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CARIBBEAN REGIONAL TECHNICAL ASSISTANCE CENTER

BERMUDA

Reforming the Tax system and Its Administration for Fiscal Consolidation

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TABLE OF CONTENTS

Tables

Figures

ABBREVIATIONS AND ACRONYMS

ARV	Annual Rental Value
CARTAC	Caribbean Regional Technical Assistance Center
CPF	Contributory Pensions Fund
DSI	Department of Social Insurance
FAD	Fiscal Affairs Department
FY	Fiscal year
GDP	Gross Domestic Product
HQ	Headquarters
IMF	International Monetary Fund
IT	Information Technology
MOF	Ministry of Finance
OTC	Office of the Tax Commissioner
PAYE	Pay-As-You-Earn
RA-FIT	Revenue Administration Fiscal Information Tool
TA	Technical Assistance
TC	Tax Commissioner
TRL	Tax on the remuneration of labor

EXECUTIVE SUMMARY

Bermuda's economy is service-based and very open, thus, very vulnerable to external shocks. In the aftermath of the global economic crisis, economic activity has been contracting since 2009. As a consequence, there has been a reduction in revenues and deficit in government accounts. Despite some rationalization of expenditures, the projected result for fiscal year (FY) 2015/16 is a deficit around $220 million, almost 4 percent of GDP. Authorities would like to explore options for increasing tax revenues. They estimate that a tax reform that would bring about permanent additional revenue of $100 to $150 million, phased in three fiscal years starting in FY 2016/17, is necessary in order to balance the budget.

Tax revenue accounted for almost 90 percent of government revenue in recent years and has been declining in real terms. In FY 2014/15, tax revenue was almost 20 percent lower than in FY 2010/11. The most important tax is the payroll tax, followed by the import duty. Other important taxes are the land tax and the tax on international companies, which consists of a set of fees which values depend on the capital of the international company (also known as exempted company) and on the activities carried on by the company. These four taxes account for about 72 percent of the total tax revenue.

Authorities prefer a tax reform that will increase the revenue provided by the existing taxes though they are open to proposals that would expand the tax base and improve equity. They do not want to increase the size of the tax administration but rather improve its efficiency and simplify compliance. Therefore, they rule out the introduction of a full-fledge income tax or a value-added tax. Given this guidance, the mission concentrated its effort on analyzing taxation of labor remuneration, of goods and services and of property, and reorganization of the tax administration. It also verified that, compared to other countries, there are few domestic concessions, and that most import duty concessions are related to investment. There are only two important exceptions. First, the rates of the payroll tax on hotels, retailers, and restaurants are reduced during off-season months. The ministry of Finance estimates that the revenue forgone due to this tax relief amounts to $31 million per year. The second is a tax break for fuel imported by the electricity company that amounts to $27 million per year. In a time when there is need for a strong fiscal adjustment, both tax expenditures should be phased out.

Labor income is subject to the payroll tax and to a contribution to the pension fund controlled and managed by the Ministry of Finance. The payroll tax is charged on remunerations (or deemed remunerations) paid by employers to the employees (or deemed employees) during the tax period and on the deemed remunerations of self-employed persons. Employers are liable for the tax but may deduct 5.5 percent of employees' remunerations from the payments made to them. There is a standard rate—currently 14.5 percent—but several other rates apply depending on size of the payroll and type of business. The contributions to the pension fund take the form of a fixed amount per week per employee. The current rate is $32.07 per week for both the employee's and the employer's contributions and $64.14 per week in the case of self-employed persons and voluntary contributors.

An important shortcoming of the payroll tax is the multiplicity of rates. It may stimulate inefficient local company splitting in order to reduce the tax burden, does not contribute to equity and may, in fact, create horizontal inequity. While multiple rates on employers' payrolls may be harmful rather than beneficial to equity, a progressive rate schedule on the remuneration of employees may improve equity. It will improve if employees are unable to shift all or, at least, part of the tax burden to employers. As this is a probable outcome, the mission recommends the adoption of the progressive tax on the remuneration of labor, and concomitant reduction of the payroll tax burden while repealing the authorization to employers for deducting 5.5% of the remuneration paid to employees. As a major objective is to boost revenue, the mission recommends that this reform be revenue-increasing rather than revenue neutral.

The proposed reform of the payroll tax is also an opportunity to improve other features of the tax. First, the ceiling on remuneration that integrates the payroll tax base ($750,000 per year) should be removed. Second, the deduction of $600 per employee for employers who are subject to a rate of 10.25 percent or higher is an unnecessary complication. A reduction in the rates would obtain similar result in a simpler way. Third, the incentive for new Bermudian hires is of difficult control to prevent fraud and according to private sector representatives who met the mission, it is of little importance for the business community. The incentive may be discontinued when it expires at the end of the current fiscal year.

The concept of notional remuneration of deemed employees and self-employed persons may be an important loophole as it is practically impossible for the Office of the Tax Commissioner (OTC) to make a judgment on the fairness of the taxpayer's valuation and taxpayers are well aware of such weakness. Though no short term solution for this problem is feasible, it can be mitigated in the medium term by replacing the subjective criteria established in the Payroll Tax

Act by more objective rules. One possible solution is a procedure similar to those used by Nordic countries to separate capital and labor income for purpose of their dual income taxes.

Bermuda's indirect taxation system is implemented through customs duties on imports and taxes on selected services including some business services, hotel occupancy and telecommunications. The customs tariff acts as a general revenue raiser, a tax on certain final consumptions goods, an excise on tobacco, alcohol and motor vehicles and provides protection to local domestic producers. Introducing a broad-based consumption tax would reduce distortions to domestic production of goods and services and to relative prices in consumer goods and services and provide a stable source of revenue. Given limited domestic production of goods, converting the current customs tariff to a low rate uniform rate tariff, with capital goods zero-rated, would provide protection to domestic industry and provide revenue for the budget.

Capacity and systems constraints in tax administration and customs suggest the need for imposing a unified single rate tax at customs on all goods except capital goods. The tax rate would include a unified customs duty, the sales tax on goods rate and take into account retail margins. Combined with the sales tax on most services, except financial, education, health and social services, serves as a transitional step to the introduction of a broad based tax on goods and services like a value added-tax in the longer-term. The current implicit excises in the customs tariff could be modestly increased in the short-run to address fiscal needs.

Bermuda taxes property through two basic channels: the land tax and property transaction taxes and fees. The land tax is imposed on the annual rental value of dwellings under a progressive rate structure with seven rental value bands and commercial property with a lower single rate. Neither equity nor efficiency is enhanced through a complex rate structure. In terms of equity, reducing the effective tax rate for some property holders simply means that others will face higher taxes if the same revenue target is to be met. In addition, taxing non-residential property differently than residential property can distort land use decisions and is inefficient. Transitioning the current rate structure to a three rate structure for residential property will mitigate current economic inefficiencies and can increase revenue.

The property transactions and registration fees are composed of three different taxes, each of which is based on a different law and is applied at different rates depending on the value of the property and the characteristics of the purchaser. The need for buyers to register their purchases and the visibility of property are advantages of collecting property transfer taxes. However, the combined maximum statutory rate for transactions taxes are high by international standards, may increase economic costs as land is not used in the best way, and could contribute to evasion and avoidance weakening confidence in the tax system. Combining the three taxes into a single tax with a single rate on a revenue neutral basis will mitigate efficiency costs of the current land transfer tax system.

OTC faces typical challenges of small and micro-administrations which essentially relate to the limitation of its manpower (25 staff allocated against 29 job positions). OTC performances, reflected by a relatively low level of compliance, are already constrained by these limitations. The reform of the tax system will inevitably aggravate this situation. While the workload will increase, OTC workforce is unlikely to progress proportionally given the on-going government efforts to reduce the civil service size and spending. To improve its effectiveness and efficiency, OTC will have no choice but to re-structure its organization, apply risk management principles and automate its processes.

To address the existing duplication, overlap and fragmentation of functions responsible for additional administrative costs and unnecessary compliance burden for the taxpayers, OTC will have to re-structure its organization. This involves: shifting from a tax-based to a function-based structure; separating central functions and field operations and establishing strong headquarters; integrating the administration of taxes which is split between different organizations; and re-organizing field delivery along taxpayer segments. This re-structuring could help re-deploy resources from other government agencies currently involved in tax administration functions to OTC such as the Land Valuation Office.

OTC is not "enforcement minded". As a result, compliance culture and performance are relatively low. There is an urgent need for OTC to improve its service delivery and to implement enforcement programs. This requires strategies enabling an optimal utilization of its limited resources. These include: adopting risk management, automating and streamlining the business processes and enhancing cooperation with other government agencies to develop the necessary synergies.

Mission Recommendations

Tax Policy

Short-term

Tax Concessions

- Phase out the payroll tax rate concession for hotels, retailers and restaurants and the import duty concession for fuels along the next three fiscal years.
- Continue to stimulate the investment phase of businesses but avoid tax concessions for their operations and results.

Payroll Tax

- Repeal the authorization to employers for deducting 5.5% of the remuneration paid to employees.
- Reduce the rates of the payroll tax.
- Remove the ceiling ($750,000) on the payroll tax base.
- Eliminate the special relief ($600 per employee) granted to taxpayers who are subject to high rates.
- Let the incentive for new Bermudian hires expire.
- Institute and start charging a tax on the remuneration of labor (TRL) in FY 2016/2017.
- Set rates for both taxes so that they render a revenue increasing reform.
- Use the Department of Social Insurance registers to collect TRL and to improve control of the payroll tax.
- Use employers as tax agents to withhold TRL.
- Require taxpayers who are exempted undertakings and those whose annual payroll is greater than $1,000,000 to file returns and pay TRL monthly; require all other to file and pay quarterly.

Taxation of goods and services

- Increase excises for the 2016/17 fiscal year to increase revenue by $15 million.
- Place a moratorium on the introduction of new stamp duties and Government fees and develop policy guidance for Ministries and Agencies for the review and approval of all existing stamp duties and Government fees based on cost of service, transparency of stamp duty and fee setting and efficiency of service delivery.

Taxation of property

- Combine the property registration fee, the non-Bermudian property acquisition licenses and stamp duty on property transfer into a unified single rate applied to the conveyance or transfer of property.
- Increase current residential tax rates by 2 percentage points and commercial and tourist property tax rates by 1.5 percentage points to mobilize modest revenue and offset declines in ARV assessed values in 2015.
- Convert the current seven band annual Land Tax rate structure to one with three rates, with a single rate applying to tourist and commercial property, over a three-year period beginning in 2016/17.

Medium-term

Payroll Tax

- Increase slightly the payroll tax rates while harmonizing them.
- Include in the base of TRL several benefits provided by employers that are excluded from the base of the payroll tax, such as contributions to the Contributory Pensions Fund and health insurance.
- Require that, from FY 2020/21 on, self-employed persons over a given size (defined by the value of their assets and/or expenses and/or rental value of the space occupied) estimate the notional remuneration to labor according to one of the methods presented in Box 1 of the text.

Taxes on goods and services

- Commence preparations for the introduction of a single unified tariff and sales tax on goods early in FY 2016/17.
- Replace the current customs tariff with a single unified tariff and sales tax on goods at a rate of 9.5 percent at FY 2017/18.
- Commence preparations for the extension of the sales tax to services early in FY 2017/18.
- Introduce a 5 percent sales tax on turnover from the provision of most services excluding health, education, social, financial and exported services to take effect at the beginning of FY 2018/19. Small service providers should be exempted from the tax.
- Require the 100 largest taxpayers to file and pay tax on services monthly and all others to file and pay quarterly.

Taxation of property

- Shorten the reassessment period of properties from five years to three years and consider undertaking an assessment of 1/3 of properties each year so that the cadaster is assessed fully every three years.

Long-term

Payroll Tax

- Gradually transform TRL into a dual personal income tax by introducing flat rate withholding taxes on different types of capital income.

Taxation of goods and services

- Consider transforming the sales tax on imported goods and on services to a broad based tax on final domestic consumption that does not tax intermediate consumption or exports, such as a VAT with a single rate, with crediting for input tax and zero rating of exports.

Tax Administration

Re-structuring the current organization

- Re-organize OTC by functions.
- Separate central from operational functions, and develop headquarters functions by establishing a design planning and monitoring unit.
- Integrate the administration of all taxes into OTC (starting with the Land tax),
- Re-organize field delivery along taxpayer segments and design specific programs for large/ medium and for small taxpayers.

Working smarter in Improving taxpayer compliance

- Adopt risk management principles.
- Improve taxpayer service delivery capitalizing on new technologies and on-line transactions.
- Re-allocate resources to the audit team and develop and audit programs targeting the highest risks.
- Accelerate the collection of collectable debts and rejuvenate the stock of arrears. In the medium term revisit existing procedures to give more enforcement power to OTC.

- Increase collaboration and cooperation with other government agencies starting with automatic and systematic exchange of data.

Other selected issues

- Undertake a comprehensive staffing and training needs assessment and integrate HR program to OTC overall strategy.

- Build training capacity by capitalizing on bilateral and/or multilateral assistance.

- Improve reporting requirements, develop key performance indicators and set service standards to improve performance management.

- Use the other available performance management tools RA-FIT and TADAT.

In response to a request from Mr. Anthony Manders, Financial Secretary of the Ministry of Finance, a CARTAC tax policy and tax administration mission visited Hamilton, Bermuda, from September 29 to October 12, 2015 to undertake a comprehensive review of the tax system and its administration. The mission comprised Mrs. Ricardo Varsano (head), and Ronald McMorran both tax policy experts and Mr. Stephane Schlotterbeck (CARTAC) tax administration advisor.

The mission met with the Honorable E.T. (Bob) Richards, Minister of Finance, Mr. Anthony Manders, Financial Secretary, Mr. Stephen Gift, Assistant Financial Secretary, Mr. Hasan Durham, Economic Advisor for the Ministry of Finance, Ms. Lucia Peniston and Michelle Hunt, Tax Commissioner and Acting Tax Commissioner, respectively, Ms. Melinda Williams, Director of the Department of Statistics, Ms. Lucinda Pearman, Collector of Customs, Mr. William G. Francis, Permanent Secretary of the Ministry of Economic Development, Mr. Stephen Lowe, Registrar of Companies, Ms. Karen Daniels, Director of the Department of Social Insurance, and other senior officials of the mentioned institutions. The mission also met with representatives of The Bermuda Chamber of Commerce, The Bermuda Hotel Association, The Hotel Employers of Bermuda, Association of Bermuda Insurers and Reinsurers, Deloitte Ltd., and KPMG.

Finally, the mission is grateful for the support and assistance provided by senior officials and staff of the mentioned institutions who took time to meet and prepare the data that it requested, and wishes to thank the authorities and all Bermudians for their hospitality.

INTRODUCTION

A. Purpose of the Mission and Content of the Report

1. In the aftermath of the global financial crisis, the Government of Bermuda has experienced persistent fiscal deficits and growing debt. The authorities have been pursuing fiscal consolidation efforts with a particular emphasis on spending rationalization. They would now like to explore options for increasing tax revenues. The purpose of this mission was to assist the authorities in developing options for reforming the tax system and its administration in order to enhance revenue and enable the tax administration to cope with policy changes and improve existing operations.

