



BELIZE

SELECTED ISSUES

December 2019

This Selected Issues paper on Belize was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on November 12, 2019.

Copies of this report are available to the public from

International Monetary Fund • Publication Services

PO Box 92780 • Washington, D.C. 20090

Telephone: (202) 623-7430 • Fax: (202) 623-7201

E-mail: publications@imf.org Web: <http://www.imf.org>

Price: \$18.00 per printed copy

International Monetary Fund
Washington, D.C.



BELIZE

SELECTED ISSUES

November 12, 2019

Approved By
**Western Hemisphere
Department**

Prepared by Julian T.S. Chow, Vibha Nanda, (both WHD)
Alexander Klemm, Sebastian Beer (both FAD) and Irving Aw
(LEG).

CONTENTS

TOURISM IN BELIZE: ENSURING SUSTAINED GROWTH	3
A. How Has Tourism Evolved in Recent Years?	3
B. What Are the Comparative Advantages and Challenges?	6
C. How Could Structural-Institutional Reforms Benefit Tourism and Belize's Economy?	9
D. Conclusion and Policy Implications	12
References	15
FIGURE	
1. Tourism Sector	4
TABLE	
1. NSTMP Targets from 2011 to 2030	5
ANNEX	
I. National Sustainable Tourism Master Plan 2012–2030	14
TAXATION ISSUES IN BELIZE	16
A. Context	16
B. The Standard Income and Business Tax Systems	18
C. Special Regimes	20
D. International Developments	25
E. Issues and Potential Reform Directions	27
References	32

BOXES

1. Ownership Structure of International Firms _____	24
2. The Cost of Capital Under Turnover Taxes _____	28

FIGURES

1. Tax Revenues in Belize and Comparator Countries, 2015-17 Averages _____	17
2. FDI Stocks, 2016 _____	17
3. Recent Developments in IBCs _____	22
4. Implicit CIT Rates _____	29
5. Turnover and Revenue Distribution _____	29

TABLE

1. The Main Special Regimes _____	20
-----------------------------------	----

TOURISM IN BELIZE: ENSURING SUSTAINED GROWTH¹

1. Belize’s tourism sector has witnessed impressive growth in recent years with overnight tourist arrivals registering double digit annual growth rates since 2016. Investments by major international hotels and recent plans to build a multi-million dollar cruise port off the coast of Belize City along with other planned development projects will contribute significantly to economic activity, given the small size of Belize’s economy. To guide the development of the tourism sector from 2012 to 2030, the government endorsed a National Sustainable Tourism Master Plan (NSTMP) in 2011, setting various initiatives and targets for the immediate and medium term.

2. The potential for further growth in Belize’s tourism sector is high. According to a study by the Inter-American Development Bank (IDB), tourism industry in Belize is still an “emerging” rather than a “mature” sector. It is a relatively new industry in Belize when compared to the long-established Caribbean tourism destinations.

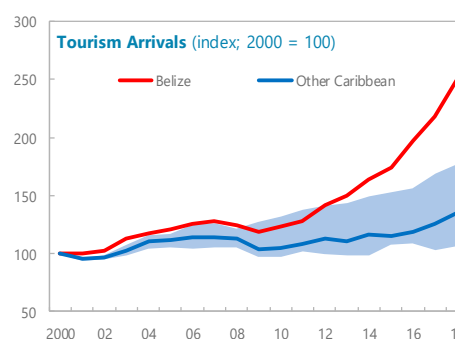
3. Given the importance of the tourism sector as the key contributor of Belize’s economic well-being, this paper addresses the following questions:

- How has tourism evolved in recent years?
- What are the comparative advantages and challenges?
- How could reforms help in sustaining tourism and contributing to economic growth?

4. This paper is organized as follows: Section A provides an overview of Belize’s tourism sector and main achievements; Section B discusses the country’s comparative advantages and bottlenecks in tourism; Section C analyzes the impact of structural and institutional reforms on tourist arrivals; and Section D concludes with a discussion of policy implications.

A. How Has Tourism Evolved in Recent Years?

5. Belize’s tourism sector has grown rapidly in recent years, contributing strongly to economic recovery (Figure 1). Tourist arrivals have increased at a rate of 8.6 percent per year from 2010-2018 (15 percent in 2018). In other Caribbean economies, tourist arrivals grew 3.5 percent per year in 2010-2018 (6.1 percent in 2018.) According to the World Travel and Tourism Council (WTTC), the direct contribution of tourism amounted to 15 percent of GDP in 2017, three times higher than the Caribbean average of 4.8 percent of GDP. Its total contribution, when including



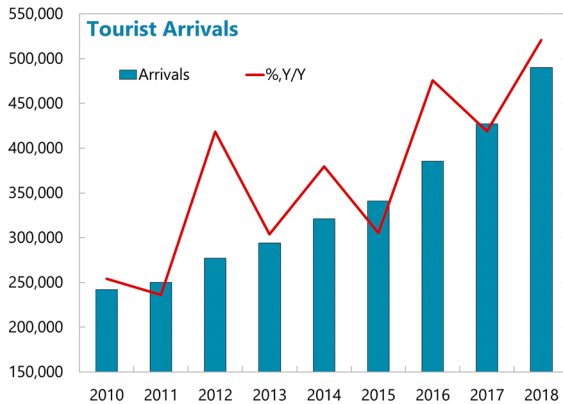
Source: National authorities; IMF staff calculations.
Note: Shading indicates inter-quartile range.

¹ Prepared by Julian T.S. Chow and Vibha Nanda (both WHD).

indirect and induced effects, was estimated at around 41.3 percent of GDP (compared to the Caribbean average of 15.2 percent of GDP). The sector provides direct employment to 13.4 percent of the labor force, rising to 37.3 percent of total employment with the inclusion of jobs that are indirectly supported by the tourism activities. With travel earnings contributing around 40 percent of total exports in 2018, up from 32 percent in 2008, tourism is also the largest earner of foreign exchange.

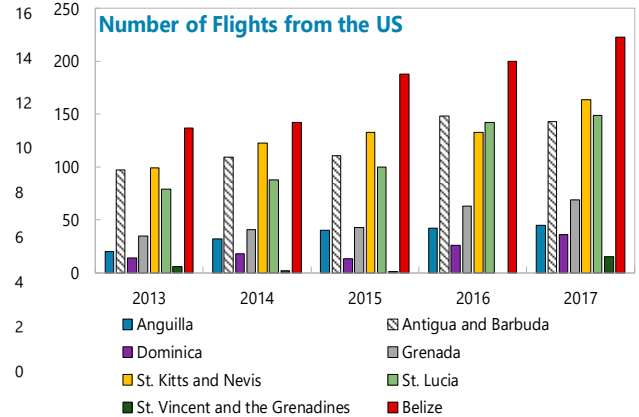
Figure 1. Belize: Tourism Sector

Tourist arrivals have grown rapidly ...



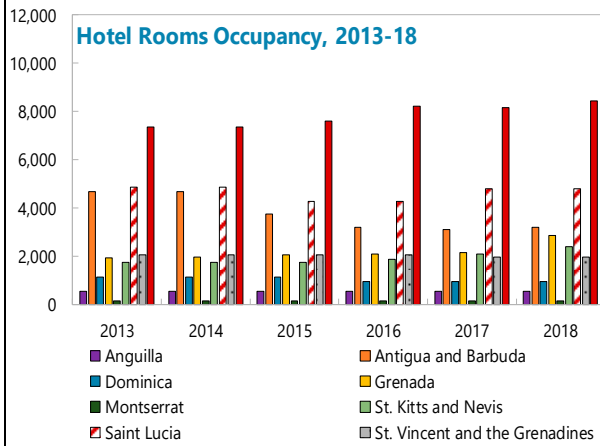
Source: Belize Tourism Board and staff calculations.

