is to meet its targets for deficit and debt reduction. There are essentially three means by which such a goal might be accomplished:

1. The first is to further curb government spending. The wage and interest bill combine to represent approximately 80% of total government expenditures. This reflects, in large part, high public sector employment levels. One way that tax reform might assist in the rationalisation of public sector employment would be to examine the feasibility of changes in the tax system that might aid administrative efficiency (doing more with less). For example, the complete elimination of certain taxes might allow either the elimination of whole departments charged with their enforcement and collection, or the reallocation of the current resources of such departments to areas of the system where revenue opportunities are greatest (for example to achieve greater compliance levels among the self-employed, to increase the collection rate of the property tax, or to the creation of a specific "large taxpayer unit").

2. The second and perhaps least painful of these is simply to achieve growth rates in GDP going forward which will both generate more revenue and increase the denominator of the debt and deficit ratios such that they decline naturally over time to more manageable levels. Given the evidence presented earlier of Jamaica's weak relative competitive position and lacklustre growth record, such a strategy would require a wide-ranging programme of economic reforms aimed at improving the efficiency and competitiveness of the Jamaican economy. A programme of tax reform might aid this effort by concentrating on removing those impediments in the current system to a more efficient allocation of resources, and to the stimulation of productivity growth.

3. The third and perhaps least attractive option open to GOJ would be to mobilise greater resources through the tax system (i.e. introduce a package of tax increases). In fact the World Bank (2003) points to the possible need for an increase in taxes to 30% of GDP by 2008 versus 24.5% in 2002/3. While such measures may well cure the fiscal imbalance and put the country on a positive path toward debt reduction, they may also run the risk of raising taxes too high, or worse, if such taxes are raised in a

manner which promotes the inefficient allocation of resources, of further compromising an already weak competitive position.

Success in achieving the GOJ's objectives will likely lie not in any one of these strategies, but rather in some judicious combination of all three. The committee's approach has been to analyse options for changes in the tax system that are consistent with our understanding of the GOJ's economic objectives, and from this analysis to present a package of reform proposals which is essentially revenue neutral, or stated more simply, that is estimated to generate approximately the same level of revenues as the current system.

Finally, we may remark that Jamaican economic development is also plagued by distributional problems, including a poverty rate and an unemployment rate that are both too high. A key element in the government's policy strategy is to reduce the level of poverty in Jamaica. Clearly, the primary fiscal instrument for addressing poverty reduction is public expenditure policy. But does the tax system also have a role to play in achieving this objective? We attempt to address this question more fully in our report, but at the very least, the presence of a high tax on labour relative to capital, and the very low thresholds for income and payroll taxes, suggest the need for some rethinking of the direction of tax policy.

Revenue Responsiveness to Growth & Inflation

Item 2 (a) of the committee's terms of reference calls for an examination of "revenue responsiveness to economic growth and inflation."

A review of tax receipts over the period 1991 – 2003 suggests that, on average, a 1% growth in GDP has been associated with a 1.1% growth in tax revenues. However this period included several discretionary changes in various tax rates, which would therefore imply that the underlying income elasticity of tax revenues is lower than estimated.

The technical team attempted to calculate the income elasticity of each of the broad categories of tax in the course of the individual tax analyses cited above with the following results:

- Individual income and payroll taxes were estimated to have elasticities of greater than unity. However it was also found that this strong responsiveness was not realised during periods of economic slowdown;
- The elasticity of GCT receipts was estimated at about unity;
- The corporate income tax demonstrated a very low income elasticity of 0.42. This is consistent with trends which have reflected lower shares of company tax in GDP internationally;
- Property tax (because of the intervals between adjustments to the base), the SCT (because of the number of specific amounts of tax), and tariffs, were shown to be the most inelastic components of the tax system;

The analysis suggests that any shift in emphasis from direct to indirect taxation under the current tax structure (see 'Tax Structure' below), might serve to reduce the built-in elasticity of the system unless steps were simultaneously taken to broaden the base of indirect taxes and to index specific tax amounts.

Is Jamaica a High Taxing Jurisdiction?

Total collected tax revenues in 2002/3 represented approximately 24.5% of GDP. The committee posed the following related questions:

- Is this an adequate level of revenue mobilization given our debt and fiscal deficit levels? Or is the problem with the expenditure side of the fiscal equation?
- Is the competitiveness of the Jamaican economy weakened by taxes that are too high relative to GDP? Or are expenditure levels too low to support adequate public services?

In attempting to answer these questions, the technical team performed a number of international tax comparisons, which are detailed in Staff Paper #10, and none of which suggests that Jamaica is a particularly high taxing country.

Firstly, ratios of tax to GDP were compared across a sample of countries with populations in the range of 2-4 million and all countries within the Caribbean and Central America. The results suggest that Jamaican taxes are about average for this group of countries.

Secondly, using regression analysis, the technical team attempted to explain the variation in taxation to GDP ratios for a sample of 117 countries by reference to the following variables:

- Absolute GDP level;
- Openness to trade;
- Size of the agricultural sector relative to GDP;
- Population size;
- The rate of population growth.

The statistically significant equations derived from this analysis were then used to "predict" the tax to GDP ratios for each of the countries in the sample and to create an index of "tax-effort" by comparing the actual and the predicted tax to GDP ratios. Again, the results indicate that Jamaica's "tax effort" is at or below the average of the sample.

While this analysis implies that the Jamaican economy may have the capacity to sustain a greater mobilisation of tax revenues in general, given the level of tax preferences in the current system and the widespread level of non-compliance, another implication is that those individuals and companies who are compliant and do not receive any preferences, are likely being taxed at an extremely high level.

Tax Structure

A key element of the committee's terms of reference was to examine the balance between direct and indirect taxes, and the possibility of over-reliance on particular taxes.

The technical team again attempted to answer these questions by reference to international data comparing the percentage of total tax revenues generated in each of 57 countries across four broad categories of taxation:

- Income and payroll taxes;
- Indirect taxes;
- Taxes on international trade;
- Other Taxes

Table 2: Percentage of Total Tax Revenues by Type – Jamaica vs. International Mean

	Income and Payroll Taxes	Indirect Taxes	International trade Taxes	Other Taxes
Jamaica	41.9%	40.5%	8.9%	8.8%
Sample Mean	32.6%	47.5%	13.4%	5.6%

Source: Staff Paper #10
Note: (a) All estimates exclude social security taxes
(b) 'Other Taxes' includes property taxes

The results of this analysis are reflected in table 2 and demonstrate a heavy reliance on income and payroll taxes in Jamaica compared with other countries around the world (approximately 29% above the average). The share of indirect taxes in Jamaica is approximately 15% below the international average, while that raised from international trade taxes is approximately 35% below the international average.

These results would seem to bear out the often-made observation that labour is relatively heavily taxed in Jamaica. Given also that our earlier analysis of Jamaica's competitive position identified low labour productivity and high relative labour costs as two contributors to our lack of international competitiveness, the committee concluded that a shift in terms of emphasis away from taxes on income would be a worthwhile objective in any comprehensive reform programme.

Distribution of Tax Burdens in Jamaica

Item 2 (e) of the committee's terms of reference called for an examination of the distribution of tax burdens (see Box 1 for a definition of "tax burden") to determine whether the existing tax system is regressive, progressive or proportional. The technical team undertook a detailed study of the distribution of tax burdens in Jamaica, which is detailed in Staff Paper #9.

Box 1 – Tax Burden Defined Taxes reduce the amount of money that individuals have to save and consume. Some taxes are borne directly, e.g., individual income taxes. Other taxes are indirectly borne by individuals. For example, a retailer may pay the tax to government but he may shift this on to consumers in the form of higher prices for the product he sells. The total taxes borne by individuals, directly and indirectly, divided by their gross income is called the "tax burden". To calculate the tax burden, we must determine the incidence —or who actually bears the burden—of the tax.

Some taxes are not shifted. For example, it is widely believed that a tax on wages (such as Jamaica's PAYE) is borne by the people who earn the wages. Other taxes, for example, the corporate income tax, are shifted forward to consumers in the form of higher prices, or backwards to labour in the form of lower wages, or to owners in the form of lower rates of return on their investment. Perhaps a rise in the corporate income tax would result in a decrease in wages so that the company can retain the same level of after tax profits. Perhaps an increase in the corporate income tax would lead to an increase in prices in the stores. Studies of the CIT in many countries lead to the conclusion that part of the CIT is borne by labour in the form of lower wages and part is borne by capital in the form of lower earnings on capital. To measure the burden of the CIT, we must apportion some of the CIT to wages and some to capital income. For purposes of our tax burden analysis, we have settled on an allocation of 50% of the tax to wages and 50% to capital. Therefore, even though wage earners do not file a corporate tax form, they do bear some of the burden of the CIT in the form of reduced wages. We would therefore add a portion of the CIT to wage earners when calculating overall tax burden. More detail regarding the incidence assumptions of the burden analysis may be found in Staff Report #9.

As reflected in table 3, the indirect tax system is very mildly progressive with effective tax rates rising from 12.93% in the lowest income decile to 15.32% in the highest. The direct tax system is significantly more progressive, rising from 10.99% in the lowest decile to 23.76% in the highest. The overall pattern of the tax system, as shown in the last column of table 3, is a progressive one.

Table 3: Distribution of Total Tax Burdens[a]

Household Income	Total Indirect Burden	Total Direct Burden	Grand Total
0 - 79,260	12.93	10.99	23.92
79,260 - 117,769	13.61	10.86	24.47
117,770 - 156,853	14.13	10.47	24.60
156,853 - 213,051	14.16	12.23	26.39
213,051 - 243,195	14.47	13.06	27.53
243,195 - 299,701	14.56	14.68	29.24
299,701 - 369,404	15.10	18.61	33.71
369,404 - 477,446	15.15	19.01	34.16
477,446 - 693,008	15.24	20.60	35.84
greater than 693,008	15.32	23.76	39.08

Source: Staff Paper #9 Alleyne, et, al. (2004).
a) All burden estimates are expressed as a percent of total (comprehensive) income.

The committee concluded from this analysis that changes in vertical equity need not be a primary consideration in any programme of tax reform. Of greater concern from a policy perspective is the burden falling on those in the lowest income brackets.

Economic Efficiency Effects of Taxation

In keeping with its Terms of Reference, the committee sought to explore the effects of the current tax structure on economic efficiency and growth. The committee was also very interested in having the ability to assess the economic effects that might arise from changes in the tax system that we might propose. The technical team was therefore asked to include in their work programme the construction of an Economic Model for Jamaica with particular emphasis on the tax system. The results were highly informative and we believe worth sharing here in some detail.

When a $1 tax is imposed, it reduces the purchasing power of an individual by $1. If that tax is not sufficiently broad-based, it induces consumers to shift away from the taxed good, into an un-taxed alternative. In the end, prices of a good (or a factor, like labour) as well as the quantity supplied, are altered in a way that lowers consumer welfare. The value of lost welfare is called a “deadweight loss” and it represents the value of this foregone consumption beyond the value of the tax itself. See Box 2 below for a more detailed definition of welfare costs of taxation.