2. In its search for reform options, the mission undertook a comprehensive review of the tax system and its administration following the guidance of the Ministry of Finance (MOF), which includes:

a) The reform should bring about permanent additional revenue of $100 to $150 million;

b) The revenue-raising measures should be phased in along three fiscal years starting in FY 2016/17;

c) The tax administration size should not increase;

d) To accomplish (c), the reform proposal should avoid introduction of new taxes or complication of existing ones. Specifically, the mission should not consider introducing a general income tax on individuals, a profit tax on companies or a value-added tax;

e) Notwithstanding (d), the mission should explore the possibility of introducing a single-stage sales tax and of improving equity of the tax system.

3. The remaining of this chapter provides a brief background on economic activity in Bermuda, tax revenue, and existing tax concession. Chapter 2 considers taxation of income (currently only the payroll tax), Chapter 3 analyses taxation of goods and services, Chapter 4 examines property taxation, and chapter 5 discusses tax administration issues.

B. Background: Bermuda's Economic Activity and Government Budget

4. Bermuda's economy is service-based and very open. The agricultural and manufacturing sector account for only 0.8 and 1.1 percent of total value added, respectively, and have lost relative importance in recent years (Table 1). Most of the goods consumed in Bermuda are imported and very few goods are exported (Table 2). The service account surplus partly compensates the trade deficit and capital inflows bring about the balance. Therefore, the economy is very vulnerable to external shocks. The most important activities are international business—essentially insurance and reinsurance—, financial intermediation, real estate and renting activities, and business services. In total they account for more than 50 percent of the gross domestic product (GDP).

5. Economic activity in Bermuda has been contracting since 2009 in the aftermath of the global economic crisis. From 2011 on, real GDP has been falling at declining rates (Table 1) and authorities expect that it will stabilize in 2015 and grow from 2016. A consequence of the decline in GDP has been a reduction in revenues and deficit in government accounts. Rationalization of expenditures was able to contain the deficit. Yet, the projected result for fiscal year (FY) 2015/16 is a deficit of around $220 million, that is, almost 4 percent of GDP.

Table 1. Gross domestic product and participation of the industries in value added

($1000)

Item	2010	2011	2012	2013	2014
GDP at current market price	5,855,331	5,620,380	5,584,319	5,639,720	5,651,289
GDP at constant market price (2006 = 100)	5,145,154	4,917,447	4,723,828	4,610,760	4,590,547
Rate of growth of GDP (percent)	-2.5	-4.4	-3.9	-2.4	-0.4
Industry share in total value-added (percent)					
Agriculture, forestry and fishing	0.9	0.9	0.9	0.9	0.8
Manufacturing	1.5	1.4	1.3	1.2	1.1
Electricity, gas and water supply	1.7	1.9	1.8	1.8	1.8
Construction	4.2	3.4	3.1	2.9	3.2
Wholesale and retail trade and repair serv.	6.2	6.0	6.1	6.1	6.2
Hotels and restaurants	4.5	4.7	4.9	4.6	4.2
Transport and communications	4.9	4.8	4.7	5.0	5.1
Financial intermediation	12.9	13.7	13.4	13.8	13.3
Real estate and renting activities	15.8	16.1	16.5	16.7	16.9
Business activities	8.4	8.7	8.5	8.1	8.2

Public Administration	5.4	5.2	5.5	5.6	5.4
Education, health and social work	6.7	6.8	7.1	7.1	6.7
Other community, social and personal serv.	1.9	1.9	1.9	1.8	1.7
International business activity	25.0	24.5	24.2	24.2	25.3

Source: Department of Statistics

Table 2. Balance of payment and inflation

Item	2010	2011	2012	2013	2014
Balance of payments statistics ($1000)					
Exports of goods	14,997	12,673	11,013	13,036	10,679
Imports of goods	972,221	900,409	900,357	1,011,522	967,970
Exports of services	1,399,350	1,469,304	1,395,995	1,369,414	1,377,257
Imports of services	967,382	936,831	943,452	941,428	981,586
Consumer price index (April 2006 = 100)					
Annual average index	113.7	116.8	119.6	121.8	124.2
Inflation (%)	2.4	2.7	2.4	1.8	2.0

Source: Department of Statistics

C. Tax Revenue and Tax concessions

6. Tax revenue accounted in recent years for almost 90 percent of government revenue (Table 3). The tax to GDP ratio has increased slightly since FY 2011/12 but only because real revenue declined less than real GDP. In real terms, tax revenue was in FY 2014/15 almost 20 percent lower than in FY 2010/11.

7. As shown in Table 3, the most important tax is the payroll tax, followed by the import duty. Other important taxes are the land tax, which in fact is a tax on the annual rental value (ARV) of land, building or part of a building capable beneficial occupation, and the tax on international companies, which consists on a set of fees which values depend on the capital of the international company (also known as exempted company) and on the activities carried on by the company. These four taxes account for about 72 percent of the tax revenue. Non-tax revenue comprises a large number of fees,[1] and receipts from services provided by the government, like postal services, and ferry and bus transportation.

[1] The Government Fees Regulations 1976 schedule contains 71 heads, each with several different fees. Most of the heads of the stamp duty also comprise fees, but the bulk of the revenue comes from heads that specify property transfer taxes. For this reason, this report classifies it as a tax.

Table 3: Government revenue structure

Revenues	2010/11	2011/12	2012/13	2013/14	2014/15 1/	2015/16 2/
Thousands of Bermudian Dollars						
Total revenue	**990,795**	**914,182**	**866,578**	**883,915**	**875,863**	**931,298**
Tax revenue	**891,410**	**792,929**	**754,482**	**764,927**	**767,977**	**819,497**
Taxes on companies	64,777	63,257	64,972	65,283	58,849	63,620
International companies	61,456	60,479	62,163	62,474	56,199	60,820
Local companies	3,321	2,778	2,809	2,809	2,650	2,800
Payroll tax	423,050	344,702	328,023	330,848	335,780	353,363
Taxes on goods and services	218,688	209,088	196,696	199,053	201,745	216,246
Custom duties	195,807	180,697	169,693	174,951	176,000	187,409
Corporate service tax	3,298	3,244	3,185	4,687	4,500	5,467
Hotel occupancy tax	7,028	10,907	10,002	9,195	10,500	11,000
Timesharing tax	57	579	169	189	15	110
Telecommunications fees	12,498	13,661	13,647	10,031	10,730	12,260
Land tax	49,131	52,313	55,845	60,477	59,000	63,186
Stamp duty	35,362	25,113	18,754	21,379	20,790	21,500
Other taxes	100,402	98,456	90,192	87,887	91,813	101,582
Betting tax	1,365	1,487	1,544	1,540	1,600	1,075
Sales of land to non-Bermudians	15,397	12,121	5,967	4,938	9,994	9,983
Passenger tax	32,345	35,069	34,578	33,921	33,410	42,294
Foreign currency purchase tax	24,712	23,107	22,072	20,823	20,000	21,000
Vehicle license and registration	26,583	26,672	26,031	26,665	26,809	27,230
Non-tax revenue	**99,385**	**121,253**	**112,096**	**118,988**	**107,886**	**111,801**
Percent of total revenue						
Total revenue	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Tax revenue	**90.0**	**86.7**	**87.1**	**86.5**	**87.7**	**88.0**
Taxes on companies	6.5	6.9	7.5	7.4	6.7	6.8
International companies	6.2	6.6	7.2	7.1	6.4	6.5
Local companies	0.3	0.3	0.3	0.3	0.3	0.3
Payroll tax	42.7	37.7	37.9	37.4	38.3	37.9
Taxes on good and services	22.1	22.9	22.7	22.5	23.0	23.2
Custom duties	19.8	19.8	19.6	19.8	20.1	20.1
Corporate service tax	0.3	0.4	0.4	0.5	0.5	0.6
Hotel occupancy tax	0.7	1.2	1.2	1.0	1.2	1.2
Timesharing tax	0.0	0.1	0.0	0.0	0.0	0.0

Telecommunications fees	1.3	1.5	1.6	1.1	1.2	1.3
Land tax	5.0	5.7	6.4	6.8	6.7	6.8
Stamp duty	3.6	2.7	2.2	2.4	2.4	2.3
Other taxes	10.1	10.8	10.4	9.9	10.5	10.9
Betting tax	0.1	0.2	0.2	0.2	0.2	0.1
Sales of land to non-Bermudians	1.6	1.3	0.7	0.6	1.1	1.1
Passenger tax	3.3	3.8	4.0	3.8	3.8	4.5
Foreign currency purchase tax	2.5	2.5	2.5	2.4	2.3	2.3
Vehicle license and registration	2.7	2.9	3.0	3.0	3.1	2.9
Non-tax revenue	**10.0**	**13.3**	**12.9**	**13.5**	**12.3**	**12.0**

Source: MOF.

1/ Estimated by the MOF.

2/ Projected by the MOF. For tax to GDP ratio the mission assumed that nominal GDP will increase by 2 percent in relation to the previous year.

Revenues	**2010/11**	**2011/12**	**2012/13**	**2013/14**	**2014/15 1/**	**2015/16 2/**
			Percent of GDP			
Total revenue	**16.9**	**16.3**	**15.5**	**15.7**	**15.5**	**16.2**
Tax revenue	**15.2**	**14.1**	**13.5**	**13.6**	**13.6**	**14.2**
Taxes on companies	1.1	1.1	1.2	1.2	1.0	1.1
International companies	1.0	1.1	1.1	1.1	1.0	1.1
Local companies	0.1	0.0	0.1	0.0	0.0	0.0
Payroll tax	7.2	6.1	5.9	5.9	5.9	6.1
Taxes on good and services	3.7	3.7	3.5	3.5	3.6	3.8
Custom duties	3.3	3.2	3.0	3.1	3.1	3.3
Corporate service tax	0.1	0.1	0.1	0.1	0.1	0.1
Hotel occupancy tax	0.1	0.2	0.2	0.2	0.2	0.2
Timesharing tax	0.0	0.0	0.0	0.0	0.0	0.0
Telecommunications fees	0.2	0.2	0.2	0.2	0.2	0.2
Land tax	0.8	0.9	1.0	1.1	1.0	1.1
Stamp duty	0.6	0.4	0.3	0.4	0.4	0.4
Other taxes	1.7	1.8	1.6	1.6	1.6	1.8
Betting tax	0.0	0.0	0.0	0.0	0.0	0.0
Sales of land to non-Bermudians	0.3	0.2	0.1	0.1	0.2	0.2
Passenger tax	0.6	0.6	0.6	0.6	0.6	0.7
Foreign currency purchase	0.4	0.4	0.4	0.4	0.4	0.4
Vehicle license and registration	0.5	0.5	0.5	0.5	0.5	0.5

Non-tax revenue	**1.7**	**2.2**	**2.0**	**2.1**	**1.9**	**1.9**

Source: MOF.
1/ Estimated by the MOF.
2/ Projected by the MOF. For tax to GDP ratio the mission assumed that nominal GDP will increase by 2 percent in relation to the previous year.

8. Compared to other countries, there are few domestic tax concessions in Bermuda, most of them granted to hotels. The only important domestic tax concession in regard to revenue forgone is the payroll rate reduction for hotels, retailers, and restaurants during off-season months. MOF estimates that the revenue forgone due to this tax relief amounts to $31 million per year.

9. Tax concessions are important in the case of import duties (Table 4) but most are related to the importation of capital goods. In the case of furniture and electric and electronic appliances, most of the concessions are for hotels; and in the case of vehicles they are for taxis and emergency vehicles. However, the tax concessions related to fuel are by far the most important. They amount to more than $27 million both in FY 2013/14 and 2014/15 and there is practically a single beneficiary, the electricity company (BELCO). This tax expenditure is equivalent to a subsidy to electric power that may be benefiting electric energy consumers or the owners of BELCO, a private unregulated monopoly.

10. In a time when budget unbalance is a threat to economic stability, authorities should consider phasing out both the benefits to BELCO and to hotels, retailers, and restaurants along the next three fiscal years.

D. Recommendation

- Phase out the payroll tax rate concession for hotels, retailers and restaurants and the import duty concession for fuels along the next three fiscal years.

- Continue to stimulate the investment phase of businesses but avoid tax concessions for their operations and results.

Table 4. Tax concessions: chapters of the tariff schedule in which concessions exceeds 1 percent of total revenue forgone either in FY 2013/14 or FY 2014/15

($1,000)

Chapter	Chapter Description	Value of Imports	Duty Paid	Duty According to Tariff Schedule	Revenue Forgone	Revenue Forgone / Calculated Duty (%)	Rev. Forg. / Total Rev. Forg. (%)
	FY 2013/14						
27	MINERAL FUELS, MINERAL OILS AND PRODUCTS OF THEIR DISTILLATION; BITUMINOUS SUBSTANCES; MINERAL WAXES.	120,633	39,738	66,995	27,257	40.7	51.8
39	PLASTICS AND ARTICLES THEREOF.	22,773	3,705	4,639	935	20.1	1.8
68	ARTICLES OF STONE, PLASTER, CEMENT, ASBESTOS, MICA OR SIMILAR MATERIALS.	10,275	929	2,287	1,358	59.4	2.6
73	ARTICLES OF IRON OR STEEL.	19,368	2,068	4,230	2,162	51.1	4.1
84	NUCLEAR REACTORS, BOILERS, MACHINERY AND MECHANICAL APPLIANCES; PARTS THEREOF.	61,873	8,873	14,912	6,040	40.5	11.5
85	ELECTRICAL MACHINERY AND EQUIPMENT AND PARTS THEREOF; SOUND RECORDERS AND REPRODUCERS, TELEVISION IMAGE AND SOUND RECORDERS AND REPRODUCERS, AND PARTS AND ACCESSORIES OF SUCH ARTICLES.	53,636	7,606	11,706	4,099	35.0	7.8
87	VEHICLES OTHER THAN RAILWAY OR TRAMWAY ROLLING-STOCK, AND PARTS AND ACCESSORIES THEREOF.	27,621	15,149	16,809	1,660	9.9	3.2
89	SHIPS, BOATS AND FLOATING STRUCTURES.	9,042	1,505	2,260	754	33.4	1.4
90	OPTICAL, PHOTOGRAPHIC, CINEMATOGRAPHIC, MEASURING, CHECKING, PRECISION, MEDICAL OR SURGICAL INSTRUMENTS AND APPARATUS; PARTS AND ACCESSORIES THEREOF.	11,435	1,176	1,939	763	39.4	1.5
94	FURNITURE; BEDDING, MATTRESSES, MATTRESS SUPPORTS, CUSHIONS AND SIMILAR STUFFED FURNISHINGS; LAMPS AND LIGHTING FITTINGS, NOT ELSEWHERE SPECIFIED OR INCLUDED; ILLUMINATED	38,235	6,151	8,288	2,137	25.8	4.1

	SIGNS, ILLUMINATED NAME-PLATE						
98	ACCOMPANIED PERSONAL GOODS; SIMPLIFIED TARIFF FOR GOODS IMPORTED BY POST OR BY A COURIER SERVICE.	112,905	15,834	16,941	1,106	6.5	2.1
	TOTAL	487,797	102,734	151,005	48,270	32.0	91.8