... as airlift from the US continued to increase



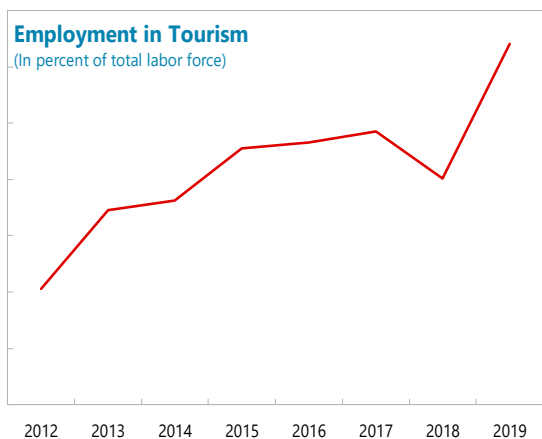
Source: US Department of Transportation.

Hotel rooms occupancy rate is among the highest...



Source: National authorities

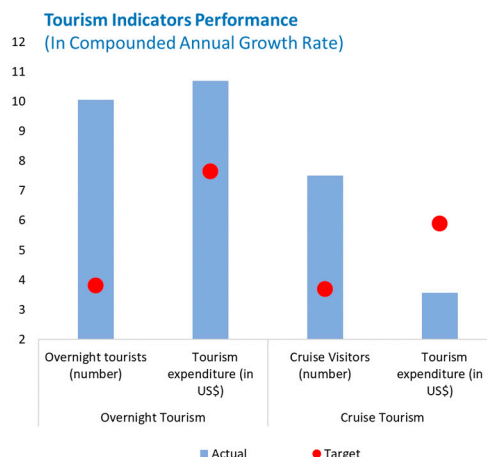
... underpinning growth in employment



Source: Statistical Institute of Belize

6. The outturns in tourism have significantly exceeded targets set in the authorities' National Sustainable Tourism Masterplan (NSTMP).

Since the launch of the NSTMP in 2011, overnight tourist arrivals grew at 10.1 percent per year, close to three times higher than the set target, precipitating growth in tourism expenditure of 10.7 percent per year which outperformed the target. Cruise visitors grew by an average 7.5 percent per year (compounded annual rate). Although it has outperformed the target in terms of the number of visitors, cruise tourism expenditure seems to be falling short of target, reflecting either these tourists are not disembarking to visit onshore tourism sites or the lack of capacity in capturing these expenditures.



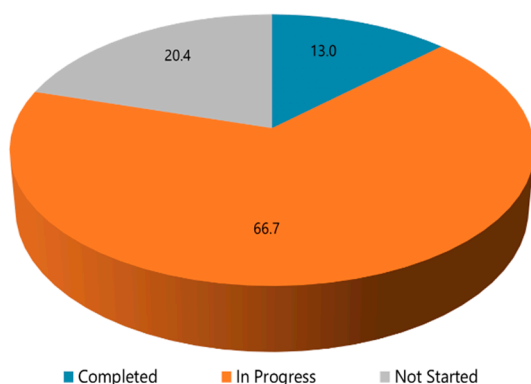
7. The implementation of the NSTMP reforms has supported the tourism sector's expansion. To guide the development of the tourism sector, the NSTMP 2011 proposes reforms and targets to propel Belize into an internationally recognized tourist destination by 2030. The five central focus areas include tourism governance, sustainability and quality assurance, infrastructures, marketing, and product development (Appendix 1). It also sets annual growth targets from 2011 to 2030 (Table 1). As of end-2018, 80 percent of the total 54 subprograms that underpin the five focus areas have been completed or in progress. The largest deliveries are in areas relating to tourism marketing, governance, and product development.

Table 1. Belize: NSTMP Targets from 2011 to 2030

	Target Growth Rate, in percent
Overnight Tourism	
Overnight tourist arrivals	3.8
Tourism Expenditure	7.65
Cruise Tourism	
Cruise visitors	3.68
Tourism Expenditure	5.89

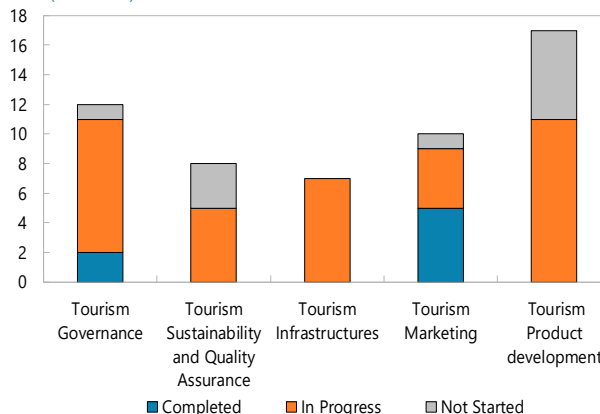
Source: NSTMP 2011

Implementation of Tourism Master Plan (In percent)

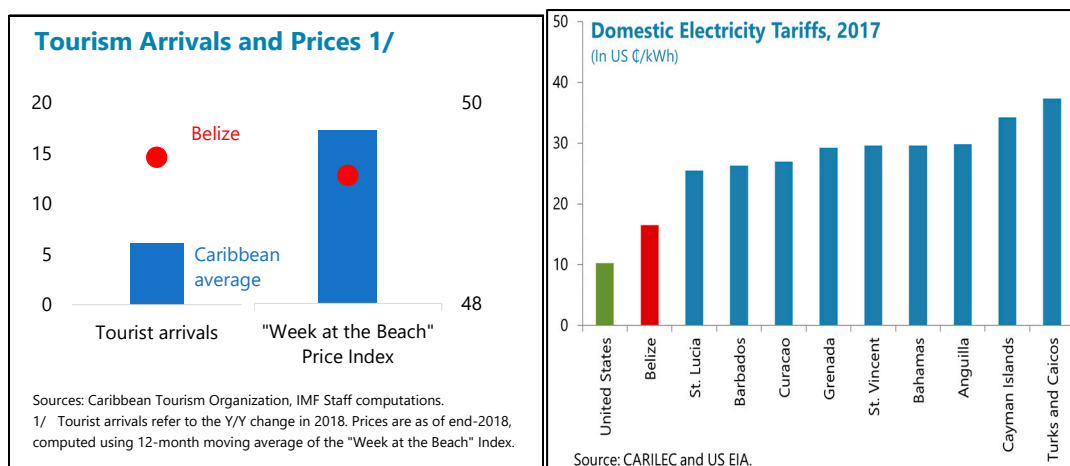


Sources: National authorities

Status of Tourism Sub-programs (In number)



power sector and dependence on expensive imported petroleum product. This has eroded competitiveness and contributed to the region's high cost of doing business.²



10. Nonetheless, a number of supply-side bottlenecks and challenges remain:

- **Concentration of hotspots and tourists.** Tourists still focus on a small number of attractions (especially those centered on the reef) and North America comprises 75 percent of arrivals, implying saturation and concentration risks.
- **Infrastructure gaps.** Belize's water and sanitation infrastructure and coastal facilities are currently stretched. Poor level of accessibility by land—mainly due to a small amount of paved roads leading to the tourism destinations—and by air results in uneven distribution of tourism flow in the country. This creates overcrowding in some sites and underutilization of others. Insufficient waste disposal and sewage systems also leads to unhealthy conditions and visual pollution.
- **Institutional gaps.** Another bottleneck is the lack of enabling institutional and legal environment. Certain tourism hotspots are faced with overcrowding during peak tourism periods, for example San Pedro in Ambergris Caye. Infrastructure, water supply, and sanitation there appear to be unable to cope with the volume of visitors. Although a development plan for Ambergris Caye exists, its implementation has not been possible as Belize does not have a land use policy and planning framework that allows these jurisdictions to properly plan and manage their development.

² Chapter 13 of the [IMF study](#) provides further details.

