



Finance Department  
Government of St Helena  
St Helena Island  
South Atlantic Ocean  
STHL 1ZZ

## 1. Why is There a Need for Tax Reform?

The domestic tax system in St Helena was implemented in 1986 and is characterized by a primary reliance on income tax. The laws have had relatively few changes since implementation and as international best practice with regard to tax design and tax administration has progressed significantly, there is now substantial scope for St Helena to benefit from modernization in a number of key areas.

Clearly not all the laws, systems and processes used in the tax systems of large developed countries will be relevant to St Helena but there is strong evidence to show that all effective tax systems have similar features.

They have laws that are fair and can be applied equitably so that all members of the community pay taxes according to their capacity to pay.

They have effective administrative systems and practices that enable the tax administrators to provide community support to help all people meet their tax obligations. They will also ensure that taxpayers who do not comply voluntarily will be held accountable through strong enforcement activities.

In many respects, these features are not present in St Helena.

The laws focus on a very narrow income base and do not levy income taxes in all areas of gains or profits where there is a capacity to pay taxes. This disadvantages people who rely solely on local employment and business for their livelihood and favour people who are able to sustain a lifestyle from gains or profits that are not presently taxable. This is clearly evidenced by the very high proportion of income tax paid by employees.

In addition, the nature of the income tax laws restricts the capacity of the tax administrators to work effectively with the community to maintain the integrity of the tax system. The inability (or reluctance) of many taxpayers to keep proper books of account coupled with a predominance and

growth of cash transactions has affected the capacity of the tax system to reach its full revenue potential. This is evidenced by the very high tax contribution by a small number of companies and businesses and an unacceptably high proportion of small business people who pay no income tax at all.

Tax reform provides St Helena with an opportunity to ease the tax burden on individuals, particularly the lowest-paid, by improving the efficiency of tax-collection and spreading the tax system over a wider base.

It also provides an opportunity to ensure that the tax system enables the Island's community as a whole to be in a position to benefit from tourism and successful inward and local investment. Also, very importantly, tax reform will provide the funding we need for the safety net of welfare benefits.

In viewing the proposals for tax reform that were submitted to the Legislative Council, many Councillors expressed concerns with the present system and emphasised the need for taxes to be fair and affordable. All welcomed the tax benefits that are proposed but were initially hesitant at charging taxes in new areas. However, benefits come at a cost and Government must be able to raise sufficient revenue to pay for the reductions. The new system will benefit and be fair to everybody. Moreover, it will ensure that all people contribute to the cost of the welfare and community benefits that they enjoy from living in St Helena and provide the opportunity for improved social welfare where it is most warranted – to the low-paid, needy and disadvantaged.

## **2. Overview of the Reform Proposals**

These proposals for a new tax system in St Helena fall under the three broad categories of administration, income tax and broadening the tax base.

### **Administrative Proposals**

These proposals improve the administration of the tax system. They are not intended to increase the amount of tax that any person should be paying under the present laws but improve the manner in which taxes are collected. They will enable the Income Tax Office to manage the tax system more effectively; provide support, help and education to all people to ensure that they understand their tax obligations; and implement enforcement strategies to identify those people that do not comply honestly and voluntarily.

### **Income Tax Proposals**

These proposals primarily clarify the law but some will broaden the income tax base and charge income tax on gains and profits that are not presently taxable.

The clarification proposals modernise the law so that it is more effective in the present and future economic environment. They are not intended to impose any new taxes but will ensure that the law is applied fairly and

consistently and all the taxes that should be paid under the present law are collected.

The proposals that charge income tax on income that is presently not taxable will generate additional income tax revenue from people who have a financial capacity to pay and will provide SHG with the opportunity to grant tax relief to those members of the community where the need is greatest.

### **Proposals to Broaden the Tax Base**

These proposals will broaden the overall tax base and enhance the capacity of SHG to generate revenues over the medium term. These proposals improve the fairness of the tax system by ensuring that everybody who derives profits or gains and has the financial capacity to pay tax, contributes to the cost of providing the social and welfare benefits enjoyed by all members of the community.

## **3. Overview of the Administrative Proposals**

The proposals to improve the administration of the income tax system are discussed under the following headings:

Registration

Filing Income Tax Returns

Self Assessment

Assessments & Amendments

Objections & Appeals to Assessments

Payment & Collection of Income Tax

Withholding Tax

Commissioner's Powers to Enforce the Income Tax Laws

Simplification for Small Business

### **3.1 Administrative Proposal – Registration**

The Income Tax Ordinance was amended in 2007 to ensure that all persons who earn income from engaging in a trade, business, profession or vocation register with the Commissioner. There is no registration charge and the requirement to register enables the Commissioner to identify all individuals and companies who derive taxable income that is not covered by the Pay As You Earn (PAYE) system for employees.

The current legislation applies to the majority of people who derive non PAYE taxable income but does not require a person to register if income is derived from a source that does not fall within the meaning of a trade, business, profession or vocation. For example, a person who derives

rental income is not required to register because the income is not derived from trade or business.

It is proposed to strengthen the registration requirement to ensure that registration is a requirement for every person who derives taxable income from any source, other than from employment, interest or dividends.

The proposed amendment will have limited affect on most members of the community. Employees and persons who earn investment income from interest and dividends will not be required to register but persons deriving rental income will have an obligation.

### **Why is this Change Necessary?**

Registration enables the Commissioner to monitor everybody's tax obligations, ensure that they are aware of these obligations and assist them in complying with them. Persons who derive income, such as rent, may not be aware of all their tax obligations and the Commissioner must ensure that everyone is provided with sufficient information to enable them to comply voluntarily.

### **Example of How the Law Will Apply**

Pat has a house in Half Tree Hollow and as he is leaving St Helena for 6 months, he decides to make it available for rent on a self catering basis. Pat presently has no obligation to register but after the change, must complete a registration form and send it to the Commissioner prior to accepting a tenant.

## **3.2 Administrative Proposal – Filing Income Tax Returns**

The Income Tax Ordinance requires every person who derives taxable income to file an annual income tax return but only when requested to do so by the Commissioner. People who derive taxable income from a source other than employment will be requested to file every year but employees are generally required to file an income tax return every three years. Filing is not compulsory for any person until the Commissioner has requested an income tax return.

It is proposed to change the filing requirements in the following manner.

Employees will no longer be required to file an annual income tax return but may do so voluntary if they believe that an income tax refund is due.

A return will be required if the employee derives income in addition to employment income.

The annual due date for all income returns will be specified as 30<sup>th</sup> June

Business persons will have an automatic filing obligation and must file by the due date. The Commissioner will no longer be required to request a return and will only do so when a person has not complied..

If a person can not file by the due date, the Commissioner will be authorised to extend the time for filing.

Persons who derive income from nominated sources – withholding income – will not be required to declare that income in an annual tax return.

If withholding income is the only income derived by a person, no return will be necessary. (See brochure 3.7 for a full description on the new withholding tax system)

### **Why is this change necessary?**

The current system is based on outdated administrative practices and is inefficient. Many of the tasks that the Commissioner is required to carry out, by law, add no value to the income tax system. The new system will clarify the law by prescribing the tax filing obligations of all taxpayers. It will also simplify the system for employees by removing their obligation to file unless there are special circumstances.

### **Examples of How the Law Will Apply**

Hazel is a business person with a small shop in Jamestown. Her annual income tax return for the year ended 30<sup>th</sup> March 2009 must be filed by 30<sup>th</sup> June 2009.

Hazel has trouble preparing her annual profit and loss account in time for filing by 30<sup>th</sup> June 2009 and writes to the Commissioner requesting an extension of time to file. The Commissioner agrees to an extension and grants Hazel a further three months in which to file, provided she makes a final payment of estimated tax by 30<sup>th</sup> June 2009.

(See brochure 3.6 for more information on payment of income tax)

Muriel is employed in a retail shop in Jamestown and has tax deducted from her income under the PAYE system. Muriel will not need to file an annual income tax return if her only income is from employment.

If Muriel does have income that has not been subject to tax under the PAYE system, she will be required to file a return.

If Muriel believes that she is entitled to a refund of over paid income tax she may elect to file a voluntary return but the Commissioner will not issue any refunds unless a return has been filed.

Gerry is a non resident consultant for St Helena Government and withholding tax has been deducted from his consultancy fee. Gerry will not be required to file an annual income tax return as he is a non resident of St Helena.

Rodney is a builder and was awarded a Government contract to repair all historical houses in Jamestown. Rodney's income from the contract has been subject to withholding tax. Rodney will be required to file an annual income tax return because he is a resident of St Helena

## **3.3 Administrative Proposal – Self Assessment**

The Income Tax Ordinance is based on the old British “assessment” system of income tax. This system required the Commissioner to

determine every person's income tax liability and issue a tax assessment based on their annual income tax return. The system was used by many countries until it became apparent that the annual assessment process was of little value. Most have now adopted a self assessment system. Under a self assessment system, a person's income tax liability is automatically calculated on the information provided in their annual income tax return and the Commissioner does not issue an assessment.

