



RE2-06-020

**Economic and
Sector Study Series**

**FISCAL ADJUSTMENT FOR
SUSTAINABLE GROWTH
IN BELIZE**

Glenn P. Jenkins
Chun-Yan Kuo

September 2006



REGION II

Inter-American Development Bank

This document in discussion is not an official publication of the Inter-American Development Bank. The purpose of the Economic and Sector Study is to provide a mechanism for diffusion of selected analytical work undertaken by the department in support of its operational program at the country or sub-regional level. Opinions and judgments expressed in these studies do not necessarily reflect the view of Bank Management or member countries.

Preface

This review of the fiscal adjustment in Belize focuses on the revenue requirement of the Government in the short term as well as the tax reform measures that are needed in order to meet the longer term revenue requirements of the public sector. The study examines the country's tax design, its administration and its effectiveness in revenue mobilization.

This report was prepared before the final approval of the General Sales Tax. It therefore includes discussions and recommendations that do not take this latest advance into account.

The report was prepared for the Inter-American Development Bank under the project "Building Social Capital through Fiscal Reform" (ATN/NC-8729-RS, ATN/FW-8730-RS, ATN/CF-8731-RS). The project was funded by The Norwegian Agency for Development Cooperation (NORAD), The UK Department for International Development (DFID), and The Swedish International Development Cooperation Agency (SIDA).

"Building Social Capital through Fiscal Reform" complemented the efforts of a previous project "Tax Policy Reform for Human Development in Central America", which scrutinized the tax systems in Central America, Haiti, and the Dominican Republic. This document updates the findings of the previous project's study on Belize conducted by the same authors in 2002.

This report was prepared under the direction of Manuel R. Agosin, Regional Economic Advisor of the Department until January 2006. He was ably seconded by Vibeke Oi (RE2/RE2). Marta Mejia-Zampieri (COF/CBL) and Luis Cesar Acosta (COF/CBL) provided important guidance and suggestions. A particular word of thanks to Miriam Perez-Fuentes, who has been responsible for the preparation and production of this report.

The IDB would like to thank the members of the Government of Belize for their assistance and support during the completion of this study. A special thanks go to Geraldine Davis, Head of Revenue Intelligence Unit; Glenn Avilez, Chief Statistician, Central Statistical Office; Lourdes Smith, Executive Director, Belize Trade and Investment Development Service; and Pete Castillo, Management Information Systems of Customs and Excise Department.

Máximo Jeria
Manager
Regional Operations Department II
Central American Isthmus, Mexico, Haiti and Dominican Republic

Washington, D.C., September 2006

TABLE OF CONTENTS

I.	Introduction.....	1
II.	An Overview of the Existing Tax System.....	2
III.	An Emergency Tax	4
IV.	Domestic Tax on Income and Transactions	5
	4.1 Income Tax.....	5
	4.2 Business Tax	6
	4.3 Sales Tax	10
	4.4 Reintroduction of a Value Added Tax.....	13
	4.5 Excise Duties.....	15
	4.6 Other Taxes	16
	4.6.1 Social Security Contributions.....	16
	4.6.2 Land Related Tax.....	17
	4.6.3 Property Tax	18
V.	Taxation of International Trade Transactions	18
	5.1 An Overview of Trade Taxes	18
	5.2 Potential Trade Tax Base	19
	5.3 Revenue Patterns of Import Duty and Revenue Replacement Duty.....	20
	5.4 Harmonization of the Tariff and Excise Tax System	23
	5.5 Potential Revenue Gains from the Proposed Reform.....	23
	5.5.1 Exempt Provisions.....	23
	5.5.2 Reform of Import Tariffs on Non-Excisable Commodities.....	24
	5.5.3 Revenue Implications of Tariff and Excise Tax Reform on Excisable Commodities	27
	5.6 Fiscal Incentives	29
VI.	Export Processing Zones.....	31
VII.	Commercial Free Zones	34
VIII.	Tax Administration.....	35
IX.	Conclusions.....	36
	References	39

FISCAL ADJUSTMENT FOR SUSTAINABLE GROWTH IN BELIZE

I. Introduction

This report studies the revenue requirement of the Government of Belize in the short term as well as the tax reform measures needed to face the longer term revenue requirements of the public sector in an environment where tariffs to international trade are being reduced. The study updates a similar study conducted in 2002, which examined the elements of tax design, administration, and its effectiveness in revenue mobilization.¹

While reviewing the fiscal system of Belize three years ago, we found that the tax system had been performing quite well. Belize had undertaken significant changes in taxation during the period 1995 to 1999. In particular, it implemented a number of unconventional tax policy measures. These include moving from an operating VAT system to an import-producer level sales tax, replacing the business income tax with a business tax on gross revenues, and increasing the basic deduction on the personal income tax system to over three times per capita income. No other personal income tax deduction is allowed, and a single tax rate of 25 percent is imposed on individual income over that amount. While these moves were unconventional and perhaps not appropriate for many countries, they did not inflict permanent damage to the tax system's ability to raise revenue. At the same time, they seem to have removed a considerable amount of taxpayer compliance costs from the system.

Although a number of improvements can be undertaken to strengthen the tax system and enhance revenues, there are no major gaps in the tax bases at this point in time. Over the past two years, Belize has increased tax rates in sales tax, excise duties, and business tax in order to finance the mounting public sector expenditures. However, the expenditure side of the budget had not been as well managed. The fiscal imbalance over the past three years has progressively worsened. As a result, its outstanding debt has risen to the point where it is greater than the GDP. If the public sector deficit is to be reduced, the main effort will have to be made toward the reduction and control of public sector expenditures. The tax system can only be a minority partner in such a fiscal reform package.

While facing a critical public sector deficit situation, Belize has another challenge. Its bilateral and multilateral negotiation of free trade arrangements with the US and other trading partners will force it to reduce the level of its import tariffs. Its reliance on revenues from import tariffs has to be reduced. The Government will be under intense pressure to restructure the current tax system. The main purpose of this report is to review the existing tax structure, analyze its strengths and weaknesses and make a number of proposals of ways it might be strengthened. While reviewing the tax system, many arguments and recommendations in our previous report remain valid; they will be kept in this report. Nevertheless, this report would further develop a short- and medium-term strategy for the tax reform that will enable Belize to move away from using taxes on

¹ Glenn P. Jenkins and Chun-Yan Kuo, Belize Fiscal Study, report prepared for Inter-American Development Bank, (December 2002) (not published).

international trade as a main source of revenues. The shift is necessary as Belize must not only deal with the current fiscal crisis but also has the desire to enter into a free trade agreement with the US and other trading partners.

II. An Overview of the Existing Tax System

Details of the major categories of public sector tax and non-tax revenues are presented as absolute amounts of Belize dollars, and as percentages of GDP in Tables 1 and 2, respectively.

From Table 2, we find that the Government of Belize since 1997 has raised about 22 per cent of GDP in tax and non-tax revenues. While 2 to 3 percentage points of revenue is raised through non-tax means, the tax system has consistently yielded tax revenues in the range of 19 to 20 percent of GDP. At present, the main sources of tax revenues are income taxes, sales taxes, import duties and revenue replacement duties. These taxes account for more than 87 percent of the total tax revenues collected in 2004, slightly greater than the 86 percent they raised in 2001.

For a country with no major natural resource exports, this is a very respectable performance for the revenue system. However, the Government's budget may not be sustainable in the near future given its current fiscal imbalance and the pressure for it to lower import tariffs as part of the free trade arrangements. As a consequence, additional tax revenues need to be found.

In both years 2004 and 2005, Belize made a number of tax policy measures, mainly raising the tax rates for the business tax, sales tax and excise taxes. The fundamental structure of tax policies remained unchanged. The actions in 2004 and 2005 undoubtedly raised tax revenues. Nevertheless, the tax system needs to be more buoyant in terms of revenue collections. A phased plan is therefore needed for not only tariff reform but also for the reintroduction of the value added tax system into Belize.

In this report, we make a number of suggestions that would serve to fine tune the tax system and make it more robust as an instrument of revenue collection and also to reduce some of the economic distortions that now exist. In carrying out the revenue estimates below, we initially assume that there is no behavioral response to the change in the tax rates. Once a complete set of revenue estimates is developed, we introduce the effect of the behavioral responses to relative price changes in our development of a second set of revenue projections.

Table 1
Tax and Non-Tax Revenues by Main Categories
(thousands of BZ dollars)

	1997	1998	1999	2000	2001	2002	2003	2004
Tax Revenues								
Income Tax								
Personal Tax	27,093.4	21,700.0	13,187.9	18,146.5	20,954.1	24,968.6	30,874.2	34,277.2
Business Income/Business Tax	23,450.5	39,330.7	48,411.7	55,039.7	54,514.1	56,684.2	59,877.4	67,710.3
Arrears	5,222.8	5,000.0	2,940.6	3,013.2	1,635.8	1,246.4	1,488.6	1,483.8
Taxes on Property	1,742.1	1,655.1	2,139.4	2,193.2	2,763.8	2,509.2	2,906.9	4,589.2
Taxes on Goods and services								
Value Added Tax	76,075.8	74,263.9	(4,221.4)	300.0	190.0	44.3	42.8	0.1
Sales Tax		-	68,577.7	81,658.9	86,195.1	90,986.7	98,190.5	116,165.6
Excise Duty	16,942.3	18,600.0	6,742.8	8,066.1	8,527.1	8,692.1	8,865.1	9,485.8
Other*	12,555.8	14,464.6	17,617.3	19,766.3	22,147.1	22,320.8	22,356.7	25,926.4
Taxes on International Transactions								
Import Duty	52,416.2	51,333.5	58,760.8	63,241.0	62,678.7	75,887.1	71,974.4	73,252.9
Revenue Replacement Duty	36,197.8	39,200.0	39,806.3	38,703.3	61,199.5	74,791.2	77,946.5	74,446.4
Environment Tax	-	-	-	-	4,195.0	6,286.1	6,526.4	7,692.9
Other**	497.5	430.0	1,0806.3	5,893.9	6,152.4	6,721.6	4,718.6	4,388.0
Sub-total	252,194.2	265,977.8	255,011.7	296,022.0	331,152.8	371,138.3	385,768.3	419,418.7
Non-Tax Revenues								
Licenses	4,966.8	5,510.6	8,886.6	7,161.0	7,410.0	6,788.8	9,041.0	9,861.4
Rent and Royalties	3,973.6	4,262.8	5,714.7	5,477.1	5,120.9	8,822.1	9,410.5	8,592.4
Ministries	11,649.0	11,558.3	17,829.0	18,349.7	18,222.7	17,343.2	14,284.3	15,033.6
Transfers	4,994.3	6,179.5	17,210.7	2,538.3	5,026.7	3,822.9	2,273.5	3,500.0
Other***	11,088.2	11,535.8	29,366.3	6,640.7	7,228.0	7,914.5	10,895.7	6,718.8
Sub-total	36,672.8	39,047.0	79,007.3	40,166.9	43,008.2	44,691.5	45,905.1	43,706.3
Grand Total	288,867.0	305,024.8	334,019.0	336,188.9	374,161.0	415,829.8	431,673.3	463,125.0

Sources: Ministry of Finance.

Notes:

* Includes taxes on foreign exchange transactions, entertainment taxes, and stamp duties.