Box 2: Welfare Costs of Taxes: In a market economy, consumers and producers react to market prices. Individuals buy goods they want and can afford; employers buy inputs they need and can afford. In most cases consumers would be willing to pay even *more* for a good than the price charged in a store. Say, for example, the going price in the market for a cd is $40. Suppose that one person is willing to pay $55 for the cd and another person is willing to pay $45. By paying the going market price of $40, both individuals benefit, the first by $15 and the second by $5, for a total benefit of $20. This "benefit" is called the *consumer surplus*. Now, consider what happens if an excise tax of $10 per cd is imposed. The going market price is now $50 for that cd. The person who was willing to pay $55 will still purchase the cd and will pay a tax of $10, but she will now enjoy a benefit of only $5. The person who was willing to pay $45 will no longer purchase the cd because its cost ($50) is now greater than the amount he was willing to pay ($45). The tax on the cd has generated revenues of $10, but the tax has also made both individuals worse off: the total benefit has fallen by $15, from $20 to only $5. Because the decline in the total benefit of $15 is greater than the tax revenues of $10, there is an "excess burden" that equals the difference, or $5. Almost all taxes create this excess burden because most taxes cause individuals (and employers) to change their behavior. If we add up the losses to everyone in society, we arrive at an estimate of the excess burden, or the welfare cost, of taxes.

The fact that the tax system introduces these changes in consumer and producer behavior is not necessarily bad from a point of view of public policy. On one hand, the government would like to offer special incentives and tax-exemptions to encourage consumption and production in a way that facilitates future economic growth or, the goal may be to achieve a more desirable distributional result. On the other hand, each tax break and incentive creates another distortion that adds to the total deadweight loss. The question is whether the benefits from the interventions with the tax system are outweighed by the efficiency costs introduced.

It is difficult to determine how the specific tax breaks, special rates, exemptions and the like affect the economy. A technique that is used to try and make such an estimate is computable general equilibrium (CGE). Using a CGE model developed by the technical team for Jamaica, we can estimate the efficiency costs of the present Jamaican tax structure. These costs are computed using a model of Jamaica's economy that includes the different levels of tax-collection across industry types and the different patterns of input purchases. The technical team utilised the computational model to quantify the inefficiencies of the current tax system in Jamaica.[1]

[1] A more detailed discussion of the Jamaica CGE model and the results discussed in this section are found in Staff Paper #8 Light (2004), and in Staff Paper #10, Bahl and Wallace (2004).

The experiment undertaken involves calculating the welfare cost of raising additional revenues equal to 1 percent of GDP from the GCT, from import tariffs and from labour taxes. In one set of scenarios, additional revenues are raised by increasing rates in the existing tax structure. In another set of scenarios we consider a “cleaner” (more uniform) system of consumption taxes and import duties to raise the same amount of revenue.

In row one of Table 4, we summarise the degree of inefficiency in the tax system using a welfare measure called the “Average Cost of Funds” (ACF). The ACF compares the total loss in consumer welfare against the total gains in tax revenues. An “efficient” tax has an ACF equal to unity (1.0), where each dollar of revenue causes consumers to forego only one dollar of consumption. For a typical tax, consumers must forego *more* than one dollar of consumption for each additional dollar collected due to the distortions that the tax introduces into the economy. So the ACF is typically greater than one.[2]

Table 4: Computational Model Results: Jamaica’s Current Tax Structure versus More Efficient Alternatives. In each scenario, an additional 1 percent of GDP is collected in tax revenues. (Steady-state[3])

	Current GCT Structure	Broad-based GCT	Current trade regime	Uniform Tariff Regime	Current Labour Tax regime	Substitute labour tax for broad based GCT
ACF[a]	3.2	1.4	3.1	2.5	4.7	0.7
Output[b]	-3.1	-2.3	-4.2	-3.6	-6.4	-1.2
Welfare[b]	-4.1	-1.8	-3.2	-2.6	-6.1	-1.0
Imports[b]	-5.6	-2.0	-9.2	-8.9	-4.5	-2.1
Exports[b]	-6.9	-2.3	-13.1	-13.1	-6.9	-2.1
CPI[b]	3.2	3.5	4.7	6.3	2.3	4.0
Real Exchange Rate[b]	-3.0	-1.6	-2.7	-1.9	-0.5	-2.4
Change in capital stock[b]	-3.1	-0.8	-3.5	-2.7	-6.0	0.3
Return to Labour[b]	-1.9	-0.7	-2.8	-1.8	-4.4	0.3

Notes: Results will vary according to modeling assumptions. These results are reported for labour supply elasticities of 3.0 where labour can move between the formal and informal sectors for all but the trade regime options. In the case of the trade regime options, the labour elasticity is 1.0.

a) Measured as J$ per J$ of revenue raised
b) Measured as percent change resulting from a tax increase equivalent to one percent of GDP.

[2] The ACF can be less than one when consumption falls less than total revenues rise. This can occur when there are multiple distortions in an economy--including various taxes. In such cases, substituting one tax for another can yield the same amount of revenue for less sacrifice in terms of reduced consumption. The welfare change refers to the welfare loss associated with raising revenue in the simulation. For example, in the last column we see that the reform option of a broad-base GCT to replace current labour taxes and increase revenue by 1 percent of GDP (approximately $4 billion) yields a gain in revenue (1 percent of GDP) greater than the welfare loss of 0.7 percent.

[3] The steady-state model allows capital and investment to change in response to policy initiatives. The static model and results are the changes in output, prices, etc. in the short-run. The steady-state is not measured in a time dimension, but rather in terms of this adjustment of capital and investment, which could happen in a matter of several months.

In columns 1 and 2 of Table 4, we show the steady-state or long-run effects of increasing revenues by the same amount, from the present GCT and from a broad-based GCT. Under the present tax system, the ACF is J$3.2, i.e., for every dollar of revenue raised, an additional J$2.2 is sacrificed in consumption on account of the distortions in the system. An equal-yield but broad-based GCT system has an ACF of only J$1.4; that is, a broad-based tax would sacrifice only an additional J$0.4 in consumption beyond the one dollar of revenue raised. The efficiency cost of the present GCT system might be thought of as an additional deadweight loss of J$1.8 in consumption for every dollar of revenue raised.

The remaining rows of the table give estimates of the differential impacts on the economy of these two taxing scenarios. Of particular note is the fact that total output and total exports are reduced less by the less distorting, broad-based GCT. Removal of exemptions or zero-rating under a broad-based GCT increases the effective tax rate in those sectors that currently receive these preferences, so that these sectors produce less under the broad-based GCT than under the current tax. However, a broad-based GCT allows the overall effective GCT rate to be lowered to 9.5 percent, which is significantly lower than the effective rate under the present GCT system. With a lower effective rate, those sectors that do not receive preferences in the current system increase their production. Overall, an increase in revenues reduces output under either the current GCT or the reformed GCT, but the negative impact on output is less under the reformed GCT because the increased efficiency of the broad-based GCT generates fewer price distortions and therefore higher output and welfare compared to the current system.

Another interesting result is that the return to labour is reduced more by the present system of GCT and labour taxes than it would be by a more broad-based GCT or a uniform tariff regime. This occurs because the broad-base GCT reform option reduces the effective tax rate on commodities that are relatively capital-intensive. In the broad-based system, a tax rate increase (via GCT) will reduce demand, but as noted above, relative to the narrow-based GCT, there is less of a reduction in output. Any reduction in output will reduce the demand for labour, thereby reducing the market wage. However, the reduced output and demand for labour (and therefore the wage) is greater in the case of a narrow-based GCT.

Two other experiments are reported in Table 4. In columns 3 and 4, we compare the current system of tariffs with a system where the tariff regime is uniform. The results are much the same. An additional dollar of revenue raised with the current system imposes a greater welfare cost on the economy than would a uniform tariff regime, and the uniform regime would also have a smaller (negative) impact on the exchange rate and overall output. Finally, columns 5 and 6 report the impact of raising the additional revenue from the current system of labour taxes (column 5) and that from reducing the tax revenue from the current system of labour taxes and instead, using a broad-based GCT to increase the revenue. These columns show that the efficiency gains from switching from the labour taxes to the broad-based GCT structure are quite large.

The committee agreed that these results further underscored the significant economic advantages of a shift away from the current heavy reliance on taxes on labour and towards a greater reliance on indirect taxes. The committee further agreed, in light of these results, that emphasis should be placed in its deliberations on changes to the tax system that would tend to broaden rather than narrow the base of taxes, and that tax rates should be held as low as possible.

Problems with The Current Tax System

1: Tax Administration is Weak

For many years, Jamaica has been plagued by problems with its tax administration. The Jamaican tax administration is still reaching for the easier "tax handles" in that it lives off the revenues from PAYE income tax revenues, income tax on interest that is withheld by banks and other companies, and GCT collections from a relatively small number of firms. This situation gives rise to horizontal inequities, revenue loss and an erosion of confidence in the fairness of the system.

Further, the structural problems identified with the current tax system also give rise to administrative problems: complicated rate and base structures make enforcement more difficult and encourage non-compliance. While the committee was not specifically charged with making recommendations in respect of tax administration, **Appendix A** to this report contains a listing of a number of issues highlighted in the course of our work together with recommendations for corrective action.

2: The Revenue Problem

When the government took on a significant amount of debt to forestall the bankruptcy of much of the financial sector, it and the society as a whole, assumed responsibility for pushing revenue mobilization to considerably higher levels than would otherwise have been the case. By some estimates, there remains a fiscal gap equivalent to about 1.7 percent of GDP. If this revenue shortfall is not resolved through other means, any tax reform package may need to be accompanied by a revenue enhancement package.

3: The System is too Ad Hoc

Jamaican tax policy has become increasingly focused on meeting the needs and wishes of specific sectors and classes of individuals. In many ways, it has become overly friendly to some taxpayers. A considerable amount of tax exoneration has been granted to companies, very specific items of consumption (e.g., school bags) and sources of income (e.g., gratuities). As the system has moved away from a rule-based approach and towards one that is characterised by numerous "special treatments," the goal of fairness in taxation has been compromised. The tax regime has become more ad hoc in three important ways: the granting of discretionary waivers, formal tax relief, and uneven administrative practices that lead to a differential treatment of individuals and companies.

4: The Tax Base is too Narrow

We might think of two ways in which the “comprehensive” tax base has been narrowed. One is legal and may take the form of exemptions or preferential treatment, i.e., “tax expenditures.” The other is because of administrative failures.

A listing of the tax expenditures in the Jamaican revenue system (see table 5 below) suggests a revenue cost in excess of 60 percent of the tax revenue actually collected in 2002-2003. In other words, for every J$100 of revenue collected in Jamaica, another J$60 is formally granted in tax relief.

Table 5: Tax Expenditures in the Jamaican System

	Year	Revenue Cost (billion J$)	Percent of Revenue
Individual Income Tax			
Threshold	2003	9.175	41.2 percent of PAYE
Allowances	2003	2.0	8.9 percent of PAYE
Gratuity Exclusion	2003	0.444	2.0 percent of PAYE
Dividends of listed companies	2003	0.350	1.8 percent of PAYE
HEART			
Gratuity Exclusion; Non taxation of government entities;	2003	1.0	40 percent of HEART Revenue
Education Tax			
Exemption of NIS Contributions, superannuations and gratuities	2003	0.25	5 percent of Education Tax revenues
General Consumption Tax			
Threshold	2002	N	N
Exemption	2002	16.3	118.3 percent of domestic GCT
Zero Rating for non exports	2002	10.7	77.7 percent of domestic GCT
Tourism	2002	3.5	25.4 percent of domestic GCT
Property Tax			
Relief and Derating	2002	N	N
Tax Incentives and Corporate Tax			
CIT Tax Holiday	2003	1.594	22.4 percent of CIT
Duty/GCT/Stamp Relief	2003	15.778	56.0 percent of taxes on international trade
Waivers of Penalty, Interest and Surcharges	2003	0.365	…
Hotel Incentives, Resort and Cottage Act	2003	1.206	16.9 percent of CIT[a]
PIT Tax Holiday	2003	.001	N
Total	2002/2003	62.633	60.7 Percent of total tax revenue in 2002/03

Source: Project Estimates & Staff Paper #10, Bahl and Wallace (2004).