It is proposed to adopt a self assessment system in St Helena. This change will have limited effect on the majority of taxpayers and is primarily aimed at alleviating the administrative inefficiencies associated with carrying out tasks that add no value. People in business and people with income from sources other than employment will continue to file an annual income tax return in much the same manner as they are presently required, but there will be one additional step. This additional step will be the calculation of tax payable based on the chargeable income declared in the income tax return.

### **Why is this Change necessary?**

The present system is outdated, very resource intensive and adds little value to the overall process of collecting revenue. Introducing self assessment will improve the effectiveness of the tax administration and ensure that everybody pays their fair share of tax

### **Example of How the Law Will Apply**

Arnold has a trading business and files an annual income tax return for the year ended 30<sup>th</sup> March 2009 showing a chargeable income of £7,500. This return is automatically regarded as a self assessment on the day it is filed. Arnold should calculate the income tax payable and pay this amount to the Commissioner. In practice, if Arnold has difficulty in calculating the tax, the Income Tax Office will provide help.

## **3.4 Administrative Proposal - Assessment and Amended Assessments**

As noted in brochure 3.3, the Income Tax Ordinance presently requires the Commissioner to assess every person who earns taxable income. This system will change under self assessment as the assessment will be automatic. However, an assessment process will still be necessary if a person fails to file an income tax return. In such cases, the Commissioner is authorised to raise an assessment based on any information that is available.

It is proposed to change the existing law to incorporate the new self assessment regime but retain the Commissioner's power to issue an assessment if an annual income tax return has not been filed.

The Commissioner is also authorised under the present law to amend an assessment at any time within 6 years. This will be done when it is apparent that a person has been assessed for an amount of income tax that is less than that which should have been charged. It is proposed to retain this provision of the law but the existing section will be redrafted for

the sake of clarity. There will be no change of substance to the existing law.

### **Why Is This Change Necessary?**

The existing law is based on the old assessment system and will be changed to reflect the new self assessment system. Other than this change, the existing features of the law will be retained but clarified.

### **Examples of How the Law Will Apply**

Roy operates a small trade business and files an income tax return for the year ended 30<sup>th</sup> March 2009 on 28<sup>th</sup> June 2009. The Commissioner will not issue an assessment and Roy must pay the income tax calculated on the chargeable income shown in the return. The due date for payment of the tax is fixed for all people at 30<sup>th</sup> June of every year so Roy should pay his income tax within two days of filing the return.

(For information on due dates for payment, refer to brochure 3.6)

Eric is a transport contractor and does not file his tax return for the year ended 30<sup>th</sup> March 2009. The Commissioner writes to Eric requesting a return but he does not do so. As there is information in the Income Tax Office that shows how much taxable income Eric received during the year, the Commissioner raises an estimated assessment on 21 September 2009. As the due date for payment for tax has been fixed for all people at 30<sup>th</sup> June, the tax is overdue for payment and Eric must also pay late payment penalties.

(For details of late payment penalties, refer to brochure 3.6)

In September 2009, the Commissioner interviews Roy in relation to taxable income that appears to have been omitted from his income tax return. Roy confirms that he has made a mistake and the Commissioner raises an amended assessment on 1<sup>st</sup> October 2009. Roy must pay the extra income tax shown on the Notice of amended assessment and as the due date for all 2009 tax was 30<sup>th</sup> June 2009, Roy must also pay late payment penalty.

Christine is a Government employee and has tax deducted from her wages under the PAYE system. Christine will no longer automatically get an annual income tax assessment. An assessment will only be made if Christine files an income tax return because she has other income that has not been taxed or is entitled to a refund of income tax.

## **3.5 Administrative Proposal - Objections & Appeals to Assessments**

The Income Tax Ordinance presently allows a person 15 days in which to dispute an assessment made by the Commissioner. This dispute is referred to as an Objection. Similarly, the Income Tax Ordinance presently allows a person 15 days to Appeal against a decision on the Objection. This Appeal entitles a person to have the dispute taken to Court and determined by an independent arbitrator.

If a person does not file the Objection or the Appeal within 15 days, the right to dispute the Commissioners assessment lapses and the assessment becomes final. This period of 15 days is far too short and does not allow a person adequate time to decide whether or not the Commissioners assessment is correct.

It is proposed to change the law to:

Extend the period in which a person can object to or appeal against an assessment from 15 days to 90 days,

Remove the Commissioner's discretion to extend the period of time beyond 15 days if there is sickness or absence from St Helena, and

Clarify the existing law to ensure that the Commissioner is obliged to consider the objection, give the Objector notice of the decision and amend the assessment if appropriate.

### **Why is This Change Necessary?**

The present law is too restrictive and does not allow a person adequate time to consider the Commissioner's assessment and decide whether it is correct.

### **Examples of How the Law Will Apply**

Ray files an income tax return for the year ended 30<sup>th</sup> March 2009 on 22<sup>nd</sup> June 2009 and self assesses for income tax. On 22<sup>nd</sup> August, Ray realizes that income has been overstated by £500. The person has 90 days to file an Objection against the self assessment and so must do so before 21<sup>st</sup> September 2009.

Peter files an income tax return for the year ended 30<sup>th</sup> March 2009 on 22<sup>nd</sup> June 2009 and self assesses for income tax. On 1<sup>st</sup> November 2009, Peter realizes that the taxable income shown in the return has been overstated by £500. The person was required to file an Objection against the self assessment no later than 21<sup>st</sup> September 2009 and as that date has passed, there is no longer a right to change the self assessment and it is final.

## **3.6 Administrative Proposal - Payment & Collection of Income Tax**

The Income Tax Ordinance presently requires business persons to pay their income tax after an assessment has been received from the Commissioner. Most often, the time of payment will be somewhere between 3 and 12 months after the end of the year and in some cases, much longer. As the Commissioner will not issue a Notice of Assessment under the self assessment system, it is necessary to change the law to specify a due date for payment.

Under the tax system in St Helena, business people have a distinct advantage over employees when it comes to the time of payment of tax. Employees are required to pay tax whenever they receive their income because tax is automatically deducted. However, business people are only required to pay their tax well after the end of the year. The majority of countries throughout the world have changed their laws to introduce a instalment prepayment system for business so that tax is paid progressively as gains and profits are derived. While many business people in St Helena voluntarily make prepayments of tax so that they are not faced with a large tax bill at the year end, it is proposed to make prepayment of income tax compulsory for business people.

There are several proposals in relation to payment and collection of income tax that will affect people who earn income other than employment income. They will not affect a person who only receives income as an employee. These proposals will make the collection of income tax more effective and ensure that taxes are paid in a timely fashion.

### **Due Date for Payment**

The final due date for payment of income tax will be the same as the due date for filing the annual income tax return. This will be no later than 30<sup>th</sup> June. Even if the Commissioner approves an extension for the date of filing an annual income tax return, the date for payment will still be 30<sup>th</sup> June.

### **Extension of Due Date**

The Commissioner will have discretion to extend the due date for payment of income tax where a person is unable to pay by the statutory date. However, the extension will not affect a persons liability to pay additional tax for late payment (see below).

### **Instalment Pre-Payment System**

An instalment pre-payment system be introduced for requiring payment of one quarter of the estimated income tax on the 3<sup>rd</sup>, 6<sup>th</sup>, and 9<sup>th</sup> month of the year of assessment and the final payment by the due date for filing of the annual income tax return.

Instalments of income tax will be payable during the year of assessment no later than 30<sup>th</sup> June, 30<sup>th</sup> September and 31<sup>st</sup> December. The final payment of income tax will be due on 30<sup>th</sup> June after the end of the year of assessment.

Tax instalments will be based on the prior year's chargeable income or an estimate of the current year's chargeable income. In the majority of cases, the prior year chargeable income will be the tax base but some taxpayers may choose to use the estimate base. The choice of methods will be made by the taxpayer but a person who under-estimates chargeable income will be liable for an administrative penalty.

The final payment of income tax will be a balancing amount and it will be payable at the same time as the income tax return is filed. Under the proposed self assessment system, a person will calculate the total

income tax payable for the year on the chargeable income shown in the income tax return and deduct the instalments of income tax that have already been paid. In this manner, the instalments of income tax will be allowed as a credit against the total tax due for the year.

Where the first three instalments of income tax exceed the total tax due for the year, an income tax refund will be sent to the person and there will be no final payment of income tax.

### **Late Payment Penalty**

The Income Tax Ordinance presently charges a 20% late payment penalty where a person fails to pay income tax by the due date. The penalty is payable once only and no further penalty is payable whether the income tax is paid shortly after the due date or some time well after the due date. This system disadvantages people who try to pay by the due date but might be only several days late and advantages people who do not want to pay by the due date and pay one or two years late. It also makes the Commissioner's job of collecting unpaid taxes more difficult as there is no ongoing penalty for failing to pay income tax.

It is proposed to change the present rate of late payment penalty from 20% to 10%. This will advantage persons who are only a short period late in paying income tax. However, it is proposed to introduce an ongoing per annum component of 20% per annum, payable when income tax is more than one month overdue. This will serve as an incentive to those people who have not paid on time as the amount of penalty they are liable to pay is dependant on the period the tax has been outstanding.

### **Remission of Late Payment Penalty**

It is proposed to provide the Commissioner with discretion to remit all or part of a late payment penalty if the late payment arose because of a cause outside that person's control or there are other exceptional circumstances.