- **Skill shortages.** The availability of appropriately skilled labor in the tourism industry is tight and finding replacement staff is difficult.³
- **Natural hazards.** Belize is exceptionally vulnerable to hurricanes and other weather-induced damage, which dissuade tourist arrivals. The [2018 Climate Change Policy Assessment \(CCPA\)](#) indicates that Belize is highly exposed climate change and natural disasters risks. Among small states, Belize ranks 3rd at risk for natural disasters, and 5th at risk from climate change. The country is low-lying and will face severe damages from inundation if the sea level rises and storm surges intensify. A significant influx of sargassum seaweed has led to travel cancellations and in some cases closure of tourism businesses.
- **Crime.** Violent crime remains high, with a homicide rate of 38 per 100,000 people, compared to a rate of 12, on average, in EMDEs. The [World Bank's 2016 Systematic Country Diagnosis](#) report indicates that crime is the biggest threat to Belize's tourism industry.⁴ The US Department of State's [Belize 2019 Crime and Safety Report](#) also noted that confrontational crimes, such as armed robbery and theft, have increased in tourist areas.
- **Governance concerns.** Survey measures of governance perceptions (relating, in particular, to the rule of law) and corruption perceptions indicate room for improvement, although they need to be interpreted carefully. Steps to enhance the effectiveness of the anti-corruption framework, including through the recently operationalized Integrity Commission, together with measures to raise the efficiency of the court system, including in enforcing contracts, are needed to improve investor confidence and support further development of the tourism sector.

11. The emergence of the “shared economy” business model has also brought new challenges, in addition to opportunities. The benefits of the peer-to-peer (P2P) accommodation available to customers on digital platforms include the expansion of tourism product, service, and sector offerings; improved access to market; and opportunities for income generation. However, recent studies by the [Central Bank of Belize staff](#) (Leslie and Waight, 2019) and by [World Bank staff](#) (Bakker and Twining-Ward, 2018) also suggest that the expanding presence of rent-share and P2P accommodation could bring new challenges, including reducing expenditure levels per visitor, adversely affecting the job-intensive hotel sector, and contributes to over-crowding. In particular, P2P accommodations can reduce the demand for hotels from financially-conscious tourists while providing alternative accommodation options for upscale tourists. Similarly-priced hotels in the same areas are impacted the most. Moreover, budget P2P accommodation listings tend to compete directly with lower-end hotels and significant affect their earnings.

³ According to an [IDB study](#), although there has been considerable progress in establishing tourism-specific training and developing expertise in the sector, labor skills and attitudes are still considered by some to impede development of the sector. Moreover, finding replacement staff is difficult, not because of a tight labor market but because of the overall lack of workplace skills.

⁴ Based on anecdotal evidence from focus group discussions with the Belize Tourism Board and the Belize Chamber of Commerce.

C. How Could Structural-Institutional Reforms Benefit Tourism and Belize's Economy?

12. The positive effect of infrastructure investment on tourism has been highlighted in a number of empirical studies. A study by [Ilić and Jovanović \(2016\)](#) found infrastructure as an important determinant of tourism development in Southeast Europe (SEE). Specifically, the correlation between tourism competitiveness in SEE countries and the level of competitiveness of tourism infrastructure is high and significant. Turning to the Caribbean, [Bolaky \(2011\)](#) found that tourism competitiveness in the region can be enhanced through policy measures that include, among others, better infrastructure, increases in investment, private sector development, lower government consumption, a more flexible labor market, reduced vulnerability to natural disasters, higher human development and slow rises in oil prices.

13. This section complements existing literature by analyzing the impact of structural and institutional reforms on tourist arrivals. A panel regression analysis, based on a sample of 12 Caribbean countries⁵, provides quantitative analysis on the contributions of primary school enrollment, regulatory quality, internet access, crime rate, and damage from natural disasters to tourist arrivals. Two other explanatory variables—US real GDP growth and real effective exchange rate (REER)—are included as proxies for external factors and price competitiveness.⁶ The model is represented by the following equation:

$$\text{ARRIVALS}_{i,t} = \beta_1 \text{Primary School Enrollment}_{i,t} + \beta_2 \text{Regulatory Quality}_{i,t} + \beta_3 \text{Internet Access}(-1)_{i,t} + \beta_4 \text{Crime}_{i,t} + \beta_5 \text{Damage/GDP}(-1)_{i,t} + \beta_6 \text{US real GDP growth}_{i,t} + \beta_7 \text{REER}(-1)_{i,t} + \mu_t + \varepsilon_{i,t}$$

where:

ARRIVALS _{<i>i,t</i>}	= Tourist Arrivals, in percent of population in each country.
Primary School Enrollment _{<i>i,t</i>}	= Enrollment at primary level, in percent of total enrollment, regardless of age in each country.
Regulatory Quality _{<i>i,t</i>}	= A governance indicator, ranging from -2.5 (weak) to 2.5 (strong), in each country.
Internet Access(-1) _{<i>i,t</i>}	= Individuals using the internet, in percent of population in each country, lagged one period.
Crime _{<i>i,t</i>}	= Homicides (per 100,000 people) in each country.
Damage/GDP(-1) _{<i>i,t</i>}	= <i>Damage from natural disasters, in percent of GDP in each country, lagged one period.</i>
US real GDP growth _{<i>i,t</i>}	= <i>Annual Real GDP growth in the United States</i>
REER(-1) _{<i>i,t</i>}	= <i>Real effective exchange rate in each country, lagged one period.</i>
μ _{<i>t</i>}	= <i>Country specific effect</i>

⁵ Comprising Belize, Bahamas, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Lucia, St. Vincent and the Grenadine, Suriname, Trinidad and Tobago, Dominican Republic.

⁶ As in Ghazanchyan *et.al.* (2019), prices are proxied by the REER.

Variables	Data Sources
Tourist Arrivals	Caribbean Tourism Organization
Damage from natural disasters	Emergency Events Database (EM-DAT)
REER, US real GDP growth	IMF
Primary School Enrollment, Regulatory Quality, Internet Access, Crime	The World Bank

14. The results suggest that structural-institutional indicators are important drivers of tourism growth. Tourist arrivals increase with measures of educational quality, governance, security, and ICT infrastructure. The arrivals-to-population ratio (“Arrivals”) is positively associated with Primary School Enrollment, Regulatory Quality, and Internet Access. It is negatively associated with crime. Increasing enrollment at primary level by 1 percent and raising regulatory quality by 1 point is associated with “Arrivals” being higher by 0.56 percent and 41.7 percent, respectively.⁷ At the same time, enhancing public access to internet by 1 percent is associated with a 0.28 percent rise in “Arrivals”.

15. Damages from natural disasters adversely affect tourism. The impact of natural disaster damages-to-GDP on “Arrivals” is significant and negative. “Arrivals” decline by 0.14 percent for every 1 percent of GDP increase in estimated economic damage. This result is broadly consistent with existing work on the effects of natural disasters on tourism. For example, a study by Bank for International Settlements Staff (Peter, Dahlen and Saxena, 2012) found that a 1 percent of GDP increase in economic damage from natural disasters could lead to a 0.28 percent decline in economic growth.

Regression Analysis with Tourist Arrivals-to-Population as Dependent Variable	
Dependent Variable	Tourist Arrivals/Population
Primary School Enrollment	0.5613* (0.33006)
Regulatory Quality	41.7212*** (12.53501)
Crime	-0.4836** (0.22532)
Internet Access(-1)	0.2779** (0.13674)
REER(-1)	-0.1898 (0.11718)
US real GDP growth	2.4012*** (0.74983)
Damage/GDP	-0.1446*** (0.03467)
Constant	69.7942* (37.94704)
Country Fixed Effects	Significant***
Sample period	2002-2016
R-squared	0.9861
Adjusted R-squared	0.9833
N	107 (unbalanced)

Note: Standard errors (in brackets) are clustered by country. For REER, positive/(negative) values denote appreciation/(depreciation). "Crime" refers to intentional homicides (per 100,000 people). "Internet Access" refers to individuals using the internet (in percent of population). "Regulatory Quality" is based on The World Bank Governance Indicators and ranges from -2.5 (weak) to 2.5 (strong).

Sample consists of Belize, Bahamas, Barbados, Dominica, Grenada, Guyana, Jamaica, St. Lucia, St. Vincent and the Grenadine, Suriname, Trinidad and Tobago, Dominican Republic.