The tax base is also markedly narrowed by tax evasion and by an enforcement program that is unable to catch up with the hard to tax. We estimate that individual income tax revenues could be at least 50 percent higher if the self-employed were fully compliant. We also find that some combination of a low rate of voluntary compliance and a low rate of coverage has led to only about 17 percent of profits being reported for company income taxation in 2003.[4] The average “true” effective tariff rate of 10.8 percent is well above the collected rate of 5.3 percent. The collection rate for the property tax is less than 50 percent.

5: The Special Problem of Tax Incentives

The system of tax incentives in Jamaica is a special problem. The government does not know the full extent of the incentives it has given, nor are these tracked on a regular basis. The tax reform project estimates that the number of separate incentives and remissions given number nearly 200,000 and the amount of tax forgiven is equivalent to about one-fifth of total government tax revenues in 2003. The policy question is whether the time has come to scale back and rationalise this program, or whether it should be continued in its present form as a key element of national industrial policy. This choice will not be an easy one, either in terms of the economics or the politics.

6: Horizontal Inequities

If a tax system is fair, equally situated individuals and companies will face the same set of tax obligations. When this is not the case, some individuals will bear a heavier burden than others who have roughly comparable means. This weakens confidence in the system and may encourage some taxpayers to look for avenues of non-payment that may have negative consequences for revenues. There are many horizontal inequities in the Jamaican tax system, including:

- Some individual income taxpayers receive non-taxable allowances while others either do not receive allowances or receive them at a lower rate. The result can be widely different tax burdens, even for households with the same income.

- Some consumers face very different GCT rates than others, e.g., in the case of the purchase of motor vehicles.

- The company income tax discriminates among companies, largely because of the array of favorable tax preferences that are given to some.

[4] “Coverage” is the ratio of statutory or chargeable income as defined in the tax code and total profits in the economy as reported in the National Income and Product accounts. There is good reason to believe that the company tax base is narrow due to exempt sources, such as approved farmers, tax exempt interest on GOJ Bonds and other sources of interest income, brought forward losses, and tax holidays. Thus, the coverage of Jamaica’s company tax is low. Consequently, the tax rate must be higher to collect a given amount of revenue.

- Relief on import duty is provided for some goods, but not others. This is mainly due to negotiated special treatments.

7: The System is Overly Complicated

There are numerous features of the Jamaican tax system that add complexity:

1. For the property tax, 11 property value categories are specified and caps on the maximum amount of property tax to be paid are specified for each value class.

2. On the surface, Jamaica's GCT has a simple rate structure: zero and 15 percent. In practice, Jamaica does not have a uniform rate GCT but rather what has been described as "anarchy in tax rates."

3. The tariff structure is complex. There are 10 basic tariff categories, but within each there are numerous exemptions and rates vary widely. In addition, several other taxes are imposed on imported goods.

4. There are five payroll taxes, with separate administrations and separate rate and base structures. Two of these, HEART and the Education Tax, are simply additional income taxes.

8: Efficiency Costs

One school of thought about good tax policy holds that the tax system should raise its target level of revenue in as neutral a way as is possible. The present Jamaican tax system introduces a great number of distortions.

The efficiency of the income tax is significantly compromised by six features of the tax structure: the differential taxation of capital income, the difference in the corporate and individual income tax rates, the availability of allowances under the individual income tax, incentives afforded to certain industries, special tax treatment for certain sectors (tourism), and the proliferation of non-compliance.

The corporate income tax fails the economic efficiency test by its favored treatment of certain investment choices and even certain sectors of the economy. The result is that investment decisions may be led by tax considerations rather than by market forces.

Property transfer taxes in Jamaica are widely decried as an impediment to a properly functioning market, and in particular to the development of primary and secondary capital markets for non-public sector debt and equity instruments, which will become increasingly important vehicles for capital raising as domestic interest rates settle at sustainable levels. Further, a tax rate of 13 percent is high enough to encourage the holding of land, to find means of transfer that avoid the tax, or to stimulate an aggressive appeal for discretionary relief. It is likely that all three phenomena are prevalent in Jamaica.

The combination of tariffs, GCT, and SCT rates and various exemptions, give rise to numerous tax rates for similar goods.

Comprehensive Reform: A Structural and Rebalancing Package

The Committee recommends that Jamaica undertake a comprehensive structural and rebalancing reform, which would shift the present balance away from the current heavy reliance on direct taxes and toward indirect taxes. The package proposed here is focused on tax neutrality, with the goal of reducing or eliminating those distortions that lead to a misallocation of resources and may compromise economic growth and competitiveness. It presumes that a generally lower tax rate is a better economic development strategy than targeted incentives. Secondary objectives are to improve the fairness of the tax system, and to make it less complicated and less administratively costly to operate. The reform outlined here goes some distance towards meeting these objectives.

Components of the Proposed Reform

General Consumption Tax

The revenue productivity and the fairness of the GCT could be addressed by eliminating all non-export zero rates other than those required by international convention, together with a significant amount of the exemption list. Our initial estimates, made from the GCT database, are that the revenue potential in this base broadening is very significant (See Table 5 & Staff Paper #7 pp. 14-16).

However, the technical team believes that these data on the revenue loss due to zero rating are suspect in that the purchase of supplies by the non-export sector may be overstated.[5] Moreover, the technical team has not been able to separate out government purchases. These issues plus the fact that some of the preferential treatments will not go quietly because of legal protection or political protection, suggests that actual realisation will be considerably lower. Based on the analysis done here and consultations with government, we estimate that this base broadening (i.e. elimination of non-export zero rates), might yield as much as J$5 billion.

The revenue yield from removing exemptions depends on how far the GOJ is willing to go. From the GCT database, the estimated revenue cost of exemptions is about J$16 billion, based on 2002 data. We estimate that removing the exemptions for utilities, construction and real estate, and transportation can yield J$2 billion[6] as set out in table 6 below.

[5] This could result because of misclassification in reporting the payment data.

[6] The current level of disaggregation and classification of exempt supplies within the GCT database did not allow the committee to specify in any more detail the list of activities to be removed from the exempt list, and a detailed analysis at the firm level must now be undertaken by TAAD in order to validate this estimate. The committee also recommends that GOJ undertake an exercise to analyse all exemptions and provide justification (i.e. protection of the poor) for any that are to remain.

Table 6: Exemptions for Utilities, Real Estate, Construction and Transportation

Business Description	Total Supplies	Exempt Supplies	Revenue Gain
TOTAL	**37,431,800,690**	**24,179,167,485**	**2,370,544,195**
UTILITIES	17,262,413,429	17,221,862,000	1,722,186,200
CONSTRUCTION	3,998,115,948	1,584,575,289	82,063,308
TRANSPORTATION	8,946,049,067	4,083,016,196	489,342,287
REAL ESTATE[7]	7,225,222,246	1,289,713,999	76,952,400

Further, the general GCT rate might be increased from 15 percent to 16 percent, to raise J$2 billion in new revenue. Under the present base, a one percent increase in the GCT rate ought to yield about J$1.8 billion. With a reduction in the amounts of zero-rating and exemptions, this proposed increase would be taken on a larger base and there will be a compensating reduction in other taxes that will produce an increase in disposable income and consumption. In total, this package might increase revenues from the GCT by about J$9 billion.

Finally, the committee recommends that the taxpayer registration threshold be raised to J$1 million, which would eliminate approximately one half of all taxpayers currently on the rolls at a sacrifice in revenue of only approximately J$20 million.

Tariffs

The weighted average "collected" rate on tariffs is about 5 percent, while the weighted average "statutory" (or applied) rate is about 10 percent. Therefore, ignoring the impact of under-reporting or non-reporting of imports (i.e. evasion), only about half of revenue potential is being realised due solely to remissions of duty.

The committee would have preferred to recommend a unification of applied and collected tariff rates at a level somewhere between the weighted average statutory rate (10%) and the weighted average collected rate (5%), which would have the effect of substantially increasing revenues while eliminating the economic distortions inherent in the current system of highly variable tariffs. However, as discussed elsewhere in this report, the Common External Tariff (CET) severely restricts our ability to amend tariff rates without negotiation and agreement with all CARICOM member states.

[7] For the sake of clarity, it is important to note that the category "Real Estate" does not include the transfer of real property, but would include residential rental payments.

A unification of the "collected" tariff rates at a level closer to the statutory (applied) rate of 10 percent might however be considered. We propose consideration of the elimination of duty remissions for imports, to gain additional revenues of J$1 billion. Since only about 50 percent of potential tariffs are collected, there should be ample room for increasing tariffs by this amount. In fact, we estimate that full collection of tariffs due would increase revenues by twice this amount. The algorithm we use in making this estimate holds in place any collected rates above 10 percent, and increases collected rates when they are both below their statutory rates and below 10 percent. Statutory rates of zero are not changed.

In order to identify those discretionary reliefs for elimination, the Government must do a line-by-line check of the present system of several thousand remissions. This will allow a separation of imports that are general government purchases and those that are protected by legislation.

Special Consumption Tax

Three changes could be introduced in the SCT, all primarily as revenue measures. First, the GOJ could subject all motor vehicles to the standard rate of GCT, and then impose a structure of SCT rates based on engine capacity.[8] Table 32 in Staff Paper #7 shows the SCT rates needed to duplicate exactly the existing system. However, if the recommended approach is followed, this unnecessarily complicated system could advantageously be replaced by a simpler system, distinguishing, for example, only four classes of vehicles – cars (including SUVs), trucks, tractors, and buses – with rates graduated, if desired, by engine cc. for cars and axle weight for other classes of vehicles. The same SCT rates should be applied on importation to all vehicles, whether imported directly or by dealers.

The revenue yield from this tax will depend on the tax structure decided. We note from Staff Paper #7, that a 55 percent standard rate of SCT (in addition to GCT at the standard rate) would have yielded additional revenue of approximately J$1.7 billion and we use that estimate here as a revenue target for the new motor vehicle rate structure.

Second, the GOJ might adjust SCT specific amounts to be equivalent to 1999/2000 levels in inflation-adjusted terms, and index these to inflation. This reform will generate increased revenue immediately, and in the future will slow the erosion in real revenues and maintain some parity with goods subject to GCT. The revenue gain from establishing the rate schedule (see Staff Paper #7)

[8] Such a system would be consistent with the goals of conserving fuel and building some notion of income redistribution into the rate schedule. For a more in depth discussion of motives for taxing motor vehicles, and the Jamaican context, see Smith (1991).

is J$2.7 billion. Indexation will produce a greater revenue flow in the years thereafter, by comparison with the present non-indexed system.

Third, we suggest that the government consider imposing a standard rate of GCT on the SCT-inclusive motor fuels base. The revenue gain would be J$2.7 billion. This has the advantage of yielding significant revenue in the very short run. It also has the advantage of building some automatic growth (and potential decline) into the tax on motor fuels and reducing the need to return periodically to the public with an "announced" hike in taxes on petroleum products.
The proposal as outlined has the disadvantage of likely being politically unpopular. The committee noted however that the continued under-taxation of items such as motor fuels is as much a subsidy to the rich as to the poor. In this regard, the committee examined an international sample of fuel prices, gross and net of tax, as shown in table 7 below.

Table 7: Comparative Taxation of Regular Gasoline

Countries	Total Price	Ex-Tax Price	Tax
Puerto Rico	0.480	0.420	0.060
USA	0.497	0.394	0.116
Jamaica*	**0.540**	**0.421**	**0.119**
Mexico	0.547	0.359	0.188
Canada	0.649	0.415	0.235
Taiwan	0.613	0.375	0.238
Brazil	0.532	0.264	0.268
Honduras	0.702	0.425	0.277
Argentina	0.563	0.285	0.278
Italy	1.413	0.495	0.922
France	1.322	0.387	0.943
Germany	1.444	0.446	1.003
U.K	1.451	0.401	1.088
max	**1.451**	**0.495**	**1.088**
min	**0.480**	**0.264**	**0.060**
mean	**0.827**	**0.391**	**0.441**
median	**0.613**	**0.401**	**0.268**
Jamaica vs. the Mean	0.287	-0.030	0.322

Source: GSU, PIOJ

While the changes recommended will significantly increase the taxation of motor fuels, a move which is likely to be extremely unpopular, the committee considered that this level of relative under-taxation should not be allowed to persist in Jamaica.