### **Withholding Tax**

Withholding tax is a deduction of income tax from certain nominated payments. It is called withholding tax because it is income tax withheld from the payment.

The Income Tax Ordinance presently deducts withholding tax from dividends paid to non residents but it is proposed that income tax will be deducted from a range of payments made to both residents and non residents.

A person who pays withholding tax will be entitled to credit the withholding tax against an instalment of income tax (discussed above) to ensure that tax is not paid twice.

A fuller discussion of withholding tax is at brochure 3.7

### **Strengthening the Commissioner's Powers of Collection**

The majority of people pay their income tax on time or by agreement with the Commissioner. In these cases, the Commissioner is able to collect all

the income tax due to Government because taxpayers comply willingly and voluntarily. However, circumstances will arise from time to time when a person does not want to co-operate and does not want to pay income tax. Where this happens, the Commissioner has difficulty collecting the unpaid income tax and the only recourse is to file a legal suit and take the matter to Court.

This is a difficult and time consuming process and the majority of countries grant the Commissioner additional powers to collect income tax in the most difficult of cases. It is proposed that the Commissioner's powers to collect income tax from defaulting people will be strengthened in the following manner.

### **Company Directors**

Company directors will become personally liable for payment of income tax where companies they control have failed to pay.

### **Deduction of Income Tax**

The Commissioner presently deducts unpaid income tax from employee wages if an employee has an amount of unpaid tax. It is proposed that a similar power be granted where any person (employees, business persons etc) has not paid income tax. The power would authorise the deduction of amounts from any payment due to the defaulter.

### **Lien**

It is proposed to authorise the Commissioner to place an administrative charge, lien or caveat over property owned by a defaulter to ensure that there is adequate security for outstanding income tax.

### **Departure Prohibition Order**

It is proposed to authorise the Commissioner to place a Departure Prohibition Order over any person who is about to leave St Helena without having paid or made adequate provision for payment of outstanding income tax.

### **Why are These Changes Necessary?**

The Commissioner's powers to collect income tax under the present law are very weak. Fortunately the majority of people comply willingly but in some circumstances, taxes are not paid until several years after the end of the year of assessment. If a person decides that they do not want to pay income tax, the only power available to the Commissioner is to go to Court and this is a very slow process.

The proposed changes will only affect those persons who do not wish to willingly comply with the law.

### **Examples of How the Law will Apply**

Cecil carries on a business activity and for the year ended 30<sup>th</sup> March 2008, had a chargeable income of £10,000. Income tax payable on that income was £1,775. The person continues to carry on business and assuming there is no change in the rate of tax and allowances, is liable to

pay instalments of income tax for the 2009 year of assessment as follows:

|                                   |         |
|-----------------------------------|---------|
| 30 <sup>th</sup> June 2008 -      | £443.75 |
| 30 <sup>th</sup> September 2008 - | £443.75 |
| 31 <sup>st</sup> December 2008 -  | £443.75 |

Cecil files his income tax return for the year ended 30<sup>th</sup> March 2009 on 20<sup>th</sup> June 2009 showing a taxable income of £12,000. As this return is a self assessment return, Cecil calculates his 2009 income tax as being £2,315. Cecil deducts the instalments of tax already paid (£1,331.25) and is required to pay the balance of tax (£983.75) by 30<sup>th</sup> June 2009.

If Cecil does not pay his final payment of income tax by 30<sup>th</sup> June 2009, he will be charged additional tax for late payment of 10% - £98.37

If Cecil does not pay his final payment of income tax by 31<sup>st</sup> July 2009, he will become liable for additional tax for late payment at the rate of 20% per annum. This penalty is equivalent to £16.39 per month.

If Cecil pays his final payment of income tax on 30<sup>th</sup> September 2009, his additional tax for late payment will be £98.37 (the 10% component) plus £32.78 (2 months at the 20% pa component). Cecil will be required to pay the final tax of £983.75 plus late payment penalty of £131.15

When Cecil finds out he has to pay additional tax, he writes to the Commissioner explaining that he has just returned from Cape Town where he had an operation and was hospitalised for one month. Cecil has normally paid all his taxes on time. The Commissioner decides to remit all the additional tax for late payment because Cecil has a good payment record and could not make arrangements to pay his tax because of his ill health.

If Cecil's chargeable income for the year ended 30<sup>th</sup> March 2009 was £7,000 (i.e. less than the prior year), the calculation of tax payable would be different. For example, Cecil calculates his 2009 income tax as being £965. Cecil deducts the instalments of tax already paid (£1,331.25) and is entitled to refund of £366.25 income tax because his instalments exceed the total annual income tax payable.

Cecil refuses to pay his income tax of £983.75 because he does not believe that Government is spending his taxes properly. The Commissioner writes to Cecil on several occasions and requests payment but he still refuses. The Commissioner finds out that Brian owes Cecil £3,000 and issues an Order on Brian requiring payment of Cecil's income tax. Brian is required to send the Commissioner £983.75 and pays the balance of his debt - £ 2016.25 directly to Cecil.

### **3.7 Administrative Proposal – Withholding Tax**

The Income Tax Ordinance presently requires that income tax be deducted from dividends paid to non residents. This is referred to in the law as a withholding tax but it is actually a withholding of income tax. Under the present system, a person who has withholding tax deducted from a dividend payment is entitled to a credit for that amount when the Commissioner issues an annual Notice of Assessment.

It is proposed to change the system in three important ways.

The withholding tax system will apply to both residents and non residents.

The withholding tax system will be extended to cover a greater range of specified payments.

In some circumstances, the withholding tax deducted will be regarded as a final income tax and the person who receives the payment will have no further tax obligations in respect of that income.

Withholding tax is a very important part of the income tax system as it enables tax to be collected in circumstances where it might otherwise be difficult to do so. For example, it is very difficult to collect income tax from non residents if they are not personally present in St Helena. Once they leave the island, payment of income tax becomes virtually optional as the Commissioner has no legal recourse to collect money from persons who are not in St Helena.

Withholding tax is also a very useful means of collecting income tax from residents because the tax is deducted from the payment, in much the same manner as PAYE. Most people accept their obligation to pay income tax and will do so voluntarily if not for the difficulties they face in firstly, keeping accurate records of income and expenditure and secondly, actually finding the money to pay when it becomes due. In fact many people already make voluntary pre payments of tax to ensure that they are not caught short when trying to find one larger sum of money when income tax is due.

Withholding tax will alleviate this problem for many people as tax will be deducted from the payment and sent to the Commissioner. In many cases, that payment of income tax is also regarded as a final tax liability and no further tax will be payable on that income.

### **Non Residents**

As noted earlier, withholding tax is presently deducted from dividends paid to non residents. It is proposed to extend the scope of the withholding tax system to ensure that withholding tax is deducted from all payments of the following type:

Interest

Dividends

Pensions

Rents and royalties

Insurance and re-insurance premiums

Commissions

Management fees

Payments for the supply scientific, technical, industrial or commercial knowledge information or assistance

Payments under a contract or agreement for labor or services

Payments for the carriage of passengers, mail, merchandise or goods embarked in St Helena.

Because of the difficulties of ensuring that income tax returns are lodged, it is also proposed that the withholding tax deduction from payments to non residents will be a final liability and no further income tax will be payable or refundable.

Residents

It is also proposed to extend the withholding tax system to residents by requiring the deduction of income tax from payments of the following type:

Interest

Dividends

Pensions

Rents, royalties and premiums

Payments under a contract or agreement for labor or services

Payments for the supply of unprocessed fresh meat, fish, fruit and vegetables

Payment for building, construction and earthmoving services.

It is proposed that deductions of income tax from payments to residents that are of the type covered by points 1 – 5 will be a final liability and no further income tax will be payable or refundable. However, the deduction of tax from payments that are covered by points 5 and 6 will be treated as a prepayment of tax. This prepayment will be applied as a credit against the final annual tax payable when the person who receives the payment lodges the annual self assessment return.

### **What is the Rate of Withholding Tax?**

The rates of withholding tax have not yet been determined but it is likely that the rate for non residents will be higher than the rate for residents. Residents can expect the rate of withholding tax to be less than the present rates of income tax. For example, the rate of withholding tax on interest may be 10% whereas the present top marginal rate for individuals is 27% and the company rate is 30%

### **Who is Required to Deduct Withholding Tax?**

Only Government, Government agencies and persons who are in business will be required to deduct withholding tax. Employees and unemployed persons will have no obligation to deduct tax but can do so voluntarily if the recipient of the payment requests.

## **Why are These Changes Necessary?**

One of the major outcomes of the tax reform is to have a new tax system that is simpler for the community to understand and easier for the Commissioner to administer. The withholding tax system provides a simple means for people who earn taxable income from business activities to pay their income tax.

Withholding tax is also a more efficient system for the Commissioner as collecting tax from people who have left St Helena or from Saints who have not saved some money for their final tax liability is often quite difficult.

## **Examples of How the Law will Apply.**

John is a non resident and provides consultancy services to Government in the field of finance. Government pays John a fee of £500 for his services. As the payment is of the type covered by item 8 of the non resident list, Government is required to deduct withholding tax from the payment. If the rate of withholding tax is 15%, John receives a payment of £425 and Government pays £75 to the Commissioner.