***p<0.01; **p<0.05; *p<0.10

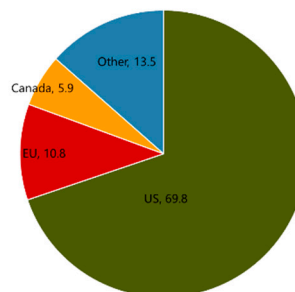
Sources: IMF, The World Bank, and Emergency Events Database (EM-DAT)

⁷ The high coefficient for regulatory quality is driven by the very small annual change in the index. Over a 30-year period, the magnitude of annual change is only 0.0002 points, on average, for the sample of 12 Caribbean countries.

16. External factors, including growth in the US economy, significantly influence tourist arrivals.

The impact of the US economy is highly significant as a 1 percent increase in US real GDP growth is associated with an increase in “Arrivals” by 2.4 percent. For Belize, the model estimates imply that about 40 percent of the rise in tourist arrivals in 2018 are explained by US growth.⁸ This reflects the large share of US tourists which accounted for 70 percent of stay-over tourist arrivals in 2018. In addition, price competitiveness proxied by the REER—although the statistical significance of its coefficient is marginal—remains economically meaningful. A 1 percent reduction in price competitiveness (a 1 percent appreciation of the REER) is associated with “Arrivals” declining by 0.2 percentage points.

Composition of Stay-Over Tourist Arrival
(In Percent Total)



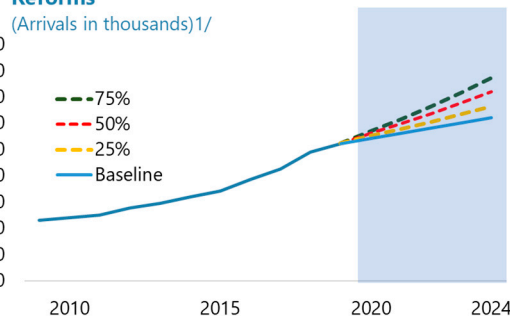
Source: Belize Tourism Board

17. Gaps exist in some of these metrics, relative to the neighboring countries. Belize appears to be underperforming in some of these structural and institutional indicators, relative to the Caribbean. The country is also highly susceptible to natural disasters, and damages could be costly although they may not be as high as some other neighboring countries. For example, damages from the 2016 Hurricane Earl were estimated at around 4 percent of GDP, by the National Emergency Management Organization.

18. Reducing these structural-institutional gaps and potential losses associated with climate change could boost tourist arrivals and enhance economic growth.

An illustrative simulation suggests that narrowing the gaps of regulatory quality, homicides rate, internet access, and natural disaster damage by ¼ to ¾ compared to the best-performing Caribbean economy could potentially increase tourist arrivals by 22 percent to 66 percent. An empirical analysis on the relationship between tourism growth and economic growth in the Caribbean by [Thacker, Acevedo, and Perrelli \(2012\)](#), suggests that an increase in tourist arrivals by 1 percent could lead to a 1.7 percentage point (ppt) increase in GDP growth. This would imply an additional GDP growth of between 0.4 ppt to 1.1 ppt.

Tourism: Illustrative Gains from Structural Reforms



1/ Dashes indicate projected impact from reforms that narrow gap between Belize and best performing Caribbean economy by 25 to 75 percent along key structural dimensions.

⁸ In 2018, overnight tourist arrivals increased by 63,290 compared with 2017. The US growth of 2.9 percent in 2018 added an estimated 7 percentage points to Belize’s tourism/population ratio, or an extra 27,000 of tourist arrivals.

D. Conclusion and Policy Implications

19. The reforms implemented based on the NSTMP over the past decade have supported the development of Belize’s tourism sector. At the same time, sustaining efforts to address various bottlenecks and challenges will help ensure continuous progress and development in tourism that will enhance economic growth.

20. Reforms in the near term should focus on addressing the impact of recurring natural hazards, infrastructure bottlenecks, fortifying the institutional and governance framework, reducing crime, and mitigating concerns relating to the “shared economy”.

- **Climate change.** The 2018 CCPA highlights the natural perils that Belize faces—such as hurricanes, flooding, sea level rise, coastal erosion, coral bleaching, and droughts—with impacts likely to intensify given expected increases in weather volatility and sea temperature. Moreover, a significant influx of sargassum seaweed has led to travel cancellations and in some cases closure of tourism businesses. Reform priorities will include the need to mobilize substantial private investment, with official sector financial involvement playing a useful supporting role, to meet the adaptation and mitigation plans.
- **Infrastructure bottlenecks.** Belize’s water and sanitation infrastructure and coastal facilities are currently stretched. Enhancements to the way visitation centers and valuable tourism resources are presented to tourists and to transportation to national tourism sites are needed. Expanding ICT infrastructure would cater to the swifts in tourism demand and changing tourist demographics.
- **Institutional and governance framework.** Addressing regulatory bottlenecks and governance concerns, including in customs and public procurement, will help enhance the business environment and promote private sector capital in developing and diversifying the tourism sector. A study by Ghazanchyan, Li and Brito (2019) on the ECCU shows that improving governance, along with ease of doing business and reducing tariffs, would increase the union’s global market share of tourism by 40 percent. At the same time, establishing a land use policy and planning framework in Belize would allow jurisdictions faced with overcrowding during peak tourism periods to properly plan, implement, and manage their developments.
- **Reducing crime.** Confronting safety and security risks to tourism will underpin perception even if tourists in Belize are rarely the victims of violent crime. The World Bank’s 2016 Systematic Country Diagnosis report indicates that crime is one significant obstacle, in addition to weaknesses in infrastructure and skillset. Policies that could help address the rise in crime rates include improving the quality of education, keeping children at school, promoting job training programs, and more direct approaches such as investing in safe neighborhood programs. A CDB Report on tourism reform highlights the successes of neighboring countries in fighting crime in tourism destinations which include, among others, better engagement with local communities which leads to “self-patrolling” (British Virgin Islands) and collaboration between the private sector and local police to develop a security plan (Grenada). A study by Plotnikov (2019,

forthcoming) on crime and output in Central America shows that crime reduces GDP by about 3 percent and tackling crime will require a combination of (i) preventive interventions that increase expected benefits from legal and non-violent activities, (ii) improving policing and other deterrence activities, and (iii) strengthening the criminal justice system to increase the cost of committing crimes while at the same time promoting the reintegration of ex-convicts in the productive economy.

- **“Shared economy”**. Formal integration of rent-share and P2P accommodation through proper regulations, standards, registration, data sharing and taxation, in addition to “high-end” branding, and offering higher quality services and adequate physical tourism infrastructure, could alleviate its less desirable effects on income, employment, and overcrowding.

21. Medium-term priorities should focus on ensuring continuous and sustainable development of the tourism sector through vocational training and diversification of source markets and attractions. Programs that connect local industries to tourism, as well as local communities to the tourism value chain, should be developed to ensure equitable and sustainable growth in the tourism sector. Promoting formal tourism degrees and tourism graduate programs would mitigate shortages in skillsets and skilled labor. Strategic and more diversified marketing, including leveraging on ICT platforms, could reduce saturation and concentration risks, particularly as North America comprises 75 percent of arrivals at present and tourists still focus on a small number of attractions.

Annex I. National Sustainable Tourism Master Plan 2012–2030

1. In 2011, the government endorsed a National Sustainable Tourism Master Plan (NSTMP) for ensuring a dynamic, competitive, and sustainable tourism industry, with specifics reform to support its development. The [NSTMP](#) is a strategic framework with the objective of propelling Belize into an internationally recognized tourist destination by 2030. The NSTMP's "Vision 2030" envisages Belize to be "an exclusive multicultural sustainable destination in the Central American Caribbean", and "a destination where the authenticity and friendliness of its people, coupled with the uniqueness of an exotic natural environment can be actively experienced within a conserved world." The strategic goals outlined in the NSTMP are:

- *Leadership:* Support Belizean stakeholders in taking leadership over sustainable tourism development
- *Optimization:* Optimize socioeconomic benefits from tourism
- *Sustainability:* Undertake sustainable and planned tourism development
- *Competitiveness:* Achieve competitiveness as a world-class destination

2. Market growth will be driven by the high value foreign tourists and domestic travels. The NSTMP aims to achieve the following:

- **Few but strong source markets:** The European main source markets (such as German, French and English) will have been tapped and a growing stream of high value European tourist will be visiting Belize. Belizean traditional markets (USA and Canada) will be enhanced and consolidated in mid-high end segments. The main source markets for Belize are expected to be few but to generate high value.
- **Specialized in niche market segments:** Additional market growth will come from consolidated highly specialized market drivers such as cavers, divers, pocket cruisers, honeymooners, yachties and sailors, adventure seekers, among others. These segments will be attracting a more diversified target source market.
- **Dynamic cross-border movement:** Increasingly, intraregional travelers will be crossing border points to reach Belize as more and better connectivity is reached, with cross-product synergies to neighboring countries through such products as the Mayan Heritage Trail, nautical routes as well as a highly attractive shopping and entertainment offering. Intraregional travelers will be from both the international and regional markets.
- **Domestic travels:** domestic travels will increase, making the Belizean residents feel and experience the country as it is one of the tourism World Class destinations of their own.