Table 4 (continued). Tax concessions: chapters of the tariff schedule in which concessions exceeds 1 percent of total revenue forgone either in FY 2013/14 or FY 2014/15

($1,000)

Chapter	Chapter Description	Value of Imports	Duty Paid	Duty According to Tariff Schedule	Revenue Forgone	Revenue Forgone / Calculated Duty (%)	Rev. Forg. / Total Rev. Forg. (%)
	FY 2014/15						
27	MINERAL FUELS, MINERAL OILS AND PRODUCTS OF THEIR DISTILLATION; BITUMINOUS SUBSTANCES; MINERAL WAXES.	112,348	39,434	66,997	27,564	41.1	55.9
39	PLASTICS AND ARTICLES THEREOF.	22,010	3,970	4,467	498	11.1	1.0
68	ARTICLES OF STONE, PLASTER, CEMENT, ASBESTOS, MICA OR SIMILAR MATERIALS.	4,870	940	1,085	145	13.4	0.3
73	ARTICLES OF IRON OR STEEL.	13,605	2,209	2,967	758	25.5	1.5
84	NUCLEAR REACTORS, BOILERS, MACHINERY AND MECHANICAL APPLIANCES; PARTS THEREOF.	58,519	8,919	14,172	5,253	37.1	10.6
85	ELECTRICAL MACHINERY AND EQUIPMENT AND PARTS THEREOF; SOUND RECORDERS AND REPRODUCERS, TELEVISION IMAGE AND SOUND RECORDERS AND REPRODUCERS, AND PARTS AND ACCESSORIES OF SUCH ARTICLES.	48,894	7,009	10,556	3,547	33.6	7.2
87	VEHICLES OTHER THAN RAILWAY OR TRAMWAY ROLLING-STOCK, AND PARTS AND ACCESSORIES	30,876	17,202	19,089	1,887	9.9	3.8

	THEREOF.						
89	SHIPS, BOATS AND FLOATING STRUCTURES.	9,154	1,438	2,352	914	38.8	1.9
90	OPTICAL, PHOTOGRAPHIC, CINEMATOGRAPHIC, MEASURING, CHECKING, PRECISION, MEDICAL OR SURGICAL INSTRUMENTS AND APPARATUS; PARTS AND ACCESSORIES THEREOF.	14,608	1,043	2,796	1,754	62.7	3.6
94	FURNITURE; BEDDING, MATTRESSES, MATTRESS SUPPORTS, CUSHIONS AND SIMILAR STUFFED FURNISHINGS; LAMPS AND LIGHTING FITTINGS, NOT ELSEWHERE SPECIFIED OR INCLUDED; ILLUMINATED SIGNS, ILLUMINATED NAME-PLATE	37,588	5,500	8,063	2,563	31.8	5.2
98	ACCOMPANIED PERSONAL GOODS; SIMPLIFIED TARIFF FOR GOODS IMPORTED BY POST OR BY A COURIER SERVICE.	109,419	15,340	16,774	1,434	8.5	2.9
	TOTAL	461,891	103,003	149,318	46,315	31.0	93.9

2. TAXATION OF INCOME

11. Though there is neither individual nor corporate income tax in Bermuda, labor income is subject to the payroll tax and to a contribution to the pension fund controlled and managed by the MOF.[2] This Chapter provides an overview of these charges and discusses reforms of the payroll tax and of taxation of income in general that may enhance revenue, improve equity and efficiency, and provide the foundation for the future creation of an income tax if so wished.

A. Overview of the Current Situation

12. The payroll tax is charged on remunerations (or deemed remunerations) paid by employers to the employees (or deemed employees) during the tax period and on the deemed remunerations of self-employed persons. Employers are liable for the tax but may deduct 5.5 percent of employees' remunerations from the payments made to them in each tax period. The tax periods are the quarters of the fiscal year.[3] There is a standard rate—currently 14.5 percent—but several other rates apply depending on size of the payroll and type of business (Table 5). Remuneration includes any benefits provided to employees whether in cash or in kind with few exceptions, among them contributions to the pension fund managed by the MOF and compulsory health insurance or approved health insurance scheme. Existing tax relieves and a temporary tax incentive are described below.

13. Businesses may have and the Government has deemed employees whose deemed remunerations are taxable. In the private sector, deemed employees are partners in a partnership, shareholders of a company and members of the governing body of an association who, besides participating directly or indirectly in profits, render services to the partnership, company or association. In the public sector, deemed employees are the members of the Senate and of the House of Assembly and those who hold an office set out in the Schedule 2 to the Ministers and Members of the Legislature (Salaries and Pensions) Act 1975.[4] A deemed employee or a self-

[2] Payroll Tax Act 1995, Payroll Tax Rates Act 1995, and Contributory Pensions Act 1970.

[3] The fiscal year starts on April 1st and ends on March 31st. Tax return and payment are due within 15 days of the end of each tax period.

[4] Premier, Ministers of Cabinet, Opposition Leader, President of the Senate, Speaker of the House of Assembly, Vice-President of the Senate, Deputy Speaker of the House of Assembly, Parliamentary Secretaries, Government Whip, and Opposition Whip.

employed person receives, for purpose of the payroll tax, a deemed remuneration which is the greater between the actual and a notional remuneration.

Table 5. Payroll tax rates

Taxpayer	Rate (%)
Annual payroll greater than $1,000,000 and all exempted undertakings 1/	14.50
Annual payroll greater than $500,000 and up to $1,000,000	13.25
Annual payroll of not less than $200,000 and up to $500,000	11.25
Annual payroll of less $200,000	7.25
Hotels and restaurants with annual payroll of $200,000 or greater	10.25
Bermuda Hospitals Board, Corporation of Hamilton, and Corporation of St George's	7.75
Educational, sporting or scientific institutions, not for profit associations or Societies, self-employed taxi-drivers, fishermen, farmers and horticulturists	7.25
The Government, parish councils, Government Boards, the Bermuda College, approved schools, registered charities, religious and cultural organization, the Bermuda Festival Ltd, and, for nine tax periods beginning in the period in which the business is established, businesses located in an Economic Empowerment Zone. 2/	5.50
Payroll of less than $650 in tax period	0

Source: Payroll Tax Rates Act 1995 as amended.

1/ For payroll tax purposes, exempted undertaking is a concept defined in the Companies Act 1981 and the Exempted Partnerships Act 1992 and qualified in subsections 3 to 6 of Section 2 of the Payroll Tax Act 1995.

2/ Economic Development Act 1968, Section 2A.

14. The notional remuneration of a deemed employee or a self-employed person is defined as "that amount which represents a fair and equitable valuation of his services to the business." The employer or self-employed person assesses its value, presumably based on the guidance provided by the Payroll Tax Act, and submits the assessment to the Tax Commissioner who has to ascertain whether the value is adequate and may increase it if he concludes that it is not adequate. Some of the criteria that the law proposes for serving as a base for the assessment are: the nature and extent of the services and its effect on the financial viability of the business; the deemed employee's experience and special skills; and the remuneration of persons rendering similar services to the same and other businesses. The notional remuneration in any fiscal year must not be less than the notional remuneration of the previous fiscal year indexed to inflation as measured by the relation between the consumer price indices for December of the two immediately preceding calendar years.

15. The only exempted employers are foreign and Commonwealth governments and their agencies, but there are several tax relieves for taxpayers. These are:

- Exemption for remuneration paid to an employee for caring for, or helping to care for, a person at that person's home in connection with a physical or mental illness or incapacity;
- Zero rate on the remuneration of an employee having Bermudian status while he is undergoing training under an approved training scheme;
- The remuneration of a person employed as taxi-driver, fisherman, farmer or horticulturist is taxed at 7.25 percent;
- The remuneration of employees in special situations is taxed at 8.25%;[5]
- Exemption for the excess over $750,000 of the remuneration of employees whose yearly remuneration exceeds $750,000; and
- Employers subject to a rate of 10.25 percent or higher may deduct $600 per employee who is on the payroll at the end of the tax period and who has worked for the employer for a minimum of 180 hours during that period.

16. A provision introduced in 2013 with the purpose of reducing unemployment reduced the rate applied to the remuneration of new Bermudian hires to 5.5 percent. Employers who hired or will hire a person who has Bermudian status in the fiscal years 2013/14, 2014/15, and 2015/16, may apply that rate to his/her remuneration provided the person had not been an employee of the employer at any time after February 21, 2013, and, at the time he/she becomes employed, he/she had been unemployed at any time during the immediately preceding three months. It is also required that the employer is not in arrears with the payment of payroll tax at the time he hires the person and that the employment does not involve arrangements that are payroll tax avoidance arrangements.

17. Every employed or self-employed person who works more than four hours a week is required, with few exceptions,[6] to contribute into Contributory Pensions Fund (CPF). Both

[5] These are employees on jury duty, on duty with the Bermuda Volunteer Reserve or the Bermuda Regiment, and hotel employees in the months of November through March and retail employees in January, February and March.

[6] The exceptions are: students who work during periods of vacation or public holidays, persons who earn less than $3,000 per year, widows and widowers while in receipt of a benefit, non-residents who work for a period of less than 26 consecutive weeks in Bermuda, and employees who are 65 years old or older (but their employers are not exempt).

employers and employees must register with the Department of Social Insurance (DSI) of the MOF and employers, as well as self-employed persons, contribute for themselves and on behalf of their employees. The contributions take the form of a fixed amount per week per employee. The current rate is $32.07 per week for both the employee's and the employer's contributions and $64.14 per week in the case of self-employed persons and voluntary contributors. To facilitate compliance, DSI sends a monthly statement to employers. They have only to review the list of employees, adding new hires and excluding those who left. The contributions are paid monthly. In case a person has more than one job, the employer considered his primary employer pays his contribution and the part of the employer contribution that he is liable for.[7]

B. Analysis and Proposed Reforms

18. Multiple payroll tax rates may stimulate inefficient local company splitting to reduce the tax burden. While a single rate applies to exempted undertakings irrespective of their size, a local company may split to enjoy a lower tax rate and will do so if the sum of the cost of inefficiency associated with splitting and the increase in local company fees is less than the gain from tax burden reduction. For example, a company with annual payroll equal to $1,100,000 may create five subsidiaries that will hire employees and sell their services to the company, thus reducing its payroll tax rate from 14.5 percent to 7.25 percent. Therefore, it would save $79,750 in payroll taxes and add $5,000 to its local company fee bill.[8] If the inefficiency cost associated with the split was, say, $20,000 per year, the company would add $54,750 to its profit, the government revenue would fall $74,750 and Bermuda would lose $20,000.

19. Multiple payroll tax rates do not contribute to equity and may, in fact, create horizontal inequity. Though the legal incidence of the payroll tax is on employers, it is difficult to assert its true incidence, that is, who ultimately bears the tax burden. Depending on market conditions, employers may be able to shift the tax to employees or even to consumers. Assuming that the true incidence is on employers, it barely makes sense to discuss equity. Under this assumption, it can be said that the payroll tax is, in fact, a tax on capital, which usually belongs to the wealthier persons and, thus, the tax is progressive. However, even under this assumption, multiple rates do not contribute to progressivity.

[7] Though the contributions to the CPF will not be analyzed in this report, it is important to what follows to keep in mind the periodicity of the contributions and the fact that DSI keeps a register of employees and employers.

[8] The local company annual fee is $1,000 regardless of size.

20. As a fraction of the tax, equal to 5.5 percent of the payroll may be deducted from employees' remuneration, one may argue that labor bears that fraction of the tax. The fraction would be a proportional tax on labor income, a fact that multiple payroll tax rates would not change. Alternatively, one may also assume that market conditions allow full shifting of the payroll tax to labor, by paying lower wages than would be paid in the absence of the tax. Under this assumption, multiple rates will not in general improve vertical equity since both companies with high and low payrolls pay high and low wages. However, multiple rates would create horizontal inequity since two employees with equal wages, one working in a company subject to high rate and the other in a company that is assessed at a low rate, would bear different tax burdens.

21. While multiple rates on employers' payrolls may be harmful rather than beneficial to equity, a progressive rate schedule on the remuneration of employees may improve equity. It will improve if employees are unable to shift all or, at least, part of the tax burden to employers. As this is a probable outcome, the mission recommends the adoption of the progressive tax on the remuneration of labor, and concomitant reduction of the payroll tax burden and repeal of the authorization to employers for deducting 5.5% of the remuneration paid to employees. As a major objective is to boost revenue, the mission recommends that this reform be revenue-increasing rather than revenue neutral.

22. The proposed reform of the payroll tax is also an opportunity to improve other features of the tax. First, the ceiling on remuneration that integrates the payroll tax base ($750,000 per year) should be removed. Payroll taxes of many other countries have a similar ceiling. The reason is that they are social insurance contributions and to the ceiling on the tax corresponds a ceiling on the benefits. This is not the case in Bermuda where the payroll tax is not linked to the social insurance. Data from OTC shows that there were 108 employees with remuneration greater than $750,000 in fiscal year 2014/15.[9] Second, the deduction of $600 per employee for employers subject to a rate of 10.25 percent or higher is an unnecessary complication. A reduction in the rates would obtain similar result in a simpler way. Third, private sector representatives who met the mission suggested that the incentive for new Bermudian hires is of

[9] There is no information on the remuneration of these employees. If their average remuneration was, say, $1,000,000, the removal of the ceiling would add $27 million to the bases of the payroll tax and the proposed tax on employees' income.

little importance for the business community. Data on the remuneration paid during fiscal year 2014/15 to new Bermudian hires support their perception: it totals about $13 million, less than 0.5 percent of the tax base, and it is likely that only part of this amount corresponds to newly created job.[10] Moreover, OTC is unable to verify whether taxpayers benefiting from the incentive have in fact satisfied the conditions determined by law for its enjoyment. The incentive may be discontinued when it expires at the end of the current fiscal year.

23. The concept of notional remuneration of deemed employees and self-employed persons may be an important loophole of the Payroll Tax Act.[11] It is practically impossible for OTC to make a judgment on fairness of the taxpayer's valuation and taxpayers are well aware of such weakness. No short term solution for this problem is feasible. However, it can be mitigated in the medium term by replacing the subjective criteria established in the Act by more objective rules. One possible solution is a procedure similar to those used by Nordic countries to separate capital and labor income for purpose of their dual income taxes. A bird's-eye view of the procedure is presented in Box 1.

24. In case authorities decide to introduce the tax on the remuneration of labor (TRL), the value of some of the benefits provided by employers that are excluded from the base of the payroll tax should be included in the base of TRL. These benefits are: contributions to the CPF, payments for compulsory health insurance or approved health insurance, hospital, life insurance or retirement scheme, payments made to employees out of a fund entirely constituted of the proceeds of any service charge, and remuneration paid to an employee who is a full-time student and who is employed on a Saturday or a public holiday or during a period of vacation.

25. TRL may be thought as the embryo of a full system of income taxation. TRL may become a dual personal income tax by adding withholding taxes at the same flat rate on different types of capital income and an assessment at the same rate of the fraction of the income of self-employed persons, individual firms and partnerships that corresponds to capital income. A business income tax of some sort would complete the system.[12] Alternatively, the system of

[10] The conditions for enjoying the incentive do not prevent employers from substituting new Bermudian hires for dismissed employees.