The tax deducted from John's payment is a final liability and John does not need to file an annual income tax return.

Jeffrey has a contracting business in Half Tree Hollow and Government awards him a contract to do earth moving works at Ruperts. Government pays Jeffrey a fee of £2,000 for the work. As the payment is of the type covered by item 7 of the resident's list, it is required to deduct withholding tax. If the rate of withholding tax is 10%, Jeffrey would receive £1800 and Government would pay £200 income tax to the Commissioner.

The tax deducted from Jeffrey's payment is a prepayment and Jeffrey would need to declare the income in his annual self assessment income tax return and claim a credit for the tax paid.

Rodney lives in Jamestown and he has a savings account with the Bank of St. Helena. For the year ended 30<sup>th</sup> March 2010, he earns £125 interest on the account. As the payment is of the type covered by item 1 of the residents list, the bank is required to deduct withholding tax when the interest is credited to the account. If the rate of withholding tax is 10%, Jeffrey would receive £112.50 and the bank would pay £12.50 income tax to the Commissioner.

The tax deducted from interest credited to Rodney's account is a final liability and Rodney does not need to include this income in his annual income tax return

Eileen works for Government and lives in Levelwood. On 1<sup>st</sup> September 2010, she signs a contract with Bob, a builder, to build an extension to her home. Bob charges £5,000 for the project.

Eileen is not required to deduct withholding tax from the payment to Bob as the payment is not related to any business activity carried on by Eileen

### **3.8 Administrative Proposal – Commissioners Powers to Enforce the Income Tax Law**

In the majority of cases, people comply voluntarily with the tax law because they accept that they have a legal obligation to pay income tax. When this happens, the Commissioner has no need to use any powers of enforcement. However, there will inevitably be instances of non compliance, either because of ignorance or misunderstanding of the law or because of a deliberate attempt to evade paying taxes. When this situation arises, the Commissioner must have sufficient legal authority to ensure that all people pay their fair share of taxes.

If the Commissioner does not have sufficient powers to enforce the law, revenue collections will suffer and Government may be faced with budget deficits. When this happens, all honest taxpayers suffer because of the actions of a relatively few.

There are some powers of enforcement in the Income Tax Ordinance but there have been some difficulties in applying them correctly because of the manner in which the law has been drafted. In addition, these powers have not kept pace with international and economic developments and might prove to be ineffective in some circumstances.

It is proposed to strengthen the powers of enforcement in the following areas to ensure that the Commissioner can adequately enforce compliance in circumstances where a person has not voluntarily complied.

Obtaining Information

Access to books and records

Non Arms length transactions

Tax Avoidance

Administrative Penalties

These powers of enforcement will generally not affect the majority of people in St Helena.

#### **Obtaining Information**

The Commissioner will be required, from time to time, to collect information about the financial activities of people who are liable to pay income tax. Often this information is held by third parties and because of the privacy and confidentiality considerations of many businesses and organisations, the Commissioner can not obtain information from them unless authorised by law. The Income Tax Ordinance provides the Commissioner with the legal authority to over-ride any privacy and confidentiality considerations but because of the manner in which the law has been drafted, it has been subject to some dispute.

The present difficulties will be exacerbated as the economy develops and multi national companies commence business activities in St Helena so it is proposed to clarify and strengthen the powers to obtain information to ensure that any third party person is required to provide information to the Commissioner that is relevant to the calculation of either their own or to another person's income tax liability.

This change is primarily a clarification measure.

### **Access to Books and Records**

The Income Tax Ordinance presently authorises the Commissioner to require a person to attend at the Income Tax office and produce any books, accounts documents or records. In a manner similar to a request for information, this power over-rides any privacy and confidentiality considerations but because of the manner in which the law has been drafted, there have been some administrative difficulties.

It is proposed to clarify the law to ensure that the Commissioner can access and copy any books and records and update the law to include access to electronic data storage device.

### **Record Keeping**

There is presently a requirement for every person to keep adequate books of account but the law does not prescribe a retention period. It is proposed to clarify the law to:

Remove any obligations for employees

Define the meaning of "adequate"

Prescribe a minimum retention period of 6 years

Ensure that people who meet the definition of "small business" have limited obligations.

### **Associated Persons**

It is proposed to authorise the Commissioner to review transactions between associated persons to ensure that they are carried out on a commercial ("arms length") basis. Where a transaction between related parties is designed to give a favourable tax outcome to one of the parties without a corresponding tax consequence to the other party, the Commissioner will be authorised to substitute an economic value for the transaction.

### **Tax Avoidance**

It is proposed to introduce laws to counter tax avoidance schemes where the main purpose of entering into the scheme was to affect a person's income tax liability. Tax avoidance schemes are artificial arrangements designed to give an unrealistic tax outcome. There is no evidence of such schemes in St Helena but with the growth of the global economy and the likelihood of more international companies doing business in St Helena, it is important that the law has safeguards.

### **Administrative Penalties**

As noted earlier in the brochure, there will inevitably be instances of non compliance and the Commissioner must have sufficient legal authority to sanction those people that do not comply. An administrative penalty is the most common sanction used internationally. In many respects it actively encourages compliance as when people are aware that there is a financial consequence for failing to comply, they will be more likely voluntarily accept their legal obligations. However, the most common form of sanction in the Income Tax Ordinance is prosecution in Court. This is a time consuming and often ineffective process. As administrative penalties do not apply to all the obligations imposed on people liable to pay income tax, it is proposed to authorise the imposition of a penalty where a person:

Fails to register,

Fails to file an income tax return,

Fails to deduct taxes from employment income or withholding income,

Makes a false or misleading statement for the purpose of reducing a tax liability.

It is proposed that the law will prescribe the varying rates of penalty that can be imposed and the circumstances under which a particular rate of penalty would be applicable.

### **Why are These Changes Necessary?**

Financial sanctions are necessary to ensure that everybody complies with their income tax obligations. The present law is inadequate and the Commissioner has difficulty in enforcing the law when people who do not comply voluntarily.

### **Examples of How the Law will Apply**

The Finance Company (St Helena) Plc carries on a loan and savings business in Jamestown. The company has information regarding the financial transactions of several people who have not complied with their obligation to file annual income tax returns. The Commissioner wishes to raise assessments on these people and in order to obtain information on their taxable incomes, writes to the company and requests information on the transactions in the investment accounts.

The Finance Company is required by law to provide this information to the Commissioner.

Richard files his annual income tax return for the year ended 30<sup>th</sup> March 2009 on 19<sup>th</sup> September 2009. As the return is filed late (it was due on 30<sup>th</sup> June 2009), Richard is liable to pay an administrative penalty of £100

Barry files an income tax return for the year ended 30<sup>th</sup> March 2009. The Commissioner carries out an income tax audit some months after the return has been received and discovers that Barry has not disclosed all his income. The Commissioner prepares an amended assessment and charges Barry the extra income tax payable and also charges an administrative penalty of 25% of the tax not paid because of his failure to declare the correct amount of income.

Barry files his income tax return for the year ended 30<sup>th</sup> March 2010. The Commissioner is not satisfied with this return and carries out another income tax audit and discovers that Barry has again not disclosed all his income. The Commissioner prepares an amended assessment and charges Barry the extra income tax payable and also charges an administrative penalty of 40% of the tax not paid because of his repeated failure to declare the correct amount of income.

### **3.9 Administrative Proposal – Small Business Simplification**

Collecting income tax from small business persons presents a particularly difficult problem for the Commissioner because of the inability or reluctance of many small enterprises to keep proper books of account and their capacity to conceal taxable income transaction through cash transactions.

Statistics available from the Department of Finance show that in the 2007/8 year of assessment, 52% of registered business taxpayers paid no income tax and a further 26% paid an average of less than £250.00 each. This low rate of income tax payment by business persons is further exacerbated by the suggestion that a number of small enterprises have failed to register and operate outside the tax system.

Many countries with developing economies face a problem with enforcing small business tax obligations and they have introduced new alternative income tax regimes to simplify their tax obligations. These alternate regimes make it easier for small taxpayers to comply and assist the Commissioner in collecting the right amount of income tax from every person.

These alternative regimes are not intended to impose new or additional tax liabilities but operate to ensure that the taxes that should have been paid under existing income tax law is actually paid.

It is proposed that small business persons be taxed under a simplified regime. The options include:

Classifying a business as a “small business” according to annual gross income. As an example, a business that earns less than £10,000 per year might be regarded as a small business

Small business would be liable for income tax calculated on the basis of either or all of the following:

an annual licence fee;

a percentage of gross income

withholding tax on gross income

Income tax calculated by one of the above methods would be a final liability and there would be no need to file an annual income tax return

If option 2.b was selected as the basis of calculating income tax, the small business person would need to file a quarterly statement of income and tax would be charged under a self assessment system and payable quarterly

Small business people would be relieved of some record keeping obligations and would only be required to keep records of income.

How Much is The Licence Fee and What is The Rate of Tax?

The amounts of the fee and the rate of tax have not been decided. However, it is not intended that small taxpayers would pay more than what they should presently pay.