** Includes administrative charges and social fees collected from imported goods.

*** Includes mining and prospecting licenses, dividends, sale of crown lands, and repayments of student loans.

Table 2
Tax and Non-Tax Revenues by Main Categories
(percentage of GDP)

	1997	1998	1999	2000	2001	2002	2003	2004
Tax Revenues								
Income Tax								
Personal Tax	2.18	1.58	0.85	1.13	1.25	1.34	1.57	1.67
Business Income/Business Tax	1.88	2.86	3.13	3.42	3.25	3.04	3.04	3.29
Arrears	0.42	0.36	0.19	0.19	0.10	0.07	0.08	0.07
Taxes on Property	0.14	0.12	0.14	0.14	0.17	0.13	0.15	0.22
Taxes on Goods and services								
Value Added Tax	6.11	5.40	(0.27)	0.02	0.01	0.00	0.00	0.00
Sales Tax	-	-	4.44	5.07	5.15	4.88	4.98	5.65
Excise Duty	1.36	1.35	0.44	0.50	0.51	0.47	0.45	0.46
Other	1.01	1.05	1.14	1.23	1.32	1.20	1.13	1.26
Taxes on International Transactions								
Import Duty	4.21	3.73	3.80	3.93	3.74	4.07	3.65	3.56
Revenue Replacement Duty	2.91	2.85	2.57	2.40	3.65	4.01	3.95	3.62
Environment Tax	-	-	-	-	0.25	0.34	0.33	0.37
Other	0.04	0.03	0.07	0.37	0.37	0.36	0.24	0.21
Sub-total	20.25	19.33	16.49	18.39	19.77	19.91	19.56	20.41
Non-Tax revenues								
Licenses	0.40	0.40	0.57	0.44	0.44	0.36	0.46	0.48
Rent and Royalties	0.32	0.31	0.37	0.34	0.31	0.47	0.48	0.42
Ministries	0.94	0.84	1.15	1.14	1.09	0.93	0.72	0.73
Transfers	0.40	0.45	1.11	0.16	0.30	0.21	0.12	0.17
Other	0.89	0.84	1.90	0.41	0.43	0.42	0.55	0.33
Sub-total	2.94	2.84	5.11	1.71	2.57	2.40	2.33	2.13
Grand Total	23.19	22.17	21.61	20.88	22.34	22.31	21.89	22.54

Sources: The figures of GDP were obtained from Ministry of Finance, Central Statistical Office, Belize.

III. An Emergency Tax

Before discussing and making recommendation to the current tax system, Belize should raise additional funds to deal with the current financial crisis.

Belize is currently facing a serious fiscal crisis. Its public debt is higher than GDP and market interest rates on each new bond issue have also been rising dramatically. Over time the economic and commercial pressure will be increasing to lower the cost of market interest rates. If an emergency tax can be found that would allow the Government to raise funds to reduce some of the debt or at least convince international capital markets that Belize has control of its finances, this could lead to a lower cost of the total debt financing burden on the economy. This would not only reduce interest rates on newly issued bonds but also lower the market interest rates borrowed by businesses and households. Such a measure is likely to have benefits that are substantially greater than the opportunity cost of these funds.

An amount of the emergency tax revenues may be considered which would be approximately BZ\$40 million in 2004 prices. Two alternative sources of tax revenues could be used. One is to raise the sales tax rates by three percentage points across the board. That means the sales tax rates of 8 percent, 9 percent and 14 percent would all be increased to 11 percent, 12 percent and 17 percent. This is our preferred option to

be considered as a temporary measure for this purpose. Hence, after a relatively short period of time the additional revenues from this measure could be used to reduce the level of import tariffs.

The other option is to impose an emergency tax of 5 percentage points on all imported goods regardless whether they are currently exempt or subject to import duty. In other words, only those goods heading for the export processing zones would not be taxed since they are to be used in the production of exported goods. The amount of tax raised from this emergency tax should only be used to lower the cost of the public debt by dramatically reducing the size of the government deficit or providing the resources to restructure the debt into a lower cost. While this tax change would be the easiest to implement, it is basically a move in the wrong direction in terms of the strategy for tax reform that is laid out in this report.

IV. Domestic Tax on Income and Transactions

The domestic tax system includes the income tax, the business tax, the sales tax, and the excise taxes.

4.1 Income Tax

The income tax system includes both the personal and business income taxes. The personal income tax is levied on the income of employed persons whose income is accrued in or derived from Belize. In 1995, it was amended to raise the annual threshold to BZ\$10,400 from BZ\$5,000. Since 1999, the threshold has been raised to BZ\$20,000 per annum. Taxes are levied on an individual basis with no further deductions allowed, except for the basic exemption. However, the income tax does not apply to interest income received from treasury bills or bonds issued by or under the authority of the Government of Belize, dividends of up to one thousand dollars, scholarships or other similar educational endowment, any pension or annuity, etc. The tax, to all intents and purposes, is levied on salaries and wages and the tax rate is fixed at 25 percent.

There is another tax rate of 15 percent levied on the gross winnings from lotteries or other similar activity (except for “Boledo lottery”, “Jackpot lottery”, etc. as specified under the act). Estate tax at a rate of 5 percent is imposed on property other than the principal residence.

In addition to the personal income tax, income taxes are also imposed on the gains or profits from any trade, business, or professional services. The tax base is measured as gross income minus the cost of goods sold, operating expenses, interest payments, capital cost allowances, bad debts and other allowable expenses stipulated under the income tax act. The tax rate is also set at 25 percent.

Where a company operates a loss, the net losses can be carried forward to each of the five succeeding taxable years. In the case of the agricultural sector in which the firm has sustained operating losses, the losses can be extended for a further two years. The losses are converted to a tax credit which may be applied against the business tax due in subsequent years, but the amount set off cannot be more than 20 percent of the business tax payable in any tax period.

In the past several years, the share of personal income tax in total tax revenues appears to be growing. In both 2003 and 2004, about one-third of the total personal and business income tax revenues were collected from wages and salaries while the remainder was collected from businesses.

Discussion

The individual income tax is clearly highly progressive with no tax being paid until the taxpayer has an income of approximately three times per capita income, and then a flat rate of 25 percent is levied on income above this level. Because of the high standard deduction, most employees will not be subject to the tax. Such a tax is very attractive for a developing country as it avoids inflicting both the compliance costs on low-income individuals and removes the burden from the tax administration to pursue many low-income individuals for income tax returns that yield little or no revenue.

Due to the existence of the business tax (explained below), very few companies actually file the corporation income tax. However, for those foreign owned businesses that can use taxes paid in Belize as foreign income tax credits, it is still possible to file the corporation income tax return and obtain a receipt for taxes paid. In this case, the business tax and the corporation income tax are designed so that eligible foreign tax credits are created that can be used as a foreign income tax credit when filing income tax return in the investor's home country.

4.2 Business Tax

The business tax was introduced in 1998 to replace in essence the income tax on self-employed persons and companies. Some amendments were made in February 2004 and further in February 2005 to make it more equitable in its application and to strengthen its revenue raising capacity.

The business tax is applicable to all individuals, self-employed persons, partnerships or corporations. It is imposed on all gross sales or receipts whether received in Belize or elsewhere. The receipts include rents, commissions, royalties, premiums, dividends, and interest income from bills, bonds and debentures. In the case of financial institutions, interest income means the financial margins, i.e., the difference between the interest earned from borrowers and the interest paid to depositors.

There are exemptions and deductions for the business tax. In the cases of trade and business, persons will be exempt from the business tax if the total receipts are less than a threshold of BZ\$75,000 per annum, an increase from BZ\$54,000 starting in February 2005. On the contrary, the threshold for a profession or vocation was lowered to BZ\$20,000. If the total receipts are below the threshold levels, the entire amount is not taxed. Once the total receipts are more than the threshold levels, they are all taxed from the first dollar onward. Interest received from treasury bills, debentures, bonds issued by or under the authority of the Government of Belize are exempt. The winnings from Boledo and Jackpot Lottery or the winnings from other lotteries for less than BZ\$1,500 are also exempt. Charitable contributions up to BZ\$30,000 per annum are also tax exempt.

The tax rates vary from sector to sector. As of 2005 they are shown below:

	Sector/Category	Tax Rate
1	Receipts from radio, on-air television, and newspaper business	0.75%
2	Receipts from domestic air line business	1.75%
3	Receipts of service station from the sale of fuel and lubricants	0.75%
4	Receipts from other trade or business	1.75%
5	Rents, royalties, premiums, and any other receipts from real property	3.00%
6	Receipts from a profession, vocation or occupation	6.00%
7	Receipts of an insurance company licensed under the Insurance Act	1.75%
8	Commissions, royalties, discounts, dividends, winnings from lotteries, slot machines and table games, and interest on loans paid to non-residents -- Provided that in the case of commissions of less than BZ\$25,000 per annum, the rate shall be 5%.	15.00%
9	Receipts of a financial institution licensed under the Banks and Financial Institutions Act -- Provided that in the case of a financial institution which falls within a "PIC Group" as defined in the International Business Companies Act, the rate shall be 8%.	15.00%
10	Management fees, rental of plant and equipment, and charges for technical services: (i) if paid to a non-resident (ii) if paid to a resident, the rate applicable to the particular trade, business, profession, vocation or occupation of the payee	25.00% Vary
11	Receipts of entities providing telecommunication services	19.00%
12	Gross earnings of casinos or licensed gaming premises	15.00%
13	Gross earnings from real estate on their commissions	15.00%

The business tax paid during the year is considered a final tax for that year. However, when the business tax paid by a firm is greater than what would have been paid in its income tax, the excess amount can be claimed as an expense in calculating the taxable income for the following taxation year. By calculating the income tax of an enterprise in the normal way, if the firm reports a loss, then the losses can be carried forward for five years and used to offset up to 20 percent of future business taxes over each of the five years.

Under the Fiscal Incentive Act, the qualifying enterprises may apply for five years of tax holidays from the date of production and can be renewed for a further ten years. The tax holidays can be extended up to 25 years if a company is engaged in agriculture, agro-industry, food-processing, mari-culture or manufacturing with operations that are highly labor intensive and production that is strictly for export. Dividends and profits derived from the enterprises are also exempted from income tax to the shareholders.

The business tax has to be filed monthly except for the following cases: In the case of receipts derived solely from rents, royalties, premiums or other revenues received from real property, the returns can be filed semi-annually. For financial institutions, firms can file their returns quarterly.

Withholding of 3 percent of all payments on gross contracts of more than BZ\$3,000 must be made. In the case of payments made to a non-resident in terms of management fees, rental of plant or equipment or charges for technical services and insurance premium, 25 percent of such payment is withheld and remitted to the Commissioner. Similarly, 15 percent of the interest received on loans paid to a non-resident is also withheld and remitted to the Commissioner.

At present, interest paid by financial institutions is not taxed. This might initially appear to be a serious gap in the tax system, but it is not. Interest expense is not deductible from the base of the business tax by borrowers; hence, to be consistent, it should not be taxable in the hands of lenders. For financial institutions the base of the business tax is the difference between interest receipts and interest expenses. Hence, the interest paid to the ultimate lenders, i.e., the depositors of savings in financial institutions, is also not being taxed at the level of the financial intermediaries. This treatment is internally consistent, as is the traditional treatment by most income tax systems where interest expenses are deductible from the tax base of the borrowers but taxed as income in the hands of lenders.

The amounts of business sales and tax revenues by type of business are shown in Table 3. The total tax collections increased slightly over time from BZ\$58.1 million in 2002 to BZ\$62.8 million in 2004.

Table 3
Gross Sales and Collections of Tax Revenues by Sector
(thousands of BZ dollars)

Category	2002		2003		2004	
	Gross Revenues	Tax Collections	Gross Revenues	Tax Collections	Gross Revenues	Tax Collections
1. Trade/Business	2,090,053	26,126	1,741,711	26,126	2,054,371	25,680
2. Professional Services	121,151	5,076	121,494	5,251	123,655	4,955
3. Commissions/Royalties	4,959	723	3,613	508	4,113	575
4. Rental Income	14,593	239	21,498	357	20,701	612
5. Radio, On-Air TV, Newspapers	80,389	66	8,923	68	8,097	61
6. Domestic Airlines	23,994	180	26,360	198	25,561	192
7. Insurance Institutions	75,922	1,139	111,207	1,668	77,665	1,165
8. Telecommunications	63,832	14,807	82,224	15,623	97,354	18,497
9. Fuel/Lubricant	70,109	526	75,112	563	75,688	568
10. Tour Operators	5,743	297	7,962	327	10,232	411
11. Financial Institutions						
■ General	64,243	6,424	47,378	4,738	72,455	7,245
■ PIC	82,031	3,281	81,908	3,276	80,021	3,201
12. Rental Income Only	4,005	62	4,196	66	4,454	128
13. Total	2,701,024	58,946	2,333,585	58,768	2,654,367	63,289
Adjust:						
- Tax Credit for Losses		283		247		254
- Below Threshold		593		581		252
Actual Tax Collections		58,070		57,939		62,783

Sources: Belize Income Tax Department.

Discussion

While the business tax system appears quite generous, it is collecting significantly more taxes than was collected by the business income tax previously. At the same time, the taxpayers much prefer paying taxes on a regular monthly basis via the business tax than filing and paying annually under the business income tax. As a consequence, the amount of tax revenue collected through the regular business income tax has become negligible. Only companies that wish to accrue foreign tax credits to offset either US or UK income taxes pay the business income taxes in Belize.