Finally, all other 'non-standard' rates of GCT would be eliminated (for example 12.5% on construction materials, 20% on phone services). Government could alternatively consider, in relation to the tax on phone services, imposing SCT at such a rate as would, together with the application of the standard rate of GCT, yield the same revenue as the current basis. This would be consistent with the classification of this service as a relatively inelastic one and therefore comparable to alcohol/tobacco.

The total revenue gain from these SCT initiatives is J$7.1 billion.

Property Tax

The Government could enact a major reform of property taxation with the adoption of a J$300,000 threshold and a flat rate of 1 percent. We also suggest consideration of an annual indexing of taxable property values as well as the threshold. The revenue increase from the rate and base change is estimated at J$600 million and the indexation should yield an increase of about 9 percent per year during the period between general revaluations.

Transfer Tax and Stamp Duty

Given the many shortcomings cited earlier in relation to Transfer Tax and Stamp Duty (see Section 8 entitled "Efficiency Costs"), the Committee recommends:

- The total elimination of Stamp Duty[9].

- The removal of Transfer Tax from transfers of securities (debt and equity). Subject to an evaluation of the effect on Jamaica's competitiveness (within Caricom in particular), the Income Tax Act should be amended to expand the definition of "interest" to include realised gains from the sales of shares (listed and unlisted) as has previously been done for debt securities. The effect would be that all gains from the disposal of securities would be subject to income tax at the rate of 25%.

- The elimination of Transfer Tax on capital distributions in keeping with the principle that taxes and gains should only be taxed once (within the company) rather than again when paid through to shareholders.

- The reduction of the rate of Transfer Tax on real estate transfers from 7.5% to a rate of 5%[10].

- That Transfer Tax on death would be charged only on real property, and at the rate of 5% (rather than 15% as now prevails).

[9] This should not however affect postal stamps on mail.

[10] This may require introducing an anti-avoidance provision that would require transfers of shares in a "real estate company" (i.e. a company whose asset base is primarily comprised of real estate) to be treated as a transfer of the underlying real estate (or the portion thereof represented by the shares being transferred).

We estimate that elimination of the stamp duty and reduction of the Transfer Tax rate to 5% will involve a revenue loss in the short term of approximately $1.8 billion (versus total revenues in 2003 of $2.8 billion under the existing system) and this is the estimate we use in determining the impact of this measure within the reform package as a whole. No account has however been taken of the income tax that could be generated by treating gains on the disposal of securities as chargeable income, which could be substantial if an effective way can be found of ensuring that such income is reported (for example, by requiring the JSE member dealers, and the Registrar of Companies, to report such transactions to the Revenue).

Individual Income Tax

A major component of this reform package would be to adopt a threshold of J$275,184 and index this amount. This option would benefit all Jamaican individual income tax payers, and would provide total income tax relief to an estimated 98,000 taxpayers. It would at once reduce administrative cost, provide significant relief to lower income taxpayers, and reduce the tax burden on labour. The substantial increase in the threshold (128%) reduces the value of a number of allowances and the current hotel gratuity scheme. This would provide an opportunity to formally eliminate these tax preference schemes, including accommodation, in favour of allowing only legitimate reimbursable expenses. GOJ should also review and adjust the basis upon which taxable values are imputed where an employee is provided a motorcar.

The revenue cost of this option is considerable as it reduces income tax revenues by J$5.5 billion, 20 percent of PAYE, and the indexing further increases the cost after the first year by an additional 2.3 percent. Self-employed tax revenue would be reduced by 30 percent—an estimated J$82 million. The main benefits of these changes are a lowering of the cost of labour, a reduction in the number of lower income workers on the tax rolls, and administrative simplification.

In addition, dividends of non-listed corporations should be exempted from tax. The revenue impact of this change for corporate and individual income taxpayers is approximately J$900 million. This change would remove the current bias against non-listed stocks.

Education Tax

The Education Tax is a second income tax, and it is not earmarked. There would appear to be no good justification for retaining it as a separate levy, and previous reviews of the Jamaican tax system have called for its elimination. Government should eliminate the Education Tax altogether. At 2003 levels, this would result in a revenue loss of J$4.9 billion.

HEART

HEART is an earmarked tax. In effect, it is a third income tax in the system. Government could abolish this tax, and fund the Heart Trust NTA from the consolidated fund. The revenue cost would be J$2.26 billion at 2003 levels.

CSFBS

CSFBS is essentially a compulsory life insurance policy operated by government on a pay-as-you-go basis. One possible reform would be to privatise this scheme. The result would be a reduction in contributions from pensionable government officers equivalent to about 4 percent of their payroll amount. The revenue cost to Government would be the tax element embedded in the contribution. There is no actuarial study on which to base an estimate of this tax component or to make a judgment about the extent to which the system is funded and without these data no hard recommendation can be made. However the manner in which this benefit is funded is clearly anomalous and should be the subject of an early review.

NIS and NHT

Administration of these principal remaining payroll taxes should be consolidated. The tax base of both programs would be expanded by a broadening of the income tax base, and could be significantly expanded by administrative efforts to increase the rate of compliance. Any base expansion could be accompanied by a rolling back of the tax rates but this would be a matter of expenditure policy and the extent to which the programs are fully funded. However, we have not made a careful study of the funding of these programs and do not make a recommendation. Several committee members expressed the view that the NHT seemed to be more than adequately resourced, and that GOJ should therefore review its ongoing funding.

Corporate Income Tax

An interesting reform choice for the GOJ would be to eliminate the corporate income tax. This would signal a friendly investment climate in Jamaica, and would eliminate the issue of corporate tax incentives. It would reduce administrative costs on the side of government and it would reduce compliance costs. The revenue cost would be about J$7.1 billion. With the elimination of the CIT, dividend withholding tax on all equities would be reinstated. This could yield J$800 million in revenue.

However, under the CARICOM double taxation treaty, dividends paid to a resident of another Caricom country are nontaxable. Therefore if the corporate income tax were eliminated, investment in Jamaica via a Caricom treaty country would escape tax altogether. Also, to avoid the non-taxed build-up of retained earnings, enforceable regulations would have to be developed to monitor the build up of retained earnings, which would be non-taxable until they are distributed or the company is sold (if a capital gains tax were in place).

We take the view, as attractive as this reform option might be in terms of stimulating economic activity, that the revenue costs and the possible tax avoidance issues recommend against it. A better option at the present time would be to harmonise the CIT and PIT rates at 25%. Reducing the CIT to the PIT rate would lower the user cost of capital and stimulate investment. This reform would involve a loss of approximately J$1.4 billion in corporate tax receipts, or an amount equivalent to approximately 1 percent of total tax revenue (based on FY 2002/03 receipts). The revenue loss would be due to the harmonizing of the tax rates at the lower individual income tax level.

Given the relative poor performance of the corporate income tax, even in an environment of increasing corporate profits, GOJ could consider the desirability of introducing an Alternative Minimum Tax, to be based on profits, which would require the payment of a minimum level of tax by all profitable companies irrespective of the level of their tax adjusted profits.

Tax Incentives

This reform proposal does not recommend the immediate and wholesale elimination of tax incentives. The arguments to support this position are the unknown impacts of removing these incentives, particularly those related to tourism (including GCT) and service industries in general, and the fact that removal of targeted incentives ought to be preceded by the correction of other elements of the tax system. In particular, the committee observed that applied tariff rates, if unified at say, 8 percent, might be a fair trade for removing incentives (and in particular, duty relief) in the tourism sector. Unfortunately, CARICOM agreements limit the reform choices that involve applied tariff rates.

In the longer term however, the fact is that if we ignore targeted tax incentives and preferences, we are ignoring what is most wrong with the Jamaican tax system. As has been argued repeatedly above, these incentives have eroded the tax base, created a situation of unfairness, complicated administration and possibly directed investment to sub optimal uses. Government has not closely monitored the extent and impact of these preferential tax treatments. We would argue that it is time for Jamaica's tax system to take a new path toward horizontal equity and if tax incentives are to be part of the new system, then they should be more limited and designed anew to ensure their effectiveness.

The package of reforms already laid out above will provide considerable relief to all businesses whether or not they currently benefit from the wide array of tax incentives otherwise available under Jamaican law:

- Taxes on labour are significantly reduced, translating to reductions in gross and net labour cost;
- The rate of taxation of corporate income is reduced from 33 1/3% to 25%;
- Transfer taxes on debt and equity securities and all stamp duties are eliminated, thereby removing a considerable investment “exit tax” and lowering investment hurdle rates of return;
- Double taxation of corporate income is eliminated;
- Administrative costs of PAYE compliance are considerably reduced by the elimination of HEART and the Education Tax and the consolidation of the NIS and NHT administrative machinery;

The committee agreed, in view of these considerable reliefs designed to stimulate growth and investment, and despite the constraints imposed by the CET, that certain steps should be taken immediately towards reducing the extent of horizontal inequities inherent in the current incentives regime. The committee therefore makes the following recommendations:

- GOJ should immediately commission an <u>independent</u> study of the existing incentives regime in order to determine the costs and benefits of the incentives provided and to make recommendations for their redesign as necessary. A suggested Terms of Reference for such a study is included in **Appendix B** for GOJ’s consideration. While this work is on going, there should be a moratorium on any extensions to previously granted incentive orders;
- Those aspects of the existing legislation which relate to Income Tax Holidays should be immediately abandoned and existing such holidays allowed to expire in the normal course; any new incentive orders made, except where firm commitments have already been made, should deal exclusively with duty and/or GCT relief related to the establishment cost of the new investment;
- As discussed here and elsewhere in this report, the current structure of the Common External Tariff within Caricom constrains our ability to reform the Jamaican tariff structure in ways that would almost certainly improve the efficiency and competitiveness of our economy. We believe that there is an urgent need along with our Caricom partners to reevaluate the effectiveness of this aspect of the treaty and we urge the GOJ to initiate such a process without delay. Depending upon the outcome of this process, the issue of duty and/or GCT relief under the incentive legislation could then be reviewed.

<u>Social Fund</u>

A problem with most of the tax reform options under consideration here is that they impose an increased burden on lower income households. In fact, most base-broadening reforms will have this result. While one goal of tax reform ought to be to protect the real income position of the poorest of the population, the committee believes that a better way to achieve this goal is on the expenditure side of the budget[11].

One approach would be to create a social fund targeted to expenditures that would benefit the lowest income families. The money is provided for within this revenue neutral reform program, hence they are “additive” funds. We have calculated the required amount of the fund as the amount of increased tax liability borne by the bottom four deciles of families under this proposed tax reform. This amount is J$755 million.[12]

This fund would be spent for the provision of services or for transfers that would be targeted toward the poorest 40 percent of the population. The social fund could be viewed as a compensation for the proposed increase in tax burden.

Other Reforms

Some reforms could improve the functioning of the Jamaican fiscal system, even if they do not have a significant impact on revenues. We propose the following such reforms.

1. The government should prepare and present an annual tax expenditure budget as part of the budgetary process.

2. Some technical revisions in the company income tax should be considered. We propose that the government investigate the possibility of simplifying capital allowance by reducing the number of asset types to five (5) and eliminating the special treatments for Basic Industries, etc. We also propose expanding the definition of intellectual property for

[11] Bird (1992, p. 49) puts it well. “While regressivity of the tax system ought to be reduced as much as possible in order not to make things worse, if our main concern is with poverty as such, with the waste and misuse of human resources and the stunted opportunities in life afforded those with income below some minimum level, any fiscal corrective must be exercised primarily through the expenditure side of the budget.”