### **Why Is This Change Necessary?**

The present income tax system is not appropriate for small business people as they have difficulty complying with the same income tax laws as medium to large businesses. Many small business people would like a simpler system that makes it easier for them to comply.

### **Examples of How the Law Will Apply**

Raymond earns income from carrying out part time carpentry work with several builders. On average, he would earn no more than £100 per week. Raymond qualifies as a small business person as his annual income is less than £10,000. The options for calculating the income payable by Raymond's include one or all of: (i) an annual licence fee; (ii) income tax calculated as a percentage of his income; (iii) withholding tax deducted from the gross proceeds.

If the rate of small business tax or withholding tax was 5%, Raymond's income tax would be £500.

## **4. Overview of the Income Tax Law Proposals**

The proposals to improve the income tax law are discussed under the following headings:

- 4.1 Taxing Income on a World Basis
- 4.2 Law Clarification – Employment
- 4.3 Law Clarification – Business
- 4.4 Personal Allowances and Tax Rates
- 4.5 Interest
- 4.6 Dividends
- 4.7 Capital Gains Tax

## **Income Tax Law Proposals – Taxing World Income**

Prior to 2004 the Income Tax Ordinance only charged income tax on people who were residents of St Helena. People who came to St Helena to work or carry on a business activity were not charged income tax if they could show that their place of residence was outside St Helena. This system of charging income tax was out of step with every other country in the world.

Most countries charge income tax under the two principals of “country of source” and “world Income”.

Firstly, all income is taxed in its country of source. That is to say that income earned from work and business carried in a particular country is subject to income tax in that country. There is rarely an exception to this rule.

Secondly, most countries charge residents income tax on the income they earn from any source in the world. This is referred to as taxing “world income” and a resident in this context is somebody who would normally live in that country or has actually been present in that country for a nominated period of time. To avoid taxing the same income twice, all countries that charge income taxes under the “world income” principal allow a credit for any tax paid under the “country of source” principal.

In 2004, St Helena made the first step in bringing the scope of its income tax law into step with international practices by adopting the country of source principal. That is to say that income tax was then charged on all income earned in St Helena whether or not the person who earned the income was a resident.

However, St Helena did not adopt the second principal of world income and in that regard, is still out of step with most other tax jurisdictions.

Taxing world income is particularly relevant for St. Helena as many residents travel to Ascension and Falklands to earn considerably higher incomes than they would by staying at home. Under the present laws, these people pay no income tax on their foreign income but are entitled to enjoy the benefits of social welfare when they return home. Government relies on income tax as a major source of revenue to fund social welfare. The majority of people who live and work in St Helena do not earn high incomes and should not be required to pay for the social welfare of their higher paid country men and women who are working offshore.

Modern tax laws are based on the principals of fairness and equity where everyone pays their fair share of taxes according to their capacity to pay. People who earn income outside St Helena have a far greater capacity to pay tax than those who remain in St. Helena and for this reason it is proposed that the tax law be changed to adopt the principal of charging income tax on a world income basis.

The Income Tax Ordinance presently has provisions that enable the allowance of a tax credit for foreign income tax paid under the country of

source principal and residents will not be charged tax twice on the same income.

### **Who is a Resident?**

St Helena adopts similar approach to determining residency for an individual as do most other countries. A person will be a resident if:

1. Their normal place of abode is in St. Helena and they were physically present in St Helena for some part of the year; or
2. The person was present in St. Helena for a period (or periods) greater than 6 months in the year of assessment; or
3. The person was present in St Helena in working under a contract of employment that has a term greater than 6 months.

The term normal place of abode is taken to mean the place where a person normally lives and it is proposed to change the fits test to ensure that a person will only be regarded as a resident if they normally live in St Helena and is actually on the island for at least 3 months of the year.

Where any person is working offshore and is not physically present on St Helena for 3 months of the years, they will not be regarded as a resident and the world income basis will not apply.

### **Why Is This Change Necessary?**

Saints who work offshore are entitled to all the social welfare benefits when they return to home to St Helena. However, they contribute less for these benefits than do people who remain in St Helena. On the basis of fairness, equity and capacity to pay, St Helena should charge income tax on world income in much the same manner as the majority of other countries.

### **Examples of How the Law Will Apply**

1. Sandra is a resident of St Helena and receives a UK Government pension for her past service as a Public Servant. The total amount of the pension is £7,500 per annum and income tax of £750 is deducted by the UK Government. Sandra has a small business in St Helena and for the year ended 31 March 2009, her profit from the business was £4,000.

Sandra's chargeable income in St Helena will be £11,500 and she will be charged income tax of £2,180 on this amount. As Sandra has paid £750 income tax in the UK, this amount will be allowed as a credit against income tax charged in St Helena and she will be required to pay £1,430.

2. Eileen is a resident of St Helena and but for six months during the year ended 30th March 2009, she works on Ascension Island and earns income £9,500 per annum. As the personal allowance in Ascension is £12,500, no tax was paid in Ascension. When Eileen is back in St Helena, she has a part time job in Jamestown and for the year ended 31 March 2009, she earned £3,500.

3. Eileen's chargeable income for the year ended 30th March 2009 is £13,000 and she will be charged income tax of £2,585. As no tax was paid in Ascension, there is no foreign tax credit to be allowed.

4. Roy leaves St Helena on 25th June 2009 to work in Falklands. Roy returns to St Helena on 28th April 2010. For the year ended 30th March 2010, Roy will not have been physically present in St Helena for at least 3 months so he is not regarded as a resident. His income from Falklands is not taxable in St Helena.

## **4.2 Income Tax Law Proposals – Law Clarification Employment**

There are three proposals to change the income tax law that specifically relate to employees.

The PAYE system presently operating in St Helena is similar to the PAYE systems that operate throughout the world but with one exception. In many countries, employees are not required to file an annual income tax return unless there is a particular need to do so. It is proposed to change the law so that employees will only file if they receive additional income outside their employment or are entitled to receive a tax refund.

The Income Tax Ordinance presently charges income tax on the majority of employee allowances and benefits but grants a concession to employees who are provided with a house or a car. This concession limits the taxable value of the benefit to £250 for each. This taxable value was determined at market value in 1986 and as it has not changed, is commercially unrealistic. In addition, this concession creates an anomaly because an employee who is provided with a cash housing or car allowance is liable to income tax on the full amount of allowance whereas an employee who is provided with a house or car is liable to income tax at a concession rate.

It is proposed to remedy this anomaly by removing the concession value of the housing benefit and substituting a market value.

Under the present law, there is limited scope to ensure that people who are engaged under a contract of labour or service are taxed in the same manner as employees. Many of the contracts for labour or service have all the indicators of employment contracts and it is proposed to strengthen the law to ensure that they are taxed under the PAYE system if there is a substantial similarity with employment.

Other proposals relevant to allowances and rates of tax are discussed separately in brochure 4.4 as they apply to all taxpayers, not only employees.

### **Why are These Changes Necessary?**

The proposals intend to remove anomalies in the application of the law and to relieve some of the tax filing obligations on employees. The majority of employees will be unaffected.

## **Example of How the Law Will Apply**

Anita is employed in a clothing shop Jamestown and receives £70.00 per week. For the year ended 30<sup>th</sup> March 2009 Anita received £3,500. Anita's tax is deducted under the PAYE system. Anita has no other income.

The Tax deducted under the PAYE system is a final liability for Anita and she is not required to file an income tax return.

Kurt is a senior Government employee earning \$15,000 per annum and is provided with a free house and electricity in Piccolo Hill. For the year ended 30<sup>th</sup> March 2009, Kurt is required to pay income tax on the benefit. As the value of the housing benefit is limited to £250 per annum, his income tax is £67.50.

Nicholas is also a senior Government employee earning £15,000 per annum and he is paid a housing allowance of £300 per month. Nicholas rents a Government house at Piccolo Hill for £300 per month and is also required to pay electricity of £50 per month. Nicholas's income tax on the allowance is £81 per month or £972 per year.

Nicholas pays £904.50 income tax more than Kurt and is also required to pay his own electricity £600 per annum.

If the proposal to change the value of benefits to a commercial market value is adopted, Kurt will be liable to pay income tax on the full market value of his house and electricity and will have the same tax liability as Nicholas.

## **4.3 Income Tax Law Proposals – Law Clarification Business**

There are quite a number of proposals relevant to business because the simplified income tax law implemented in St Helena did not address many of the areas that are relevant in today's business community. In every respect, the law is presently administered in a manner that is fair and reasonable but the proposals are necessary to ensure that the business community and potential investors have certainty in relation to the application of the tax laws. In addition, it is important that there are no weaknesses and loopholes in the tax law that could be exploited.

### **Gains and Profits**

All gains and profits arising from a business, profession, trade or vocation are presently liable for tax, whether or not they arise from normal trading activities or from transactions in business assets. It is proposed that the meaning of taxable income will be clarified to ensure that there is no confusion and that the gains and profits that are presently liable to income tax continue to be so.

### **Long Term Contracts**

There are presently no laws on the manner of calculating gains and profits for long term construction projects. With the likely advent of major construction projects in the years ahead, it is necessary to ensure that the rules that are applied in other countries can be applied in St Helena.