To the degree that the rates of business tax are the same across sectors, this tax becomes a uniform rate of tax on turnover. This has the potential to lead to cascading of the tax rates, but this is more of a theoretical problem than a practical one. Because Belize is a very small country most manufactured items are imported. Hence, the scope for tax cascading is minimal. In such a situation, the business tax would be largely passed on to final consumers through higher prices. In such circumstances, the business tax is no longer a tax on the income of capital, but basically is a low rate of sales tax.

The tax rate on profession receipts has been raised from 4 percent to 6 percent since February 2005. The threshold for the exemption of professionals from the business tax has also been lowered from BZ\$54,000 to BZ\$20,000. These adjustments should, to a degree, improve the equity between the self-employed professionals and the salaried workers being taxed under the individual income tax system. These measures will help to reduce the incentive for people that normally are employees to try to restructure their arrangements with their employers in order to be classified as self employed.²

To bring the business tax more in line with the burden imposed by the individual income tax system, the rate on self-employed professionals should be raised to 15 percent from the recently amended 6 percent. This provides for self-employed professionals in Belize to have business expenses that average up to 40 percent of their gross receipts before their marginal tax rate would be equal to that of individual employees. A marginal rate of 15 percent is unlikely to create an undue incentive for tax evasion.

Beginning in February 2005, the tax rate on receipts on a financial institution was increased from 10 to 15 percent while in the case of a public investment company (i.e., within a PIC Group), the rate was increased from 4 to 8 percent. It is recommended that the rate of business tax on the financial institutions that form part of a public investment company be raised from 8 percent to 15 percent. The base for this tax is the difference between the interest revenue plus fees and investment income they receive, less the amount of interest they pay out. Given that banks are taxed on the same definition of tax base at a rate of 15 percent, and these financial institutions fundamentally compete with each other, it is advisable to bring their tax rates closer together.

It is also the case that the rates on some specific sectors are exceedingly low for no obvious reason. We therefore propose raising the tax rates to 1.75 percent that are now 0.75 percent on the receipts of radio, on-air television, newspaper businesses, as well as services from sales of fuel and lubricants. Insurance company receipts and rents and royalties have also been taxed at 1.75 percent since February 2005. Thus, the tax system would become much simpler as all sectors are being taxes at 1.75 percent. A gross receipt tax of 1.75 percent is hardly a heavy burden on any business and creates little incentive for tax evasion.

² Prior to February 2005, there was an issue if a person has more than one income from employment and personal services, but receipts were all below the threshold for the respective sources in which the threshold for the business tax was high at BZ\$54,000 per annum. It created an enormous incentive for an individual to become self employed. This incentive would be much mitigated because the threshold for professionals becomes much lower.

Our final recommendation is to amend the Fiscal Incentives Act so that it is not possible to provide a tax holiday for the business tax under this legislation. The Fiscal Incentive Act also provides considerable incentives on import duty exemptions; they will be discussed further later.

Revenue Impact

The revenue impact on the adjustments to the business tax rates is estimated to amount to BZ\$17.0 million per year in 2004 prices since most of the adjustments have already been made since February 2005.³ Of this amount about 95 percent is raised by the higher taxes on professionals and the financial institutions that are part of the public investment corporations.

4.3 Sales Tax

In 1996, the Government of Belize introduced a value added tax at 15 percent while reducing customs duties on goods imported from Caribbean countries. It was, however, repealed in 1999. The tax was replaced by the current single stage sales tax.

The current sales tax is charged at the time of importation and on production and services. In essence, it is imposed on the manufacturer's sales price of goods produced in Belize for domestic consumption and on the duty paid value of imported goods. Wholesale and retail margins are basically excluded from the tax base.

There were two sales tax rates when it was implemented. One was 12 percent imposed on alcohol beverages, tobacco products and fuel. The other was 8 percent applied to all other goods and services. As of February 1, 2004, both the rates were raised by one percentage point being imposed on respective goods and services, with the exception of telecommunication goods and services, which remain to be taxed at 8 percent.

In February 2005, the tax rate of 13 percent was further increased to 14 percent. In addition, goods subject to this high tax rate category were expanded to include air conditioners, vehicles over 4 cylinders, yachts, jewellery, perfumes and cosmetics. In summary, the basic rate of sales tax as of July 2005 is 9 percent. This is accompanied by a lower rate of 8 percent on telecommunication and a higher rate of 14 percent on alcohol, tobacco, fuel and a few items that are presumed to be luxuries.

A wide range of goods is specifically exempted from the tax. They include:

- basic food such as rice, flour, bread, corn, fresh meat, eggs, bean and sugar;
- some medicines and medical supplies for human use;
- tuition fees, text books, equipment and furniture used in recognized educational institutions;
- electricity;
- transport of passengers and freights;
- water and sewerage services;

³ The estimate is based on the assumptions that the gross revenues received by various sector presented in Table 3 were uplifted proportionally while exemptions due to threshold were also allowed in proportion with their gross sales by sector.

- financial services by institutions not licensed under the Banks and Financial Act;
- accommodation charges; and
- exports including those bounded for Export Processing Zones or Commercial Free Zones.

Also exempt are goods and services that are made available from grants from international organizations, or funds borrowed from external financial institutions by the Government of Belize or under a Government Guarantee to assist the economic development of Belize.

There is a small business threshold. Businesses and individuals with taxable sales of no more than BZ\$54,000 per annum or BZ\$4,500 per month are not required to register and collect sales tax from their customers.

In order to prevent cascading of the tax, sales tax agents may be exempt from the payment of tax on the purchase of goods and the acquisition of services that are considered essential for the production of the final product. The list of essential goods has to be approved by the Commissioner of the Sales Tax. For the exemption of sales tax from purchase of goods or services or from any other sales tax agent, the sales tax agents are required to present a signed tax exemption certificate.

A sales tax agent shall file a tax return monthly and remit the tax to the Government. Failure to do so will result in the levy of a penalty of 5 percent per day on the amount outstanding.

There is a great deal of controversy over what are or are not essential inputs for the production of a good or service. As a consequence, regulations for the administration of the sales tax are not issued as of today.

Discussion

It is recommended that the threshold amount of gross sales for a business sales tax should be either raised from BZ\$54,000 per annum to BZ\$75,000 to be the same threshold amount as the business tax, or the threshold for the business tax should be lowered to BZ\$54,000. It makes no administrative sense to have two different levels where an enterprise is subject to one ad valorem tax but not subject to the other ad valorem tax.

The controversy over what is or is not an exempt input for a local producer is not surprising. This problem is one of the many tax issues that could be solved by the system of input credits employed by the modern value added tax. Given that Belize is a small economy with business activities that are not very complex, the single stage import and producer level sales tax could have a considerable life span if it were carefully administrated. However, if the rate of tax is raised, the problem of exempting intermediate inputs from the tax will become a more serious issue for the tax administration.

A step that is critical to reducing the controversy over the input exemption problem is to get a set of regulations implemented. These regulations may need to be essentially

detailed memorandums of agreement between operators within specific sectors and the Sales Tax Department. As the sectors and the economy develops through time, these agreements will need to be modified, however, they are essential to bring certainty to the system, and to prevent the incubation of corruption that usually emerges around this aspect of administration of the sales tax. It might be interesting to note that before Canada abandoned its import and manufacture level sales tax, over 20,000 of such agreements were in operation.

At the present time, it is the Commissioner of Sales Tax that has the sole authority to approve exemptions for essential inputs and for the inputs entering the Export Processing Zones (EPZ) and Commercial Free Zones (CFZ). In the case of essential inputs to domestic producers where no official regulations now exist, this is a very heavy administrative responsibility to be placed on the Commissioner. To date, the administration of this tax appears to be running quite well and honestly, but it is a very dangerous situation if the Government wishes to maintain the future integrity of the administration of this tax. An official transparent set of sales regulations are needed as soon as possible. Alternatively, the Government should give up the attempt to run a sales tax system with relatively high rates and move to a value added tax where the credit for the tax paid on inputs is credited as part of the tax system.

Another alternative would be to move the sales tax to the retail level. This move would dramatically increase the number of taxpayers subject to sales tax administration. Because of the difficulty of controlling the tax-exempt purchases of registered taxpayers, we do not recommend moving the level of the sales tax to the retail level at this time. In the future, when the tax administration has the technology and human resources to audit adequately the accounts of retailers, the Government might wish to consider moving the stage of the sales tax to the retail level. At the retail level, the tax base would be bigger; hence, the rate of tax could be lowered.

The sales tax revenues have been increasing along with GDP. It accounts for 5 percentage points of GDP over years; in Fiscal Year 2004, it increased to 5.65 percent of GDP because of an increase in one percentage point of tax rates. In order to broaden the base of the sales tax, electricity sales should be taxed. Because there is a local monopoly in the production and distribution of electricity, it would be administratively easy to levy this tax. Furthermore, as electricity consumption tends to be progressive with respect to income levels, the current exemption of electricity sales makes the sales tax a more regressive tax than it needs to be. Currently, most countries in the world have made electricity sales subject to domestic indirect taxation.

The revenue impact of extending the 9 percent rate of sales tax to electricity sales is estimated to amount to approximately BZ\$5.5 million a year in 2004 prices.⁴ Nevertheless, the fundamental change in the general sales tax system should be the reintroduction of the VAT system of tax administration.

⁴ This is based on the residential consumption of electricity and the approved electricity tariff structure for the period July 2003 to June 2004. That is the multiplication of the consumption of electricity (189,498 GWH) and the price per GWH (BZ\$0.33). All industrial and commercial purchases of electricity would get sales tax exempted.

4.4 Reintroduction of a Value Added Tax

The lack of regulations under the current sales tax system makes the administration of the tax unsustainable. Although the sales tax rates have been raised a couple of times recently, a consumption type VAT will be needed if the sales tax rates are raised much higher. The VAT administration will be necessary if the sales tax is used to make up the revenue lost if the taxation of imports is to be reduced.

If a VAT were substituted for the sales tax and the import duties, much of the incentive for under invoicing would also disappear. The incentive to cheat is reduced because if the VAT is not paid at the point of import, more net VAT revenue will be collected when the goods are sold either to the retailer or the final customer. When less VAT is paid at point of import, there will be fewer credits to offset the taxes due at the point of the next sale.

Given that Belize is small and its imports are mainly from the US, it is simply not practical to try to verify the invoices of the majority of goods being imported. The solution of moving to a VAT is virtually the only option that has a proven track record of success of dealing with this problem.

The switch from the administration of the sales tax as a ring fenced tax on imports and the sales of domestic producers to an invoice credit type tax administration should be relatively easy process in Belize. As the present tax administration ran such a value added tax successfully for several years, most of the personnel of the tax administration as well as the private sector accountants are familiar with its legislation and operation. However, the minimum amount of time required to move to administering a broad based VAT in Belize would be from 9 to 12 months.

Having said that, we propose that Belize should reintroduce a consumption type VAT and also limit its list of the exempt goods and services. A number of studies have shown that the VAT tends to be progressive rather than regressive as politicians and the general public often believes.⁵ In the previous VAT system, Belize zero-rated a wide range of goods. The list includes unprocessed foods, some agricultural equipment, medicines, medical supplies, books, educational supplies, water tanks, stoves, refrigerators.⁶ Our recommendation is that basic groceries and agricultural equipment should be exempted. All the others should be taxed, as all of these items are consumed in much greater amounts by the better off households. The exempt list in the proposed VAT system should only include:

- live animals;
- basic groceries including unprocessed meat, fish, milk, rice, bread, potatoes, corn, vegetables, fruits;
- a list of essential drugs prescribed by medical doctors;

⁵ See., e.g., Glenn P. Jenkins and Chun-Yan Kuo, "Is the ITBIS (VAT) Regressive in the Dominican Republic?", paper prepared for the Government of Dominican Republic, (July 2004).

⁶ See, e.g., Tax Reform Committee, Recommendations on Tax Policy and Administration, report prepared for Cabinet-Government of Belize, (December 22, 1998).

- deposit-taking and other financial services for technical reason that virtually no country in the world has taxed this sector;⁷ and
- some social services for no commercial purpose such as education and health services because of the difficulty in measuring the price of their output. However, for services provided by private schools and private clinics for the purpose of making profits should be taxed.

There should not be any exemption allowed for goods or services purchased by government departments or public institutions. This would remove the bias in favor of government bodies and also help to avoid any abuse of the tax system.

