

TECHNICAL COOPERATION DOCUMENT

I. BASIC INFORMATION

Country/Region:	Belize
TC Name:	Support for trade and tax policy reform.
TC Number:	BL-T1059
Team Leader/Members:	Fernando Velayos (IFD/FMM), team leader; Mario Umaña (INT/TIU), alternate team leader; Alberto Barreix (IFD/FMM); Agnes Rojas (IFD/FMM); Venetia Eck-Salazar (CID/CBL); Louis-Francois Chretien (LEG/SGO); and Marina Massini (IFD/FMM).
Taxonomy:	Client support
Date of Abstract authorization:	June 23, 2014
Beneficiary:	Ministry of Finance of Belize (MOF)
Executing Agency:	Inter-American Development Bank (IDB)
Donors providing funding:	Special Program for Institutional Development (SPID) US\$405,000
	Local counterpart funding US\$0
	Total US\$405,000
Disbursement period:	24 months
Execution period:	24 months
Required start date:	August 2014
Type of consultants:	Individual
Prepared by Unit:	Fiscal and Municipal Management Division (IFD/FMM)
Unit of Disbursement Responsibility:	Institutions for Development (IFD)
GCI-9 Sector Priority:	Competitive Regional and Global Integration, Institutions for Growth and Social Welfare

II. OBJECTIVES AND JUSTIFICATION

- 2.1 The overall objective of this Technical Cooperation (TC) is to contribute with a more efficient, simplified and equitable tax policy and tax administration in Belize. This will be achieved through: (i) proposals for reforms in the main taxes and fiscal incentives, and analysis of their economic consequences; (ii) the institutional strengthening of Belize's Tax Administration; and (iii) the dissemination, discussion and validation of the reform proposals.
- 2.2 **Justification.** Belize has had one of the most revenue-effective systems in the Central America and Caribbean sub-region in the last decade. Net tax revenue in Belize is high compared to the average of the sub-region¹ (23.8% of GDP vs.

¹ Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama.

14.4%) and the Latin American and Caribbean region as a whole (17.9% of GDP). However, tax revenues have remained relatively flat in the last years, in a context where public debt amounted to 75% of GDP in 2012. Although Belize's tax system is relatively effective in generating revenue, it does so in a manner that harms economic decisions, is inequitable and is complex for both tax administrators and tax payers. These adverse outcomes stem from five main problems: (i) too many different taxes (for instance, three different types of import duty); (ii) continued over-reliance on sub-optimal forms of taxation – notably trade taxation – rather than more benign taxes, like the value added tax; (iii) numerous exemptions; (iv) special tax regimes, for instance for the tourism sector, whose special tax, the Hotel Tourist Accommodation Tax (HTAT), significantly harms the GST efficiency; and (v) fragmentation of the tax administration. Additionally, these taxation issues are closely linked to trade policy, where there are significant tax and non-tax impediments to trade despite the small economy's dependence on exports. These problems will be addressed in detail in the following sections.

- 2.3 Regarding indirect taxation, Belize's collection comes from three main taxes: trade-related taxes with 22% of total tax collection (import duties, Revenue Replacement Duty-RRD, and Environmental Tax-ET), General Sales Tax-GST (27%), and excises (3.5%). Besides the efficiency problem, the existence of various trade-related taxes makes their administration complex and, in the particular case of the ET, goes against World Trade Organization (WTO) non-discrimination principles.
- 2.4 The GST is a value-added tax and was introduced in 2006. Revenue from GST reached 6.8% of GDP in 2012, which is on par with the average of Latin America and the Caribbean (7%) and is higher than the 5.2% collected, in average, by the Central American sub-region. However, revenue-raising potential of this tax is eroded by numerous exemptions on goods and services² and a zero-rate on a wide range of products³. Not only are these tax benefits challenging to administrate and generate differentiated effective rates across sectors, but they are also highly regressive, since middle and high-income households benefit more from them as they consume more in absolute value than low-income households (IMF, 2013).
- 2.5 In terms of direct taxation, Belize charges corporations a Business Tax (BT). The business tax (that raises 6.7% of GDP) is a distortive element of the Belizean tax system due to the fact that it does not tax net income but gross sales, thus potentially taxing losses. As designed, the tax is not correlated with the taxpayer's actual capacity to pay, and the tax burden can be very high for some taxpayers and minimal for others, depending on the ratio of profits to sales. In consequence,

² Certain financial services, sale of used homes and residential rentals, educational services, equipment, medical supplies, accommodation services, public transport, supplies of international transport of passengers, goods and services provided by the Government of Belize, among others.