References

- Bolaky, B., 2011. "Tourism competitiveness in the Caribbean," Caribbean Development Bank, Economic Commission for Latin America and the Caribbean: CEPAL Review 104.
- Cheasty, A., et al., 2018. "Belize Climate Change Policy Assessment," IMF Country Report No. 18/329 (Washington: International Monetary Fund).
- Familiar, J., et al., 2016. "Belize: Systematic Country Diagnostic," The World Bank Group Report No. 102973-BZ (Washington: The World Bank Group).
- Ghazanchyan, M., Zhao, L., Brito, S., Parlak, V., 2019. "New Insights into ECCU's Tourism Sector Competitiveness," IMF Working Paper WP/19/154 (Washington: International Monetary Fund).
- Ilić, I., and Jovanović, S., 2016. "Infrastructure As Important Determinant Of Tourism Development In The Countries Of Southeast Europe," ECOFORUM Volume 5, Issue 1 (8), 2016.
- Nuenninghoff, S., Lemay, M., Rogers, and C., Martin, D., 2015. "Sustainable Tourism in Belize," Inter-American Development Bank Technical Note No. IDB-TN-737.
- Peter, G., Dahlen, S., and Saxena, S., 2012. "Unmitigated Disasters? New Evidence on the Macroeconomic Cost of Natural Catastrophes," BIS Working Paper No. 394
- Plotnikov, D., 2019, "Crime and Output in Central America: a Model," IMF Working Paper (forthcoming).
- Ram, J., et al., 2017. "Tourism Industry Reform: Strategies for Enhanced Economic Impact," Caribbean Development Bank.
- Thacker, N., Acevedo, S., and Perrelli, R., 2012. "Caribbean Growth in an International Perspective: The Role of Tourism and Size," IMF Working Paper WP/12/235 (Washington: International Monetary Fund).
- World Bank Group, 2018, "Tourism and the Sharing Economy: Policy & Potential of Sustainable Peer-to-Peer Accommodation." (Washington: The World Bank Group).

TAXATION ISSUES IN BELIZE¹

Belize's domestic business taxation is mostly based on turnover taxes, which are very cheap to administer and less prone to tax avoidance, including internationally, but also exhibit inefficiencies. In parallel, there are various generous special regimes. These used to be separated from the domestic economy but have now been opened up to domestic businesses. This addresses the issue of the ring-fencing of preferential tax treatment, but also exposes the system to significant revenue leakage risks. Aligning the tax rate in special regimes could prevent such risks, without affecting international activities, given the territorial system. With an increasing use of corporate income taxes (initially in the special regimes), it will be necessary to pass anti-avoidance legislation and strengthen the tax administration. Further reforms are still needed to comply with international commitments. Given international tax developments, for instance regarding corporate taxation in the context of digitalization, reform pressures will not recede.

A. Context

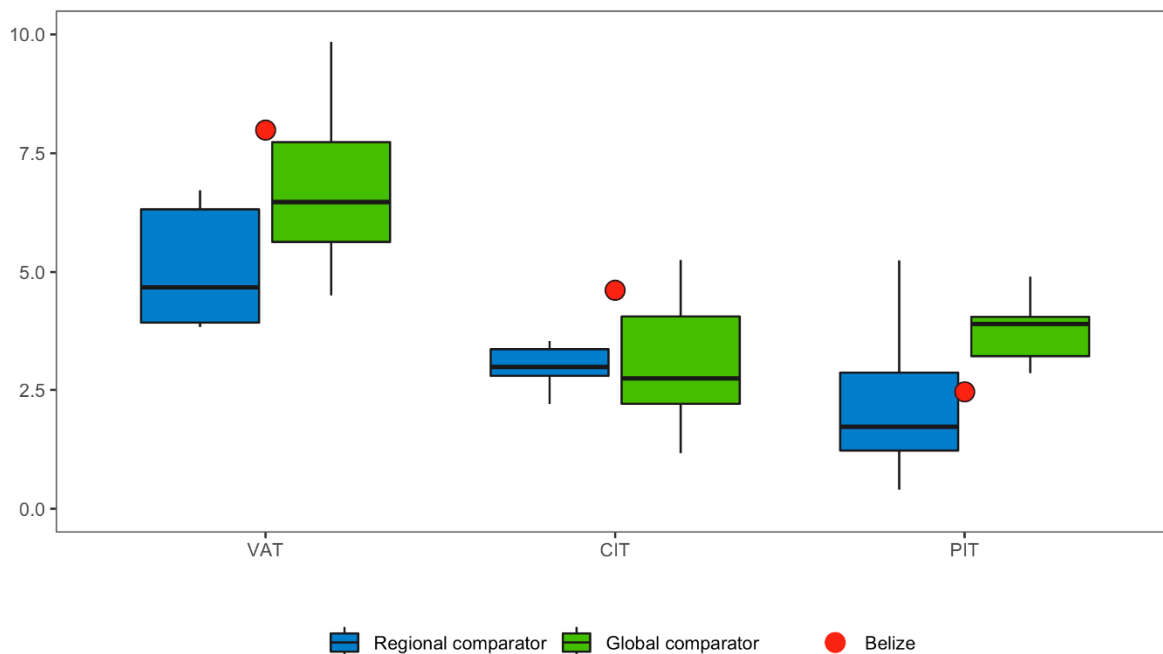
1. Like all open economies, Belize faces pressures on its corporate tax system, but some issues are specific to its situation. A recent IMF staff paper for the Executive Board (IMF, 2019) describes the general global issues, including profit shifting and tax competition, and how they are intensified by digitalization; it also discusses several reform options. For Belize, pressures from tax competition are likely higher, given its small size and the widespread use of tax incentives in the Caribbean region. Belize's reliance on turnover taxes reduces some profit-shifting risks, such as thin capitalization and transfer price manipulation on the cost side. Turnover taxes also create challenges, though, notably in the interaction with other countries' predominantly profit-based systems, and such issues may intensify with global developments, such as moves toward minimum taxation. In March 2019, Belize was added to the European Union's list of non-cooperative tax jurisdictions. Belize is working on various international tax reforms and adopted an economic substance act. On November 8, the Council of the European Union decided to remove Belize from the list of non-cooperative tax jurisdictions.

2. Belize's tax revenues are relatively high at 25 percent of GDP, with a strong reliance on taxes on businesses. Corporate income tax (CIT) revenues, in the great majority stemming from the business tax, exceed both regional and global comparator² averages at around 5 percent of GDP (Figure 1). Receipts from value-added tax (VAT)—known in Belize as the General Sales Tax (GST)—are equally very strong. Personal income tax (PIT) revenues exceed local, but not global comparator averages.

¹ Prepared by Alexander Klemm (FAD), Irving Aw (LEG), and Sebastian Beer (FAD)

² The regional comparator group includes six neighboring/close countries: the Dominican Republic, Guatemala, Honduras, Mexico, Panama, and Jamaica. The global comparator group includes six countries that resemble Belize in terms of GDP, GDP per capita, GDP growth and the tax to GDP ratio. To identify countries with similar economic fundamentals, the IMF's WEO and GFS databases were used to calculate for each of the 190 included countries a similarity score, based on the Mahalanobis distance between Belize and other countries. The six countries with the highest similarity score are Guyana, Montenegro, St. Lucia, Solomon Islands, Eswatini, and St. Vincent and the Grenadines.