Like any other VAT jurisdictions in the world, for administration reasons a threshold for exempting small businesses should be part of the system. We recommend that the threshold be BZ\$75,000 per annum, the same amount as the current threshold for the business tax. That is, businesses whose annual gross sales are BZ\$75,000 or greater should be registered for the purpose of this tax. In other words, those earning less than the threshold would be outside of the tax system; as a result, they would be paying the value added taxes on their business inputs.

The newly introduced VAT should operate as a normal consumption type VAT in which a refund mechanism must be in place to accommodate businesses with excess tax credits. This is particularly important for exporters in order for them to be able to remove taxes on business inputs thereby competing in the international market. The system would also provide the self policing through the collection and credit mechanism over the production and distribution chain and the audit trail for the tax administration.

The tax base of the VAT implemented in 1997 and 1998 was approximately 51% and 46% of private consumption. The tax administration in Belize today is much more experienced and effective. In addition, the annual threshold is BZ\$75,000 instead of BZ\$100,000 under the previous VAT regime, one would expect to have a greater percentage coverage of private consumption in the tax base. For the purpose of this exercise, we assume 55% of the private consumption would be the tax base. Thus, the potential tax base would have been BZ\$898 million in 2004 prices if the adopted tax policy were implemented. Moreover, exempting basic groceries would increase the tax base by BZ\$20 million.⁸ If financial services were also exempted, taxes would also be collected from the business inputs used to generate these services. The tax base could be augmented by additional BZ\$15 million.⁹ Finally, government's

⁷ Although the range of exempted services should be narrow in order to preserve tax neutrality with other goods and services, the services purchased through fees may be closely related to the intermediation process. These items should also be exempt in order to minimize the incentive to combine these fees with interest charges in an effort to avoid paying the VAT. See, e.g., Harry D. Garber and David G. Raboy, "Value-Added Taxation of Financial Services", edited by Murray L. Weidenbaum, David G. Raboy and Ernest S. Christian, *The Value-Added Tax: Orthodoxy and New Thinking*, (Boston/Dordrecht/London: Kluwer Academic Publishers, 1989).

⁸ This figure stands for business inputs such as farming equipment, truck, fertilizer, etc used in the production of live animals, crops, fruits, vegetable, animal and fishing products. For conservative estimates, we have assumed business inputs account for 10% of their output. That is approximately BZ\$20 million.

⁹ In the case of financial services, main business inputs would include vehicle, computer, telecommunication services, furniture, office supplies, and so on which are assumed to account for approximately 10% of finance services provided.

purchases on vehicles, public utilities, materials and supplies, and some maintenance costs would also be subject to VAT that would amount to at least BZ\$65 million in 2004 prices.¹⁰

The total tax base would have amounted to BZ\$998 million in 2004 prices if the proposed VAT were held in 2004. This is a very crude approximation of the VAT base because of lack of detailed data on household and government expenditures by commodity. In other words, one percentage point of VAT would generate about BZ\$10 million of the tax revenues. Hence, to replace the existing sales tax revenue with a VAT at a flat rate on all the taxable items, the rate would need to be about 12 percent. However, if the business tax were amended as previously recommended, the VAT rate could be set at a lower rate of 11 percent.

4.5 Excise Duties

Excise duties are imposed on the manufacture of cigarettes and production of rum, beer, soft drinks and aerated water. The excise duty rates were fairly low as compared to other countries in the region in 2002. In 2005, the tax rates were substantially increased across the range of excise goods. They are described as follows:

Cigarettes: BZ\$4.00 per 100 cigarettes in 2002; it was raised to BZ\$12.00 per 200 cigarettes in March 2005, and again to BZ\$18.00 per 200 cigarettes in July 2005.

Rum: BZ\$30.00 per gallon in 2002; it was raised to BZ\$60 in March 2005, and again to BZ\$90 in July 2005.

Beers: BZ\$1.80 per gallon in 2002; it was raised to BZ\$3.60 in February 2005, to BZ\$4.00 in April 2005, and again to BZ\$6.00 in July 2005.

Soft drinks: BZ\$0.0325/12ozs in 2002; it was raised to BZ\$0.0650 in March 2005.

Aerated water: BZ\$0.0408/17ozs; it was raised to BZ\$0.0816 in February 2005, and again to BZ\$0.1632 in July 2005.

The breakdown of excise duty revenues and associated production by commodity is presented in Table 4. Because of the increase in tax rates, one would expect to receive much greater tax revenues in 2005 even taking into consideration the demand response to higher prices.

Table 4
Annual Production and Tax Revenues by Commodity

Category	2002	2003	2004
Cigarette: Production (cartons)	532,296	529,768	542,340
Excise Tax (BZ\$000)	2,129.2	2,119.1	2,169.4
Rum: Production (gallons)	12,107	13,487	24,788
Excise Tax (BZ\$000)	363.2	404.6	743.6
Beer: Production (bottles)	34,088,070	36,604,744	33,867,558
Excise Tax (BZ\$000)	4,297.2	4,474.1	4,242.6
Soft Drink: Production (bottles)	40,451,683	41,728,750	40,768,938
Excise Tax	1,566.8	1,642.3	1,829.5

¹⁰ There may be no net revenue implications for the government. However, in order to not favor purchases made through the government, and to maintain simplicity for vendors, the government will pay tax on purchases just like any other organizations.

Discussion

At the present time, the excise duties are levied only on the domestic production of these items. It is proposed later that the excise tax system be uniformly applied to both the domestic production as well as import of a specific set of commodities. These commodities would include the items currently subject to excise taxation as well as revenue replacement duty. A detailed discussion of these issues is conducted in Sections 5.4 and 5.5 of this report.

4.6 Other Taxes

Other domestic taxes include social security contributions, land related tax, and property tax.

4.6.1 Social Security Contributions

The social security contributions used to be set at 7 percent of insurable earnings in 2002. At present, it is increased to 8 percent of insurable earnings. The contributions are shared by employers and employees, depending upon the level of insurable earnings. The amount of contributions by weekly earnings is shown in Table 5.

Table 5
Social Security Contributions by Earnings

Weekly Earnings (BZ\$)	Average Insurable Earnings (BZ\$)	Employer's Contribution (BZ\$)	Employee's Contribution (BZ\$)
Under 70.00	55.00	3.57	0.83
70.00 to 109.99	90.00	5.85	1.35
110.00 to 139.99	130.00	8.45	1.95
140.00 to 179.99	160.00	9.65	3.15
180.00 to 219.99	200.00	11.25	4.75
220.00 to 259.99	240.00	12.85	6.35
260.00 to 299.99	280.00	14.45	7.95
300.00 and over	320.00	16.05	9.55

The total collections of the social security contributions are BZ\$31,196,253 for 2001, BZ\$35,120,091 for 2002, BZ\$40,977,522 for 2003, and BZ\$46,681,397 for 2004.

Discussion

At the present time social security contributions are primarily for purposes of funding a traditional public social security pension system. However, there is a movement in Belize to introduce a publicly funded health insurance scheme. As has been experienced by many countries that are much richer than Belize, a public health insurance scheme can be extremely expensive. Furthermore, if the experience of Canada and the UK are any indication, its future costs will be almost impossible to control. Hence, in terms of maintaining fiscal stability in Belize, it is recommended the Government exercise due diligence in the examination of the health insurance options before undertaking this major public expenditure commitment that will affect current and future generations.

4.6.2 Land Related Tax

There are three kinds of tax related to land. The first is called Land Tax that is imposed on the unimproved value of land. The tax rate is 1 percent of the assessed market value of land. The unimproved values for different categories of land are set by the Government and published in the Gazette as shown in Table 6.

Table 6
Declared Unimproved Values per Acre
(BZ\$)

Categories	Districts and Declared Unimproved per Acre Value				
	Corozal and Orange Walk	Cayo	Belize	Stann Creek	Toledo
30 acres or less	100.00	100.00	100.00	100.00	50.00
31 acres to 300 Acres	500.00	550.00	600.00	500.00	100.00
301 acres and above	600.00	650.00	700.00	600.00	300.00
Suburban	1,000.00	1,000.00	1,500.00	700.00	500.00
Beaches and Cayes	10,000.00	--	10,000.00	10,000.00	5,000.00
Village Lots (One Acre and Less)	1,000.00	1,000.00	1,000.00	1,000.00	500.00

The second is the Land Speculation Fee that is charged on all blocks of land if that is greater than 300 acres. The tax rate is set at 5 percent of unimproved land value. Since the tax is aimed at the speculation of unimproved land, it is tax exempt if improvements of the land are made by more than 1 ½ times unimproved value, 30 percent or more in agricultural land, or land used for eco-tourism. The Speculation Fee Act was passed into Law in 2000 and the collection of this tax was only BZ\$3,000 in the first fiscal year. The Government has now issued notices to all those persons who own land and fit the criteria for assessment.

The third is the Land Transfer Tax. It was recently amended to 10 percent for Belizeans and 15 percent for non-Belizeans.

Discussion

While the Land Speculation Fee has considerable populist political appeal, it is likely to be nothing more than a nuisance tax or an instrument of harassment against some passive lands owners. Throughout history, such a tax has been tried in many jurisdictions but with a uniform track record of failure in achieving either the objective of stimulating economic development or collecting revenue.

In Belize, there appears no shortage of land readily available for development, and the prices of land are already relatively low. Hence, it is difficult to see if any legitimate economic purpose for the Land Speculation Fee. A land speculation tax will not bring about development if there are currently no obstacles for such development. If this tax is imposed, then the likely result is a further fall in all land prices. This is hardly a desired result. The tax should be eliminated.

4.6.3 Property Tax

In urban area, there is a property tax that is levied on assessed annual rental value of the property at 12 percent.

Discussion

This type of property tax is an important source of revenue for the financing of the costs of municipalities. It is recommended that a system of indexation of rental values to the current rate of general inflation in Belize be introduced. If in the future the rate of inflation were to increase, then real property tax revenues would not fall if the tax base were indexed for inflation on an annual basis.

V. Taxation of International Trade Transactions

5.1 An Overview of Trade Taxes

The tax system of Belize relies heavily on taxes on international trade to raise revenues. These include import duties, revenue replacement duties, and an environment tax on the value of imports. These sources of revenues accounted for approximately 40 percent of total tax revenues or 8 percent of GDP in the past four years. It is the most important source of tax revenues in the country. This section will first discuss the nature of these trade taxes and develop the strategies for Belize under the dynamic world trade liberalization.

The tariff rate structure and its trade-related levies in Belize are somewhat complicated by international standards. Following the recent trade liberalization around the world, the import duty rates in Belize remain high, ranging from zero to 70 percent, some commodities such as rum are even more than 100 percent when converted from unit to ad valorem rates. Details of import value and the associated import duty and other taxes for each commodity in 2004 can be found in Appendices B.1 and B.2.

To capture the forgone tariff revenue due to the reduction of import duty rates, the Government of Belize has introduced the revenue replacement duty, which is levied on the aggregate value of c.i.f. price plus import duty of certain imported goods. The duty rates were amended several times from commodity to commodity. In 2002, the rate ranged from 2 percent for fertilizer to 30 percent for aerated water. Starting in July 2005, lists of revenue replacement duty rates were amended and implemented. In fact, the revenue replacement duties are nothing more than import tariffs by another name.

In addition, an environmental tax used to be charged at 1 percent on imports other than basic food. The rate was raised to 5 percent on vehicles over 4 cylinders and 3 percent on all other goods as of February 1, 2005. A social fee is also charged on fuel and all other goods imported into the Commercial Free Zone. The tax rates are 10 percent on fuel and 1.5 percent on all other goods, respectively. Another levy is related to the purchase of all foreign currency in which a rate of 1.25 percent is imposed on the value of the foreign currency expressed in Belize currency of more

than BZ\$100. These levies appear to be for revenue generation, rather than for economic, environmental or any other reason.

In addition, Belize provides full or partial import duty exemptions to various institutions. These exemptions may be types of imported goods, purchasers of imported goods or the purpose of concessions.

5.2 Potential Trade Tax Base

The combined trade taxes collected from import duty and revenue replacement duty, as shown in Tables 1 and 2, accounted for approximately 38 percent of total tax revenues or 8 percent of GDP in the past four years.