³ Includes 17 categories of unprocessed foods, over 20 types of processed foods, agricultural inputs, water supply, domestic sewerage services, butane gas for domestic use, a number of medicines and medical supplies, household appliances, school supplies, eyeglass frames, among others.

private investment decisions can be importantly affected by tax considerations (IMF, 2013). Important distortions are also generated by the existence of numerous rates that try to counterbalance the lack of proportionality of the tax burdens; they range from 0.75% to 25%.

- 2.6 Belize's tax expenditures also manifest through fiscal and export incentives. The current incentives policy is based on three instruments: Fiscal Incentives Act, Export Processing Zone (EPZ) and Commercial Free Zone (CFZ). Benefits under the Fiscal Incentives Act include exemptions on custom duties and indirect taxes, though a moratorium exists since 1999 for income and business tax exemptions. The duration of incentives is determined on a case-by-case basis. In EPZs, consumption taxes, import duties, excises, foreign exchange tax, property, land, capital gains and business taxes are exempted for the first 20 years of operation with the possibility of extension, and dividends paid by EPZ businesses are exempt in perpetuity. Within CFZs, no taxes are applied for the first 10 years (with the possibility of extension); thereafter, business tax is applied at a rate of between 2-8%. These systems are complex in their administration, costly in terms of foregone revenue (above 1.5% of GDP), introduce distortions in the economy and their efficiency in promoting growth is questionable. Additionally, they are mostly non-compliant with WTO obligations that establish the elimination of export subsidy programs after December 2015.
- 2.7 Inefficiencies are also present in the tax administration, which is organized by type of tax instead of functions. In Belize, four agencies are in charge of tax collection (not counting Social Security): Department of the GST, the Income Tax Department, the Customs and Excise Department, and the Belize Tourism Board, the latter responsible for the collection of the HTAT. Each department has their own taxpayers' database and there is not an information sharing protocol between entities. Inefficient coordination and duplication of functions characterize the tax administration, hampering its capacity to control evasion, raising the costs of collection, and eroding potential tax revenue.
- 2.8 This project will provide support to develop proposals to address the problems in the above mentioned areas. This will be achieved through reform proposals in income, consumption and trade taxes, the revision of the fiscal incentives framework, and also a strategy of reform of the tax administration. The project will also reinforce the technical expertise and know-how of the Ministry of Finance public servants regarding tax and trade reforms to ensure sustainability, and will promote the use of instruments/systems that contribute to innovation and institutional development, by the creation of a model/tool that assesses present and future tax and trade reforms under different scenarios. This support will be complemented with dissemination activities to generate consensus and facilitate the dialogue with the different stakeholders on the scope of the reform proposals and their benefits, in order to move towards implementation.
- 2.9 This TC is aligned with the Bank's Trade and Tax Policy strategic priority of the Country Strategy with Belize 2013-2017, which has as objective the strengthening

of the competitiveness of Belize while at the same time ensuring public sustainable finances. It is also aligned with the sectorial priorities defined in the Report on the Ninth General Increase in the Resources of the Bank, GCI-9 (AB-2764), specifically with competitive regional and global integration, and institutional strengthening for fiscal efficiency and sustainability.