[11] According to MOF, it is in fact a loophole.

[12] In meetings with private sector representatives, the mission was informed that part of the international business sector favors the adoption of an income tax.

income taxation might be completed by an origin-based, subtraction method value-added tax, in which case the payroll tax should be dropped (or the amount of the payroll excluded from the base).[13] If authorities wish to implement a system of income taxation like the one mentioned in this paragraph, this must be viewed as a long term project to be initiated soon as, besides preparation of the tax administration, it will require discussion with stakeholders and negotiations at the international level to ensure acceptance in conditions favorable to business and to Bermuda.

Box 1: Splitting income of self-employed person

Self-employed persons have invested in their business and work in their business. Thus, income derived from their business is part capital income part labor income. Both the payroll tax and TRL intend to tax only that part of their proceeds that corresponds to labor income. Therefore, it is necessary to split the income of self-employed persons into its two component. The Payroll Tax Act created the concept of notional income which is unsatisfactory due to its subjective nature that makes it difficult to the tax administration to contest the valuation offered by the taxpayer.

Nordic countries, which have adopted a dual income tax—labor income assessed by a schedule of progressive rates and capital income taxed at a flat rate that, in most cases, is lower than the marginal rate on labor income—, face the same problem. Since the determinants of labor income—working hours, effort and skills of the self-employed—cannot be observed by the tax administration whereas business assets in principle can, those countries preferred to use a deemed rate of return on assets and treat the residual business income as labor income.

Self-employed persons' incomes are split by two alternative methods. Under the 'gross assets' method, the net financial liabilities of the firm are not deducted from the asset base. The labor income is estimated by deducting a deemed return to gross assets from gross profits (profits before deduction of interest on debt). Under the 'net assets' method, capital income is determined by estimating the deemed return to the net assets of the firm (assets minus debt), and labor income by subtracting the deemed return from net profits (profits after deduction of interest debt). In all cases it is necessary that the self-employed persons carry accounting system that register the value of the assets.

Norway uses a variant of the gross assets method, while Finland and Sweden practice variants of the net assets method. Denmark allows self-employed taxpayers to split or not their incomes and those who split may opt for one of the methods.

[13] A tax of this kind exists in Italy, the regional tax on productive activities (l'imposta regionale sulle attività produttive - IRAP). The portion of the IRAP that corresponds to capital income taxation is accepted as an income tax in a treaty for avoidance of double taxation signed by the United States and Italy on August 25, 1999.

Source: Sørensen, Peter Birch (2009), "Dual Income Tax: a Nordic Tax System" (Copenhagen: University of Copenhagen), March

C. Revenue Estimates

26. The mission performed simulations in order to gain insight on the revenue raising capacity of combining a reduction in rates of the payroll tax with the creation of the TRL (Appendix I). Tables 6 and 7 summarize the results. Table 6 presents a possible rate schedule for the TRL and the corresponding tax yield. Assuming that the change in the payroll tax and the introduction of the TRL will not affect gross labor remuneration, that is, the remuneration paid by employers, about 90 percent of the labor force would have an increase in net remuneration. In other words, for workers earning less than $149,333, the TRL that they would pay would be less than the 5.5 percent that employers may currently deduct from their remunerations. Table 7 is self-explanatory.

27. It is feasible to implement the TRL in fiscal year 2016/17. The employees are registered with DSI and their employers are known. Practically all the paperwork would be prepared by employers. To avoid overburdening small businesses, employers may be allowed to file quarterly, as they do with respect to the payroll tax, except those with annual payroll over $1,000,000 and exempted undertakings, who account for almost ¾ of the base, that may file and pay monthly, as they do with respect to the contribution to the CPF.

Table 6. Simulated yield of a tax on the remuneration of labor

($ 1,000)

Labor remuneration ranges	Rates (%)	revenue
0 < wage < 48,000	1.0	3,617
48,000 ≤ wage < 96,000	5.0	32,796
96,000 ≤ wage < 235,000	10.0	52,914
235,000 ≤ wage	15.0	76,975
Total revenue		166,301

Source: Elaborated by the mission based on data provided by OTC and the Department of Statistics (2014 Annual Employment Survey).

Table 7. Simulated yield of the payroll tax and TRL

($ 1,000)

Taxpayer	FY 2014/15		FY 2015/16 1/		FY 2016/17 2/		FY 2017/18 /2		FY 2018/19 2/	
	Tax rate	Tax Due	Tax rate	Tax Due	Tax rate	Tax Due	Tax rate	Tax Due	Tax rate	Tax Due
Exempt undertakings	14.00%	149,526	14.50%	154,866	9.50%	101,464	9.50%	101,464	10.00%	106,804
Annual payroll > $1,000,000	14.00%	119,049	14.50%	123,301	9.50%	80,783	9.50%	80,783	10.00%	85,035
$500,000 < Annual payroll ≤ $1,000,000	12.75%	15,390	13.25%	15,994	9.50%	11,467	9.50%	11,467	10.00%	12,071
$200,000 ≤ Annual payroll ≤ $500,000	10.75%	13,352	11.25%	13,973	8.50%	10,557	9.00%	11,178	10.00%	12,420
Annual payroll < $200,000	7.25%	10,526	7.25%	10,526	8.00%	11,615	9.00%	13,067	10.00%	14,519
Hotels & rest. w/annual payroll ≥ $200,000	9.75%	13,646	10.25%	14,346	8.00%	11,197	9.00%	12,596	10.00%	13,996
Gov., Gov. Boards, Parish Council, & Bda College	5.25%	21,970	5.50%	23,016	0.00%	0	0.00%	0	0.00%	0
Taxi, farm, fish & educ, sport, scient inst.	7.25%	13,048	7.25%	13,048	4.00%	7,199	4.50%	8,099	5.00%	8,999
Char, Schl, relig. And cult. Organizations	5.25%	5,414	5.50%	5,672	4.00%	4,125	4.50%	4,641	5.00%	5,156
Economic Empowerment Zone	5.25%	19	5.50%	20	4.00%	15	4.50%	16	5.00%	18
Total payroll tax revenue		361,941		374,762		238,422		243,312		259,019
Total TRL						166,301		166,301		166,301
Grand total						404,723		409,613		425,320
Increase in relation to FY 2015/2016						29,961		34,851		50,558

Annual increase	29,961	4,890	15,706

Source: OTC. Elaborated by the mission.

1/ Simulated: tax due 2015/16 equals tax due 2014/15 multiplied by the relation between rates in 2015/16 and 2014/15

2/ Proposed: tax due for FY equals tax due in FY 2015/16 multiplied by the relation between rates proposed for the FY and rates of 2015/2016.

D. Recommendations

Short-term

- Repeal the authorization to employers for deducting 5.5% of the remuneration paid to employees.
- Reduce the rates of the payroll tax.
- Remove the ceiling ($750,000) on the payroll tax base.
- Eliminate the special relief ($600 per employee) granted to taxpayers who are subject to high rates.
- Let the incentive for new Bermudian hires expire.
- Institute and start charging a TRL in FY 2016/2017.
- Set rates for both taxes so that they render a revenue increasing reform (the example in Tables 6 and 7 yields an estimated increase of about $43 million).
- Use DSI registers to collect TRL and to improve control of the payroll tax.
- Use employers as tax agents to withhold TRL.
- Require taxpayers who are exempted undertakings and those whose annual payroll is greater than $1,000,000 to file returns and pay TRL monthly; require all other to file and pay quarterly.

Medium-term

- Increase slightly the payroll tax rates while harmonizing them (as exemplified in Table 7).
- Include in the base of TRL several benefits provided by employers that are excluded from the base of the payroll tax, such as contributions to the CPF and health insurance.
- Require that, from FY 2020/21 on, self-employed persons over a given size (defined by the value of their assets and/or expenses and/or rental value of the space occupied)

estimate the notional labor remuneration according to one of the methods presented in Box 1.

Long-term

- Gradually transform TRL into a dual personal income tax by introducing flat rate withholding taxes on different types of capital income.

3. TAXATION OF GOODS AND SERVICES

28. This Chapter provides advice on improving the taxation of goods and services and expanding its scope. Recommendations developed in this section balance current administrative capacity constraints, the need to mobilize additional revenue, and amelioration distortive aspects of the current indirect tax system. Short-term recommendations are aimed primarily at mobilizing additional revenue through an increase in excise taxes while medium-term recommendations provide tractable steps for the introduction of a generalized tax on goods and services that reflects administrative capacity constraints and a uniform rate customs tariff.

A. Overview of the Current Situation

29. Indirect tax systems are generally composed of three major revenue handles. First, a general tax on final consumption of goods and services like a value-added tax or general sales tax is intended to efficiently mobilize revenue. Second, customs duties are imposed on imports at a low rate of tax on most imports to mobilize revenue, or with a few rates—varying by the extent to which goods are either primary, intermediate, final consumption or capital goods—to provide some protection to local producers. Third, excises are typically imposed on a small list of goods the consumption of which increases social or environmental costs or is highly inelastic in demand like tobacco, cigarettes and petrol.

30. Bermuda's indirect taxation system is implemented through customs duties on imports and taxes on selected services. The customs tariff applies to goods at rates varying from 5 percent to 33.5 percent—a standard rate of 22.5 percent applies to the highest number of tariff lines. Higher rates apply to a few goods such as tobacco and petroleum products. Most rates are ad valorem, except on petroleum products, alcohol products and tobacco.

31. The customs tariff incorporates a number of policy objectives of the government. First, the tariff acts as a general revenue tool, raising about 24 percent of total tax revenue. Second, it provides reduced rates of tax on certain final consumption items, food and necessities while taxing others at the standard rate or a higher rate. Third, it acts as an excise tax on tobacco, alcohol, and motor vehicles. Finally, the tariff provides some protection to domestic producers.

32. Bermuda imposes sales tax on a number of selected services. Revenue from these taxes amounts to about 3 percent of total tax revenue. Service taxes include the Corporate Services Tax on services provided to exempt undertakings[14], the Hotel Occupancy Tax and the Telecommunications Fee. Most services remain untaxed distorting consumption decisions between goods and services.

33. Stamp Duties constitute about 3 percent of tax revenue. Revenue is further bolstered by government service charges and license fees. The vast majority of duties are imposed for the recording and validation of documents but the stamp duty on the sale or transfer of land functions like a land transfer tax. (Discussed further in the next chapter). Government fees imposed under 71 statutes are consolidated under a single regulation. Fees are charged for the provision of government services and the issuance of licenses. The turnover tax on telecommunications services is imposed under the regulation.

B. Issues

34. **The mission does not recommend the adoption of a VAT in the short- to medium-term.** Most countries have adopted some form of VAT to tax final consumption of goods and services. From the final consumers perspective, a VAT appears much like a retail sales tax but tax is paid on imports and the value added at each step in the production and distribution process. A broad based destination principle VAT with a single rate and few exemptions could mobilize significant revenue for Bermuda—in the range of 0.4 to 0.5 percent of GDP for each point of tax rate—and maintain the competitiveness of the economy for the export of goods and,

[14] An exempted company is a Bermuda company established by a foreign entity or non-resident of Bermuda that is exempt from the ownership restrictions that apply to local companies. Exempted company are involved in a broad range of business activities from holding assets to insurance, reinsurance, trading, inter-group financing, take-overs, collective investment schemes and, more recently, shipping, aircraft leasing and holding of intellectual property rights.

more importantly, financial and other services. Some characteristics of Bermuda's economy offer an opportunity for the introduction of a VAT including a short production and distribution chain, a high degree of concentration in trading, hospitality, regulated utility, and telecommunication sectors, and a large professional services sector. A high concentration of economic activity in typically exempt sectors like financial intermediation and refund receiving export sectors like financial and business services is the most significant constraint on the introduction of a VAT due to limited administrative capacity for the control of exempt sectors and the payment of refunds for input tax paid on the export of services.

35. **Tax administration capacity constraints hinder the adoption of a retail sales tax on goods.** An alternative to the VAT and the current system of taxation of goods and services would be to introduce a retail goods and services tax. Such a tax would ensure that domestic value added is subject to tax at the retail level which is currently not the case and would broaden the current services tax base. Given current and anticipated tax administration capacity constraints, such a tax would expose government revenue to considerable risk because tax would be collected at one stage of production and distribution—the retail sector—and that sector typically has relatively weak tax compliance.

36. **A sales tax imposed on the import of goods by importers and for personal use and on the provision of services can function like a generalized tax on goods and services.** Such a tax would be imposed at the same rate on the import of goods and the provision of services. Services tax would be imposed on the value of the service provided and the tax would be calculated on the turnover of the service provider. In the case of goods, the value for tax would assumed to be the value for import duty plus import duties and any excise taxes plus an assumed retail sector margin. To illustrate, retail margins in Bermuda average about 50 percent based on 2014 national accounts data. A service tax rate of 5 percent would be therefore equivalent to a 7.5 percent tax on the value of imports including customs duties and excises—a tax rate of 5 percent on the tax value of the good plus a 5 percent tax on the margin. In this way, the tax is neutral in the taxation of final consumption of goods and services.

37. **Distortions to domestic production can be mitigated by providing sales tax relief to capital inputs and intermediate goods.** Imposition of sales tax on capital inputs and intermediate goods would have adverse economic impacts by increasing the cost of capital thereby reducing the incentive to invest and distort relative prices in domestic production. For

this reason, sales tax should not apply to capital inputs and intermediate goods. Given constraints at customs, this could be implemented by only providing relief for imports by new projects and the expansion of existing projects during construction with the approval of the Minister of Finance.

38. **Sales tax should apply equally to final consumption goods and to most services to promote neutrality between the consumption of goods and services.** The adverse consequence of sales tax exemptions is that they distort relative prices and thereby the purchasing decisions of consumers. Often exemptions for goods such as basic food are rationalized on the grounds of providing tax relief to the poor. However, such measures are not necessarily progressive as they disproportionately benefit higher income groups. The Financial Assistance Program provides an offset to current indirect taxes in the fiscal system for the poorest and most disadvantaged Bermudians.

39. **All services should be subject to tax except for some exemptions for technical or social policy reasons.** Taxing all services would include imposing tax on electricity, water, construction, accommodation, restaurant, transportation, communications, and professional services. Financial intermediation services and risk pooling (insurance) services—the value of which is difficult to measure—should be exempt for technical reasons. Privately provided health, education and social work services may be provided an exemption for social policy reasons. Publicly provided services should be exempt.

40. **Services provided to non-residents—i.e., persons outside of Bermuda--should be exempt from sales tax.** Imposing sales tax on exported services would increase the cost of purchasing services from domestic providers of business and financial services in the international marketplace and put them at a competitive disadvantage. For this reason, services provided to non-residents should be exempt. Services such as accounting and legal services provided to Exempt Companies would be taxable. In the long-run, the adoption of a general sales tax that did not tax intermediate inputs of service providers would improve the competitive position of providers of exported services.