[12] The value of the social fund was calculated as follows. The change in tax burden was estimated based on the reform package. The fund amount necessary to hold harmless each of the bottom four income groups is the change in tax burden multiplied by the total amount of household income in that income group. We obtain the total amount of income from our SLC sample. For example, in the SLC, there are 679 households in the lowest income group and they report 34,938,848 in comprehensive income total. These 679 households represent a population total of 74,194. This group sees an increase in tax burden of approximately 3.82 percent. We estimate the social fund need for this group as: (34,938,848/679)*(74,194)*. 0382 = 145,074,536. Based on these calculations, we estimate the total value of a social fund of $755 million to hold harmless the bottom four income groups.

depreciation purposes, and allowing the LIFO method of inventory valuation. Finally we recommend that consideration be given to amending the income tax act to provide for group tax relief by allowing groups of companies to file consolidated tax returns.

3. Eliminate the present restrictions on input credits for capital goods under the GCT. Eliminate all artificial restrictions on claims for input tax credits. Allow, without restriction, input tax credits for all expenditure related to the business, including start-up expenses. Not to remove these special features of the tax results in some cascading of taxes, an impact that value added taxes were designed to eliminate. We have been unable to estimate the revenue cost of this change.

4. Eliminate the system of ministerial discretionary reliefs under the various tax headings and, where such measures are deemed desirable, institutionalise the criteria and administrative processes by which such reliefs are granted.

5. A. It is time for the Government of Jamaica to upgrade its abilities to regularly do fiscal policy planning and research. The scope of the fiscal monitoring unit should be expanded and the unit strengthened to support the work of the Ministry of Finance and Planning, and to regularly monitor and evaluate the performance of the fiscal system.

   B. Government and this fiscal analysis unit need access to a much expanded and developed fiscal database. Much progress has been made in developing a fiscal information system in Jamaica but there is much more to be done. There needs to be a greater urgency about taking the next steps to improve this system. The issue is much less about technical matters, and much more about getting the most useful and most correct information into the system. (See also **Appendix C**).

6. Undertake a comprehensive legal review and amendment of the various pieces of tax legislation, in particular the Income Tax and GCT Acts, which are fraught with inconsistencies and which give rise to administrative complexity.

Impacts of the Proposed Reform Package

Revenue

The reform package is approximately revenue neutral, as may be seen in Table 8. In total, there is a swing of about J$16 billion from income, property and transfer taxes to consumption taxes. The thrust of the reform is to lower the tax burden on labour, and in fact this reform would make Jamaica a country with relatively low taxes on labour (see Table 12).

The future revenue-income elasticity may not be affected very much. The indexed threshold for the individual income tax will lower elasticity, as will the elimination of the payroll taxes, but the broadened GCT base and the indexed base of the SCT and property tax will increase it. Another consideration is the possibility that the shift from income taxes, which the self-employed seem to be able to easily evade, to consumption taxes where evasion will be more difficult, may lead to a revenue enhancement. The same is true for elimination of allowances under the individual income tax.

Table 8: Revenue Impacts of the Proposed Reform Package

	(in billions J$)
Property Tax	+0.6
GCT	+9.0
SCT	+7.1
Tariff Remissions	+1.0
Property Transfer Tax	-1.8
Individual Income Tax	-5.5
Dividend Relief	-0.9
Education Tax	-4.9
HEART	-2.3
CIT	-1.4
Social Fund	-0.9
Net Effect, year one	+0.0

Tax Burdens

The increased reliance on the GCT and SCT shifts the burden toward consumers and therefore would reduce the progressivity of the tax system. The reduction in the corporate income tax reduces the tax burden on both owners of capital (a regressive effect) and labour (a proportional or progressive effect). The regressive effects of this reform are partly offset by the income tax reductions and elimination of HEART and Education Tax (which reduce the tax on lower income workers since the incidence study assumes that these taxes are borne by labour) and the increased taxation of allowances and non-taxed income (which increase the tax on higher income workers). The impact of this package on the distribution of tax burdens is described in Table 9. These results show that the rebalancing would lead to increased tax burdens for lower income households and for the higher income households, and marginally reduced tax burdens for some households in the middle of the income distribution. While the overall distribution of tax burdens remains quite progressive, as is shown in Table 9, the bottom 40 percent of households, would see their relative position weakened, e.g., the bottom decile would see an increase in taxes equivalent to about 3.8 percent of income.

Table 9: Estimated Changes in Tax Burden Associated with Reform

Household	Effective Tax Rate				
Decile	Present System	Reformed System	Change	Social Fund	Net Change
1st	23.92	27.74	+3.82	-3.82	0.0
2nd	24.47	26.98	+2.51	-2.51	0.0
3rd	24.60	26.89	+2.29	-2.29	0.0
4th	26.39	27.80	+1.41	-1.41	0.0
5th	27.53	27.71	+0.18	-	+0.18
6th	29.24	29.04	-0.20	-	-0.20
7th	33.71	33.07	-0.64	-	-0.64
8th	34.16	34.90	+0.74	-	+0.74
9th	35.84	36.16	+0.32	-	+0.32
10th	39.08	39.48	+0.40	-	+0.40

Source: Staff Paper #10

Is this a damning criticism? The answer is that it probably is not. For one thing, the changes are very small. Another point is that the overall distribution of tax burdens remains progressive, as may be seen from the "reformed system" column in Table 9. For another, the better way to subsidise the position of the poorest households is probably on the expenditure side of the budget where they can be better targeted.[13]

As noted above, and in recognition of the increased burden on lower income households, we have provided for a "social fund" the magnitude of which is sufficient to offset the increased tax burden on those households in the four lowest income deciles. The column entitled "Net Change" in table 9 simply shows the change in burden by income decile after application of transfers via the social fund.

[13] Bird (1992, p. 49) puts it well. "While regressivity of the tax system ought to be reduced as much as possible in order not to make things worse, if our main concern is with poverty as such, with the waste and misuse of human resources and the stunted opportunities in life afforded those with income below some minimum level, any fiscal corrective must be exercised primarily through the expenditure side of the budget."

Winners and Losers

This reform is comprehensive and touches virtually every tax in the system. The pattern of winners and losers is not so clear. In Table 9 below, we describe this pattern in a general way. The impacts on various sectors of the economy may be telling about the political feasibility of this reform. As may be seen from the table below, the biggest winners are workers who are already in the income and payroll tax systems, and owners of capital who tend to be higher income. The biggest losers are consumers, as a class, whose tax burdens would rise.

Table 10: Winners and Losers under the Proposed Reform Package

Tax Change	Winners	Losers
Eliminate zero rating under GCT for all but exports		All consumers, some owners of capital
Raise GCT rate by 1 percent		All consumers
Reduce GCT exemptions		Consumers of formerly exempt items
Abolish stamp duty & apply transfer tax at a reduced rate of 5% to real property only	Owners of real and financial property	
Flat rate one percent property tax, with J$300,000 exemption	All property taxpayers will benefit from the exemption; those with rates above 1% percent will gain from the flat rate. Approx. one third of all parcels will be eliminated from the tax roll.	
Introduce an individual income tax threshold of J$275,184.	All income tax payers; 98,000 taxpayers will be dropped from the tax roll.	
Abolish allowances, accommodation relief and preferential treatment of gratuities		Higher threshold largely eliminates the tax expenditure associated with gratuities. Some losers in the upper income groups due to allowances and other non-taxed income becoming taxable.
Eliminate Education Tax	353,000 taxpayers	None
Eliminate HEART	254,000 taxpayers and employers	None
Revised tax on motor vehicles	Some consumers of motor vehicles	Some Consumers of motor vehicles
SCT inflation rate adjustment		All consumers
Apply GCT to motor fuels		All consumers
Harmonise CIT and IIT rates at 25 percent	Owners of capital	
Amend ITA to make gains on sales of shares subject to tax		Owners of capital

Horizontal Equity

This reform would produce a tax structure that is fairer than the present system. The main horizontal inequities in the individual income tax system – allowances and gratuities – would be gone. Preferential treatments under the GCT would be significantly lessened with a more limited exemption list and the restriction of zero rating to exports.

Another potential advantage is the possibility of capturing more of the taxable capacity of the self-employed sector in the tax net. The individual income tax structure has not made great inroads in expanding the tax base to include these individuals and businesses, but a consumption tax might do a better job of reaching them. This would tend to narrow the difference in the tax treatment of the self-employed vs. PAYE workers, as exists under the present tax regime.

Administration

This reform would produce a system that is less complex than the present system, and likely one that would be less costly to administer. The Stamp Duty, the Education Tax and HEART would all be eliminated. This alone significantly reduces administrative complexity. The tax on motor vehicles would be moved to a much less complicated system. The number of taxpayers included under the individual income tax and the property tax would be reduced in significant numbers. On the other hand, indexation of the specific SCT amounts, the income tax and property tax thresholds, and the valuation base of the property tax, are moves toward complication and will impose some administrative costs.

Economic Development

The rebalancing reform has positive effects on economic development, and on incentives for investment. Basically, it shifts the tax burden away from labor, by raising the threshold for payment of individual income tax, and by eliminating the education tax and HEART. This could reduce one comparative disadvantage to Jamaican competitiveness by lowering the price of labor. It also removes certain tax induced distortions to methods of doing business in that it eliminates the stamp duty and reduces the property transfer tax, harmonises the individual and corporate income tax rates, reduces the differential treatment of purchases by substantially reducing zero-rating and reducing the number of classes of exempt goods, and eliminates the differential tax treatment of dividends paid by non-listed companies. It raises the same amount of Jamaican taxes in a more efficient way, including the cost of financing the social fund.

We have simulated the effects of this reform program with the Jamaica Computational General Equilibrium model, with the results presented in Table 11. In the steady state, with mobile labor, individuals are expected to move into the formal productive economy due to the reduction in income and payroll taxes. This dampens the pre-tax wage (thereby lowering costs to employers, by 3.5 percent by these estimates), but the after tax return to labor is significantly increased due to higher labor productivity (which results from an expanded capital stock and reduced taxes on labor).

Table 11: Summary CGE Results: Proposed Reform Package (steady-state[14])

	Impact
Percent change in output	1.4
Percent change in welfare	2.8
Percent change in exports[15]	-1.5
Percent change in imports	-2.9
Percent change in CPI	0.8
Percent change in return to labour	3.2
Percent change in employment	3.2
Percent change in the pre-tax wage	-3.5
Percent change in capital stock	3.4

Overall, output and employment increase substantially in the steady state, due to reductions in the cost of labor and expansion of the capital stock, brought about by the rationalisation of taxes on consumption. By the estimates generated in the model, output will be 1.4 percent higher in the long run, all other things being equal, while employment will be 3.2 percent higher and the capital stock will expand by 3.4%.

However, not all sectors of the Jamaican economy will fare equally well. Those sectors faced with the highest increases in GCT and tariff costs (i.e., those that experienced preferential treatment in the past), and those that are not labour intensive, tend to be the ones whose output falls. However, sectors that do not face GCT rate increases, that have a high export share, or that have a high dependence on labor inputs, tend to fare better. For example, demand and output expand in sectors where the GCT rate is already near the statutory rate. On the other hand, sectors like construction, which will see an increased net rate of tax due to the proposed changes in GCT exemption policy, will see a reduction

[14] Steady state here denotes the long run effects of the reform.