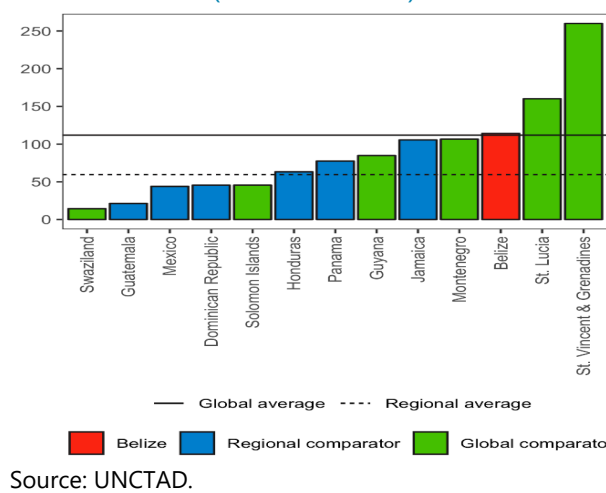
Figure 1. Belize: Tax Revenues in Belize and Comparator Countries, 2015-17 Averages
(percent of GDP)



Source: Belize Authorities, WEO, GFS, and IMF Staff Estimates.

3. Belize has a strong dependence on foreign direct investment (FDI). FDI inflows have averaged about 5 percent of GDP over the last 5 years, with the stock standing at 117 percent of GDP at end-2018, higher than in regional, but similar to global comparators (**Figure 2**). The stock of inward portfolio investment, all of which is debt, stands at just below a quarter of direct investment. The stock of inward other investment, mostly loans, is also significant approaching 50 percent of GDP. International assets are much smaller at about 25 percent of GDP, more than half of which are reserve assets.

Figure 2. Belize: FDI Stocks, 2016
(Percent of GDP)



Source: UNCTAD.

4. With Belize’s fiscal position remaining vulnerable, any reform will have to avoid risks for revenues. The primary fiscal balance is now in positive territory, supporting a slow decrease in the still high public debt stock of close to 90 percent of GDP. Risks to debt sustainability remain high, with particular sensitivity to changes in interest and exchange rates.

B. The Standard Income and Business Tax Systems

Domestic Aspects

5. In Belize, taxation of personal income covers employed labor and, among capital income, dividends. Employed labor is subject to a flat rate tax of 25 percent. Combined with a personal allowance, this leads to a progressive system. The stepwise withdrawal of the allowance, however, creates threshold effects with marginal tax rates exceeding 100 percent. Employed labor is also subject to social security contributions. Dividends are taxed at a flat final withholding tax (WHT) rate of 15 percent. Capital gains, pension income, and most types of interest are not taxed.

6. Companies and self-employed workers effectively pay a turnover-based tax, known as business tax, instead of income tax. Domestically, the turnover tax is charged at industry-specific rates ranging from 1.75 to 19 percent,³ with a weighted average of 3 percent in 2016 and 2017.⁴ For interest-based activities of the financial sector, only the margin is taxed. In theory, the corporate income tax still exists, but it is rarely of relevance: (i) the main exception is the oil-producing company, which is under the income tax at an increased rate of 40 percent, (ii) loss-making firms have the option to file and recover the business tax by crediting it over 5 years, with the ability to reduce the business tax liability in the following years by up to 20 percent per year. This happens very occasionally (24 instances over the last 5 years); (iii) also firms whose income tax liability is below the business tax, but who are still profitable, are theoretically allowed to credit the difference over 5 years, but this does not happen in practice. Presumably because of the costs of calculating and documenting the tax base under the CIT, most firms simply treat the business tax as the only tax—even though it is theoretically a maximum tax.

International Aspects

7. Belize has a purely territorial system, exempting both foreign active and passive income. The exemption of foreign active corporate income is a common way to prevent double taxation,⁵ although it is usually combined with safeguards, which are absent in Belize. The nontaxation of foreign-sourced passive income poses greater risks of double non-taxation of such income, given that Belize as residence jurisdiction would have primary right to tax such income under current international tax norms. Such income will only be taxed if the foreign jurisdiction applies a tax on outward passive income, for example through withholding.

³ The high 19 percent rate is exceptional and applies to telecommunications.

⁴ For owner-run companies, the business tax is final, with no taxation (or deductibility) of wages or distributions. Dividend tax is only applicable for limited-liability companies.

⁵ The other solution is worldwide taxation with credits for foreign taxes paid.

8. Even some domestic source income may escape taxation, given the absence of clear source rules.⁶ Under international tax norms, source jurisdictions have the primary right to tax active income. The active income of a nonresident is taxable in the source jurisdiction only to the extent that it is attributable to a taxable business presence, which is commonly referred to as a permanent establishment (PE). The Income and Business Tax Act (IBTA) does not explicitly provide for source rules in relation to business and investment income—the term “chargeable income... accruing in or derived from Belize”⁷ would be construed by case law. Specifically, the IBTA does not adopt a PE concept when determining whether the business profit of a nonresident is considered taxable in Belize. To the extent that Belize does not tax active income of nonresidents attributable to a PE in Belize, it leads either to double non-taxation or to an effective transfer of revenues to the treasury of country of residence, depending on how such income is treated in the residence country.

9. WHTs on payments to nonresidents are the only tool enforcing source-based taxation. Management fees and similar payments are subject to a 25 percent WHT, equaling the main rate. Interest is subject to WHT at a rate of 15 percent, although most types of interests are exempt from tax, including interest on savings where the investment of funds does not constitute the ordinary business or normal trading activities of the taxpayer. Dividends are covered by the general dividend WHT of also 15 percent.

10. Belize has in force various tax information exchange and double tax agreements (DTAs). Comprehensive DTAs cover the Caribbean Community (CARICOM) as well as the United Kingdom and Austria.⁸ Given the territorial system, the main impact of these DTAs is the reduction of WHT rates. For inbound investment, the benefit to Belize is that the DTA ensures that credit is given in the residence country for Belizean income tax, including the business tax. To prevent tax treaty abuse, Belize has incorporated the Principal Purpose Test in its DTAs with treaty partners through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI).⁹ Belize also has in force tax information exchange agreements with a number of countries, including Australia, the Netherlands, Ireland, France, Finland, Mexico, and Poland. As a member of the Global Forum on Transparency and Exchange of Information, Belize has also committed to the implementation of both international agreed standards on exchange of information, including the Common Reporting Standard under the Automatic Exchange of Information (AEOI) standard, and in this regard, has become a signatory to the Multilateral Competent Authorities Agreement (MCA) in September 2018.

⁶ Apart from a deemed source rule in respect of employment income based on place of exercise of the employment in section 5(3) of the IBTA.

⁷ Section 5(1) of the IBTA.

⁸ Belize has signed a DTA with Switzerland, but it is unclear if the treaty has been ratified.

⁹ Article 7 of the MLI.

C. Special Regimes

11. In parallel to the standard tax system, Belize offers a range of generous special regimes.

They are mostly offered in specific legislation outside the tax laws, the most important of which are: the International Business Company (IBC) Act,¹⁰ the Designated Processing Areas (DPA) Act (which replaced the Export Processing Zones (EPZ) Act in 2018), and the Commercial Free Zones (CFZs) Act. Table 1 provides an overview of the main incentives offered by these acts. Additionally, the Fiscal Incentives Act provides limited indirect tax incentives.¹¹

Table 1. Belize: The Main Special Regimes

Regime	Income tax	Dividend and interest	Cross-border withholding	Customs duties, excises, and property taxes
	Rate, in percent	Exemption		
IBC (previous IBC)	1.75-3 (0)	Yes	Yes	No
Public Investment Company	0 for 30 years, renewable	Yes	Yes	Yes, also stamp duties
DPA (EPZ)	1.75-3 (0)	Yes	Yes	Yes (also stamp duties), for 10 (20) years
CFZ	0 for 10 years	No	No	Yes
Fiscal Incentives Act	Standard	No	No	Yes

Notes: The table provides tax rates applied on companies registered under special regimes in first column and indicates whether companies are exempt from another tax in the other columns. Public Investment companies are regulated under the IBC Act (see below). Information in parentheses refers to previous regimes that have been amended.
Source: Tax Laws, IMF Staff Compilation.