41. **Providing relief for business purchases of services will be difficult to administer.** Imposing sales tax on business-to-business services could distort domestic production. However, if there is a choice it is between a broad sales tax base with a low rate and a narrower

sales tax base with a higher rate because of the extent to which business-to-business sales of services are exempt, the lower tax rate and broader base will have a less adverse impact on the efficient allocation of resources. In addition, for many small and professional businesses personal and business use of services—such as telecommunications, hotel rentals, and auto and computer repair—are difficult to determine and preventing abuse would require that substantial additional resources for tax enforcement. The costs of preventing tax evasion could exceed the economic benefits of exempting business inputs from taxation. Thus, business to business services should be taxable.

42. **Some of these services are currently subject to tax under the corporate services tax, the hotel occupancy tax and the telecommunications fee all of which should be repealed.** Repeal of the corporate services tax at the time of the introduction of the sales tax at a lower rate would ameliorate some of the impact of the corporate services tax on exported services and domestic service providers. In addition, taxing most services would reduce the incentive for employers to engage high-income employees under services contracts to minimize payroll tax obligations.

43. **Small turnover service providers should be exempt from the services tax.** Small taxpayers often are large in number, contribute little revenue and distract scarce tax administration resources from focusing on the largest taxpayers who are small in number and pay significant amounts of tax. Small traders often have poor books and records and present higher compliance risk. For this reason, many sales tax systems exempt small traders and service providers from registration, payment and filing obligations of the sales tax. Initially, this exemption threshold could be at $100,000 but further analysis is required to confirm its level.

44. **Payment and filing obligations for large turnover service and medium turnover service providers should be different.** Payment and filing obligations are often different for large-sized taxpayers and medium-sized taxpayers. The timing of the payment and filing of sales tax requires balancing the administrative capacity of the tax administration against the cash flow cost the government is able to incur by allowing sales taxpayers to retain tax paid by purchasers. Given administrative constraints, the sales tax on services should require monthly payment and filing by the 100 largest taxpayers while requiring all other taxpayers to pay and file quarterly.

45. **Introduction of a sales tax on imported goods provides an opportunity to rationalize customs duty rates on imports.** The principle economic role of customs duties is to provide protection to domestic producers. Varied rates of protection for domestic producers are often delivered through a graduated rate scale based on relatively few rate bands—i.e., primary goods, intermediate goods, final consumption goods, and capital goods. Under such a structure, effective rates of protection increase depending on the stage of production.

46. **A low-rate uniform customs duty is the preferred fiscal tool to provide modest protection to domestic producers.** With limited goods production in Bermuda, a graduated tariff structure would unnecessarily distort relative prices in final consumption and efficiency costs to domestic purchasers would vary by the extent of processing of imported goods. These efficiency costs can be mitigated, in part, with a customs tariff with a low uniform rate for most imported goods and a zero-rate for capital goods. A relatively low tariff rate of 2 percent can function adequately as a means of protecting domestic production and mobilizing revenue. A low rate of duty would reduce the demand for exemptions from duty payment. Any exemptions should be limited and clearly defined. As noted above, exemptions should be limited to new projects and the major expansion of existing projects during construction with the approval of the Minister of Finance.

47. **The current customs tariff imposes a selected number of excise taxes on alcohol and tobacco products, petrol, and passenger vehicles.** Excises account for about half of all revenue collected on imports. The excises discourage consumption of particular items (for example, alcohol and tobacco); links tax payments to the existence of negative externalities (for example, a gasoline tax as a means of pollution abatement); or taxes certain luxury goods. Under the current excise structure, tax is only imposed on imported excisable goods. Excises should be levied equally on domestic production and imports but with no domestic production of excisable goods there is no effective special treatment for domestic producers. Should domestic production commence at some point in the future equal treatment of imports and domestic production will need to be provided for in tax legislation.

48. **Separating the imposition of excise taxes from the customs duty would improve the transparency of the fiscal system.** Most countries impose excise taxes under a separate statute from the customs tariff. The government should consider a statute separate from the customs tariff to impose excise duties. This allows for a clear presentation of the role and intent of

excise tax policy for excisable goods. A consequence of this measure is that excisable goods would only be subject to customs duties in the tariff.

49. **Excise duties should be reported separately on customs declarations.** Excisable goods are generally subject to customs duties, excises and general sales tax. Importers generally calculate these amounts separately as part of preparing their customs declarations. Implementing such a measure would require advance preparation by Customs to revise the customs tariff, information provided to importers, customs declarations and IT systems. All of which will take some time to implement. Given capacity and systems constraints at Customs, this should be implemented over the medium-term coincident with revisions to the customs tariff and the introduction of sales tax on imports.

C. A Way Forward

50. **Administrative capacity constraints guide the implementation of reforms to indirect taxes so that they are phased in over three years.** The preceding discussion proposes an indirect tax system that is comprised of three revenue handles: (1) a general tax on goods and services; (2) a low-rate uniform tariff on imports of goods; and (3) an excise tax that is imposed on selected goods. Customs will need some time to prepare to implement such a system in order to revise importer information, declarations, the customs tariff and IT systems. Implementation can be simplified by combining the sales tax on imports and the low-rate uniform tariff for the purposes of the customs tariff. All revenue would be collected at the time of importation. As excisable goods are subject to sales tax, duty, the excise component should be separately identified for customs declaration and payment purposes.

51. **To illustrate, a combined rate of sales tax and customs duty could be 9.5 percent.** It would comprise a 2 percent customs duty, a 5 percent sales tax on the value of imports and a 5 percent sales tax on an average retail margin of 50 percent. Imports of capital goods would generally be zero-rated or exempt. The combined rate is 0.3 percentage points higher than the current average duty on imported goods excluding excisable goods (9.2 percent). The general sales tax on goods could be implemented in time for the 2017/18 fiscal year.

52. **Implementation of the general sales tax at 5 percent on services will require additional time given OTC's current human and institutional capacity.** Implementing system changes, introducing new systems and procedures, training staff and preparing taxpayer

information and returns will take some time. For this reason, the sales tax on services and the repeal of the current sales tax on services should be implemented in time for the 2018/19 fiscal year.

53. **In the short-run, currently imposed excises should be increased to begin the process of increasing the revenue yield from indirect taxes.** A modest increase in specific excise taxes on alcohol, tobacco, and petrol would increase revenue by $15 million dollars. Excise taxes on the value of cars remains unchanged at 75 percent of the first $10,000 and 150% of the remainder of the value of the car (Table 8).

Table 8. Current and proposed excise rates

Excisable goods	Current rates	Proposed rates	Unit for Duty
Cigarettes	0.22	0.25	cigarette
Alcohol Products			
Beer	0.99	1.5	litre
Wine	2.89	3.5	litre
Spirits	26.57	30.5	litre
Petrol			
Kerosene	0.17	0.27	litre
Other Fuel Oil	0.25	0.35	litre
Gas Oil	0.37	0.47	litre
Petroleum Oils	0.57	0.67	litre
Automobiles			
First 10K	75%	75%	value
Remainder above S10K	150%	150%	value

D. Revenue Estimates

54. Table 9 presents the revenue impact over three fiscal years of: (1) the introduction of a simple customs tariff at 4 percent in 2017/18 and 2 percent in 2018/19; (2) a modest increase in excise taxes in 2016/17; (3) the introduction of a sales tax at 5 percent on imported goods excluding capital inputs and intermediate goods assuming a 50 percent retail margin in 2017/18; (4) the introduction of a 5 percent tax on most services in 2018/19; and (5) the repeal of the telecommunications fee, corporate services tax and hotel occupancy tax in 2018/19. Taken

together these measures will increase revenue by $15 million in 2016/17, $33 million in 2017/18 and $66 million in 2018/19.

Table 9. Revenue Impact of Indirect Tax Measures

$million

Tax	2016/17	2017/18	2018/19
Customs Duties & Sales Tax	-	3	3
Excise Taxes	15	15	15
Services Tax	-	-	77
Telecom Fee	-	-	-11
Corp Services Tax	-	-	-9
Hotel Occupancy Tax	-	-	-5
Net Revenue Impact	15	18	70

E. Recommendations

Short-term

- Increase excise rates for FY 2016/17 to increase revenue by $15 million.

- Place a moratorium on the introduction of new stamp duties and user charges and fees and develop policy guidance for Ministries and Agencies for the review and approval of existing fees based on cost of service, transparency of fee setting and efficiency of service delivery.

Medium-term

- Commence preparations for the introduction of a single unified tariff and sales tax on goods early in the FY 2016/17.

- Replace the current customs tariff with a single unified tariff and sales tax on goods at a rate of 9.5 percent at FY 2017/18.

- Commence preparations for the extension of the sales tax to services early in FY 2017/18.

- Introduce a 5 percent sales tax on turnover from the provision of most services excluding health, education, social, financial and exported services to take effect at the beginning of FY 2018/19. Small service providers should be exempted from the tax.

- Require the 100 largest taxpayers to file and pay tax on services monthly and all others to file and pay quarterly.

Long-term

- Consider transforming the sales tax on imported goods and on services to a broad based tax on final domestic consumption that does not tax intermediate consumption or exports, such as a VAT with a single rate, with crediting for input tax and zero rating of exports.

4. PROPERTY TAXATION

I. **This Chapter provides advice on the taxation of property taxation and land transfer taxes.** A three rate annual tax on residential property is proposed that would improve the efficiency of the current property tax, mitigate abuses of the current 7 rate tax system, and eliminate distortions between property used for dwellings and property used for commercial and other purposes. This three rate system could be phased in over 3 years and a modest increase in the average tax rate on property would mobilize additional revenue for the budget. The property transfer stamp duty and the property transfer registration fee are proposed to be unified at a single low rate to reduce barriers to the sale and transfer of land and mitigate distortions to the efficient use of land.

A. Overview of the Current Situation

55. **Bermuda taxes property through two basic channels: the land tax and property transaction taxes and fees.** Land Tax is a property tax charged on all developed land throughout Bermuda with some exceptions. The tax is charged under the authority of the Land Tax Act 1967 and the Land Valuation and Tax Act 1967. Land Tax is assessed on the annual rental value of each valuation unit (i.e., dwelling). Annual rental values are established every five years and are updated periodically to reflect improvements to property. The owner of each valuation unit is liable for tax. Land Tax is billed twice a year in January and July, and is

payable in March and September. Private dwelling units are taxed on a progressive scale of tax rates. There are seven annual rental value bands with a minimum rate of 0.6 percent and a maximum rate of 23 percent. Bermudians who are sixty-five years or over, who own and occupy a private dwelling, are exempt from tax on the first $50,000 of the annual rental value. Commercial properties are taxed on a single rate of tax of 5.5%.

56. **The property transactions and registration fees are composed of three different taxes, each of which is based on a different law.** A tax of up to 7 percent is levied on the sale of land under the Stamp Duties Act—this tax is a progressive tax on the value of the property with 5 rates with the highest rate applying on properties above $1.5 million. A tax of 0.1 percent of the property is levied as a registration fee under the Land Title Registration Act. Non-Bermudians must also acquire a license to purchase residential property—rates currently vary between 4 percent and 8 percent depending on the visa status of the non-Bermudian and the type of property acquired. The taxes are administered by the MOF and the land registry office of the Ministry of Home Affairs. Values for tax are based on declared values in land conveyance or transfer documents and may be reviewed by the Land Valuation Office.

B. Issues

57. **Economic efficiency losses can arise because annual property taxes alter otherwise efficient behavior.** Efficiency is actually enhanced if comparatively higher taxes are imposed on bases that are relatively unresponsive to taxes and lower taxes are levied on bases that are relatively responsive. The reason is that the overall changes in behavior are lessened. Different tax burdens across types of property leads to behavioral responses that will encourage land and property to be used in the tax favored manner. These distortions harm economic efficiency as they discourage the best use for property and increase the extent of behavioral changes. In addition, property taxes are normally intended to spread tax liabilities across taxpayers based on the value of property. Thus, efficiency is hampered to the extent that different classes of property bear different tax liabilities and different properties bear different average tax rates.

58. **Average effective property tax rates are relatively low, which is a common practice around the world.** The average tax rate on annual rental value is 8 percent which translates roughly into a property tax rate on land value of about 0.58 percent for dwellings and 0.36 percent for commercial properties. However, the progressive rate structure is heavily skewed to

higher value properties making the property tax highly sensitive to reassessments in value. To illustrate, the tax structure is heavily skewed so that 2009 assessed value of up to $44,000 ARV accounts for 80% of the tax base but only 30% of the tax revenue. Preliminary 2015 assessed values suggest that amounts up to $44,000 ARV account for 85% of the tax base and 37% revenue with unchanged tax rates. (See Table 10).

59. **There is no tax on vacant land other than vacant commercial storage yards.** This runs counter to economic theory, which indicates that taxes on land are relatively efficient because the supply of land cannot respond to the tax rate. Thus, a tax on land (but not on the improvements) imposes no efficiency losses because it cannot create behavioral distortions (since the amount of land cannot be increased or decreased). Further, taxes on vacant land raise the opportunity cost of holding land for speculative and other purposes and can encourage the land to be converted to its best use.

Table 10. Residential property valuations by ARV band

ARV Band	Cumulative Share (%)			
	2009 ARV		2015 ARV	
	Base	Revenue	Base	Revenue
1 - 11,000	31.2	4.6	36.9	6.8
11,001 - 22000	56.7	12.2	63.6	16.6
22,001 - 33,000	71.2	20.8	77.0	26.4
33,001 - 44,000	79.5	30.7	84.2	37.0
44,001 - 90,000	93.0	62.9	95.3	69.6
90,001 - 120,000	96.0	77.2	97.6	82.9
120,001 +	100.0	100.0	100.0	100.0

60. **Bermuda assesses property every five years using annual rental value based on a mass appraisal methodology.** Many jurisdictions prefer to use the market value approach, though it is not always used, and good practice is to reassess property values every 1 to 3 years. A consistent relationship often exists between the market and rental values, since rents should reflect the market value of the property, often making these two measures substitutes. But rental value fails when property is not employed in its best use and this can be exacerbated when property assessments are too infrequent.

61. **The definition of valuation unit provides for the division of property into smaller tax units.** A common practice is for property owners to divide their properties into multiple dwellings to evade or avoid tax by taking advantage of the progressive rate structure of the Land Tax. By doing so, owners are able to minimize their property tax obligations as the tax is assessed on each dwelling at a lower average tax rate than would be the case had the tax been assessed on the combined value of the dwellings on the property.

62. **Multiple Land Tax rates are often justified on a variety of grounds. In some cases, certain properties may represent a greater burden on government services, and thus it is argued they should pay higher taxes based on the "benefit" principle.** In other instances, higher taxes are rationalized on the basis of ability to pay: those with more means are asked to pay more. Finally, in some countries—like Bermuda--there is an effort to redistribute wealth through the property tax resulting in much higher rates on higher valued property. Or industrial property might be taxed at a higher rate than other property in an effort to export part of the tax burden to non-residents. What is less clear is the extent to which such multiple rate systems are desirable.

63. **A simple single rate Land Tax is preferred.** Simplicity means few land use classifications, uniform assessment rates and very few rates. Neither equity nor efficiency is enhanced through a complex rate structure. In terms of equity, reducing the effective tax rate for some property holders simply means that others will face higher taxes if the same revenue target is to be met. In addition, taxing non-residential property differently than residential property can distort land use decisions and is inefficient.