The detailed data we have received from Customs and used for this analysis were captured under the customs ASYCUDA computerized information system.¹¹ It captures the information on all formal customs declarations, including declarations of imports, warehousing and import/export licenses. For those people that cross the border daily and make purchases which are dutiable but who are not required to prepare a formal declaration, the imports are not captured in the ASYCUDA system. As a result, the data account for more than 95 percent of the tax revenues.¹²

For fiscal year 2004, the total amount of imports for domestic use in Belize was recorded at BZ\$769,768 thousand as shown in Table 7.¹³ Of this amount, the imports from Caricom countries were BZ\$23,868 thousand; virtually all were exempted from import duty while a total of BZ\$640 thousand was paid in revenue replacement duty. One can anticipate that the Caricom free trade area will remain as it is in the foreseeable future. For all intents and purposes, the imports from Caricom countries are tax exempted. We will thus concentrate our analysis on imports from non-Caricom countries, a total amount of BZ\$745,900 thousand.

Table 7
Potential Tax Base of Imported Goods for Domestic Use in Fiscal Year 2004
(Thousands of BZ dollars)

Category	Incremental Imports	Total Amount of Imports
Imports from Non-Caricom Countries:		
Imported Goods without Partial or Full Exemptions	-	557,351.5
Plus: Possible Removal of Exemptions	174,469.1	731,820.6
Plus: Impossible Removal of Exemptions	14,079.1	745,899.7
Imports from Caricom Countries	-	23,868.3
Total Imports	-	769,768.0

¹¹ See Belize Customs and Excise Department, Instruction Booklet for Completion of the Customs Declaration (Import/Export) Form C-100. However, for Fiscal Year 2004 the import duties and revenue replacement duties imposed on various fuels have not been properly recorded in this data file at the time of this study; they are nevertheless obtained manually from the Customs for completeness.

¹² The total amounts of import and revenue replacement duties were BZ\$69,524 and BZ\$71,510 thousand, respectively, in Fiscal Year 2004 from April 2004 to March 2005. They account for more than 94.9 percent and 96.1 percent of the actual collections for the country as a whole.

¹³ This figure does not include imports entered in bonded warehouses, in transit to export processing zones or commercial free zones, but include those goods entered for domestic consumption from them.

In contrast to raising revenue, there is a long list of import duty exemptions, fully or partially, provided to various institutions. These provisions are often not very straightforward. They can be classified in two groups. The first group is the exemptions to which removal of the exemptions is possible; especially at the time the country faces an extreme financial crisis. These exemptions are also distortionary. For example, some goods are fully exempt of import duty from the Ministry of Finance while others are partially exempt of 50 percent or 60 percent. They should be treated in the same manner as other purchasers in order to prevent over consumption or abuse of the system. Other exemptions may be the concerns of health, cultural or social aspects but these can all be better addressed elsewhere through expenditure programs in order to minimize tax distortions.

The second group is those exemptions that are impossible to remove because the imports are for use by the government of a foreign country or by international organizations. These exemptions are due to either reciprocal agreements between countries or a common international requirement if receiving external assistance from international institutions. The list may also include equipment, uniforms and supplies for use by the military forces and medical products certified by the Government Chief Pharmacist. The total imports of this group amount to BZ\$14,079 thousand in fiscal year 2004. If the exempt provisions only applied to this group, the potential tax base for imported goods is referred to in Table 8 “Base Case with Removal of Exemptions”. The tax base would only be reduced to BZ\$731,821 thousand. The effective combined import duty and revenue replacement duty rates are 19.17 percent. However, if no removal can be made for any full or partial import duty exemptions under the first group, the tax base for traded goods would be substantially reduced to BZ\$557,352 thousand. In Table 8, it is called “Base Case without Removal of Exemptions”. The effective combined duty rates are 24.33 percent. These two base cases will be further discussed and analyzed below.

5.3 Revenue Patterns of Import Duty and Revenue Replacement Duty

As was previously mentioned, there are two types of duties imposed on imports, import duty and revenue replacement duty. For example, they were approximately BZ\$73,253 thousand and BZ\$74,446 thousand in fiscal year 2004, accounting for 17.47 percent and 17.75 percent of the total recurrent revenues, respectively. It is the most important source of tax revenues; we would thus focus our discussion in this area.

Import Duty

According to import duty rates, imports in Belize may be classified in the following categories:

- A low rate of 0 to 5 percent commodities: The zero-rated commodities include tractors for agricultural use, fungicide and other insecticides, fishing hooks and rods, butane, painted brushes, balls for soccer, printers, printed books, paper and other materials. The five-percent rate ones include broom, ceramics and prefabricated building materials, instruments for measuring and other appliances, typewriter ribbons, printing machines, telephone sets and other apparatus, front-end shovel loaders, textile materials, etc.

- A moderate rate of 10 to 20 percent commodities: The 10 to 15 percent rate commodities include writing and drawing pencils and chinks, sailboats, water-skis, keyboard instruments, tiles and building cement. The 20 percent rate commodities cover a wide range of consumer goods, including tooth brushes, ball point pens, detergents, cloth and footwear, brooms and brushes for households, toys, games, lighters, lamps, mattresses and furniture framed with plastics, carpet, cartridges, projectors, etc.
- A slightly higher rate of 25 to 45 percent commodities: This includes potatoes, biscuits, ice cream, grapes, golden apples, furniture with wooden frame, microwave ovens, magnetic discs other than diskette, magnetic tape-type, motor vehicles and parts, fully automatic machines, and so on.
- A high rate of 50 to 70 percent commodities: This includes cosmetics, clocks and wristwatches, jewelry, pistols and other firearms.

For certain commodities, the rates are quite specific with respect to unique designs or features of the product. For example, a 10 percent rate applies to furniture with metal frame, 20 percent with plastics, and 35 percent with wood. Similarly, a 5 percent applies to sardines and tunas, 20 percent to salmon and 35 percent to crab. The motivation appears to be an attempt at fine-tuning of tariff protection for the protection of local activities from international competition.

Revenue Replacement Duty

As was noted earlier, there are certain commodities that are subject to the revenue replacement duty in order to recoup the foregone tariff revenue, which in fact is not much different from imposing the same import duty and thus creates administrative complexity. These commodities are mainly excisable goods as would be discussed later.

In Belize, it is interesting to observe that a significant amount of import duties is collected from a small number of commodities. These commodities could normally be classified as part of the excisable tax base in developed countries. They include alcoholic beverages, cigarettes and other tobacco products, and motor fuels. In less developed countries, the list often expands to include motor vehicles and cosmetics because they are considered as luxury goods. In Belize, these commodities attract not only a substantial amount of import duty but also revenue replacement duty. For example, under the Base Case with Removal of Exemption as shown in Table 8, while excisable commodities accounted for only 19.13 percent of the total imports in fiscal year 2004, the share of import duty and revenue replacement duty was about 35.67 percent and 97.63 percent, respectively.

If expressed as a percentage of their respective import values, the collections of import and revenue replacement duties in fiscal year 2004 were 8.16 percent and 0.28 percent for non-excisable commodities while for excisable commodities, they were 15.17 percent and 49.39 percent. If both import and revenue replacement duties are combined, the effective tax rates would be 8.44 percent and 64.56 percent for non-excisable and excisable commodities, respectively.¹⁴ By comparison, it is clear that

¹⁴ The contrast between non-excite and excise commodities has become greater in 2004 than that in 2001 where the respective effective duty rates are 6.99 percent and 58.49 percent.

the excisable commodities tend to be levied more heavily by the customs duties as compared to non-excisable commodities, even more so by revenue replacement duty.

Table 8
Potential Tax Base for Imported Commodities from Non-Caricom Countries
in Fiscal Year 2004

	Import Value	Import Duty	Revenue Replacement Duty	Total of Import Duty and Revenue Replacement Duty
Base Case without Removal of Exemptions				
Non-Excisable Commodities: Amount (\$000) As Percentage of Import Value	438,936	43,935 10.01%	1,652 0.38%	45,587 10.39%
Excisable Commodities: Amount (\$000) As Percentage of Import Value	118,415	21,013 17.75%	68,993 58.26%	90,006 76.01%
Total Imports: Amount (\$000) As Percentage of Import Value	557,351	64,948 11.65%	70,645 12.68%	135,593 24.33%
Base Case with Removal of Exemptions				
Non-Excisable Commodities: Amount (\$000) As Percentage of Import Value	591,850	48,292 8.16%	1,675 0.28%	49,967 8.44%
Excisable Commodities: Amount (\$000) As Percentage of Import Value	139,971	21,228 15.17%	69,131 49.39%	90,359 64.56%
Total Imports: Amount (\$000) As Percentage of Import Value	731,821	69,520 9.50%	70,806 9.68%	140,326 19.17%

Sources: Special requests from Belize Customs and Excise Department.

When no distinction is made between excisable and non-excisable commodities, the effective tax rate was about 9.50 percent for import duty alone and 19.17 percent for import and revenue replacement duties combined. This implies that, if a single import duty rate were imposed on all imported goods other than those from members of Caricom countries, a rate of 9.5 percent would be sufficient to raise the same amount of import duties. If a single 10 percent rate had been imposed on all imports, the Government would have raised approximately an additional BZ\$3,662 thousand in 2004. This is based on the Base Case with Removal of Exemptions.

Suppose that the present exemption provisions remained unchanged, the effective tax rate would have become 11.65 percent alone and 24.33 percent for import and revenue replacement duties combined.

5.4 Harmonization of the Tariff and Excise Tax Systems

At the present time, excise duties in Belize are levied only on the domestic production of goods and services that are also subject to import duty and revenue replacement duty. Hence, the import duties and the revenue replacement duties are designed to function both as revenue systems as well as instruments for providing domestic protection for industries. This structure of trade taxation is not consistent with either future bilateral trading arrangements or multinational trade negotiations under the auspices of the World Trade Organization (WTO). In these circumstances, it will be expected that Belize should reduce its level of tariffs dramatically. Under the present circumstances, this would have very serious fiscal repercussions.

In order to prepare for such trade negotiations, Belize needs to develop a modern excise tax system whose primary objective is to generate revenue. By reforming the excise tax system, much of the tax revenues that would have been lost by import tariff reductions could be retained. By excisable goods we refer to alcoholic beverages, cigarettes and tobacco products, motor fuels and kerosene, cosmetics, and motor vehicles.

A modern excise tax system would levy either per unit or ad valorem rates of tax on the duty inclusive price of imports. These taxes would be imposed at the same rate on both imported or domestic produced goods and services of the same type. Imposing such excise taxes would be perfectly consistent with the rules of the WTO or any other likely bilateral trade agreement.

Our recommendation would be to lower all the tariffs on excisable goods to 10 percent and then to levy an excise tax on each of the goods at a rate that would bring the total tax burden up to the current level that is now imposed by the import duties and revenue replacement duties. This reform would allow the import duties to be significantly rationalized without an undue loss of revenue. For the non-excisable goods, the import duties and revenue replacement duty should be combined and levied as a single import duty. This report will outline a strategy over time of reducing these import duties in a program that is likely to arise if bilateral or multilateral trade negotiations take place in the future.

5.5 Potential Revenue Gains from the Proposed Reform

5.5.1 Exempt Provisions

Based on our earlier discussion, it would be impossible to remove the exempt status from the imports of the following four categories of end users of imported goods: (a) goods imported for use of any institutions involved with science, medical or technical research, (b) for use in military forces, (c) medical products certified by the Government Chief Pharmacist, and (d) imports by the diplomats or international aid agencies. This is the Base Case with Removal of Exemptions. All other exempt provisions would be repealed that would yield a potential net revenue of import duty alone for the treasury at about BZ\$9,697 thousand, consisting of BZ\$8,335 thousand for non-excisable commodities and BZ\$1,362 thousand for excisable commodities. The Ministry of Finance appears to be the biggest cause of the import duty exemptions as presented in Table 9 since it accounts for almost 47 percent of the total revenue gains.

The potential gains of eliminating these import duty exemptions represent 0.47 percent of GDP. Removal of these tax incentives to specific institutions would increase economic efficiency, and also reducing the scope for tax evasion. This Base Case with Removal of Exemptions would therefore be used for further discussions.