## **Prior Year Losses**

A deduction for losses incurred in prior years is available under the present law but it does not address certain areas that are relevant in today's economic environment. It is proposed that losses

Will be deductible beyond the present 5 year limit where the loss arose from a new capital allowance

Will not be deductible where the loss arose from a transaction which occurred outside St Helena

Will not be deductible for a company that changed more than 50% of its shareholders

## **Bad Debts**

The Income Tax Ordinance requires business to account for gains and profits as they are derived. This requirement means that business transactions become liable for income tax before payment has been received. In cases where payment is not received, accounting standards require that the amount not received be deducted from the financial accounts. The amount not received is referred to as a bad debt.

The law in St Helena does not allow a deduction for a bad debts but it is proposed to allow a deduction where a debt has actually been written off because it is unrecoverable.

## **Trading Stock**

The cost of trading stock purchased for resale in a business is a normal business outgoing but there are no trading stock provisions in the law. As accounting standards prescribe alternative means of valuing stock and accounting for profits, it is proposed to introduce provisions that

Specify the method of valuing stock

Specify the manner of accounting for the cost of trading stock

Specify the manner of accounting for profits on disposal of trading stock.

## **Losses on Sale of Business Assets**

As noted earlier in this brochure, the Income Tax Ordinance charges income tax on all gains and profits. Gains on the sale of all business assets are liable for income tax and losses on the sale of business assets that qualify for a capital allowance (wear and tear deduction) are deductible. However, the law does not allow a deduction for the loss on sale of assets that do not qualify for a capital allowance. This feature of the law works to the disadvantage of some taxpayers as gains will be taxable but losses not deductible. This outcome is unfair and it is proposed to change the law so that all losses on the sale of business assets are deductible.

## **Capital Allowances**

The Income Tax Ordinance has a very general provision that provides the Commissioner with discretion to allow a deduction for the wear and tear of a business asset. The law has no rules for calculating the

deduction and a person who wishes to claim a deduction has no opportunity to question the Commissioners calculation because it is discretionary.

The tax laws of all other countries contain specific rules on the manner of calculating a capital allowance deduction and it is proposed to introduce those rules into the Ordinance. The new rules will primarily reflect relate the present administrative practices but by including them within the body of the law, the manner of application will be transparent and fairness in application will be enhanced. The rules will address such matters as:

The standard rate of allowance

The method of depreciation

The ownership, acquisition and cost of an asset

Disposal of an asset

Accelerated Rates of Capital Allowances

In order to encourage development of St Helena and new investment both locally and from abroad, it is proposed to introduce an accelerated rate of capital allowance. This accelerated rate will be calculated in the same manner as a standard capital allowance but would be at a higher rate.

As an example, Government is considering:

Lifting the rate of allowance for buildings from the present rate of 5% per annum to 10% per annum. In doing so, the cost of new buildings and renovation of existing buildings could be claimed as an income tax deduction over 10 years rather than the present 20 years.

Granting a bonus investment allowance to "Approved Investors" of 20% so that, in addition to the accelerated allowance deduction, the approved investor would be entitled to deduct an additional 20% of the cost in the first year of use.

### **Why Is This Change Necessary?**

The Income Tax Ordinance is outdated and does not adequately deal with current economic and financial transactions. The changes will clarify the law and specify additional deductions additional to which a business may be entitled.

### **Examples of How the Law will Apply.**

Examples on the application of the law will be provided when the first draft of the proposed legislative changes is available for public consultation.

## **4.4 Income Tax Law Proposals – Personal Allowances and Tax Rates**

Personal Allowances

The income Tax Ordinance presently allows for a range of personal allowances that are deductible from taxable income. In effect these are the tax free amounts a person can earn.

These allowances are:

1. Personal Allowance (£2,500)
2. Dependant Child Allowance (1st Child £330; 2nd Child £220; Subsequent child £80)
3. Dependant Allowance (£200)
4. Life Assurance Allowance (Maximum £30 per annum)
5. Superannuation Allowance (No Limit)
6. Seaman's Allowance (£250)

It is proposed to change the entitlement to allowances as follows.

1. Increase the personal allowance by at least a further £500. The actual amount will depend on the extent to which all the tax reform packages are accepted, including the consolidation of allowances in point 2 below.
2. Consolidate allowances 1 and 2 into an increased single allowance that applies to everyone regardless of whether they have any children. The actual increase in personal allowance from consolidation has not been determined but if the consolidation is adopted, the personal allowance will be increased by a further amount for everyone.
3. Remove the entitlement to allowances 3, 4 and 6. There is relatively limited application of these allowances and they apply to only a relatively few people. The Seaman's allowance is considered inappropriate as employees of RMS earn considerably more income than the majority of Saints, are provided with free lodgings while on board and have a capacity to pay income tax that exceeds most other Saints.
4. Prescribe rules for an entitlement to a superannuation or pension allowance. The Income Tax Ordinance presently has no rules for an entitlement to a pension allowance and Government would like to encourage all people to invest in funding their own retirement benefits.

### **Rates of Tax**

There are presently two tiers for personal income tax. The first tier of 17% applies on the first £2,000 of chargeable income and the second tier of 27% applies on remaining chargeable income. Government and Councillors are concerned that the top rate of tax now applies to average income and are examining the threshold at which the second rate applies. There is also consideration on the possibility of introducing a third tier that would fall between the 17% and 27% tiers.

However, the extent to which rates of tax can be lowered will depend on whether the overall package of reforms is acceptable. Government is required to exercise responsible fiscal management and to ensure there is sufficient budget capacity to meet the cost of tax reductions and the increased cost of social welfare. It is committed to reducing the overall

tax burden on individuals but to achieve this, taxes must be levied in areas that presently do not contribute.

### **Why is This Change Necessary?**

It is Government's intention that everyone share in the benefits of tax reform. Increasing the basic personal allowance will ensure that everyone pays less income tax. The present tax codes gives preferential tax benefits to only certain segments of the community and consolidation of allowances will ensure that everyone shares equally in the benefits of tax reform.

### **Example of How Will the Law Apply**

1. Larry is employed by Government and earned £4,500 during the year ended 30th March 2009 and is entitled a personal allowance of £2,500.

For the year ended 30th March 2009, Larry's income tax liability is as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £4,500 |
| Less Personal Allowance  | £2,500 |
| Chargeable Income        | £2,000 |
| Tax on Chargeable Income | £340   |

If the proposal to increase the personal allowance to £3000 is adopted, Larry's new tax liability would be as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £4,500 |
| Less Personal Allowance  | £3,000 |
| Chargeable Income        | £1,500 |
| Tax on Chargeable Income | £255   |

Larry will be £85.00 better off.

2. If the proposal to consolidate dependant allowances are adopted, Larry's new personal allowance will increase and there will be a further tax saving.

## **4.5 Income Tax Law Proposals – Interest**

The general exemption from income tax for interest earned from funds deposited with the Bank of St Helena was originally included in the Income Tax Ordinance in 1999 to promote investment in Government Savings Bank. This exemption was transferred to the Bank of St Helena in 2004 to continue support for the Bank.

The decision to grant an exemption may well have had a sound economic base at the time but it is contrary to the principles of tax policy. Most countries seek to charge tax fairly across all forms of gains and profits and remove the benefits that weigh unevenly to any particular

segment of the community. Where a segment of the economy derives a form of income and has a capacity to pay tax, it is unfair on all other members of the community to give them preferential treatment. While it is true that many Saints hold accounts at the Bank of St. Helena and earn interest on their savings, the real benefit from the interest exemption goes to a relatively few. These few are the large account holders, the companies and the large profitable businesses.

At a time when St Helena is undergoing a process of broadening the tax base to share the tax burden across all areas of profit and gain, it is difficult to justify continued economic support for one taxpayer (the bank) and preferential income tax treatment that favours large account holders. While it is true that small account holders, as well as large account holders, will be required to pay tax on their interest, the tax will be returned by way of higher personal allowance and lower tax rates. The net affect of this will be an overall reduction of tax for most taxpayers.

It is proposed to remove the exemption for interest earned from the Bank of St Helena.

## **Collection of Income Tax**

It is proposed to include bank interest as a specified payment under the withholding tax regime. The Bank will be required to deduct withholding tax at the rate of 10% from interest credited to every account.

### **Why is This Change Necessary?**

The real benefits from the exemption are enjoyed by a relatively few. The tax reform proposals seek to ensure that everyone who derives a gain or profit contributes their fair share of revenue to Government and all the benefits of that additional tax revenue will be returned to taxpayers by way of increased allowances and lower tax rates.

### **Examples of How the Law Will Apply**

Rosemary earns interest of £50 during the 6 month period up to 31<sup>st</sup> May 2009. As the interest is regarded as withholding income, the Bank deducts £5.00 income tax (10%) Before crediting the amount to Rosemary's account. The Bank forwards the withholding tax to the Commissioner and credits Rosemary's account with £45.00

## **4.6 Income Tax Law Proposals – Dividends**

The Income Tax Ordinance has no provisions that are relevant to dividends, other than the requirement to deduct withholding tax from dividends paid to non residents. While there are relatively few companies operating in St Helena, this situation is likely to change with the growth in the economy through tourism, and investment. Because of this, the program of tax reform presents an opportunity to introduce specific dividend provisions that will ensure the regime in St. Helena operates in a manner similar to other countries.