64. **The current rate structure of the Land Tax can be transitioned over three years so that there are fewer rates, and the property tax is less susceptible to large changes in valuations, particularly for properties with ARV value above $44,000 while increasing land tax revenue by $24 million.** Table 11 illustrates a three-year transition plan for land tax rates to move from its seven residential rate bands to a system with three rate bands, thereby improving the efficiency and equity of the Land Tax. In addition, commercial and tourist property tax rates are increased to reduce disparities between average tax rates for different uses of property. Rates are increased by 2 percentage points in 2016/17 to maintain revenue neutrality following the 2015 ARV revaluation before consolidating into three rate bands in 2018/19. The commercial and tourist property tax rates are raised to 810 percent by 2018/19.

Table 11. Proposed land tax rates and the revenue impact

Residential Property ARV Band	2015 ARV			FY 2016/17			FY 2017/18			FY 2018/19		
	Total ARV ($)	Current rates (%)	Potential revenue ($)	Proposed rates (%)	Potential Revenue ($)	Incremental Revenue ($)	Proposed rates (%)	Potential Revenue ($)	Incremental Revenue ($)	Proposed rates (%)	Potential Revenue ($)	Incremental Revenue ($)
1 - 11,000	343,509,200	0.6	2,061,055	1.6	5,496,147	3,422,094	3.2	10,992,294	8,918,241	5.0	17,175,460	15,101,406
11,001 - 22000	248,671,400	1.2	2,984,057	3.2	7,957,485	4,571,050	4.0	9,946,856	6,560,421	5.0	12,433,570	9,047,135
22,001 - 33,000	124,021,400	2.4	2,976,514	4.4	5,456,942	1,597,300	5.0	6,201,070	2,341,428	5.0	6,201,070	2,341,428
33,001 - 44,000	67,282,000	4.8	3,229,536	6.8	4,575,176	152,571	5.0	3,364,100	-1,058,505	5.0	3,364,100	-1,058,505
44,001 - 90,000	103,424,000	9.6	9,928,704	11.6	11,997,184	-2,381,043	12.5	12,928,000	-1,450,227	15.0	15,513,600	1,135,373
90,001 - 120,000	21,018,000	19.2	4,035,456	21.2	4,455,816	-1,964,165	23.0	4,834,140	-1,585,841	25.0	5,254,500	-1,165,481
120,001 +	22,650,000	23.0	5,209,500	25.0	5,662,500	-4,521,670	25.0	5,662,500	-4,521,670	25.0	5,662,500	-4,521,670
Residential Property	930,576,000	3.3	30,424,822		45,601,250	876,137		53,928,960	9,203,848		65,604,800	20,879,687
Commercial Property	295,679,900	5.5	16,262,395	7.0	20,697,593	133,220	7.5	22,175,993	1,611,619	8.0	23,654,392	3,090,019
Tourist Property	33,071,000	5.5	1,818,905	7.0	2,314,970	3,287	7.5	2,480,325	168,642	8.0	2,645,680	333,997
Total Revenue			48,506,121		68,613,813	1,012,643		78,585,278	10,984,109		91,904,872	24,303,703

65. **The need for buyers to register their purchases and the visibility of property are advantages of collecting property transfer taxes.** However, the highest statutory rate for Bermudian transactions tax is high by international standards and could contribute to evasion and avoidance. Taxpayers may seek to avoid the tax in several ways. First, the most obvious response is to make fewer real estate purchases for high value properties above $1.5 million is increased by between 7.1% for Bermudian purchasers and up to 15.1% for non-Bermudian purchasers. Second, the graduated rate structure provides an incentive to undervalue properties for land transfer tax purposes due to high marginal stamp duty rates applying to high value properties.

66. **These responses to the tax harms the economy in several ways.** A loss of economic efficiency results to the extent that property is not used in the best way or that purchasers employ less efficient financing techniques. Loss of confidence in the tax system can result in increased evasion, and this could have implications for other taxes as well. Revenues collected by the tax may be much lower than expected because of the combination of evasion and avoidance techniques.

C. Recommendations

Short-term

- Combine the property registration fee, the non-Bermudian property acquisition licenses and stamp duty on property transfer into a unified single rate applied to the conveyance or transfer of property.

- Increase current residential tax rates by 2 percentage points and commercial and tourist property tax rates by 1.5 percentage points to mobilize modest revenue and offset declines in ARV assessed values in 2015.

- Convert the current seven band annual Land Tax rate structure to one with three rates, with a single rate applying to tourist and commercial property, over a three-year period beginning in 2016/17.

Medium-term

- Shorten the reassessment period of properties from five years to three years and consider undertaking an assessment of 1/3 of properties each year so that the cadaster is assessed fully every 3 years to minimize large shifts in the value of the tax base due to external shocks or other economic factors.

5. IMPROVING OTC EFFECTIVENESS AND EFFICIENCY

This Chapter discusses OTC organization and operations.

A. Addressing the organizational issues

Challenges of a small administration

67. In 2015, the Management Consulting Section (MCS) of the Cabinet Office completed a "functional review" of the Bermuda Government. The survey identified multiple cases of duplication, overlap, fragmentation and redundancies of government functions, including some that do not fulfill their mandate, and a number of departments that do not reach a sustainable scope/size. These observations are valid for the administration of taxes in Bermuda.

68. OTC faces typical challenges of small and micro-administrations which essentially relate to the limitation of its manpower. The authorities' plan to reform the tax system will inevitably impact OTC. While its workload is likely to increase, its resources should not progress proportionally given the on-going Government efforts to reduce the civil service size and spending. OTC will have no choice but to optimize the utilization of its resources. Re-structuring its organization, applying risk management principles to manage compliance and automating its processes offer the most potential to improve OTC efficiency and effectiveness.

69. The current organization of the OTC is not supportive of its mission and goals. While globally organized by functions[15], OTC mainly operates as a tax-based organization. Employees in the two divisions (Operations and Compliance) are essentially specialized by tax and their respective roles and responsibilities are relatively unclear. Front offices activities (data capture, assistance to payroll taxpayers, issuance of compliance certificates and land tax bills) consume

[15] OTC comprises 4 divisions: Administration, Operations, Compliance and Stamp Duty.

an important part of their time at the expense of more value added tasks such as compliance management.

70. There is no separation between central and operational functions. Senior managers concentrate on day to day operations while insufficient attention is given to key management tasks such as planning, program design and monitoring. As consequences, field delivery difficultly meets standards and targets, major risks are not addressed, programs execution is poorly monitored and performance is not measured.

71. The administration of the different taxes is extremely fragmented and key functions are split between different organizations. Not less than 17 government agencies or regulatory authorities collect fees[16], 14 are responsible of licensing, 11 carry out registration functions and 7 are involved in the administration of land. Land administration offers a typical example of fragmentation. While the ARV of properties is assessed by the Land Valuation Office, billing and collection functions are the responsibility of the OTC. The two offices do not share the same data base and the exchange of information (66,000 assessments per year) is essentially manual.

72. Another example of fragmentation is given by the system of tax collection, which involves different departments and units including OTC. The cashiering of spontaneous payments is under the responsibility of the Accountant General network of cashiers. The enforcement of tax arrears is exercised by the Debt Enforcement Unit of the Attorney General Chambers.[17]

73. These current arrangements present multiple drawbacks in terms of efficiency and effectiveness. They generate unnecessary administrative costs and disperse government resources and competences that grouped together could create economies of scale. From the customers/taxpayers stand point they multiply the counterparts and increase compliance burden. All these departments/agencies operate in silos, use their own identification/registration number

[16] All the taxes and fees are collected by a network of cashiers depending of the Accountant General. Their system (E-1) has no or limited interfaces with those of the other agencies (including OTC).

[17] See section related to the collection of arrears Paragraph xx

and different (sometimes out of date) information systems that do not communicate with the others. Exchange of information is manual and in most of the cases is made on ad hoc basis.

74. To address these issues, modern administrations apply the following key organizational principles no matter what their size is**:** (1) a function-based organization with separated headquarters and operational functions, (2) integration of all tax-related operations and, (3) segmentation of the taxpayer population into large, medium and small taxpayers. These principles can be readily adapted to the specific needs of Bermuda without burdening the organization with too much structure. An organizational structure for OTC is proposed in Figure A.II.1 (see appendix II).

75. **Establishing a function-based organization.** A function-based organization is structured on the basis of the type of work performed (e.g. registration, taxpayer service, return processing, audit, collection, appeals, etc.,), and generally works across taxes. It contributes to eliminate significant duplication of tasks (and costs) that exists with a "type-of-tax" organizational structure; provides a single point of contact for delivery of services to taxpayers and reduce taxpayers' compliance costs; ensures a consistent treatment of a taxpayer's liabilities across different tax types; ensures a high-level of coordination and facilitate a holistic approach of compliance management; and facilitates a more flexible use of a revenue administrations human and other resources. The function-based organization is usually anchored by a strong headquarters organization distinct from field units responsible of operations and program delivery.

76. Separating central functions and field operations. The mission acknowledges that resource limitation is a major constraint but emphasizes that it is critical to establish a clear separation between central and operational activities to ensure effective management and accountability. An essential feature of effective tax administrations is a dedicated headquarters responsible for the strategic direction and oversight of field operations. (The typical responsibilities of headquarters functions are described in Box 2). There is critical need for OTC to clarify its strategic orientations, the respective roles and responsibilities, to arbitrate resource allocation and to set targets and monitor the execution of its programs and plans. In the context of in-depth transformation, HQ will be instrumental in managing the reform project, setting timetables and deliverables and most importantly in conducting change management.

77. In small tax administrations, the headquarters functions (excepted Human Resource Management and budget) are generally grouped together in a Design, Planning and Monitoring

Unit. This approach has notably been implemented in Dominica and St Kitts and Nevis, and is being currently introduced in Grenada and St Lucia (see Box 3). In these countries DPM units have been established as part of an in-depth restructuring of the IRD comprising the integration of VAT operations and the shift to a function-based organization. These units are generally headed by a senior manager (Deputy or assistant Comptroller) and depending of the size of the administration, available resources they may comprise from 4 to 14 experienced officers. For example, in addition to their core functions (strategic management, policy design, planning and monitoring), the DPM unit include appeals, legal and ruling functions in Grenada (all above plus risk management in St Lucia and IT and data analysis in St Kitts and Nevis).

Box 2. Typical responsibilities of a design, planning and monitoring section

- ✓ Developing strategic plan
- ✓ Developing operational plans and national programs
- ✓ Establishing performance measures and standards
- ✓ Recommending resource allocation/distribution in operational offices.
- ✓ Developing and maintaining standardized procedures and policies
- ✓ Issuing and maintaining instructions
- ✓ Determining appropriate business processes, risk parameters and IT requirements
- ✓ Providing direction and guidance (and technical advice) to operational units,
- ✓ Developing methodology staff procedure manuals.
- ✓ Setting the qualifications and training requirements, as necessary.
- ✓ Setting reporting requirements.
- ✓ Developing appropriate information systems.
- ✓ Monitoring and evaluating operational performance.

Box 3. On-going reforms in Dominica, St Kitts and Nevis, St Lucia and Grenada.

- All are small islands with small tax administration (of less than 120 staff) responsible for the administration of Income tax— corporate Income tax (CIT) and personal income tax— PAYE, VAT and land/property tax and/or stamp duty.
-
- Historically, these tax administrations were organized by type of tax (sales tax, income tax and stamp/property tax), with different units (one by tax) each responsible of taxpayer service and education, audit and collection enforcement functions. When VAT was introduced, the four countries established an additional unit to administer separately the new tax thus further stretching resources and increasing task duplications.

-
- Over the past two years these countries have engaged and some completed the following reforms : (1) moving from a tax-type to a function-based organization, (2) fully integrating operations for all tax types notably VAT operations into mainstream domestic tax department, (3) applying segmentation principles to organize field operations (creating a unit to administer large and medium taxpayers and another for small taxpayers) and (4) creating a design, planning and monitoring unit to provide strategic orientations and oversee field operations.

✓ Preparing an annual report of performance against the plan

78. **Integrating the administration of all taxes.** The evolution of the tax system will also give rise to the need for more integration. Integration must be understood as the consolidation or unification of the management, operational systems, and core functions (including registration, returns and payment processing, audit and collection enforcement) in one single administration. The key argument for unifying collections of all taxes is the elimination of existing silos and related duplication/fragmentation of tasks (see Box 4).

79. Several organizational options could be possibly explored[18]: The first would consist of integrating the land tax administration. This could notably involve the transfer of the valuation function to OTC and the integration of the Land Valuation Office into OTC. This would permit to redeploy a total of 8 trained and qualified officers. A broader option could be to integrate also the Land Planning Department and the Land Survey and Registration Departments into OTC. Another direction to contemplate could be to re-deploy staff from different agencies responsible for the collection of fees into OTC (for example those responsible for Telecom fees). This will allow OTC to reach a critical size and to eliminate small departments that do not have the critical size.

[18] Organizations options will be explored together with (i) re-engineering the processes, (ii) establishing automatic connections with other IT systems, (iii) establishing one-single window for registration and (iv) enhancing the collaboration with other agencies discussed later in this report.

Box 4. Advantages of the Integrated Functional Organization

- ✓ A single facility for a taxpayer to register for all current tax obligations and receive a single identification number for all tax administration purposes that is recorded in a single-registration system with a common database of taxpayer identification details.
- ✓ A single approach to taxpayer services that provides all necessary information and support to meet a taxpayer's needs in one place, tailored according to the taxpayer segment being catered to. Specialist staff can provide expert advice to complex queries with generalist officers responding to routine issues.
- ✓ Single payment and returns processing arrangements to simplify taxpayer compliance.
- ✓ An integrated audit strategy and approach to optimize the use of audit resources, eliminating duplicated and uncoordinated audits.
- ✓ An integrated approach to debt management and collection enforcement ensuring that the taxpayer is viewed and treated as a single entity for debts, non-filing and offsetting of credits.

80. **Organizing field delivery along taxpayer segments**. A common feature in almost every country is that the largest share of revenue comes from a relatively small number of taxpayers who not only pay their taxes but also pay other taxpayers' taxes through withholding systems. Delays in detecting noncompliance of large taxpayers can place tax revenue at risk. Modern tax administrations generally differentiate their taxpayers by segment to adapt their service delivery to the specific needs of each group and their enforcement programs to the risks they may pose. This concept is valid for both large and very small administrations. OTC has not enough staff to create a full-fledged large and medium taxpayer office. However, a model comprising two field offices could be considered. ***Shared Services Section*** could deliver typical front office services (notably registration, and payment processing) for all taxes and all taxpayers while ***Compliance Section*** with two sub-units one managing large and medium taxpayers' programs the second "other operations and programs" (see proposed organizational structure in appendix II).