[15] There is a trade model embedded in the CGE model. An assumption in this model is that the current account trade balance is held constant at the pre-reform level. Under this simplifying but necessary assumption, if imports decline due to increases in the tax rate on imports, the value of exports also must decline in order to satisfy the requirement that the trade balance remain constant. A dynamic version of the model has not been developed, but such a model would incorporate the expected expansion of exports in the face of expanded capital stock, lower labor costs, and output growth.

in output. In the long run, employment grows, as the reduced pre-tax wage encourages increased production, and as the capital stock expands.

The results for the international trade sector reported in Table 11 should be interpreted with care. In the long run, the balance of payments should improve as a result of this tax reform package. The new tax regime will lead to higher prices of imported goods and therefore a reduced demand for imports. On the other hand, the reduced cost of production should enhance the competitiveness of Jamaican exports. In the CGE model that is used here, there is an explicit restriction on the current account trade balance—it must remain at the pre-reform level. As imports decline due to higher relative prices, the CGE model requires a decline in exports in order to hold the trade deficit constant. There will be some offsetting reduction in output for certain traditional exports (excluding tourism, which is not treated as an export in the model). The model estimates generated by this static CGE model are for a reduction in imports and exports. If we relax the model's assumption of a constant trade balance, the expansion in capital stock, reduction in labor costs, and expansion of output can be shown to yield an increase in exports and the level of imports will fall somewhat less than in the static model case. This would seem to be a more realistic view of the impact on foreign trade.

Tax Structure

As noted above the reform package results in a substantial shift away from a reliance on taxes on labour and towards indirect taxes. Table 12 below repeats the data from Table 2 and adds, in the row entitled 'Jamaica (Reformed),' the percentage of total tax revenues that each broad category of taxes would be estimated to represent after the proposed reform package is implemented.

Table 12: Changes in Tax Structure Under The Proposed Reform

	Income and Payroll Taxes	Indirect Taxes	International trade Taxes	Other Taxes
Jamaica (current)	41.9%	40.5%	8.9%	8.8%
Jamaica (reformed)	29.7%	53.1%	9.9%	7.3%
Sample Mean	32.6%	47.5%	13.4%	5.6%

Source: Staff Paper #10
Note: (a) All estimates exclude social security taxes
(b) 'Other Taxes' includes property taxes

As will be noted from the table, the share of income and payroll taxes in total tax revenues is significantly reduced from 41.9% to 29.7% under the reformed system, slightly below the international mean of 32.6%, which is probably appropriate given Jamaica's labour surplus economy. Indirect taxes, which were previously 15% below the international mean, move to a level approximately 12% above the mean.

Implementation Issues

The committee considers that the approaches to planning for and implementing the proposed reform package are as important as the specifications of the reform itself. We therefore offer the following recommendations as to an appropriate approach to implementation.

Policy Paper

As a first step GOJ should develop and disseminate a "tax reform policy paper," which would:

- Set out the elements of the reform, and justify it in terms of the impacts that are expected. This will give transparency to the process, and "put everyone on the same page" in terms of understanding what is being done;
- Serve notice to capital markets that the Government is addressing its fiscal problems;
- Advise the international agencies about how Jamaica is confronting its economic and fiscal situation;

This policy paper cannot be finalised until government decides exactly what it will do, but its general outlines should be fleshed out for discussion purposes as soon as possible. By getting the reform program properly justified and specified in a careful way, reformers can, to some extent, define the parameters of the political debate that will (and should) occur. Here the importance of hard quantitative analysis is underlined, so as to remove much of the mythology in the debate and force the reform discussion to begin at a higher level.

Phase In Versus "Big Bang" Implementation

Government will need to decide if the approach to reform will be to phase it in gradually, or to implement in a single stage or "big bang." A phase in, over a two or three-year period, has the advantage of being less risky because government can gain some experience with the revenue productivity of the new tax structure.

On the other hand, there are strong arguments for doing this reform as a "big bang:"

- Political leadership will grow weary of announcing tax reforms each year of the phase-in, and might even lose their resolve;
- The pressures of the budget will provide a significant temptation to postpone parts of the program, which could undermine the reform objectives;
- A big bang approach also has the advantage of a one-time announcement of a program that provides tax relief and tax increases to virtually all

taxpayers in the system. That kind of program should be easier to sell than one that imposes mostly tax increases in year 1, and holds the reductions to year 2, etc.

On balance the committee recommends that the “big bang” approach be adopted. However, areas of revenue uncertainty must be dealt with before the reform goes forward. The analysis carried out by the technical team was based on data available through Fiscal Services and other government agencies, and while great strides have been made in data collection and management in Jamaica, there is still some distance to go before these data can be used for what must be precise revenue estimates. As a first step, government must undertake three exercises in painstaking detail.

- Rework the GCT database and related information, to re-estimate the revenue gains from eliminating zero rating and exemptions. In particular the technical team has some concern that the distinction in the data base between zero rating for exports and zero rating for other goods might not be accurate. TAAD will need to sort this out on a firm-by-firm basis in order to get a cleaner revenue estimate.

- A revenue gain has been estimated from partial tariff unification based on detailed data on the C78 forms, and a detailed consideration of CARICOM limitations. What is needed now is a careful examination, line by line, of the remissions in order to separate out those that are government purchases and those that receive preferential treatment due to a legislative enactment. The goal is to determine those duty remissions that can be called back into the tax system.

- A policy analysis group should be charged with developing the indexes that will be used for annual revisions in the individual income tax base, the property tax base and specific SCT amounts.

<u>Rules and Regulations</u>

The tax administration will need to draft the implementing regulations and laws to make the reform program clear. It is also necessary to make provision for a set of tax administration procedures to assess and collect under the new system.

<u>Public Awareness and Education</u>

Finally, there must be a program of public education and awareness. The reform needs to be justified to the taxpayer, and its hoped-for impacts explained. Otherwise, opponents will explain it to taxpayers in a less informed way, and public acceptance will be more difficult to achieve. It is better for Government to set out the facts of the reform than to have the presentation guided by emotion and self-interested presentations.

Taxpayers need to be given a full briefing of the new program, and assistance should be provided to assist compliance. This implies seminars conducted by the tax administration to explain the new rules, new printed and web-based rules and instructions, and perhaps even new tax forms.

Conclusion

All committee members agreed that the conclusion of this report should reflect our strong views as to the improvements necessary in our tax administration structures and processes. We again refer to **Appendix A**, which sets out a number of administrative issues which were highlighted by the technical team during the course of their work, and which also makes a number of suggestions for improvement.

While the committee is generally satisfied that the recommendations we make in this report in relation to tax policy will substantially improve the fairness of the system and also eliminate a number of distortions which will inure to the benefit of the economy, we are deeply concerned that these changes be accompanied by at least as concerted and considered an effort in improving our administrative capabilities within the tax system.

We have identified in this report the fact that government has significantly narrowed its tax base through the granting of a wide range of preferential treatments, and we have proposed elimination of a number of such preferences as well as further study with a view to eliminating some of those that remain. However, it is important to recognise that losses due to poor tax administration are at least as high as those created by the system of tax preferences, and those who do comply within the system as a consequence face higher effective tax rates than would otherwise be necessary. This cannot be good for economic development.

Specifically, the tax administration has over many years been unable to capture the revenues for a large informal sector (the “self-employed”), and the technical team has observed that “Jamaica appears to be caught up in a culture of non-compliance (‘catch me if you can’) and a culture of finding the path of least resistance on the administrative side (‘I will catch who I can’).” Government must answer the question of whether these administrative failures will continue, and if not, what actions will turn the situation around. We commend to government the longstanding admonition that “tax administration is tax policy,” and that administrative improvement is critical to the success of any and all of the structural reforms we have recommended. This would inevitably require that additional resources be made available to strengthen tax administration capabilities.

SIGNATURE PAGE:

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VELMA BLAKE	V. Blake.
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ALLISON A. PEART	Allison Peart

* Neither Mr. Wilfred Baghaloo nor Mr. Lloyd Goodleigh was available to affix their signatures at the time of finalisation of this Report.

Technical Team

Senior Staffing

The project co-Directors were Professors **Roy Bahl** and **Sally Wallace**. Both are senior public finance experts with international experience. They will oversee the preparation of each individual tax analysis, and will be responsible for preparation of the comprehensive tax review document (final report).

Dr. Dillon Alleyne is Professor of Economics at University of West Indies.

Dr. James Alm is Professor and Chair of the Department of Economics in the Andrew Young School of Policy Studies at Georgia State University. He has worked extensively on fiscal reforms overseas, including projects in Jamaica, Bangladesh, Indonesia, Grenada, Turkey, Egypt, Hungary, China, the Philippines, the Russian Federation, Uganda, India, and Nigeria. He was a member of the Jamaica tax reform project in the 1980s

Dr. Roy Bahl is Dean and Professor of Economics in the Andrew Young School of Policy Studies at Georgia State University. He has served as Director of the Jamaica tax reform project and co-director of the Guatemala tax reform and has worked on tax and fiscal policy issues all over the world.

Dr. Richard Bird is Professor Emeritus of Economics at the University of Toronto and distinguished Visiting Professor of Economics in the Andrew Young School at Georgia State University. He has worked all over the world and is generally considered to be one of the foremost authorities on tax policy. He was a member of the Jamaica tax project in the 1980s.

Dr. Kelly Edmiston is Assistant Professor of Economics in the Andrew Young School at Georgia State University. He has worked on fiscal issues in the United States, Bosnia and Serbia, and in Papua, New Guinea. He has extensive experience in analysis of the corporate income tax, and has written extensively on this subject.

Dr. Jorge Martinez is Professor of Economics and Director of the International Studies Program in the Andrew Young School of Policy Studies at Georgia State University. He served as Director of the Russia tax reform project and co-Director of the Guatemala tax reform and has worked in over 30 countries on tax and fiscal policy issues. He was a member of the Jamaica tax reform project in the 1980s.

Dr. Mark Rider is Associate Professor of Economics in the Andrew Young School of Policy Studies at Georgia State University. He served as Resident Advisor to the Russia tax reform project, is a former US Treasury official, and has worked on fiscal policy issues in numerous countries around the world. He has special expertise in corporate income taxation and tax compliance.

Dr. Felix Rioja is Assistant Professor of Economics in the Andrew Young School at Georgia State University. He specialises in macroeconomics and economic development, and has familiarity with economic issues in the U.S. and in Latin American economies.

Dr. David Sjoquist is Professor of Economics in the Andrew Young School at Georgia State University. He is considered to be one of the foremost experts on property taxation in the world. He worked on the Jamaica payroll tax review in the early 1990s.

Dr. Sally Wallace is Associate Professor of Economics in the Andrew Young School of Policy Studies at Georgia State University. She served as Resident Advisor of the Russia tax reform project, is a former U.S. Treasury official and has worked on fiscal policy issues in numerous countries around the world. She has special expertise in income taxation.

Submissions

The following is a listing of those submissions received and analysed by the committee from the public and other interested organizations:

1. John Allgrove
2. Bacardi Caribbean Corporation
3. Barnett Limited
4. Mr. M. J. Burchell
5. Vivienne T. Clarke
6. Mr. Clive Dalley
7. Deloitte & Touche
8. Ernst & Young
9. M. N. Hamaty & Company
10. Mr. Beresford Hay
11. In-Bond Merchants Association of Jamaica
12. Institute of Chartered Accountants of Jamaica
13. Jamaica Hotel and Tourist Association
14. Jamaica Manufacturers' Association
15. JAMPRO
16. Jam Row Trading Company Limited
17. Manpower & Maintenance Services Ltd.
18. Carmen McLeod
19. PricewaterhouseCoopers
20. The Private Sector Organisation of Jamaica
21. The Realtors Association of Jamaica
22. Red Stripe & Big City Brewing (joint)
23. Miss Sanchia Smitson
24. Mr. Paul Thorbourne
25. University College of the Caribbean
26. Mr. Denzil Whyte
27. Mr. A. Hugh Wilson, J.P.
28. Wisynco Group Limited
29. Ena Wong Sam
30. J. Wray & Nephew Ltd.