A dividend is a distribution of, after tax, company profits to the owners of the company (shareholders). Most countries recognise the principal that shareholders are effectively drawing the after tax profits from the company and to tax those dividends at the full normal rate is effectively taxing profits twice – once in the hand of the company and again in the hands of the shareholder. For this reason, there is quite often income tax relief on the dividends.

It is proposed to follow the practices of most other countries and introduce a reduced rate of tax on dividends paid to residents. The proposed rate is 15%.

Tax will be collected by classifying the dividends paid to a resident as withholding income under the new withholding tax regime (See brochure 3.7 for further information). A company will be required to deduct withholding tax from a dividend at the time it is declared and forward the tax to the Commissioner.

The deduction of withholding tax will be a final liability and the account holder will not be required to declare dividends in an annual income tax return.

It is also proposed to introduce a definition of dividends so that certain payments by companies to shareholders will be regarded as a dividend. These include:

All distributions by companies in excess of the paid up value of the shares

Loans to shareholders that are not intended to be paid

Distributions on winding up that are in excess of the paid up value of shares.

Why is This Change Necessary?

Dividends are not adequately dealt with under the tax law.

Examples of How the Law Will Apply

Spar Supermarket (St Helena) Plc has an authorised capital of 10,000 £1.00 shares and on 28<sup>th</sup> October 2009, it declares a dividend of £5.00 per share. The total dividend payable is £50,000 and all the shareholders of the company are resident in St Helena. Spar must deduct £7,500 withholding tax (15%) from the dividends and pay this amount to the Commissioner.

Barry is general manager of Spar Supermarket (St Helena) Plc and also owns 2,000 shares. His salary for the year ended 30<sup>th</sup> March 2010 is £20,000 and he receives dividends of £8,500 after deduction of withholding tax. Barry has no other income.

Barry does not need to file an income tax return as both his salary and the dividends have been subject to a tax deduction (withholding tax and PAYE). Both taxes are a final liability and Barry does not need to pay any more tax.

#### **4.7 Income Tax Law Proposals – Capital Gains Tax**

The income tax laws presently charge income tax on all capital gains arising from the sale of business assets. As noted in brochure 4.3, it is proposed to amend the law to ensure that all losses on the sale of business assets are deductible.

However, the law does not address other gains and profits that are not connected with a trade or business. In order to ensure that all gains and profits arising from transactions in St Helena are liable to income tax, a new capital gains tax will be introduced.

It is proposed that the Capital Gains Tax will apply to all gains and profits except those arising from the sale of:

1. Business assets (because there is normal income tax on all profits)
2. A family home
3. Household furniture and effects
4. Personal use assets having a value of less than £500.

Any loss on the sale of assets liable to capital gains tax will only be deductible from capital profits derived in the same year or any subsequent year. However, losses on the sale of motor vehicles not used exclusively for business purposes will not be deductible.

Capital gains will be regarded as taxable income and must be included in an annual income tax return. Tax will be charged on the total chargeable income shown in the return at the normal rates of income tax.

#### Why is This Change Necessary?

It is intended that the new tax system will apply to all gains and profits so that the tax burden can be shared equitable amongst everyone who has a capacity to pay.

#### Examples of How the Law Will Apply

1. Matthew buys a house in Alarm Forrest for £45,000 on 21st July 2008. He rents it out on a self catering basis for two years and then decides to sell it. He advertises for 3 months and eventually sells the house on 20th October 2010 for £52,000. Matthew has expenses of £1,500 on the sale and makes a profit of £5,500. The profit is a capital gain and is liable to income tax.

Matthew must file an income tax return for the year ended 31st March 2011 and declare all his taxable income. The capital profit will be added to his other income and he should calculate the tax on his total chargeable income for the year

2. Jeffrey buys a house in Half Tree Hollow for £55,000 on 30th June 2008. He lives in the house for two years and then decides to sell it to shift into Jamestown. He advertises for 3 months and eventually sells the house on 15th November 2010 for £70,000. Matthew has expenses of £1,500 on the sale and makes a profit of £13,500. The profit is not a taxable capital gain as it is covered by the family home exclusion.

3. Lionel buys a car over the internet in the UK for £6,500 and ships it to St. Helena. His expenses in shipping the car here amount to £1,250. When the car arrives here, Lionel is offered £10,000 for it by a consultant and he finds the offer to good to refuse. Lionel accepts the offer and makes a gain of £2,250 after his shipping costs.

Lionel's gain is a taxable capital gain and he must declare the profit in his annual income tax return.

## 5. Overview of the Proposals to Broaden the Tax Base

The proposals to broaden the tax base to ensure that everyone contributes their fair share of tax are explained in the following categories:

5.1 Hotel Tax

5.2 Inward International Remittance Levy

5.3 Property Tax on vacant Residential Property

5.4 Value Added Tax

5.5 Landing Fees

5.6 Stamp Duty

### 5.1 Broadening the Tax Base – Hotel Tax

The Hotel Tax Ordinance applies to charge tax at the rate of 10% on the value of accommodation provided in a hotel. A hotel is defined in the Ordinance as any establishment that provides short term accommodation and for that reason any establishment such as a guest house or bed and breakfast should be charging tax. The tax is not limited to establishments that are licensed as a hotel but because of confusion with the wording of the existing law, It is proposed to clarify the law to ensure that all establishments providing accommodation are liable to charge tax.

In addition, it is proposed to change the law so that the tax is paid to Commissioner every month, rather than the present situation of one annual payment.

The changes to the Ordinance are unlikely to have any impact on tourism. All visitors to St Helena are accustomed to pay a Value Added Tax (VAT) in their home country at rates as high as 20%, so it is very unlikely that any would be concerned with an hotel tax at 10%.

Because VAT is such a common tax throughout the world, it is also proposed to expand the nature of the hotel tax to include all services provided in establishments plus nominated services. Tax would then be levied on services such as:

The cost of all services provided in an establishment that provides accommodation

Short term car rental

Tours and excursions

Restaurants

Brochure 5.4 contains information on the proposal to introduce a broadly based VAT and the tourist related taxes suggested in this brochure would be temporary measures pending introduction of the VAT.

#### Why is This Change Necessary?

The hotel tax is not administered according to the intention of the law and needs to be clarified. In addition tourism presents an opportunity for all Saints to benefit. Tourists expect to pay taxes when they travel and it is unlikely that the proposals would cause any impact on the tourist industry.

#### Examples of How will the Law Apply.

Maxine is a tourist from the United Kingdom and arrives in St Helena for a three week holiday. She stays at the Napoleon Guest House and charges all her expenses to her account. At the end of the three weeks, Maxine's bill is as follows:

|                             |           |
|-----------------------------|-----------|
| Room 21 nights @ £60.00     | £1,260    |
| Car rental 15 days @ £10.00 | £150      |
| Meals                       | £625      |
| Drinks (Wine and Beer)      | £250      |
| 2 Island Tours              | £125      |
| Sub Total                   | £2,410    |
| Plus Taxes                  | £241.00   |
| Total Payable               | £2,651.00 |

Maxine's taxes are £241 and the Napoleon Guest House must remit this to the Commissioner every month.

## 5.2 Broadening the Tax Base – Inward International Remittance Levy

St. Helena is one of many small island nations that rely on remissions from its citizens who live and work abroad. These inward remissions are a very important part of the economic base and provide the means of livelihood for many residents. However, under the present system, they are not liable for any tax or levy.

One of the guiding principals in the reform of the tax system is that all gains and profits should be liable to tax and the tax burden should be shared equally amongst the community according to the financial capacity of each person to pay. By sharing the burden fairly amongst the community, tax relief can be given in the areas where it is most needed and improved social welfare can be delivered to the poor and disadvantaged. Saints who are the beneficiaries of foreign remissions do have a capacity to pay tax in the same manner as any other employee or business person and by not doing so, they receive a considerable unfair advantage.

Many countries charge a levy on the inward remission of funds and it is coincidental that Tristan Da Cunha has also recently include a levy on inward remissions in its draft tax laws. It is proposed to introduce a 1% levy on all funds remitted into St. Helena. The levy would be primarily collected through the Bank of St Helena on all inward remission and full details will be released when the draft legislation has been prepared.

Why is This Change Necessary?

If everybody does not pay their share of taxes, the burden will fall far heavier on those who have no option but to do so. Employees are responsible for contributing a very high proportion of total Government revenue and in order to grant tax relief to those that are in the greatest need, it is necessary to ensure that the tax base is spread evenly across the community.

Example of How The Law Will Operate

John has worked in Ascension for 3 years but his wife and children have remained in St Helena. John regularly deposits £200 per week to his account at the Bank of St Helena and his wife draws those funds for family livelihood. Under the proposed system, a levy of 1% (£2.00) would be deducted from every deposit by the Bank and forwarded to the Commissioner.

Brett has worked in Ascension with his wife and children for 5 years but intends to return to St Helena when he has saved enough money. On 21<sup>st</sup> January 2010, Brett decides he is returning home to St. Helena and deposits £10,000 cash savings to his account. Under the proposed system, the Bank will deduct £500 (1%) from the deposit and forward it to the Commissioner

### **5.3 Broadening the Tax Base - Property Tax on Vacant Residential Property**

The former property tax legislation was repealed principally because it imposed an unfair burden on some members of the community who could least afford to pay tax. This reasoning is consistent with the principal adopted in the present reform process that taxes be affordable, applied fairly and directed towards those people that have a financial capacity to pay.