International Business Companies

12. Most IBCs benefit from very low CIT rates and various exemptions from other taxes, while qualification requirements are minimal. The CIT rate stands at only 3 percent, further reduced to 1.75 percent on profits exceeding USD 1.5 million. Interest and dividend income are exempt and there are no international WHTs on these payments either, only on management fees. Anyone can register an IBC for almost any activity—the word “international” having lost its meaning. An exception is the holding of intellectual property, which is not allowed anymore. IBCs are required to maintain full bookkeeping, may be audited under IFRS, and must keep a record of beneficial owners.

¹⁰ Moreover, there are International Limited Liability Companies (ILLCs), international trusts, and foundations, but they have seen less uptake than the IBC.

¹¹ The Fiscal Incentives Act provides customs duty exemptions for a period of 15 years. This period can be extended for companies in so-called priority sectors (Manufacturing, Agro-processing, Aquaculture, Data processing, and industrial park developers).

13. IBCs without a physical presence are considered nonresidents and remain exempt from all taxes and reporting obligations. The current IBC Act only requires activities licensed under the International Financial Services Commission (IFSC)¹² Act to have a physical presence, which is satisfied already if the company is managed and controlled via a management agent located in Belize.¹³ However, activities not licensed under the IFSC Act, such as holding companies, are not required to have a physical presence in Belize. An amendment, which has yet to be passed by parliament, foresees that all companies, except holding companies, are required to meet the physical presence test.

14. Another vehicle under the same act, Public Investment Companies (PICs) benefit from a full CIT and indirect tax exemption but need to fulfil more stringent eligibility requirements. The CIT exemption covers all direct and indirect taxes on inputs, land tax and stamp duties and operates as a renewable 30-year tax holiday. These companies need to have operated in Belize for at least 2 years, with minimum capital, labor, and profitability requirements. Furthermore, to be registered as a PIC, the company needs to (foreseeably) be listed on an Approved Stock Exchange, which includes several exchanges in the United Kingdom, Ireland, and the United States. Majority owned affiliates of PICs in Belize are taxed at a reduced rate on a consolidated basis.¹⁴

15. Prior to 2018, IBCs were taxed even more lightly and had further administrative advantages but were restricted to international owners and offshore activities. Previously, IBCs were not allowed to carry on business with domestic residents,¹⁵ own property in Belize, hold shares or other securities in Belizean companies incorporated under the Companies Act, or issue securities that are beneficially owned by residents of Belize. They paid no income tax, no WHT, and were exempt from certain stamp duties. Moreover, IBCs were allowed to issue bearer shares. The requirements for full auditable accounts and up-to-date beneficial ownership information also did not exist.

16. The number of firms operating in and revenues coming from the IBC regime and the related maritime registry have declined notably. Peaking at roughly 48,000 in 2012, the number of IBC license renewals has declined since (**Error! Reference source not found.a**). The activity of a company operating in the IBC regime is only recorded if the activity is regulated under the IFSC Act and given the small share of IBCs carrying out activities regulated under the IFSC Act, the activities of most IBCs are thus not known. However, data on the industry and ownership structure of firms

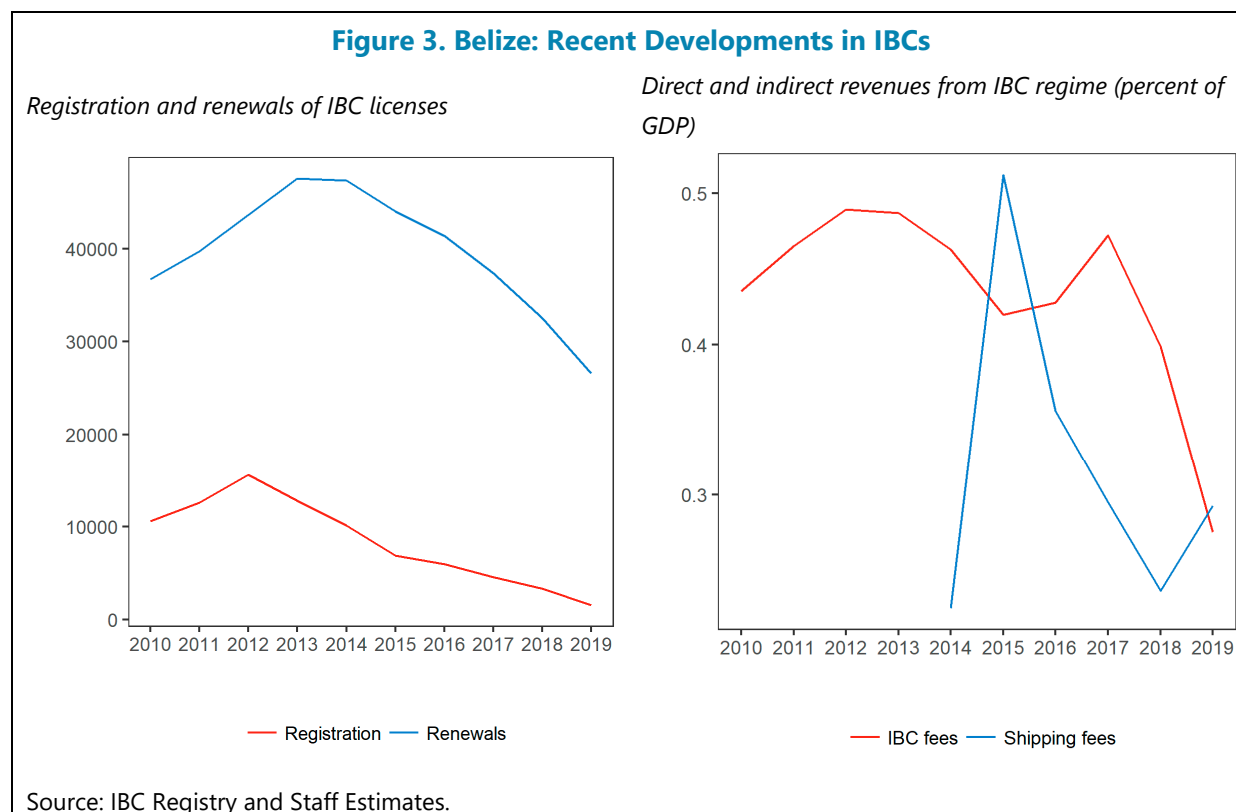
¹² These are: IBC, trustee, and international insurance services, securities trading, brokerage and consulting services, as well as various services related to money exchange, transmission, and payment processing services.

¹³ Non-binding physical presence requirements are that the company employs sufficient number of persons with adequate qualification to carry out the core business and that it has sufficiently large expenditures consistent with the size and complexity of the business activity.

¹⁴ Majority-owned subsidiaries of PICs with substantial activities in Belize constitute a PIC group and enjoy additional tax concessions. The PIC Group is taxed on the consolidated chargeable income, as defined in the IBC Act, at a rate of 5 percent. Moreover, PIC group entities are exempt from WHT on intra-group payments and the group holding company is exempt from dividends, interest, or other distributions by a PIC Group entity.

¹⁵ The ownership of vessels in Belize, registered under the Registration of Merchant Ships Act was not considered as carrying on business in Belize.

incorporated in Belize, as recorded in the Orbis database, suggest that an important share of IBCs provide holding services and sea and coastal freight transportation (Box 1). Revenues directly linked to the IBC regime and those from the maritime registry have declined from a combined valued of 0.95 (=0.5+0.45) percent of GDP in 2014 to roughly 0.6 (=0.3+0.3) percent of GDP in 2018.