Table 9
Removal of Import Duty Exemptions
In Fiscal Year 2004
(BZ\$000)

Organization	Non-Excisable Goods				Excisable Goods			
	Import Value	Import Duty			Import Value	Import Duty		
		Current Tax Revenue	Potential Tax Revenue	Gains		Current Tax Revenue	Potential Tax Revenue	Gains
City Council, Town Boards	25	0	4	4	0	0	0	0
No Commercial Value	78	0	12	12	0	0	0	0
Health Equipment	10	0	0	0	0	0	0	0
Educational Organizations	445	0	18	18	0	0	0	0
Sport Equipment	8	0	1	1	0	0	0	0
Contracts with Government	0	0	0	0	66	0	8	8
Indigenous People	116	0	7	7	0	0	0	0
Development Concessions	33,065	4	3,249	3,245	1,406	0	476	476
Ministry of Finance	40,638	26	4,066	4,040	1,950	81	593	512
Sales Tax Exemption Certificate*	63,285	4,304	4,373	69	834	134	126	(8)
National Agreements	15,244	23	962	939	17,298	0	374	374
Total	152,914	4,357	12,692	8,335	21,554	215	1,577	1,362
Total as Percentage of GDP	7.40%	0.21%	0.61%	0.40%	1.04%	0.01%	0.08%	0.07%

Sources: Belize Customs and Excise Department.

Note: *These certificates refer to those who purchased the essential inputs in their production. These inputs would be exempt of sales tax but would be taxed at the end product.

5.5.2 Reform of Import Tariffs on Non-Excisable Commodities

We now move to examine the potential revenues if tariff structure is simplified. For analytical purposes we combine the import duty and revenue replacement duty into one levy. For those commodities where the import duties are essentially serving the purpose of an excise tax on imports, we reduce the import duty to 10 percent and add an excise tax with a sufficient rate to replace the revenue. We will discuss how this is done and the implications in the next section.

This leaves us with the problem of reforming the tariffs and revenue replacement duties on those items that are not normally part of the excise tax system. At the present time, the rates of tariff range from 0 to 70 percent on these items. The total revenues collected from non-excise commodities in fiscal year 2004 are shown in the third column of Table 10, based on combined import and revenue replacement duty rates on c.i.f. value. The total amount was BZ\$49,967 thousand.

Suppose there is a structural reform of the rates of tariff so that in the future there are only three rates of tariff, 5, 10 and 15 percent. That is, raising the bottom rate from 0 to 5 percent to 5 percent; consolidating the rate from more than 5 to 15 percent to 10 percent; consolidating the rate from more than 15 percent to 15 percent. This may be called Phase I reform.

Table 10
Tariff Restructure and Potential Government Revenues
For Non-Excisable Commodities in Fiscal Year 2004

Current Combined Rates (percent)	Import Value (BZ\$000)	Import and Revenue Replacement Duties (BZ\$000)	Proposed Combined Rates (percent)	Potential Duty Revenues (BZ\$000)
0	159,407	57	5	16,916
0 to 5	178,905	6,925		
5 to 10	29,910	2,222		
10 to 15	67,149	6,871	10	9,706
15 to 20	122,009	22,653		
20 to 25	4,453	883	15	23,471
25 to 30	9,333	2,725		
30 to 35	11,037	3,818		
35 to 40	3,392	1,211		
40 to 45	4,257	1,696		
45 to 50	1,446	545		
50 to 55	0	0		
55 to 60	197	118		
60 to 65	0	0		
65 to 70	352	243		
70+	0	0		
Total	591,850	49,967	-	50,093
Total as Percentage of GDP	28.62%	2.42%	-	2.42%

Phase I reform would generate almost the same amount of the revenues from the existing import and revenue replacement duties combined from non-excise commodities. The difference is BZ\$126 thousand. Persons importing goods of the first group would bear the most significant changes of import duty, especially those that are currently subject to zero rates. The second group does not seem to be much affected, while those in the third group paying very high import duties would gain. Part of the revenue gains in this proposal is also due to the removal of exemptions in favor of various organizations as discussed earlier. The system, nevertheless, would be simpler, less distortionary and more transparent. If there were particular commodities, e.g., guns, that the Government wished to tax more heavily, they should be brought under the excise tax system.

The proposed tariff rate changes above might be considered as the transition to a single tariff rate program, like the one in Chile. In this Phase II Reform, the tariff rates would be set at a single rate of 10 percent. If this were done, then total tariff revenues from non-excisable commodities would be BZ\$59.2 million, or an increase in revenue of BZ\$9.2 million. This could provide some room for an introduction of the proposed low VAT rate.

In addition to revenue gains, this reform would greatly reduce the distortionary impact of the tariff system. The rates of tariff could be reduced for finished goods, and also a number of the inputs used in domestic production now subject to a rate of 5 percent. This action would serve to reduce the effective rates of protection, and the inefficiencies created by the import tariffs on final goods and services.

To this point, we have implicitly made the assumption that the elasticities of demand for all the imported items are equal to zero. Clearly this assumption is not realistic. Hence, we carried out a second set of estimations of the revenue changes from the proposed transitional and matured reforms. In these estimates, we make the simplifying assumption that the price elasticity of demand for each import commodity is equal to -1.0 . The revenue impacts are derived by first estimating the change in the quantity demanded of imports caused by the increase or decrease in the rate. The new tariff revenue for each item is then calculated by multiplying the new quantity of import for the commodity by the new tariff rate. The results of the estimation that include the behavioral response for Phase I and Phase II tariff reform are presented in Table 11.

Table 11
Tariff Restructure and Potential Government Revenues
For Non-Excisable Commodities in Fiscal Year 2004
Inclusive of Behavioral Responses

Current Combined Rates (percent)	Phase I		Phase II	
	Proposed Combined Rates (percent)	Potential Duty Revenues (BZ\$000)	Proposed Combined Rates (percent)	Potential Duty Revenues (BZ\$000)
0	5	16,512	10	58,655
0 to 5				
5 to 10				
10 to 15	10	9,982		
15 to 20				
20 to 25				
25 to 30				
30 to 35				
35 to 40				
40 to 45				
45 to 50				
50 to 55				
55 to 60	15	24,993		
60 to 65				
65 to 70				
70+				
Total			-	51,487
Total as Percentage of GDP	-	2.49%	-	2.84%

The behavioral response to changes in the tariff rates proposed in Phase I of the tariff reform is estimated to lead to a BZ\$4.83 million increase in the aggregate value of imported commodities, and the total tariff revenues amount to BZ\$51.5 million which is slightly higher than BZ\$50.1 million revenue estimated earlier without the behavioral response. In Phase II, a single tariff rate reform, the behavioral response decreased the total amount of imports by BZ\$5.30 million but tax revenues are estimated to be raised to BZ\$58.7 million, which is close to the estimate of BZ\$59.2 million revenues raised without considering the behavioral response.

Another important consideration is what revenue would be needed in order to fill the shortfall if all import duties were reduced to zero when the free trade arrangements with the US takes place. This may be termed Phase III tariff reform. In the case of excisable commodities, the excise taxes can be adjusted for any reduction in import tariffs. However, another source of revenue would need to be found to replace the revenue lost from the reduction in tariffs on non-excisable commodities. From Table 10, column 3 we find that the loss in tariff revenue would be approximately BZ\$50.0 million. From Table 1 row 6, the current revenue from the imposition of the sales tax is currently BZ\$116.2 million. This includes both the revenue from the basic rate of 9 percent as well as the 13 percent on alcoholic beverages, tobacco products and fuel. Considering only the tax base of the 9 percent tax rate commodities, we estimate that the revenue from the elimination of tariffs on non-excisable commodities could be made up by increasing the basic sales tax rate from 9 percent to 15 or 16 percent. Since the excise is applied on top of the sales tax, the amount of the excise tax would be automatically adjusted upward in this case.¹⁵ While such a high rate of domestic indirect tax is commonly imposed by countries levying a value added tax, it is getting to the upper end of the range of rates that can be administered under a single stage sales tax system.

Recall that the proposed VAT could generate BZ\$10 million per percentage point and also, Phase II trade reform would generate an extra BZ\$9 million, the Government can therefore introduce a VAT at 11 percent to generate enough tax revenues to replace BZ\$116 million of the sales tax. Then, in Phase III when the free trade agreement with the US takes place, the VAT rate can be raised to 16 percent in order to recover the loss of import duties collected from non-excisable goods.

It should be pointed out that the above analysis is under the scenario “Base Case with Removal of Exemptions”. This implies that the revenue gains generated from repealing the exemptions discussed earlier have already incorporated in this section.

5.5.3 Revenue Implications of Tariff and Excise Tax Reform on Excisable Commodities

For excise commodities, it is reasonable that they are also levied by a normal import duty. Suppose they are all subject to an import duty rate at 10 percent. On top of it, there is a general sales tax rate of 14 percent and an excise levy structured in such a way that the total burden of buying each commodity remains unchanged from the current system. These rates are presented in Table 12.

¹⁵ We propose not to adjust the excise tax downward when the general sales tax rate applied to all goods is raised.

Table 12
Excise Tax Rates on Imported Excise Commodities
Under Phase I and Phase II

Categories	Goods	Excise Rates (percent)
Alcoholic Beverages	Beer and Stout	145
	Wine	55
	Sprits	95
	Ethyl Alcohol	15
Cigarettes and other Tobacco Products	Cigar	40
	Cigarettes and other Tobacco Products	330
Fuels	Gasoline	110
	Diesel Fuel	30
	Aviation Fuel	5
	Kerosene	0
Cosmetics	All	35
Motor Vehicles	Cars, Trucks	25
	Dempers Designed for Off-highway Use	0
	4 Cylinder with Less than 3 litres	0
	G.V.W.	5

With the above structure, the option would have generated total revenue of BZ\$89.7 million, consisting of BZ\$14.0 million of import duties and BZ\$75.7 million of excise taxes. This is only BZ\$0.6 million less than the total of the import duties for BZ\$21.2 million plus revenue replacement duties for BZ\$69.1 million collected in 2004. Details of the revenues by major commodity categories can be found in Table 13. The system would be much simpler and transparent. The tax authority should get ready to make appropriate tax adjustments to each of the excisable commodities and issue the statement to the taxpayers and the public the policy intent and the means to achieve them. Of course, the excise tax on various commodities can be converted to a unit tax rate for administrative simplicity and may be adjusted from time to time according to price indices in order to maintain the real value in tax collections.

As the excise taxes would be on both domestic as well as imported goods, there would be no trade distortions imposed on the production side of these goods. Furthermore, if Belize decided to eliminate its import tariffs completely, it could adjust its excise taxes on these same excisable commodities to compensate for the revenue lost from the elimination of tariffs.

In addition to the proposed reform, the government revenues can also be increased if the Customs has improved its administration. However, the revenue implications of such improvements are difficult to estimate.

Table 13
Gains and Losses for Each of the Excisable Commodities
(thousands of BZ dollars)

Excisable Goods	Current System		Proposed System		Difference
	Import Duty	Revenue Replacement Duty	Import Duty	Excise	
Alcoholic Beverages:					
Beer and Stout	171.2	799.8	58.3	929.6	16.9
Wine	1,242.2	1.3	176.5	1,067.7	0.7
Spirits	1,700.5	59.2	155.9	1,629.0	25.2
Ethyl Alcohol	4.7	0.5	1.8	3.0	(0.3)
Cigarettes and Other Tobacco Products					
Cigar	57.9	0	10.7	47.3	0.1
Cigarettes and other Tobacco Products	241.5	406.5	17.3	627.2	(3.5)
Fuels:					
Gasoline	6,580.5	44,879.3	2,175.2	47,108.4	(458.2)
Diesel Fuel	4,098.0	20,423.4	5,722.7	18,884.9	86.1
Aviation Fuel	0	130.2	83.9	46.2	0
Kerosene	0	315.3	325.2	0	9.8
Cosmetics	499.4	749.4	256.8	988.6	(3.5)
Motor Vehicles					
Cars and trucks	5,123.8	413.2	1,485.5	4,085.0	33.5
Dempers Desined for off-highway use	585.4	368.2	830.6	0	(123.1)
4 Cylinder with Less than 3 litres	362.4	0	384.0	0	21.6
G.V.W.	560.3	584.5	594.7	327.1	(223.0)
Total	21,227.7	69,130.8	13,997.1	75,744.0	(617.5)
Total as Percentage of GDP	1.03%	3.34%	0.68%	3.66%	(0.03%)

5.6 Fiscal Incentives

Under the Fiscal Incentives Act, the approved enterprises are exempted from customs duty and stamp duty on all building materials, plant, machinery and equipment, utility and transport vehicles, fixtures and fittings, office equipment and appliance, spare parts and any raw materials for use in the approved enterprises. The exemption period is 15 years from the date of approval and can be renewed for additional 10 years. In the case of companies that are engaged in agriculture, agro-industry, food processing, mari culture or manufacturing and that are highly labor intensive and strictly for export, the exemption can be up to 25 years.