B. "Working smarter[19]" in managing taxpayer compliance

81. Most OTC resources are consumed by front office activities at the expenses of compliance management, notably audit and collection enforcement. As a result, taxpayer compliance is relatively low. Two indicators reflect the level of compliance: the filing rate on due date and the collection rate. For Payroll tax, the most important source of domestic revenue, the filing rate on due date is (66%). For corporate service tax it ranges between 77 and 81% (see tables 12 and 13 below). These performances are low by international standards.[20] The accumulation of arrears is also symptomatic of a relative failure in managing compliance. During the last 3 years the stock of arrears has increased by 11% and represents 38% of the total revenue collected by OTC. Most importantly these arrears are generally the result of late payments of self-assessed liabilities and system-based assessments in cases of non-filing. There have been no field audits during the last two years. With only 1 examiner on 2 job positions, OTC does not have the capacity to conduct a minimal field audit program. In these conditions, audit activities have proven to be ineffective in detecting, deterring and sanctioning noncompliance.

[19] Refers to "Working smarter in revenue administration"—two OECD information notes published in January 2012

[20] The international standard is that 90% of the taxpayers file and pay on due date.

Table 12. Payroll Tax return filing statistics

Year/Details	2012-2013	2013-2014	2014-2015
Number of Returns expected:	25,432	25,424	24,588
Number Filed on time:	16,363	16,042	16,248
Number Filed Less than 3 months late:	2,116	2,209	2,073
More than 3 months late but since filed	1,222	1,204	841
Number Still Not Filed	5731	5,060	5,426
% field on time	64%	63%	66%

Table 13. Corporate service Tax return filing statistics

Year/Details	2012-2013	2013-2014	2014-2015
Number of Returns expected:	228	232	236
Number Filed on time:	177	197	192
Number Filed Less than 3 months late:	12	8	12
More than 3 months late but since filed	7	0	2
Number Still Not Filed	32	27	30
% filed on due date	77%	84%	81%

Source: OTC

82. Improving taxpayer compliance will probably require additional staff, but in priority OTC should develop and implement strategies enabling an optimal utilization of the existing resources. These strategies include: (i) the adoption of risk management principles, (ii) the automation and streamlining of the business processes and (iii) enhancing cooperation with other government agencies. These strategies will enable OTC to re-deploy staff from "front office" activities to the compliance division (audit and collection).

83. **Adopting risk management principles**. Modern compliance strategies are generally embedded in multiyear strategic/operational plans. They involve a broad range of treatments and types of interventions and most importantly they are underpinned by risk management principles. Compliance risk management is a formal process for identifying, analyzing and prioritizing compliance risks. It enables tax administration to respond to the most significant risks and achieve the best possible impact on compliance with finite resources (see Box 5). In other words, risk management will help OTC decide on what requires immediate attention. The

best compliance strategies generally offer a mix of responses and a balance between: (1) facilitating compliance: through improved services to taxpayers, and (2) deterring/sanctioning noncompliance through a broad range of targeted interventions.

Box 5. Practical aspects of risk management.

- **Risk identification**: The risks posed by the different groups of taxpayers (enterprises/ individuals, segments, sectors) compliance areas, for all core taxes must be identified. This requires intelligence capabilities to collect, process and analyze information from (i) internal sources (taxpayer information, registration system, tax returns, audit and appeal outcomes, taxpayers' inquiries and correspondences), and (ii) external sources (other government agencies such as customs, social insurance; third parties and intermediaries such as banks) to detect instances of non-compliance.

- Main risk areas to consider:

✓ Non registering for tax
✓ non filing, late filing
✓ late payment, non-payment
✓ non and underreporting of tax liabilities

- **Risk analysis**: Understanding the factors (drivers) influencing noncompliance (ignorance or deliberate willingness) is also a critical step to shape a treatment strategy.
-
- **Prioritization**. The third step consists of ranking the risks to determine priorities. The capacity to respond to risks is determined by the level of resources. Traditionally, tax administrations concentrate in priority their (limited) resources on extreme and high risks, those whose consequences/impact on the integrity and confidence of the tax system are serious and the likelihood to happen certain.
-
- **Planning and implementing the treatment strategy**. Tax administration has to identify the expected outcomes of its interventions and to decide which treatment strategy to adopt.
-
- **Performance indicators** must be set to measure the outcomes of tax administration interventions and the impact (overall effectiveness) of the treatment strategy.

84. **Facilitating compliance through improved services.** Shifting to full automation and expanding the offer of on-line services are two efficient ways to improve service delivery while cutting down costs associated to direct contacts and interactions with taxpayers. It will also allow OTC to concentrate its resources on more value-added activities. As a prerequisite, a number of processes must be re-engineered. Priority should notably be given to the elimination of remaining paper-based and manpower consuming transactions, the introduction of a unique taxpayer Identification Number (TIN) (see Box 6), the integration of the registration system, the development of interfaces with other government data bases and the development of a broader range of on-line services.

Box 6. Characteristics of an effective registration system

- ✓ It is the responsibility of the tax administration to register those individuals or entities required by law, to file a return, make a payment, submit information, or receive a benefit.
- ✓ Taxpayers should be exclusively identified by a unique TIN, that should have the following characteristics: a simple sequential number, with a check-digit. It should contain *no embedded characteristics*, indicating such things as place of business, date of registration or formation, entity type (corporation, partnership, etc.) or economic activity. The TIN should be used for all economic activities of the taxpayer, and for all branches of the business.
- ✓ Subordinate details for specific tax obligations and other TIN purposes (e.g., registration as a customs client) are stored within the TIN registration database.
- ✓ Controls to minimize duplicate and bogus registration necessitate a single, centralized taxpayer register and database. Strong taxpayer proof of identity is critical to ensure and maintain high register integrity.
- ✓ The responsibility to assign TINs and manage the register and its associated database should be vested within the tax administration. For individuals, a national identification or social security number could be used for tax purposes in lieu of the TIN if the details are reliable and the number format is compatible with tax needs.
- ✓ Even though multiple business registration databases and systems exist across different agencies the taxpayer register should ultimately be the superior repository of all businesses.
- ✓ It should be required to furnish a unique taxpayer identification number (TIN) for a wide range of administrative transactions (with Customs, Procurement, and other government agencies) and commercial activities (notably banks), including compulsory provision of cross-referenced data.
- ✓ A single TIN may need authorizing legislation. All aspects of taxpayer registration, including the rules for a universal TIN should be incorporated in a single piece of legislation such as (a tax administration act also called tax procedure code).

85. OTC assistance and provision of information is essentially delivered through resource consuming channels particularly through face-to-face. For example, helping small Payroll taxpayers to prepare their return consumes the major part of the resources of the operation division. While payroll forms should be simplified, the provision of information should be further streamlined. Most generic information must be disseminated through the Website. To that effect, the website menu needs to be re-organized to be more user-friendly and facilitate taxpayer inquiries. In addition, a broader set of on-line services including self-service facilities

could be also developed. They would enable a direct access to their personal information and account by taxpayers with the aim to reduce the need for additional interactions such as phone calls, written mails and face to face.

86. E-filing and E-payment solutions can also considerably improve OTC efficiency by removing unproductive tasks related to data capture, checks and payment reconciliations. For payroll tax, e-filing represents 34% of the total of all returns filed and e-payment 56% of the total value of the payments made. For land tax, e-payment represents 29% in number and 40% in value of the total payments. The utilization of e-filing and e-payment needs to be increased. They will enable OTC to cope with the additional workload generated by the introduction of a broad-based tax on services. They could also support a shift from quarterly to monthly obligations for the top 100 largest taxpayers (responsible for the bulk of payroll and service tax collection). They should be mandatory for large taxpayers while incentives (delays, rebates) could be granted to increase their in-take by small taxpayers.

87. E-registration also offers great opportunities. A single window for a multi-purposes registration supported by a unique identifier[21] and using the government portal should be developed. A consolidated (or more centralized) registration system would contribute to simplify the creation of business and reduce all related-costs and administrative burdens. It would eliminate duplicated formalities and redundant application forms and questionnaires. To that effect e-government initiatives must be encouraged. The introduction of a unique TIN and its utilization by all government agencies for their transactions with customers will facilitate the exchange of information. It will also facilitate OTC compliance management. Automatic exchange of information with Customs, Pension Fund, Procurement, Land valuation and other relevant government agencies will enable OTC to update and cleanse the taxpayer register, broaden the tax base and cross check data for audit purposes with a minimal deployment of resources. With a unique identification number OTC will be able to provide each taxpayer with a single account enabling an overall view of his obligations.

88. The implementation of the new Tax Information Management System (TIMS) developed by a local company is expected to have a major impact on the deployment of resources and the quality of service delivery. Using TIMS in priority to administer the stamp duty is probably not the best choice, and an opportunity to re-visit the stamp duty process has been missed. Based on

[21] For individuals, this could be the current Social Insurance Number and for incorporated businesses the Business Identification Number currently issued by OTC.

the project document developed by the partners in 2012, the system is normally designed to support electronic transactions (e-filing and e-payment for all taxes), to provide an overall view of each individual taxpayer account, to support the use of a TIN and to connect with other systems. However, such functionalities are not in use for the administration of stamp duty. The main information flows are still manual: supporting documentation must be scanned into the system by OTC staff and the payments are manual. Nor is TIMS connected with other systems (land registry and E-1). Most importantly, the transactions are not recorded in the system with a taxpayer identification number but with a distinct internal key.

89. If OTC wants TIMS to facilitate the full automation of the business processes, it is critical to ensure that the project is consistent and support its future strategic directions. Priority should be given to a full re-engineering of the existing processes with the aim to simplifying[22] and streamlining the transactions, integrating/consolidating key functions (such as registration, payment and accounting, valuation and billing) into OTC mainstream and connecting with other government agencies' databases. It is also particularly important to ensure that TIMS provides at least the functionalities described in Box 7.

90. **Concentrating audit programs on the highest risks.** Up to now, audit activities have a very limited (or no) impact on non-compliance. To be credible an audit program must play as a deterrent. It must increase the belief that non-compliance will be detected and sanctioned. Given the lack of auditors no field audit has been undertaken during the last two years, OTC mainly relies on a desk audit[23] program to ensure the accuracy of reporting. It is thus critical for OTC to field audit activities. The immediate priorities are: (i) to re-deploy staff to the compliance division and particularly to the audit team, (ii) to deliver training, and (iii) to design and implement an annual audit program. With limited resources, interventions must be targeted and concentrate on higher risks. For example, the program could target large non-filers and cases where major discrepancies are detected through data matching with third party information. By demonstrating its capacity to detect and sanction major cases of underreporting, OTC will certainly impact taxpayers behavior towards compliance.

[22] Several simplification options may be considered: reducing from 2 to 1 the number of payments of Land Tax, linking the different units to one single owner, designing a simple form/interface valid for all payments, using bar-codes or system-based codes for stamping the documents, differentiating the forms for large businesses and self-employed individuals, etc.

[23] 19 desk audits (also called manual audits) have been completed during 2013/2014 and 278 during 2014/2015.

Box 7 Main functionalities of a modern IT system

- allow a single view of the taxpayer population nationwide,
- allow an overall view of each individual taxpayers' obligations,
- support the allocation and utilization of a unique identifier (TIN),
- support secured e-transactions (e-registration, e-filing and e-payment),
- allow on-line access and management of individual taxpayer single account,
- allow connections with other government data bases and access to third party information,
- support risk management (audit case selection, debt management),
- support case management
- support resources and time management
- support performance management and reporting (based on a full range of performance indicators and service standards).

91. **Rejuvenating the stock of arrears.** There is a worrying accumulation of arrears. The total stock of arrears represents 38% of the total tax collection at the end of FY 2014/2015 which is high by international standards. Among the total stock of arrears more than 90% are older than 12 months and more than 80% are older than 3 years (see tables 12 and 13)[24]. While the accumulation of arrears can be partially imputable to OTC low reactivity and a preference given to payment plans[25], the main factor is the lack of power and autonomy of OTC to enforce tax collection[26]. To be enforceable, sanctions (fines and penalties) require the authorization of the Department of Public Prosecution. To date, no penalty has been sued to court. The application of enforcement measures and pursuits also requires a court decision. Cases must be referred to the Attorney General Chambers and are generally handled by its own Debt Enforcement Unit. The Debt Enforcement Unit which is also responsible to enforce social

[24] There has not been any recent writing-off of uncollectible.

[25] There is an example of debt of $ 1,9 million installed in monthly payment of S 500 each. It will require 316 years to be paid.

[26] OTC can only garnish and seize properties for the recovery of land tax. Garnishment of bank accounts is not allowed.

insurance debts does not have the resources to fulfill its mission and OTC does not have the legal expertise to build its cases. As a consequence, a few debts are actually enforced.

92. Regular write-off of uncollectible will help OTC concentrate its resources on productive cases. Priority must be given to the inventory of the total stock of arrears. Uncollectable needs to be separated from collectable and the latter must be ranked by age, order of importance and chance of recovery. It is also critical to accelerate the detection of outstanding liabilities and the sequence of actions. Each step of the process must be closely monitored and the outcome of each action assessed.

Table 12. Flows of the total stock of tax arrears for the last three years

	2012-2013	2013-2014	2014-2015
Total arrears at the beginning of FY	164,879,657	177,698,720	190,464,658
+ new liabilities	19,958,970	19,523,093	12,522,372
(-) Collected or discharged during the FY	7,139,907	6,757,155	5,977,946
(-) written off during FY	0	0	0
Total arrears at FY end	177,698,720	190,464,658	197,009,084

Source OTC

Table 13. Tax arrears by type of tax

Tax	2011-12	2012-2013	2013-2014	2014-2015
Payroll tax	136,936,862	129,451,712	140,894,604	146,304,481
Land Tax	26,335,063	30,471,770	34,170,346	39,356,173
Stamp duties	1,557,846	1,585,791	2,558,645	2,477,401
Hotel occupancy tax	4,470,373	7,061,865	6,452,221	3,909,618
Corporate service tax	641,580	720,606	1,496,169	1,500,294
Others	1,284,949	1,288,422	1,329,108	1,418,718
TOTAL	171,226,673	170,580,166	186,901,093	194,966,685

Source OTC

93. **Increasing collaboration and cooperation with other government agencies**. There is a critical need for the different government agencies to remove all existing organizational and functional silos. To use their limited resources more efficiently they should enhance synergies and develop their collaboration. Cooperation between different agencies could take multiple forms including automatic and systematic exchange of data[27], joint surveys (detection of hidden activities, undeclared manpower, illegal constructions), resource sharing.

94. There are several examples of data that should be exchanged electronically to assist OTC with broadening the tax base and monitoring taxpayer obligations, these include: (1) The register of employers and self-employed maintained by Social Insurance Department; (2) cadastral information maintained by the Land Surveys and Registration Department[28] and Gazetteer; (3) construction programs authorized by the Department of Planning; (4) properties and owners registered by the Land Valuation Office; (5) land values, land transfers, voluntary conveyances, deeds, mortgages available in the electronic data base of the Registry General Office; (6) local and international companies registered by registrar and licensed by the Ministry of Economic Development and; (7) professional licenses (taxis, truck drivers, fishermen, lawyers, barristers, expatriate workers) delivered by the respective licensing authorities such as transportation Control Department, Health Department, Environment, Immigration, Entertainment, etc...

C. Other selected issues

Managing Human Resource

95. The mission has not explored all the issues related to HR management (which for the most part are connected with the functioning of public service) but it concentrated on areas requiring immediate attention. If the scope of its missions is expanded, and if no change is made to its organization, systems and processes it is likely that OTC will lack resources to fulfill its mission. It is difficult to determine at this stage the adequate level of resources and competences

[27] For example, instead of issuing manual compliance certificates, OTC could flag non-compliant taxpayers and/or post a warning that could be used by other agencies. Customs could deny the clearance for a shipment, a licensing authority could reject an application.