Non resident Saints who own properties in St Helena will take advantage of the welfare and lifestyle benefits of St. Helena when they return home. It is Government's view that they should contribute to the costs of those benefits. If they do not pay their share of costs, the burden will be shifted to Saints who are living and working in St Helena, many of whom can ill afford to pay more taxes.

People who own properties and rent them commercially are contributing to the country's economic benefit through their taxes but those that leave their properties vacant contribute little, other than standing charges.

It is proposed that tax be charged on the rental value of the vacant residential property owned by non residents.

### Why is This Change Necessary?

Government is concerned that not all people who enjoy or intend to enjoy the benefits of living in St Helena are contributing to the cost of those benefits. The change is part of a package designed to relieve the burden on working Saints who are living and working in St Helena.

### Examples of How The Law Will Operate

The full details of the application of the new law, with examples, will be made available for public discussion at a later time.

## 5.4 Broadening the Tax Base – Value Added Tax

The tax system in St. Helena is heavily reliant on income tax and import duties as a source of Government revenue. The present tax reform has addressed many of the weaknesses in the income tax system but the reform has not addressed the Customs Ordinance. There are many goods that are not liable for import duty and the duty base is therefore quite narrow, relying heavily on taxes indirectly paid by those people who consume taxable goods. This narrow tax base effectively means that the tax burden falls far more heavily on some people than it does others.

The present system also significantly advantages people who work abroad for a number of years, pay no taxes to St Helena Government and subsequently return to enjoy all the same free / low cost benefits that resident Saints have paid for all their working life. This is hardly a fair system for resident Saints and is a major factor in the high taxes that they pay.

It is proposed to address this situation by implementing a Value Added Tax (VAT) within the next 3 years.

VAT is the fastest growing tax in the world, principally because it charges tax on all forms of consumption of (spending on) goods and services. In countries like St Helena where income from employment and business is not the only indicator of a capacity to pay taxes, VAT has been particularly useful in addressing the imbalance and sharing the burden. It also has the advantage of ensuring that all tourist pay taxes on their spending when they visit St Helena. With the anticipated growth in tourism, it is very important that a mechanism be in place to ensure that Government revenue grows in step with tourism and all Saints can share in the benefits through improved Government services.

It is proposed that the VAT for St Helena exhibit the major features of other VAT laws that have been successfully introduced in other small island nations. The features would include:

All imported goods would be taxable (with limited exemptions)

All locally manufactured goods would be taxable

All locally provided services would be taxable

The limited exemptions would include health; education; locally grown and unprocessed fresh meat, fruit and vegetables; financial (banking) services and employment

VAT would replace import duty and wharfage (but not excises on goods such as fuel, tobacco and alcohol)

The registration threshold will be set at a high level (£52,000) so that the majority of small business operators would not have any tax obligations.

Export industries would be charged tax at the rate of zero % to encourage development of local export industries

#### Why Is This Change Necessary?

The very narrow tax base in St Helena imposes a heavy burden on most employees. Tax is not shared equitable throughout the community and the returning Saints or Saints whose livelihood depends on foreign remissions do not carry the same burden as those that work in employment or business. A VAT will apply to everybody.

#### Example of How the Law Will Operate

Bob is a building contractor and is engaged by Marion to build her new house in New Ground. The total cost of materials and labour is £80,000 but Bob will be required to add VAT to the bill. Marion will be required to pay £88,000.

Bob is registered for VAT as his annual sales exceeds the threshold of (£52,000). The building materials he purchased from the Empire Hardware Store Plc. for Marion's house cost him £55,000 and included in the price was VAT of £5,000. Bob will be required to file a VAT return as follows:

|                   |         |        |
|-------------------|---------|--------|
| Gross revenue     | £88,000 |        |
| VAT collected     |         | £8,000 |
| Taxable purchases | £55,000 |        |
| VAT paid          |         | £5,000 |
| Net VAT payable   |         | £3,000 |

Bob must pay £3,000 VAT to the Commissioner as he has already paid £5,000 to the supplier of the materials.

The Empire Hardware Store is an importer of building supplies. During the month of May 2012, supplies to the value of £100,000 were landed in Jamestown aboard the RMS. Bob is required to pay VAT of £10,000 when the goods are landed.

During the month of June, the Empire Hardware store sells all the imported building material for £143,000. It is required to file a VAT return as follows:

|                               |          |         |
|-------------------------------|----------|---------|
| Gross revenue                 | £143,000 |         |
| VAT collected (at 10% = 1/11) |          | £13,000 |
| Taxable imports               | £110,000 |         |

|                          |         |
|--------------------------|---------|
| VAT paid (at 10% = 1/11) | £10,000 |
| Net VAT payable          | £ 3,000 |

The Empire hardware Store is required to pay £3,000 VAT to the Commissioner. It has already paid £10,000 VAT at the time the goods were imported.

### **5.5 Broadening the Tax Base – Landing Fees**

It has been proposed that Government examine the opportunities for introducing a tourist landing fee in much the same manner as occurs in Falklands.

There is currently a £12 Visitors Pass Fee levied by Immigration when all tourists physically come ashore in St Helena. However, the Falkland fee is directed more towards the cruise ship and is charged on the number of passengers on board rather than the numbers that come ashore.

There is no intention to levy both charges simultaneously and if a review determines that the Landing Fee is more effective than the Visitors Pass, the latter will be abolished.

The fee is primarily directed at tourists and it is not envisaged that it will have any affect on the number of ships that call into the island. As tourist fees in one form or another are common place.

### **5.6 Broadening the Tax Base – Stamp Duty**

Stamp duty is presently collected on the transfer of all property and on the execution of a range formal agreements and deeds. Duty is payable at a prescribed rate on the value of the property transferred or a nominated amount for agreements and deeds.

Stamp duty normally collects a considerable amount of Government revenue. For instance, in the United Kingdom, stamp duty contributes a greater amount of revenue than taxes on either of tobacco, alcohol, or general import duty (excluding VAT). Estimated revenue from stamp duty in the St Helena Annual Recurrent Budget is £20,000. This is a fairly insignificant amount and there is concern that the stamp duty Ordinance may not be operating as effectively as it ought.

It is proposed to carry out a review of the stamp duty law and compliance with the law to determine whether there is any scope for increasing revenue collections. Full details of any recommended changes to the Ordinance arising out of the review will be made available at a later time.

## 6. Indicative Examples of How the Changes May Effect You

1. Andrew is a Government employee and earns of £5,000 for the year ended 30<sup>th</sup> March 2009 (this presently the average income in St Helena). During the year, he received some money from his mother's UK Estate and has invested £5,000 in the Bank of St Helena. The interest received on that is £350.

For the year ended 30<sup>th</sup> March 2009, Andrew's income tax liability is as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £5,000 |
| Less Personal Allowance  | £2,500 |
| Chargeable Income        | £2,500 |
| Tax on Chargeable Income | £425   |
| Tax on Interest          | Nil    |
| Total Tax                | £425   |

If the proposals to increase the personal allowance to £3000 and charge income tax on interest are adopted, Andrew's new tax liability would be as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £5,000 |
| Less Personal Allowance  | £3,000 |
| Chargeable Income        | £2,000 |
| Tax on Chargeable Income | £340   |
| Tax on Interest          | £35    |
| Total Tax                | £375   |

Andrew is £50 better off, even though he is required to pay tax on his bank interest.

2. Mary does not work but lives in Longwood with her three children. Mary's husband has worked on Ascension for 3 years and sends money to her for the family livelihood. For the year ended 30<sup>th</sup> March 2009, Mary received £5,000

For the year ended 30<sup>th</sup> March 2009, Mary pays no income tax as the money she has received from her husband is not taxable.

If the proposal to charge a 2% levy on funds is adopted, Mary would be liable for a levy of £100

Mary is worse off but now contributes something towards the cost of providing health, education and welfare services for herself and her family.

Mary still pays less tax than Andrew and the amount of money they have for their livelihood the same.

3. Peter is a senior manager employed by Government and earns £9,500 during the year ended 30<sup>th</sup> March 2009.

For the year ended 30<sup>th</sup> March 2009, Peter's income tax liability is as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £9,500 |
| Less Personal Allowance  | £2,500 |
| Chargeable Income        | £7,000 |
| Tax on Chargeable Income | £1,640 |

If the proposal to increase the personal allowance to £3000 is adopted, Peter's new tax liability would be as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £9,500 |
| Less Personal Allowance  | £3,000 |
| Chargeable Income        | £5,500 |
| Tax on Chargeable Income | £1,555 |

Peter will be £85.00 better off.

If the proposal to adopt three tiers of tax is adopted, Peter's new tax liability could be as follows:

|                          |        |
|--------------------------|--------|
| Gross Income             | £9,500 |
| Less Personal Allowance  | £3,000 |
| Chargeable Income        | £5,500 |
| Tax on Chargeable Income | £1,330 |

Peter will be £310 better off.

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