During the past seven years, more than 145 large companies received the fiscal incentive approvals. The amount of investment and the number of employment by these enterprises are shown in Table 14 by sector and by year.

In addition, there were also 59 small firms in 2003 and 46 firms in 2004 with a more than 51 percent of domestic equity who could be qualified to receive the fiscal incentives. The profiles of their investment and employment are also presented in Table 15.

Table 14
Investments of Large Firms under the Fiscal Incentive Program

Categories	1998 Sep-Dec.	1999 Jan.-Dec.	2000 Jan.-Dec.	2001 Jan.-Dec.	2002 Jan-Dec	2003 Jan.-Dec.	2004 Jan.-Dec.
<u>Approved Enterprises (#):</u>							
▪ Tourism	3	8	3	12	12	11	10
▪ Agriculture	1	3	6	3	-	2	-
▪ Agro-processing	0	1	1	1	-	1	1
▪ Manufacturing	3	8	4	8	8	7	3
▪ Services	1	0	0	2	4	6	7
▪ Mari-culture	2	2	0	1	-	-	-
Total	10	22	14	27	24	27	21
<u>Investment (\$M):</u>							
▪ Tourism	4.730	21.760	16.745	40.385	181.62	73.07	68.088
▪ Agriculture	.230	86.550	23.080	8.825	-	4.7	-
▪ Agro-processing	0	.950	9.000	1.0	-	12.5	0.445
▪ Manufacturing	.930	4.135	2.580	14.561	15.715	4.143	13.022
▪ Services	.450	0	0	1.235	13.48	19.265	77.831
▪ Mari-culture	1.800	2.095	0	1.000	-	-	-
Total	8.140	115.490	51.405	67.006	210.82	113.678	159.386
<u>Employment (Numbers):</u>							
▪ Tourism	95	183	294	439	879	430	691
▪ Agriculture	30	354	1,480	140	-	620	-
▪ Agro-processing	0	45	512	10	-	20	34
▪ Manufacturing	47	101	163	209	365	239	195
▪ Services	15	0	0	12	219	170	348
▪ Mari-culture	40	0	0	5	-	-	-
Total	227	773	2,449	815	1,463	1,479	1,193

Sources: Investment and Business Facilitation Department, Beltraide.

Table 15
Investments of Small Firms under the Fiscal Incentive Program

Categories	2003 Jan. – Dec.	2004 Jan. – Dec.
<u>Approved Enterprises (#):</u>		
▪ Tourism	26	26
▪ Agriculture	1	1
▪ Agro-processing	1	-
▪ Manufacturing	10	4
▪ Services	20	15
▪ Mari-culture	1	-
Total	59	46
<u>Investment (\$M):</u>		
▪ Tourism	3.85	5.20
▪ Agriculture	.14	0.30
▪ Agro-processing	.13	-
▪ Manufacturing	1.89	0.90
▪ Services	3.94	3.0
▪ Mari-culture	.17	-
Total	10.12	9.40
<u>Employment (Numbers):</u>		
▪ Tourism	170	151
▪ Agriculture	14	15
▪ Agro-processing	13	-
▪ Manufacturing	86	28
▪ Services	110	71
▪ Mari-culture	8	-
Total	401	265

Discussion

Beltrade has provided tax exemptions for a wide range of economic endeavors. In order to stop the erosion of the tax base over time, the activities of this incentive granting organization should be curtailed. Facing the current public sector budgetary crisis, it is recommended that like EPZs and CFZs, newly approved firms by Beltrade should only be allowed for import duty and other indirect tax exemptions but they should be subject to the business income tax at the rates proposed in the section of the business tax.

VI. Export Processing Zones

The export processing zones (EPZ) are a type of free trade zones established to attract investments to produce goods and services for export. Because the goods and services are produced for international markets, no import duties are imposed on the imported inputs into the zones.

In Belize, the EPZ program was established to promote investment and economic growth as well as to create new employment opportunities. The program encourages business enterprises not only to produce goods but also services so long as they are for export or sale to buyers who are not residents of Belize. As a result, businesses established in the EPZ zones include agriculture, fisheries (aquaculture), manufacturing and services sectors such as electronic commerce services.

Within the EPZs, no import duties are levied on raw materials and intermediate goods. Nor are import duties levied on capital equipment, services and utility vehicles, office furniture, spare parts and supplies.¹⁶ In addition to import duties, consumption taxes, excise taxes, trade turnover taxes and other taxes are all exempted. The exceptions are fuel and vehicles in which the exempt fuel is restricted to use for energy generation purposes only and the exempt vehicles are restricted to those that can be used in the zone only.¹⁷ Other than indirect taxes, businesses are also exempt from income tax, withholding tax, capital gain tax or any corporate tax for a minimum of the first 20 years of operation. Any dividends paid by an EPZ business are also exempt.

If the goods are sold domestically, the firms are required to pay import duty on inputs and other taxes as other domestic firms. That is, all taxes applicable to business inputs are applied to value of imported inputs.

Since its inception, 179 companies have applied to operate in EPZ, of which 163 were approved. As of December 2003, 112 companies have already opened and are operating within EPZs. Their distribution among industries is shown in Table 16. Most of the firms are engaged in electronic market, telephone and other data processing. The next important one is in growing and processing of shrimps; there are 18 companies currently operating in the zone.

¹⁶ It may be useful to note that in 2001 there was more than BZ\$84 million of goods imported to EPZs.

¹⁷ This becomes effective as February 2004.

Table 16
Number of Operational EPZ Companies by Sector

Industry	1998	1999	2000	2001	2002	2003
Aquaculture	6	8	14	16	19	20
Data Processing	1	9	30	41	52	70
Manufacturing	-	-	2	4	5	5
Fruits/Vegetable	2	5	6	6	7	7
Hotel	-	-	-	-	3	3
Other	2	-	3	3	5	7
Total	11	22	55	70	91	112

Source: Ministry of Finance (Revenue) Annual Report 2003.

In terms of total investment, it increased from BZ\$60 million in 1998 to BZ\$451 million in 2002, but declined to BZ\$112 million in 2003. However, the number of total workers increased from 1,541 persons in 1998 to 3,472 in 2003. The foreign exchange earnings were also increased from BZ\$17 million to BZ\$116 in the corresponding period. Details of yearly movements can be found in Table 17.

Table 17
**Annual Employment, Investment and Foreign Exchange Earnings
Generated from EPZ Program**

Year	Employment (# Employees)	Investment (BZ\$000)	Foreign Exchange Earnings (BZ\$000)
1998	1,541	60,069	16,744
1999	1,967	1,230,259	25,107
2000	2,486	191,451	177,593
2001	2,169	307,055	50,038
2002	2,684	451,433	73,370
2003	3,472	112,152	116,439

Source: Ministry of Finance (Revenue) Annual Report 2003.

Discussion

The export processing zones in Belize are different than traditional EPZs as most operate as a single firm and there is not the usual tight Customs control, such as sealing of containers moving from the port to the zones that is common with EPZ elsewhere. The EPZs in Belize are much closer to the arrangement of bonded factories that are common in many countries. Again the difference in Belize is that the EPZs are not bonded, nor are banking guarantees required to insure that the tax-exempt goods do not leak into the rest of the economy.

The exemption of indirect taxes for activities undertaken in an EPZ is appropriate because the final products are directed to international markets. However, the favorable treatment of income and other direct taxes such as the 20-year income tax holidays and the exemptions from capital gain tax, property and land taxes are questionable.

Many countries exempt firms operating in EPZs from customs duties and domestic indirect taxes, while making the firms operating in the EPZs subject to income taxes. Taiwan is an example of such an arrangement. This recognizes the fact that duty and sales tax exemptions are many times more important than any corporate income tax exemption (Jenkins and Kuo, 2002), and that a modest amount of revenue is required to compensate for the administrative and social costs related to the EPZs.

WTO stipulates that firms operating in free trade zones should be subject to the same income tax rules as the firms serving the domestic market beginning in 2009. Belize is well positioned with its business tax that can be integrated with the corporation income tax for levying a modest tax on the income generated by EPZ firms. For the foreign firms such as those from the U.S., UK, Japan and Taiwan the taxes that are paid in Belize may not be an additional cost to the firms. But instead they may through the foreign income tax credit mechanisms cause a reduction in the taxes these firms pay to their home countries.

It is recommended that in the future new firms entering the EPZ be subject to the corporation income tax at the rates proposed in the section of the Business Tax. For the foreign investors it could create foreign tax credits that could be used to offset their home country taxes.

In this regard, we have three recommendations. First, Customs should administer the tax free goods going into EPZs in the way it would normally administer a tax and duty suspension system. In other words, it should keep a record of the physical quantities and the amount of duty and taxes suspended on all the goods that enter an EPZ, according to the firm operating in the EPZ and by the commodity that is being transferred to the EPZ. In addition, when the firm exports commodities then the quantity and value of the commodity exported should be captured in the customs database. If this information is retained in the information system of Customs then it would be in a position to audit the EPZ firm to determine if the exports have been sufficient to utilize the amounts of inputs that were imported duty free.

Customs currently has a very good data system, and no forms would need to be changed to capture this information. The Customs Brokers would simply have to provide more information on the existing customs entry form. With this information a series of selected audits should be made over the next six months to a year to determine if leakages of tax-free goods are taking place and if they are significant to take measures to stop this behavior. If it is found that a firm is not in compliance, then it should be required to post a customs bond, or bank guarantee for the amount of duty and taxes in suspense for a period until Customs is satisfied that the fraudulent behavior is unlikely to resume.

Second, a prior determination should be made of the fuel requirements for energy generation purposes only. With Customs keeping a record of the amount of fuel entering tax free (or partially tax free) into a zone, they would give credit to the enterprise for the amount used for energy generation only. Only the amount of tax on this quantity of fuel would be permanently suspended, and the remaining amount should be fully taxable. This exemption should be closely monitored.

Third, with the measures related to the WTO regulations in mind, we would recommend that the firms operating in the EPZs, be administered as bonded factories, and the income/business tax applied to the firms in the same fashion as firms serving the domestic market. In almost all countries around the world that have as professional a customs service as Belize, exporting firms are administered according to a system of bonded factories, and not as EPZ. Belize is already most of the way to such a system and should proceed further in that direction. The compliance costs of such a system should be no higher than the existing system, but would close off most avenues for tax fraud in this area.

VII. Commercial Free Zones

The Commercial Free Zone (CFZ) Act was established in 1994. Any private or public companies may establish within a zone warehousing, retail sales, light manufacturing, processing, packaging, and distribution of good and services for international markets. The companies are exempt of import duty on their purchase of fuel and goods used for business, income tax, and capital tax for ten years, as well as tax exemption on dividends paid by a CFZ business. However, a social fee is charged on fuel at 10 percent and on all other goods at 1.5 percent.

The CFZ is essentially provided to offer duty free shopping to Mexicans who cross the border. Residents of Belize are not allowed to purchase goods in the Zone. Such facilities exist solely because of the tax advantages they offer. It is alleged that some sales, for example gasoline, are also being brought back into Belize without paying tax. It is difficult to know the extent of this smuggling, as gasoline when purchased is stored in the fuel tanks of automobiles it is impossible to measure the volume of gasoline that returns to Belize from the Commercial Free Zone. It is also difficult to know what to do about the problem, short of prohibiting the CFZ from selling duty free motor fuels.

A more serious system flaw is the provision that allows a firm in the CFZ to purchase an automobile free of duty and taxes. This should be prohibited as it has been on several occasions an important part of the motivation for the setting up the CFZ firm in the first place.

With the regularization of Mexico's trade laws and tariffs, it is likely that Belize will be pressured to close down this form of cross-border tax avoidance by Mexicans. Most neighboring countries (e.g., Canada, U.S., and Mexico) do not allow tax free gasoline sales even when they are allowing other lower taxed goods to be imported duty free.¹⁸

Until that time comes, we would recommend that the Customs keep a detailed record of the goods that go into the CFZs by commodity and by the firm purchasing the items. This information is an absolute necessity for monitoring or auditing of the firms operating in the CFZ. Such enforcement will likely assist in reducing the amount of fuel sales that end up running automobiles with the rest of the country.

This problem will be partially solved if the import duties are lowered on gasoline while the excise duties are raised to compensate for the lowering of import duties. After that takes place, the excise duties should not be reduced for sales made to anyone in the CFZs.