III. DESCRIPTION OF ACTIVITIES/COMPONENTS AND BUDGET

- 3.1 **Component I. Institutional Strengthening for Belize Tax Administration.** The objective is to propose a viable plan to bring together some or all of the revenue collection agencies, building on previous works on the subject, such as the one carried out by the Caribbean Regional Technical Assistance Centre. The plan will include the merging/improvement of the information systems, and will address the consequences of a possible elimination of the tax collection function of the Belize Tourism Board (due to the repeal of the HTAT).
- 3.2 **Component II. Analysis of the economic consequences of tax reforms for Belize.**
- (i) Indirect taxation reform. This study will analyze the consequences of a reduction (streamlining) of trade related taxes (import duties, RRD and ET) and excise taxes⁴, a simultaneous maximization of the GST tax base, and the repeal of the HTAT. The analysis will include the revenue implication of such measures, and price and equity analysis.
 - (ii) Income tax reform. The study will analyze the potential of a gradual phase-in of a conventional corporate income tax, to replace the current BT. The analytical work would focus on the economic consequences of such reform: (i) the revenue implications; and (ii) the final effective tax burden and differences before and after the change in selected sectors of the economy.
 - (iii) Tax incentives policy reform to promote investment. This study will propose a new incentives framework that adheres to international good practices, is WTO compliant and, if possible, aligned with the integrated policy that is being promoted in the rest of Central America. It will include the revenue and efficiency costs of EPZ and CFZ, as well as costs and benefits of the new framework.
 - (iv) Design of a model/tool for tax and trade reforms assessment that will permit the simulation and evaluation of different tax and trade reforms scenarios. The personnel of the MOF will be trained on how to use this tool.

⁴ The scenarios regarding Excise Taxes are to be determined with the MOF, once a decision has been made as regards trade related taxes.

3.3 Component III. Dissemination, discussion and validation of the reform proposals. It aims at supporting the Belizean Government in holding discussion around the proposals for reform with key stakeholders, to generate consensus and facilitate dialogue, in order to move towards a realistic and sustainable implementation. Activities in this component include: (i) workshops with the attendance of Bank specialists and experts, authorities, technical staff of the MOF and the Tax Administration; and (ii) workshops with sectors that could be affected by reforms, such as representatives from the tourism and exports sectors. Representatives from governments of other countries from the region, with comparable tax frameworks, will also be considered as part of the dissemination activities⁵. After a final workshop with most or all the stakeholders, conclusions and recommendations with broad support ought to be included as part of the proposal.

A. Indicative Results Matrix

Final Result	Intermediate Indicator	Base Line	Expected Product	Means of Verification
1. Strengthening of the institutional capacity of the Belize Tax Administration.	- One study with the plan for the organizational reform of revenue collection agencies in Belize.	0	1 study	Proposal presented and disseminated to the Government and key stakeholders.
2. Streamlining of trade-related and excise taxes, and maximization of the GST tax base.	- One study with the proposal and economic consequences of indirect taxation reform.	0	1 study	Proposal presented and disseminated to the Government and key stakeholders.
3. Phase-in from the business tax to a conventional corporate income tax.	- One study with the proposal and economic consequences of direct taxation reform.	0	1 study	Proposal presented and disseminated to the Government and key stakeholders.
4. Investment promoted by new tax incentives policy.	- One study with the proposal and economic consequences of tax incentives policy reform.	0	1 study	Proposal presented and disseminated to the Government and key stakeholders.
5. Personnel of the MOF trained in the use of the model for tax and trade reforms assessments.	- Design of a model/tool for tax and trade reforms assessment.	0	1 model/tool	Model/tool in operation.
6. Implementation of proposed reforms.	- Consensus among the key stakeholders on the reforms proposed	0	3 seminars	Seminars for the dissemination and validations of reforms.

B. Indicative Budget

Description	IDB	Total
Component I	70,000	70,000

⁵ The dissemination activities will recognize the key support of the Special Program for Institutional Development in the funding of this TC.