Appendix A: Summary of Tax Administration Issues and Options for Jamaica

Category	Issues	Benefits of Change
Administrative Resources	A significant increase in resources available to the Revenue administration, with a concomitant commitment to close monitoring of accountabilities is required. Areas requiring urgent attention include ➢ There is need for a dedicated capability to draft tax legislation on a timely basis; ➢ There is urgent need for an improvement in the accounting systems in the Inland Revenue Department; ➢ Emoluments particularly at entry level positions are inadequate to ensure attraction and retention of capable employees; ➢ The provision of adequate physical resources, including computers and modern office facilities.	
Corporate Income Tax	A large number of "math errors" are present on the tax returns and are not immediately followed up. A program patch to determine the cause of these errors can be done, although the current format of the IT02 makes it difficult. However, for this change to have any	Increased corporate tax revenues in the short-run at relatively low cost. Increased revenues over the longer-term due to diligence in follow up and data input increasing the perception of detection.

	impact, TAAD would have to be immediately notified of the cause of these errors and then immediately follow up on these errors by letters, phone calls and visits to the companies with the reporting (and therefore liability) errors. DETAIL OF OUR EXPERIENCE: We have identified approximately 6,000 line items with math errors. Some of these errors can be explained by data entry errors, i.e., entering minus signs on subtraction items. Some of these errors can be explained by line items that could assume a negative or positive sign. Nevertheless, we have not been able to confirm that all of these errors, or even a majority of them, can be explained in this manner. For example, line 9 (Gross Operating Profit) is equal to line 7 less line 8. We have identified approximately 100 returns with math errors on line 9. Of these 100 returns, 50 of them overstated line 9 and 50 understated line 9. Of the 50 that overstated line 9, we found that a negative sign had been mistakenly (correctly entered in the sense that is how it appears on the return, but incorrect in terms of the computer algorithm) entered on line 8. By changing the math error algorithm to account for these "false" negatives, we could resolve 11 of the 13. That means that there are still 89	

	unexplained math errors on line 9 alone. In order to resolve these math errors, a trained auditor will have to go through each return (with errors) to determine, if the return is correct or the math error program is correct. They will not begin this work, if at all, for another six months. Verifying the math on returns should be one of the first steps in processing returns. The tax administration should automatically send assessment letters to filers of returns with math errors. In addition, we have identified 26 returns that are claiming tax credits for tax holidays due to incentive acts. Since we believe that many more corporations than 26 are receiving tax holiday through some type of incentive, this suggests that the filing rate for incentive corporations is low. This becomes a problem when the incentive period is over because incentive firms are able to claim capital allowances and losses incurred during the 10-year incentive after the 10-year period. If firms did not file during the incentive period, the tax administration has no paper trail to verify these claims (capital allowances and losses) subsequently.	
Corporate Income Tax	The box that identified the incentive act on IT02 is not being checked, or at least this information is not being recorded in	Changing the format of information capture for IT02 could increase revenues in the medium term as auditors

	the database. Auditors need to know what incentive act, if any, under which the firm is claiming relief for verification purposes. This makes it very difficult to use the electronic database for tax compliance. The incentives data in general are not kept in a clean form where auditors from TAAD may use them. The information is currently in a number of different ministries. These data should be centrally collected and kept.	have more detailed information regarding incentives.
Corporate Income Tax	The present requirement for all taxpayers to file their tax returns on 15 March presents severe difficulties for taxpayers, preparers and the Revenue. The filing dates should be staggered possibly tied to Accounting year-ends. This would spread the work of the Revenue over the entire year, rather than concentrating the effort at the end of the Financial year, which would enhance their capacity for effective review of tax returns. If final payments were required on this basis, the timing of Government's cash flows would be improved.	
Individual Income Tax/Payroll Tax	There is need for companies and the self-employed to present information on total payroll at the time of monthly payment of PAYE. This data should be entered into the system as total PAYE payments are entered. This would not significantly	Potentially smooth the PAYE payments so that an ad hoc reconciliation is not made at the end of the year. Currently, there is no effective penalty for companies who postpone their PAYE liability and pay more later in the year,

	increase the burden on neither the taxpayer nor on the tax system. The program should verify the tax paid over by reference to the total emoluments reported. There are instances where the tax paid does not equate to the reported income, minus allowable deductions times tax rate and these are not followed up by TAAD	although this disregards the letter of the law for PAYE.
Individual Income Tax/Payroll	Some of the same reporting errors as noted in Corporate Income Tax (1). Same recommendations	A potential increase in revenues in the short-run.
Individual Income Tax	There is need to change the laws on interest and dividend disclosure. The current system makes it nearly impossible for the tax administration to determine under-withholding on capital income. A recommended change is to give the tax administration the right to receive information on interest and dividend payment by individual taxpayer.	May increase the tax on interest and dividend income.
Property Tax	There is a need for the Stamp Office to require that the property tax roll number be included on sale documentation, to facilitate the comparison of sales prices with property tax values. A certificate of payment of property tax should also be required at the time of payment of transfer tax	May increase the ability to monitor the tax and therefore increase collections.
Property Tax	There is need for increased taxpayer awareness and education regarding the valuation and billing processes.	Increased taxpayer education may increase compliance.
Property Tax	There is need for better coordination	Since data from property transfers are

	among the land agency, transfer tax office and Inland Revenue in revenue assessment and collection related to the taxation of real property. The property tax and the property transfer tax are involved. What is needed is a uniform system of identifying property for purposes of transfer tax, property tax assessment, titling, and property tax collection. At present, the stamp office uses their own identifier (basically an invoice number), while the titles office, Land Valuation and Inland Revenue use a land valuation number. Only Inland Revenue records the taxpayer registration number. All offices need to fix on a unique number (perhaps the valuation number) and all need to include a taxpayer registration number.	used for both titling and land valuation, the information is necessary to do a better job of tracing changes in ownership and to do a better job with land valuation. There are not short-term revenue gains, but these changes may offer considerable room for long-term revenue gain. Inland Revenue collects the property tax, and records a TRN. The same TRN should be on the land valuation records and the stamp duty records. This will be essential if land and property value data are to be used eventually as inputs into some sort of presumptive assessment of income tax.
International Tax (Customs)	There is need for additional scope and resources for Customs for doing audits and they should be permitted to do so without prior notice. The law of evidence requires the individual who prepared documents to give evidence for those documents to be admitted in evidence in a prosecution for breaches of the Customs Act, including under-invoicing. The rules of evidence should be amended to facilitate the easier introduction into evidence of all relevant records and data. They also (perhaps through CARICOM) need more ability to	Increasing the resources for customs audits could yield long-term revenue gains from customs. Reducing the burden of proof so that individuals responsible for booking need not be presented would increase the potential for Government to collect from those undervaluing imports.

	develop an information database about average import valuations in the Caribbean and further abroad. They might also consider initiating a conversation with competition authorities (if there aren't any, then with foreign experts) about how to prosecute and/or deter under-invoicing at the export stage.	
GCT	The audit effort under the GCT is not appropriately targeted. The tax administration might consider a large taxpayer unit (LTU) model for administration in GCT.	Increase compliance in the longer-term due to more tailored and productive monitoring.
GCT	There are many good data collected for GCT analysis, but it does not appear that they are regularly used for administration and compliance purposes. For example, data not regularly used or not collected include: distribution of tax payments by size of taxpayer, number of registered taxpayers who are stopfilers or slow filers, percent using quick option, details of approval process for using this option (how many apply, how many accepted, time of process, nature of investigation made, etc.), number claiming refunds (with respect to what), extent and manner in which the Revenue Protection Service actually does post-border follow-up re the myriad duty-free shops and countless exemptions, the number of returns	This calls for more resources in the short-term but could significantly increase revenues in the long-term due to increased audit capacity and compliance.

	showing different kinds of zero rating, and the estimated cost of various concessions. These data need to be collected and analyzed regularly.	
GCT	Most companies need to pay their liability each month at an Inland Revenue office. They should be able to do so through the banks.	This change could increase the regularity of revenue flows.
GCT	Only one form of GCT return is needed. The special tourist and insurance forms can be eliminated, and the quick relief form, if retained, can be handled by completing only a section of the GCT return. The basis on which estimated assessments are raised should be reviewed to ensure that they are reflective of the recorded trading history of the enterprise, where available. All payments, including those on estimated assessments, should be accompanied by returns. The possibility of making more use of financial institutions to both collect payments and do an initial processing of simple returns (those accompanied by full payment) should be explored.	These various administrative reforms move the system to one that is less discretionary and more transparent. They also ease some of the compliance burden.

	There should be no waivers except perhaps in very exceptional cases of hardship such as theft or embezzlement. Again, it must be remembered that in many cases, these funds are treasury funds being temporarily held by a third party, and there should be no leniency with respect to collecting from such parties what they have already collected from citizens. If any waivers are granted, full details should be reported to the legislature. Auditing procedures should be modernised. In particular, efforts should be made to make better use of the rich information already available to crosscheck transactions and follow the audit trail into the informal economy to the extent feasible. There should be no arrears at all with respect to either SCT or GCT due on imports, since these taxes should be paid before goods are released for sale. If this is considered unduly harsh for some exporters, consideration should perhaps be given to a limited 'deferral' scheme for a small number of bonded exporters. The present system of 'simplified accounting' should be eliminated. If something along these lines is still considered necessary even if thresholds	Formalizing the system of waivers and requiring greater Parliamentary oversight increases the credibility of the tax system in the eyes of the international community and potential investors in particular.

	are increased, a simple 'quick relief' system at more favourable rates than at present may perhaps be considered. A 'one-time' amnesty of pre-2004 accrued 'interest and penalties' may perhaps be considered to clear the books of what are likely to be uncollectible debts. If this is done, however, it is critical that it should be accompanied or even preceded by considerable tightening of payment, audit, and enforcement procedures. C78 - The CUSTOMS ENTRY FORM - This form needs to be revised.	
GCT	The legislation should be amended to entitle businesses to claim as input tax, GCT incurred on pre-trading expenses, including Capital Expenditure for start up businesses.	
International Trade Taxes	On the C 78 form, include the breakdown between Customs Duties and GCT as done on the C 79 form. The C78 form could benefit from redesign in this and other respects.	The face of the C 78 form does not indicate the allocation of payments to the Collector of Customs between Custom Duties and General Consumption Tax. Consequently the GCT is included in the cost of the goods, instead of being claimed on the monthly/bi-monthly return.
International Trade Taxes	Include on the C 79 form the foreign currency value of the goods being imported at the rate of exchange being applied and the name of the foreign	Where a person has continuous imports during the year this makes it difficult to reconcile import entries with supplier invoices.

	supplier.	
General administrative issues	The Commissioner of Appeals should not report to the Director General. He should be independent of the Tax Administration Regime and should report to an Appeals Board, comprised of representatives of the Revenue, Ministry of Finance and the Private Sector, including the Institute of Chartered Accountants and the Bar Association of Jamaica	Would add credibility to the Appeals process and inspire confidence in it. More issues could then be resolved at that level and action taken after it makes a determination (e.g. it may be more acceptable for assessments to be enforced after the Board makes a determination than merely when the assessment is raised by TAAD).
Treatment of unpaid refunds	When refunds are due, they should be paid. Government cash flow problems should be managed by better expenditure management, not by improperly withholding funds legally due to taxpayers. The right to offset liabilities against refunds due for over 3 months should be enshrined in the legislation and extended to allow such set-off between connected persons, in particular groups of companies and between different tax-types (e.g. PAYE and GCT) This would be particularly valuable in the case of Financial Institutions which are permanently owed hundreds of millions in refunds, representing a permanent non-performing asset on their books. All unpaid refunds of Income Tax should bear market rates of interest	

Penalties & Interest	When tax, interest and penalties are assessed, they should be enforced rigorously and at once, unless there is an appeal to the Appeals Commissioner or to the Revenue Court, in which event payment should be made when the Court renders a decision, subject only to any other order by the Court of Appeal. If payment is not made in a timely fashion after an appeal to the Revenue Court confirms the liability, there must be a credible sanction (e.g. seizure of property or interception of cash flows). If penalties are considered to be too high, then they should be reduced. But if they exist they should be enforced, without exception. It must always be recalled that the firms liable for paying consumption taxes have, in most instances themselves collected those taxes from others and should not be allowed to hinder the process of transmitting funds to the treasury.	
Penalties	The penalty regime should distinguish between situations where tax is underpaid as a result of "honest" mistakes and errors of interpretation as against "fraud and willful neglect" TAAD should be allowed to make a determination of this, subject to the determination of the Appeals Commissioner. See General Administrative Issues below.	