[28] It has been established in 2009 to facilitate the registration of lands in Bermuda. But the supportive legislation has never been enacted. The department is then confined to the registration of government lands for the time being

required to support OTC operations and strategic goals. This should be addressed in a multiyear strategic plan in which OTC will clarify its new direction, set its institutional goals and objectives in all key areas, including HR management. An updated corporate strategic business plan covering the next 3-4 years will definitely help OTC support its resources management case with the authorities.

96. To accompany possible staffing and/or re-deployment of staff, training will be a critical component of the HR strategy. OTC needs to ensure that its staff has the technical skills and competences required to achieve its goals. Currently OTC has limited budget and capacity to delivering training. An option is to develop partnership and cooperation with other countries in the region where trainers/training programs are available.

Technical assistance needs

97. There are several areas where CARTAC can deliver technical assistance. Immediate needs to cover include: re-structuring the current organization, building HQ capacity, strategic planning. Assistance can be also delivered in the audit and collection enforcement areas.

Managing performance

98. Performance management is relatively weak. OTC suffers from data integrity issues, its current IT systems do not fully support the production of proper reports and preference is given to outputs rather than outcomes. To improve its performance management OTC needs to redefine its reporting requirements and standards and identify a set of key performance indicators and service standards to be monitored on regular basis. A model of possible performance indicators and standards is given in Table A.II.1(See Appendix II).

99. A better utilization of RA-FIT (revenue Administration Fiscal Instrument Tool) a web-based data reporting system developed by the IMF, could immediately help OTC improve its performance management. It comprises a large volume of information (revenue collection total and by tax, organizational arrangements, segmentation, taxpayer population), and several indicators (collection costs, filing and payment rates, service delivery outputs and outcomes) covering all key functional areas including taxpayer service, audit, collection enforcement and dispute resolution. RA-FIT is an instrument to gather confidential information used to establish baseline indicators by income/regional grouping, make data analysis available for member

countries, improve performance management and better target the technical assistance delivered by the Fund.

100. Another tool TADAT (Tax Administration Diagnostic Assessment Tool) is currently tested will be soon available. TADAT is designed to provide an objective and standardized performance assessment of tax administration system. It notably helps identify its strengths and weaknesses and helps focus on improving performance in the areas that are weak. It particularly helps decision makers set reforms objectives, establish priorities, and sequence implementation.

D. Recommendations

Re-structuring the current organization

- Re-organize OTC by functions.
- Separate central from operational functions, and develop headquarters functions by establishing a design planning and monitoring unit.
- Integrate the administration of all taxes into OTC (starting with the Land tax),
- Re-organize field delivery along taxpayer segments and design specific programs for large/ medium and for small taxpayers.

Working smarter in Improving taxpayer compliance

- Adopt risk management principles.
- Improve taxpayer service delivery capitalizing on new technologies and on-line transactions.
- Re-allocate resources to the audit team and develop and audit programs targeting the highest risks.
- Accelerate the collection of collectable debts and rejuvenate the stock of arrears. In the medium term revisit existing procedures to give more enforcement power to OTC.
- Increase collaboration and cooperation with other government agencies starting with automatic and systematic exchange of data.

Other selected issues

- Undertake a comprehensive staffing and training needs assessment and integrate HR program to OTC overall strategy.
- Build training capacity by capitalizing on bilateral and/or multilateral assistance.
- Improve reporting requirements, develop key performance indicators and set service standards to improve performance management.
- Use the other available performance management tools RA-FIT (immediately) and TADAT (when available)

APPENDICES

I. Estimation of the TRL base and yield

The base of the TRL was estimated from payroll tax return data provided by OTC as equal to the sum of the total remuneration subject to tax, including special situations and special relief, with non-taxable remuneration, for both local companies and exempt undertakings (Table A.I.1.).

Table A.I.1. Estimated base of the TRL for FY 2014/15

Item (field # in form PR1)	Local companies (Form PR1)	Exempt undertakings (Form PR1EX)	PR1+PR1EX
Total Remuneration Subject to Tax (63)	2,125,947,209.16	1,079,298,670.80	3,205,245,879.96
Total Remuneration in Special Situations (82)	27,413,364.88	12,094.85	27,425,459.73
Total Special Relief (87)	32,770,096.00	9,066,000.00	41,836,096.00
Total Non-Taxable Remuneration (Section O: Total)	285,078,226.49	53,377,050.18	338,455,276.67
Base of the TRL	2,471,208,896.53	1,141,753,815.83	3,612,962,712.36

Source: OTC

The Department of Statistics provided data on the distribution of workers by gross labor income ranges. This is data from the 2014 Annual Employment Survey and it was not possible to obtain values for the total gross labor income in each range. Gross labor income includes employment income before deductions from wages, salaries, commissions, bonuses, tips and earnings from self-employment. There are 17 gross labor income ranges. 382 workers out of a total of 25,300—1.5 percent of the workers—did not state their respective incomes. The mission disregarded these workers and therefore considered 24, 918 workers in the survey (Table A.I.2).

The mission estimated the survey's total gross labor income for each income range by assuming that the average income per worker in each range is equal to the arithmetic mean between the lower and upper limits of the range and multiplying this mean value by the number of workers in the range. For the top range—$750,000 and over—, the average income per worker was assumed to be equal to $1,000,000. The total base of the TRL (Table A.I.1.) was then distributed among gross income ranges in proportion to the estimated values of the survey's total gross labor income per range. The number of workers whose remunerations make up the TRL base in each range was estimated by dividing the estimated base of the TRL in the range by the assumed average income per worker for the range. It follows that the distribution of workers whose remunerations make up the TRL base is the same as the distribution of workers in the survey.

Table A.I.2. Estimated distribution of the TRL base by gross labor income ranges

Gross Labor Income Ranges	Number of Workers 1/	Percentage of workers in the range	Range middle point ($) 2/	Estimated income in the range ($) 3/	Distribution of estimated income (%)	Estimated distribution of TRL base ($) 4/	Estimated number of employees 5/
Under $12,000	975	3.91	6,000	5,850,000.00	0.28	10,099,614.48	1,683
$12,000 to $29,999	1,782	7.15	21,000	37,422,000.00	1.79	64,606,456.96	3,076
$30,000 to $35,999	1,435	5.76	33,000	47,355,000.00	2.26	81,755,084.43	2,477
$36,000 to $47,999	2,831	11.36	42,000	118,902,000.00	5.68	205,275,959.22	4,888
$48,000 to $59,999	4,519	18.14	54,000	244,026,000.00	11.66	421,293,764.81	7,802
$60,000 to $71,999	2,824	11.33	66,000	186,384,000.00	8.91	321,778,896.76	4,875
$72,000 to $83,999	2,549	10.23	78,000	198,822,000.00	9.50	343,252,230.94	4,401
$84,000 to $95,999	2,530	10.15	90,000	227,700,000.00	10.88	393,108,071.47	4,368
$96,000 to $107,999	1,388	5.57	102,000	141,576,000.00	6.77	244,421,029.10	2,396
$108,000 to $131,999	1,413	5.67	120,000	169,560,000.00	8.10	292,733,441.36	2,439
$132,000 to $155,999	653	2.62	144,000	94,032,000.00	4.49	162,339,649.43	1,127
$156,000 to $234,999	1,040	4.17	195,500	203,320,000.00	9.72	351,017,712.30	1,795
$235,000 to $349,999	525	2.11	292,500	153,562,500.00	7.34	265,114,880.21	906
$350,000 to $499,999	259	1.04	425,000	110,075,000.00	5.26	190,036,763.14	447
$500,000 to $649,999	82	0.33	575,000	47,150,000.00	2.25	81,401,166.31	142
$650,000 to $749,999	20	0.08	700,000	14,000,000.00	0.67	24,170,017.57	35
$750,000 and over	93	0.37	1,000,000	93,000,000.00	4.44	160,557,973.85	161
Total	24,918	100.00		2,092,736,500.00	100.00	3,612,962,712.36	43,019

Source: Department of Statistics - 2014 Annual Employment Survey; elaborated by the mission.

1/ Excludes 382 workers that did not state their incomes.
2/ Average between the range upper and lower bounds. For the top range the middle point was assumed to be $1,000,000.
3/ Number of workers multiplied by middle point.
4/ Percentage of estimated gross income in the range multiplied by the estimated TRL base.
5/ Base of the TRL divided by the range middle point

Table A.I.3. provides an example of a possible TRL rate structure and its estimated tax yield. The yield in each income bracket is equal to the sum of the yields for the ranges comprised in the bracket. The yield for each range was obtained by computing the tax due by a worker whose remuneration is equal to the average for the range and multiplying this result by the estimated number of employees in the range. Assuming that employers currently deduct 5.5 percent from wages paid to all employees, as allowed by the Payroll Tax Rates Act, all employees with wages below $149,333—that is, more than 90 percent of the employees—will benefit from a reduction in the amount of tax that they currently bear.

The simulation could be improved if: a) the Department of Statistics would be able to provide gross labor income for each gross labor income range; b) OTC would be able to provide the total number of workers whose wages compound the payroll tax base and the number of workers whose remuneration is not subject to the tax; and c) OTC could provide the remuneration of workers in the top range.

Table A.I.3. Simulated yield of the tax on the remuneration of labor

($ 1,000)

Labor remuneration ranges	rates	revenue
0 < wage < 48,000	1.0%	3,617
48,000 ≤ wage < 96,000	5.0%	32,796
96,000 ≤ wage < 235,000	10.0%	52,914
235,000 ≤ wage	15.0%	76,975
Total revenue		166,301

Source: Elaborated by the mission based on Table A.I.2.

II. Proposed OTC organizational structure and performance indicators

Figure A.II.1. Bermuda: Proposed Refinements to the OTC Organizational Structure

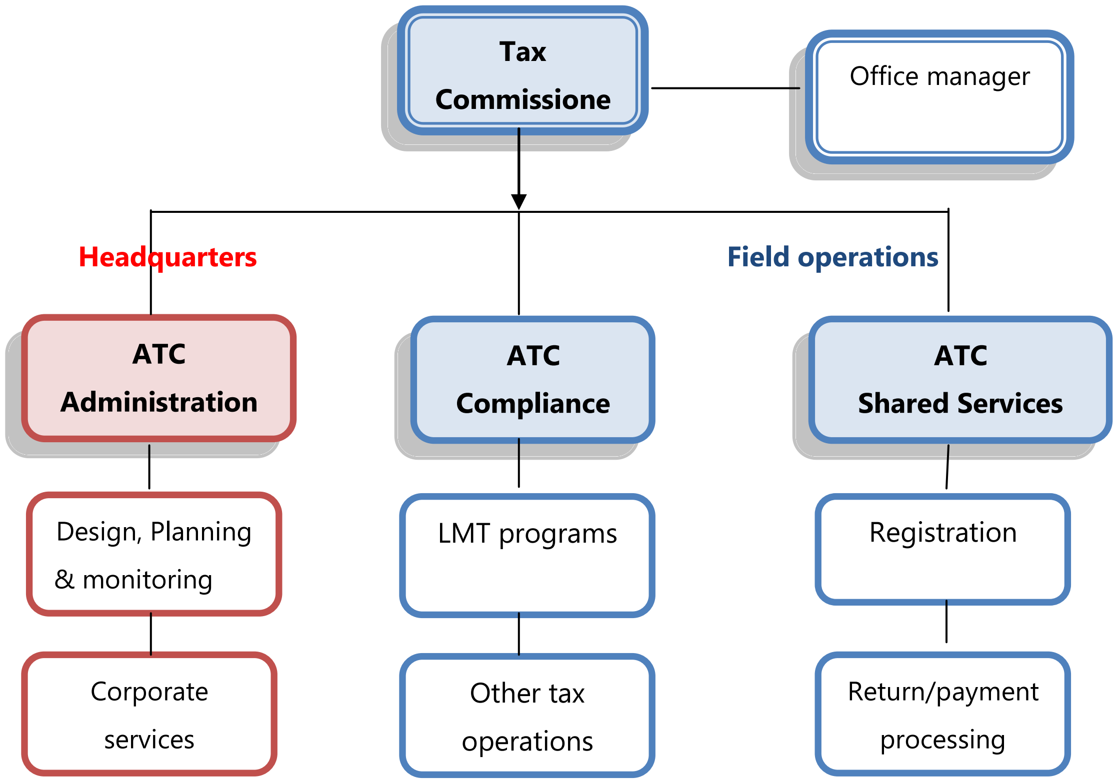

Table A.II.1. Key performance indicators and service standards

Revenue collected (Total)

Revenue collected/GDP
Revenue collected/forecast

Filing rate on due date

PAYROLL filing rate on due date: $\dfrac{\text{Number of Payroll returns filed on due date}}{\text{Number of Payroll returns expected}} \times 100 = 90\%$

HOT filing rate on due date: $\dfrac{\text{Number of HOT returns filed on due date}}{\text{Number of HOT returns expected}} \times 100 = 90\%$

ST filing rate on due date: $\dfrac{\text{Number of ST returns filed on due date}}{\text{Number of ST returns expected}} \times 100 = 90\%$

On time payment (PAYROLL)

$$\frac{\text{Number of PAYROLL payments made by due date}}{\text{Total number of PAYROLL payments due}} \times 100 = 90\%$$

$$\frac{\text{Value of PAYROLL payments made by due date}}{\text{Total value of PAYROLL payments due}} \times 100 = 90\%$$

Stock and flows of arrears

$$\frac{\text{Value of total core tax arrears at end of FY}}{\text{Total core tax collected for FY}} \times 100 \leq 10\%$$

$$\frac{\text{Value of collectible core tax arrears at end of FY}}{\text{Total core tax collected for FY}} \times 100 \leq 5\%$$

$$\frac{\text{Value of core tax arrears} > \text{12 months old at end of FY}}{\text{Value of all core tax arrears at end of FY}} \times 100 \leq 25\%$$

$$\frac{\text{Number of core tax arrears cases at end of FY}}{\text{Number of core tax arrears cases at start of FY}} \times 100 \leq 90\%$$

Flow of disputes

$$\frac{\text{Value of tax in dispute at FY end}}{\text{Total tax revenue collections for the FY}} \times 100 \leq 5\%$$

$$\frac{\text{Number of disputed cases at FY end}}{\text{Number of disputed cases at start of FY}} \times 100 \leq 90\%$$

Table A.II.1. Key Performance Indicators and service standards (cont.)

Time taken to determine objections

90% of objections processed within 30 calendar days

Time taken to issue a TIN

90% of TIN issued within 48 hours

Time taken to respond to taxpayer request (received by mail: letter and e-mail)

90% of written inquiries receive a substantive reply within 30 calendar days

Time taken to post accounting transaction to the taxpayer ledger

90% of accounting transaction (payments) posted on the taxpayer ledger within 24 hours

Time taken to identify late and non-filers

100% of late and non-filers identified within 24 hours

Time taken to follow –up on late and non-filers

100% of late and non-filers reminded within 48 hours