In the case of income tax, there is no real reason firms operating in CFZs should be exempt of business income tax. We recommend that any new firm entering the CFZ be subject to business tax or income tax so that foreign tax credits can be used to offset their home country taxes.

¹⁸ In fact, Belize and Mexico are currently negotiating a certain amount of goods that would be import duty free and the excess amount would be subject to a flat duty rate.

VIII. Tax Administration

By far the most important tax administrative measure that needs to be undertaken is to formally approve the regulations governing the administration of the sales tax. With the Commissioner of Sales tax being the person responsible for all decisions concerning the exemption of inputs, without formal rules, it will be extremely difficult to maintain the integrity of the system. While the Commissioner of Sales Tax had been coping with a difficult situation, it is important to provide a legal backing to her administrative decisions.

Most of the different tax administrations have a good computerized information system. They are also able to retrieve information in the form of reports fairly easily and supply this information readily to each other upon request. It is important to have modern information technology in place so that the tax information can be retrieved uninterrupted and quickly. So are personnel trained with adequate knowledge and appropriate tool.

It is now the appropriate time to consider electronically linking the information systems of the three departments (i.e., Income Tax, Sales Tax, and Customs and Excise) and developing a taxpayer master file. In order to do this, it will be necessary to issue each taxpayer a unique taxpayer identification number that would be used for all tax and customs transactions. Given the relatively good shape the computer information system is for each of the tax systems and customs, it would be a relatively easy task to take this additional step of data systems integration.

As was previously mentioned, EPZs in Belize appear to be functioning like bonded factories in other countries. To ensure the tax-exempt goods not to leak to the domestic market without paying appropriate taxes, record keeping of goods for coming and leaving the zones must be well maintained.

At the present time, a number of tax administrations around the world are making extensive use of Internet connectivity to allow the taxpayer to interface with the tax system. This is principally done through the on-line filing of tax returns and the payment of taxes via bank transfers. Such a system would improve the accuracy of the information received as the computer can eliminate any arithmetic mistakes and do some consistency checks at the time the taxpayer is inputting his/her data.

If the VAT is to be reintroduced soon in Belize, some transitional rules should be put in place to ensure a smooth transition from the existing sales tax to the VAT. Although the VAT was implemented seven years ago, the tax department still needs administrative machinery ready to implement the invoice credit sales tax system.

Recommendation

1. Belize needs to implement a unique taxpayer identification number system that is the same for all taxes.
2. Belize should integrate the tax administrative information systems of income/business tax, sales tax, customs and excise tax departments so that

different tax liabilities of the same taxpayer can be crosschecked and audited at the same time.

3. An internet-based system should be introduced for each of the tax systems so that the taxpayers can file their tax returns on-line, and pay their taxes through direct transfers from their bank. Such a system would reduce much of the paper load that is chronic to tax administrations, and would also reduce compliance costs.

IX. Conclusions

The Belize tax system has a number of positive features. The personal income tax is designed to remove all the low and middle-income individuals from its base, hence, allowing the administration to concentrate on collections from those with higher incomes. With only a single deduction allowed, and a single tax rate, it is a wonderful example of how simple an individual income tax can be made.

The integration of the business income tax with the business tax is certainly innovative, and has a very solid track record of performance. The business tax is fundamentally a low turnover tax for most activities, while at the same time is an instrument for extracting some economic rents from activities such as banks, and the telephone company, which are regulated. The taxation of professional services, which are extremely difficult to tax under an income tax system, puts them in a similar position to other labor services provided as employees. As an outcome of this review we recommend that the very low rates of business tax be raised somewhat so that the overall revenue performance of the tax can be enhanced. At the same time a rate of 1.75 percent is unlikely to have serious competitive repercussions or cascading effects.

The application of the business tax to foreign investors has two very positive features. First, in its normal application it is not a tax on capital, but on the total output of the enterprise. Hence, it will not cause the same distortions as a corporation income tax. Second, because it is possible to treat it as a withholding tax for the purposes of the corporation income tax, if desired by the taxpayer, it becomes eligible for the foreign tax credit provisions of many of the foreign investor's home countries, such as that of the USA.

The system of taxes on international trade and excise taxes needs to be completely revamped. Excise taxes should be applied to both imports and domestic production of excisable goods. The purpose of these taxes is primarily to raise revenue. The import duties can be greatly reduced to a uniform rate of around 10 per cent, with their eventual level determined by the outcome of the bilateral and multilateral trade negotiations undertaken by Belize. This trade tax reform should include a raising of the rates of duty on those items that are to be consumed locally that are now imported duty free, as well as lowering the higher rates of duty and substituting excise taxes on many of these items. In this way, Belize can be brought into full compliance with the WTO rules without losing any revenues.

A very substantial reform of the import tariff system could be carried out with little overall revenue loss, if the currently zero rate imports were taxed at 5 percent, and excise taxes were used to offset the rate reduction of a 15 excisable groups of

commodities. In the future, import tariffs could be eliminated completely if certain offsetting measures were taken. First, the excise taxes on excisable goods would have to be further adjusted to make up for the revenue on this group of 15 commodities, plus the basic rate of sales tax would have to be increased by more than 50 percent to a rate of tax in the range of 15 to 16 percent. With this high tax rate, a consumption type VAT at a rate of 16 percent must be reintroduced to replace the sales tax in order to continue to finance the programs the Government wishes to undertake.

Because Belize has a small rather uncomplicated economy, the substitution of the import-domestic producer single stage sales tax for the value added tax has worked out better than most would expect. On tax policy and administration grounds, the value added tax is a much superior tax system, and that is why over 120 countries in the world have implemented it in the past 40 years. But in the case of Belize the sales tax is not creating many serious distortions. A major omission from the tax base of the sales tax has been sales of electricity to final consumers. There is no obvious reason why this sector should be favored. While the electricity prices are high in Belize, they should be no higher than any other country that generates its electricity using oil. In almost all of such countries, e.g., North and South Cyprus and the Dominican Republic, electricity sales are subject to domestic indirect taxation.

Perhaps the most appealing strategy is that, if Belize is ready to introduce the proposed comprehensive VAT system along with Phase II trade reform, the VAT rate should be set at 11 percent to replace the sales tax. Then at Phase III trade reform, the VAT rate be raised to 16 percent in order to recover the elimination of import duties as a result of the free trade arrangement with the US.

The administration of the tax system is fairly good for such a small country. It is highly effective with an appropriate number of competent staff. It is a credit to the tax and customs administrations that they were able to adapt to the policy changes of 1998 and 1999 so quickly, without serious revenue consequences. Nevertheless, in order to carry out the task of collecting the revenues for the taxes legislated, the tax administration needs to be given the appropriate tools. Some of the computer facilities are aging and not functioning as it used to be. Personnel also need to be tuned up with modern information technology. In addition, a modern unified tax administration information system also needs to be set up so that the information on all taxes a taxpayer is required is maintained in a single master file. A modern tax management information system can then provide policy decision makers adequate and most up-to-date information. If the tax system continues to be adjusted to meet the changes in economic circumstances, and adequate resources are provided for its administration, it should continue to perform in an effective manner in the future.

The summary of various proposals and their revenue implications are presented below.

Major Tax Systems	Recommendations	Impact on Annual Revenue in 2004 prices
Business Tax	<ul style="list-style-type: none"> ▪ Raise tax rates on the following groups: <ul style="list-style-type: none"> - professional receipts from 6% to 15% - public investment company from 8% to 15% - receipts that are currently taxed at rates of 0.75% to 1.75% ▪ Amend the Fiscal Incentives Act to eliminate tax holiday for the business Tax ▪ Impose the business tax on new entrants to EPZs ▪ Impose the business tax on new entrants to EPZs 	<ul style="list-style-type: none"> ▪ Raise BZ\$17m for rate changes ▪ Eliminate potential negative effect ▪ Positive effect ▪ Positive effect
Sales Tax	<ul style="list-style-type: none"> ▪ Issue regulations for the administration of the sales tax ▪ Impose the sales tax on electricity sales to households at 9% 	<ul style="list-style-type: none"> ▪ Protect tax revenues ▪ Raise BZ\$5.5m
Reintroduction of a VAT	<ul style="list-style-type: none"> ▪ Reintroduce a VAT at 11% to replace the Sales Tax at the same time as Trade Reform Phase II ▪ Raise the VAT rate to 16% at the same time as Trade Reform III 	<ul style="list-style-type: none"> ▪ Loss of BZ\$6 m ▪ Gains of BZ\$50 m
Tariff Reforms	<ul style="list-style-type: none"> ▪ Simplify tariff structure (including elimination of the revenue replacement duty) ▪ Remove import duty exemptions for some specific end-use organizations <p>Tariff Reform for Non-Excisable goods:</p> <ul style="list-style-type: none"> ▪ Phase I: import duty rates consolidated to 5, 10, and 15% ▪ Phase II: import duty rates consolidated to a single 10% ▪ Phase III: eliminate all import duties <p>Tariff Reform for Excisable goods:</p> <ul style="list-style-type: none"> ▪ Phase I: impose import duty rate at 10% and adjust excise tax rates to keep the prices to consumers unchanged ▪ Phase II: the same as Phase I ▪ Phase III: eliminate import duty and adjust the excise tax rates to keep the prices to consumers unchanged 	<ul style="list-style-type: none"> ▪ Positive effect ▪ Gain of BZ\$9.7m ▪ Revenue neutral ▪ Gain of BZ\$9.2 m ▪ Loss of BZ\$50m ▪ Revenue neutral ▪ Unchanged ▪ Revenue neutral
Export Processing Zones	<ul style="list-style-type: none"> ▪ Impose the business tax on firms operating in the EPZs at the proposed rates ▪ Provide no duty or sales tax exemption for fuels 	<ul style="list-style-type: none"> ▪ Positive effect ▪ Protect revenues
Commercial Free Zones	<ul style="list-style-type: none"> ▪ Impose the business tax on firms operating in the CFZs at the proposed rates 	<ul style="list-style-type: none"> ▪ Positive effect
Tax Administration	<ul style="list-style-type: none"> ▪ Implement a unique taxpayer identification number system ▪ Tight administration of EPZs ▪ Integrate the tax administrative information systems ▪ Introduce an internet-based system 	<ul style="list-style-type: none"> ▪ Minimize leakage ▪ Positive effect ▪ Protect tax revenues ▪ Provide taxpayer services

REFERENCES

- Belize, Ministry of finance, Tax and Non-Tax Revenues, (2002).
- Belize, Ministry of Finance, Central Statistical Office, Household Expenditure Survey 1990, Preliminary Results, (January 1993).
- Belize, Ministry of Finance, Central Statistical Office, Abstract of Statistics, 2004.
- Belize, Ministry of Finance, Central Statistical Office, Special Requests.
- Belize Customs and Excise Department, Instruction Booklet for Completion of the Customs declaration (Import/Export) Form C-100.
- Belize, Law Revision Commissioner, Excise Duties Act, Chapter 48, Revised Edition 2000, (December 2000).
- Belize, Law Revision Commissioner, Customs Regulation Act, Chapter 49, Revised Edition 2000, (December 2000).
- Belize, Law Revision Commissioner, Income and Business Tax Act, Chapter 55, Revised Edition 2000, (December 2000).
- Belize, Law Revision Commissioner, Sales Tax Act, Chapter 63, Revised Edition 2000, (December 2000).
- Central Bank of Belize, Twentieth Annual Report and Accounts, (Annual 2002).
- Central Bank of Belize, Understanding our Economy, (July 1999).
- Garber, Harry D. and David G. Raboy, "Value-Added Taxation of Financial Services", edited by Murray L. Weidenbaum, David G. Raboy and Ernest S. Christian, *The Value-Added Tax: Orthodoxy and New Thinking*, (Boston/Dordrecht/London: Kluwer Academic Publishers, 1989).
- Jenkins, Glenn P. and Chun-Yan Kuo, "Information, Corruption, and Measures for the Promotion of Manufactured Exports", paper prepared at the Tenth Annual Villa Colombella Group Conference, (September 2002).
- Jenkins, Glenn P. and Chun-Yan Kuo, Belize Fiscal Study, report prepared for Inter-American Development Bank, (September 2002) (not published).
- KPMG, "Review of Tax Exemptions and Offshore Financial Services", (November 2000).
- Tax Reform Committee, Recommendations on Tax Policy and Administration, report prepared for Cabinet-Government of Belize, (December 22, 1998).