General administrative issues	Eliminate the need for Taxpayers to obtain clearances from several agencies of Government when they seek TCCs. All agencies (should only be NHT & NIS if recommendations are accepted) should report delinquent taxpayers to TAAD who should then use that information in evaluating TCC applications.	This change could reduce the overall compliance costs for taxpayers.
General administrative issues	The Inland Revenue Department should be required to communicate the existence of outstanding liabilities to Taxpayers. Frequently assessments are not properly served on taxpayers and they become aware of them only when they apply for TCCs.	
General administrative issues	Put the TRN system into creative use, e.g. by identifying those landowners who own properties and are not paying. Cross-reference with motor vehicle registration and other files.	These cross-uses of the TRN file could help identify non-compliance, but would only be moderately effective unless the TRN file was updated regularly.
General administrative issues	Legislation should provide for the issuance of formal rulings by the Revenue, which should be binding on them. These should be published to ensure that all taxpayers are aware of the Revenue's position on issues and that all are treated equally.	
General administrative issues	Penalties for non-payment of tax should distinguish between "honest" mistakes and interpretation errors versus "fraud and willful neglect". The Head of TAAD should be able to make the	

	determination, subject to confirmation of an independent Appeals Tribunal as discussed above. The laws are replete with "grey" areas that cause differences of interpretation between taxpayers and the Revenue. The penalty in such instances (which frequently take many months for even the Revenue to rule on) should not be as severe as when taxpayers clearly intend to defraud the revenue (for example maintaining separate books).	
General administrative issues	Only designated officers at or above a specified level of seniority within the Revenue should be allowed to take positions on behalf of the Revenue, and legislation should make such positions binding on the Revenue. Persons signing on behalf of the Commissioner should be required to print their names.	Would improve credibility in what taxpayers are told. Presently there are too many instances of the Revenue needing to change their position after a contentious matter is pursued.
General administrative issues	Increase ease of paying taxes via computer and credit cards.	
General administrative issues	Clarify the language of the tax laws, in particular the *Income Tax Act* (dividend taxation is one example). Circumstances in which services are deemed to be "exported" for GCT purposes are another.	
General administrative issues	Establish an explicit transfer pricing regime and regulations.	Jamaican entities conducting transactions with non-resident related entities would be required to prepare and keep on file appropriate transfer pricing documentation to prove that they are using arms length rates to price the

		inter-company transactions.
General administrative issues	The ICTAS system needs updating and technicians need adequate training to use the system effectively.	
General administrative / procedural issues	Development of tax laws should adhere closely to documented procedures. The Jamaica Gazette should be sequentially numbered so that the chronology of changes can be determined. The system of Gazettes needs to be modernised and rationalised. Provisional Collection of Tax Acts should not be renewable more than once. An index of all tax-related gazettes should be published.	Concern has been raised that the airing of tax changes has not been by the Parliament and other entities, creating confusion regarding the efficacy of measures ordered by the Ministry of Finance and Planning.
General administrative / procedural issues	In keeping with the implementation of the recommendation above to improve the efficiency with which TCCs are issued, the presentation of a TCC should be made a requirement for various administrative transactions such as renewal of work permits and transfers of real property and motor vehicles.	
General administrative / procedural issues	Government Departments need to communicate effectively; for example, the income tax department should be notified of all work permits issued.	

Appendix B: Proposed TOR for Incentives Study

Proposed Terms of Reference and Research Questions To be Addressed in a Study of Tax Incentives in Jamaica

Objective: The basic goal of this work is to supplement the recently completed tax study with a more in-depth look at the competitive position of Jamaica's tax incentives package. To date, there is very limited information on the scope of incentives among Jamaica's potential competitors. This evidence will be used in making a more informed decision about whether Jamaica's existing preference regime ought to be abandoned in favor of a more broad based tax system that treats all investors the same. Or, the question might be framed as whether the existing incentive regime is absolutely necessary to protect Jamaica's economic base in certain sectors (e.g., tourism).

Approach: The study must be objective, so should not be carried out by any group with an advocacy position that might affect the results. Yet, to have any chance for serious consideration by Government, this work must benefit from the participation of the interest groups that are at risk. An interesting approach that might enhance the acceptability of the eventual results is to include advocacy groups in both the design and the implementation of the study. Implementation in this case means participation in arranging interviews and meetings with various enterprises, and reviewing the results of the study. The basic analysis and study results however, need to be protected and assigned to an objective research group with credibility.

We recommend that an advisory group be appointed as a review team, to work with the consultants. Plan A: We do not recommend that this group be charged with developing independent recommendations. The advisory group would be free, as individuals, to write an opinion on the results of this study. Plan B: Appoint a Committee, similar to the current Tax Policy Review Committee, and charge this group with making recommendations to Government. The problem with this approach is that it would require appointing only people who do not have a business interest in the outcome.

Coverage: Should the study consider all sectors of the economy, or only tourism? We recommend the former on grounds that the entire incentive regime should be considered. We also think the case study comparative analysis should focus on countries in the region that are genuine competitors. If there really is tax competition, then analysis of a few, well-chosen countries should provide the necessary information.

Scope of Work. While it should be left to the consultant(s) to propose the way the work will be done, and the way the study will be organised, we propose that at least the following six issues/questions be addressed.

1. Frame the problem in the Jamaica context. Start with the positions as stated by the various advocacy groups, and the international agencies that advise the Jamaican Government. Start the research on the base provided by the current tax reform project, and the evaluations of reform options presented by the technical team and the committee.

2. Provide a review of the theory of tax incentives. Review the literature on the effectiveness of incentives. Invite the interest groups to submit evidence to be considered in this respect. Here the work may draw heavily on what was done in the present study, but it can also drill down to a more detailed level, e.g., on issues such as various types of sales tax or customs exonerations.

3. Develop a list of “incentive instruments” that are commonly used in tax policy in competitor countries. These would include all the various forms of tax relief, and some of the expenditure subsidies, that are provided to attract jobs. We also are interested in the extent to which incentive policy is typically integrated into the tax structure, and whether it has been evaluated as a part of a tax reform project.

4. Review the constraints to tax incentive policy. These might include CARICOM, WTO, FTAA and bi-lateral agreements, in addition to national laws. This can be done in a context of a review of the situation in competitor countries. Meetings with CARICOM officials would probably be necessary.

5. In all of the above, we recommend a focus on a set of “competitor countries” that would be identified by the Government and the Advisory body or committee. The number and choice of countries would be determined by relevance (are they Jamaica’s primary competitors as regards the industries in question) and cost (can easy access be provided for carrying out the work). If carefully chosen, perhaps as few as three or four competitor countries might be sufficient to gain the knowledge desired.

   Comparative case studies would be carried out. First, there should be a comparison of the detail of Jamaican incentives vs. those in the competitor countries. How do they differ in structure and in level? Second, if the interest groups would cooperate, we would like to see a comparative analysis at the firm level of the potential impacts. Finally, the evaluation of the experience in the competitor countries would be reviewed.

The heart of the study would be a hard analysis of the question: would Jamaica’s competitive position be harmed significantly by a shift away from the incentives regime? The related question is whether this shift could take the form of a movement toward a restructuring of incentives, more in line with what international best practice might suggest.

Appendix C: Data sets used and issues

Data	Description	Use of data	Issues encountered
IT01-IT06	Income tax files covering individual income tax, PAYE, corporate, self-employed, pensioners	The data are invaluable for developing micro simulation models of the various income taxes. The PAYE data served as the basis for those models and enabled the simulation of a variety of tax reforms—including an analysis of the revenue and distributional impacts. Since the corporate and self-employed returns are not in high compliance, the models for those taxes are developed, but only provide information on the direction of change in revenue and burden for various policy proposals. These data were also used in the burden analysis to answer questions related to the relative distribution of interest income, dividend income, and rental income.	As noted in the report on corporate and individual income tax, there are very few returns made, and most returns are not made on time. Additionally, there are errors in line items of the returns so it is difficult to determine the numbers to use to approximate tax liability.
TRN file	This taxpayer return number file provides the taxpayer return number, the primary business and the reason for registration.	This file is large, and could be used to provide information regarding the population of compliant corporate and self-employed taxpayers, by sector. Limitations of the data prevented this use.	The file is not cleaned regularly and so there are a number of TRNs listed for businesses that are no longer active. In some cases, an entrepreneur establishes multiple TRNS for branches, some of which never exist. When a business "dies" it is not withdrawn from the register.
Land Value	Data on valuation of property	Overall the data on property tax that was obtained from Land Valuation and from the collection office was very good. The data were used to estimate the current effective tax rates for property tax and to	The only missing piece was that the use of the land was not reported for many of the parcels. The data on rating and relief, particularly discretionary relief, had to be constructed. The information contained in the large files was

		simulate impacts of changes in tax rates, thresholds, and exemptions.	incorrect. It does not appear the data on discretionary relief is routinely captured in the system.
Trade data	10-digit HS tariffs were used to aggregate up to 3-digits for computing various collected rates. The imports data were also aggregated.	The data were used to develop estimates of the effective tax rates on various commodities and to simulate impacts of reform options.	There was some missing Information on whether any tariffs or taxes on trade are specific or compound as opposed to ad valorem, some mis-classification of goods, and the lack of information on bands allowed by type of product.
Survey of Living Conditions	Micro-level survey data on the expenditures of households	These data were used as a basis of the burden simulation model.	The sample size is quite small and no population weights are made. Also, there is very little data on income, and virtually no other source of income of the population available. This is a very big limitation to designing a tax burden analysis.
National Income Accounts	National income data	Used to provide aggregates of the economy such as GDP, income	The level of detail in the NIA is limiting. It would be helpful to have information on rents, other capital payments, and entrepreneurial activity.
Income tax ledger files	File containing detailed records of income tax payments	These data were used to estimate the timing of tax payments.	These data were for the most part in very good shape. It would have been helpful to have a TRN file that more closely estimated the population of firms so that we could compare the income payers to the "universe" of individuals and self-employed in Jamaica.
GCT ledger file	File containing detailed records of GCT payments	These data were used to calculate GCT payments, total revenues, and timing of payments.	These data were for the most part in very good shape. It would have been helpful to have a TRN file that more closely estimated the population of firms so that we could compare the GCT payers to the "universe" of businesses in Jamaica.
C-78 File	Customs duty returns	These data were used for analyzing issues related to GCT, international trade taxes and tax	The data for the most part was very good. The use of an unidentifiable free-code made it difficult to analyze

		incentives, including estimating effective tax rates and the revenue impact of changes in tax rates.	the cost of various incentive and waivers.