Description	IDB	Total
Study that proposes a plan for the organizational reform of revenue collection agencies in Belize (individual consultants).		
Component II		
Study that proposes and analyzes the consequences of a reduction of trade and excise taxes, maximization of the GST base, and a repeal of the HTAT (consultant firm).	150,000	150,000
Study that proposes and analyzes the potential and economic consequences of a gradual phase-in from the business tax to a conventional corporate income tax (individual consultant).	40,000	40,000
Study that proposes and analyzes a new tax incentives policy framework to promote investment (individual consultant).	40,000	40,000
Design of a model/tool for the simulation and assessment of tax and trade reforms scenarios (individual consultant).	75,000	75,000
Component III		
Activities for the dissemination, discussion and validation of the reform proposals.	30,000	30,000
Total	405,000	405,000

IV. EXECUTING AGENCY AND EXECUTION STRUCTURE

- 4.1 **Execution.** The MOF of Belize has requested that the Bank be the executing agency of this TC⁶, through the Fiscal and Municipal Management Division (IFD/FMM) in coordination with the Bank's Integration and Trade Unit (INT/TIU) and the Country Office in Belize (CID/CBL). This is based on the Bank's ability to identify qualified consultants, its experience as an execution agency, and because compliance with MOF internal requirements might delay the execution of the TC. Moreover, contracting by the Bank would enhance independence, which is crucial for the potential reform success.
- 4.2 The MOF will be the beneficiary. It will participate in the preparation and approval of the Terms of Reference and products to be delivered. The Bank, as executing agency, will be in charge of the acquisition of goods and services. Hiring of consultants will follow the rules and procedures of the Summary of Benefits and Fees Framework for Contractual Modalities (AM-650-1), and logistics, workshops, travel and other expenses, will comply with the Bank's Corporate Procurement Policy (GN-2303-20).
- 4.3 **Monitoring and Evaluation Plan.** Supervision and monitoring will be coordinated by the Bank and the MOF. The Bank, in coordination with the Ministry, will be responsible for preparing monitoring and evaluation reports. These reports will be submitted annually and include: (i) results and products progress⁷, according to the results matrix; and (ii) financial progress. Supervision meetings will be determined by the Bank and the MOF during project implementation.

⁶ See [Letter of Request](#).

⁷ Products and results will be shared with the Special Program for Institutional Development.

V. MAJOR ISSUES

- 5.1 Potential risks include: (i) availability of quality data for construction of reform scenarios; (ii) lack of political will to effectively carry out the proposed reform agenda; (iii) resistance from tax administrations' staff in case one or some have to be consolidated; and (iv) resistance from beneficiaries of tax incentives to proposed changes. To mitigate the risk of lack of quality data, IFD/FMM, together with the Inter-American Center of Tax Administrations (CIAT), has worked on a fiscal revenue database for Belize that covers more than 20 years. Besides, the Bank has the contacts in the MOF that may be needed to complete the information. Regarding resistance to reforms (points (ii) to (v) above), the Bank, being the executing agency, will assure a high level of co-ordination and monitoring with MOF on the progress in the TC and the room for agreement. It is expected that the dissemination and validation activities proposed under this TC will increase political leverage for reform, and will also raise consensus among private actors potentially affected by reforms.

VI. EXCEPTIONS TO BANK POLICY

- 6.1 No exceptions to Bank policies are anticipated.

VII. ENVIRONMENTAL AND SOCIAL STRATEGY

- 7.1 This TC is not expected to cause significant social or environmental impacts. Therefore, a its classification is "C" ([Safeguard Policy Filter Report and Safeguard Screening Form](#)).

Required Annexes

- Annex I: [Letter of Request](#)
- Annex II: [Terms of Reference](#)
- Annex III: [Procurement Plan](#)

SUPPORT FOR TRADE AND TAX REFORM

BL-T1059

CERTIFICATION

I hereby certify that this operation was approved for financing under the Special Program for Institutional Development (PID) through a communication dated June 23, 2014 and signed by Kai Hertz, ORP/GCM. Also, I certify that resources from said fund are available for up to US\$405,000 in order to finance the activities described and budgeted in this document. This certification reserves resources for the referenced project for a period of four (4) calendar months counted from the date of eligibility from the funding source. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount, may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, for which the Fund is not at risk.

Original firmado

Sonia M. Rivera

Chief

Grants and Co-financing Management Unit
ORP/GCM

07/31/2014

Date

APPROVAL

Approved:

Original firmado

Vicente Fretes

Division Chief

Fiscal and Municipal Management Division
IFD/FMM

08/06/2014

Date