Designated Processing Areas

17. DPAs face the same low CIT rate as IBCs and additional indirect tax exemptions, but only for a period of 10 years and with stricter eligibility requirements. In addition to the exemptions granted to IBCs, DPAs are exempt from customs duties, excise taxes, GST on imports, and land and property taxes. However, DPAs pay a “social fee” of 3 percent on imports. DPA licenses are given only to companies operating in priority sectors (Manufacturing, Agro-processing, Aquaculture, Data processing, and industrial park developers) and are subject to stricter eligibility requirements. For instance, at least 85 percent of the employees need to be nationals of Belize or a CARICOM Member State, the produce needs to meet international quality standards, and the principals of the company need to be “fit and proper” persons.

18. The predecessor of the DPA regime, the EPZ regime, was even more generous, with tax holidays of up to 20 years but was restricted to firms that export all of their goods. Any losses incurred during the tax holiday could be carried forward and set off profits for another 5 years. Furthermore, the regime limited the interaction between EPZ companies and the domestic economy by prohibiting the sale or lease of any items or goods between EPZ and other companies.

After termination of the tax holiday, EPZ companies were subject to business tax at a rate of 2 percent. To prevent domestic sales, EPZs were set up as either as geographically delimited areas, owned or leased by zone developers who provide infrastructure, facilitate customs administration, property, and public services against a fee or—in the case of Special EPZs—as stand-alone units, required to take precautionary measures themselves against domestic sales.

Commercial Free Zones

19. The Free Zones Act, regulating CFZs, targets retail and wholesale companies catering to foreign residents. CFZ licenses are issued to companies conducting service, trade, and investment activities that have no deleterious effect on the environment. Domestic sales of up to 25 percent of total production are permitted, but subject to indirect taxes. In practice, there are two areas of duty-free retail operations, located on the Mexican and Guatemalan borders.

20. CFZs are exempt from all corporate income taxes and dividend taxes for 10 years. Any losses incurred during this time can be carried forward and be offset against future profits for a limited period of 3 years. Thereafter, CFZs are liable to business tax at a rate of 2 percent, but with a tax credit, the amount of which is determined by number of persons employed. Instead of standard import duties, they benefit from the reduced social charges. In addition, non-tax benefits include an exemption from all price controls and rent restrictions.

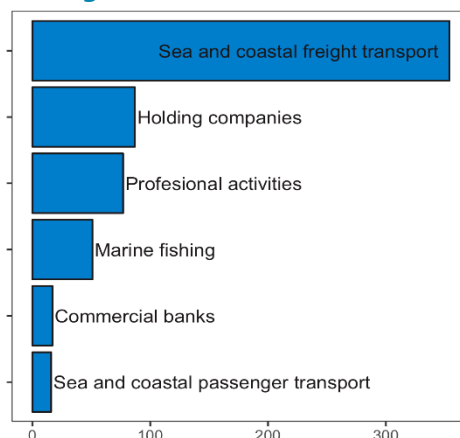
Box 1. Ownership Structure of International Firms

Commercial databases can be used to obtain limited information about the ownership structure and business fields of a subset of internationally active firms in Belize. The ORBIS database (Bureau van Dijk) records limited ownership and business activity information for companies operating in Belize, but given the lack of financial reporting requirements, financial statements are not available for Belizean firms. The primary activity is reported for some 700 firms, while the location of foreign affiliates and shareholders is available for 1600 firms. While the database does not specify the legal form of firms, it can be assumed that most of the tracked firms are IBCs or EPZs, given that those are most likely to have international ties.

The majority of firms with known sectoral information are active in the business of providing sea and coastal freight transportation (Figure 1). The second most important business are holding companies (100 firms), closely followed by professional service activities (90 firms), and marine fishing (70 firms).

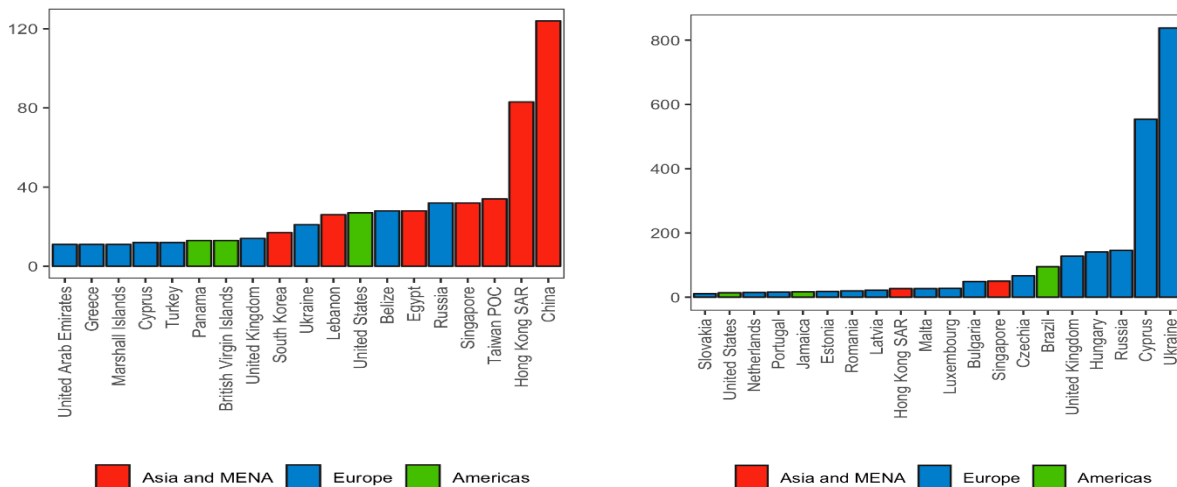
Majority shareholders are concentrated in East Asia while subsidiaries primarily operate in Eastern Europe. The database provides information for 1600 firms in Belize on the location of 2400 of their majority owned foreign affiliates. For 700 firms in Belize it provides data on foreign shareholders that are directly or indirectly controlling the company. The vast majority of companies with known ultimate shareholders is controlled from China, Hong Kong SAR, and Taiwan POC (**Error! Reference source not found. 2**), important locations for international ship transportation. In contrast, subsidiaries are primarily held in Russia, Cyprus, and Ukraine.

Box Figure 1. Sectoral Distribution.



Source: ORBIS.

Box Figure 2. Foreign Ownership (left) and Location of Subsidiaries (right)



Source: ORBIS.

D. International Developments

G20/OECD Base Erosion and Profit Shifting (BEPS)

21. Belize is a member of the G20/OECD Inclusive Framework on BEPS (Inclusive Framework) and has therefore committed to the implementation of the four minimum standards thereunder.¹⁶ With regards to the implementation of BEPS Actions 6 and 13, Belize has signed the MLI on January 11, 2019. Peer review of compliance with Action 6 has been scheduled for Belize, while initial preparations are being made to amend the domestic laws to enable country-by-country reporting (CbCR) under Action 13. Peer review of compliance with Action 14 on effective dispute resolution has been deferred for Belize on the basis that it is a developing country.

22. In relation to BEPS Action 5, Belize has taken steps to address the Forum on Harmful Tax Practices (FHTP)'s classification of the IBC regime in its October 2017 report as containing potentially harmful features. Many of the above-mentioned legislative amendments were made to in this regard, notably: the removal of restrictions for IBCs to hold real property in Belize or interest in a Belizean company, conduct business with residents; the introduction of mandatory physical presence requirements for activities under the IFSA; and the introduction of a CIT, though at reduced rates.

23. In light of these legislative changes, the FHTP appears to have considered the amended IBC regime not to be a harmful preferential regime. As noted in its 2018 Progress Report on Preferential Regimes, no harmful intellectual property regime exists in Belize with the abolishment of the IBC regime and the grandfathering of existing incentive holders in accordance with FHTP Guidelines. The IBC was also reviewed and cleared by the FHTP as a financing and leasing regime on the basis that ring-fencing measures were removed, substance requirements were in place, and grandfathering was carried out in accordance with FHTP Guidelines. Pending review of Belize's exchange of information on tax rulings, Belize appears to have complied with BEPS Action 5.

EU List of Non-Cooperative Jurisdictions for Tax Purposes

24. The EU maintains a list of Non-Cooperative Jurisdictions for Tax Purposes (EU List), inclusion in which entails consequences that may impact investment flows into the jurisdiction. First, EU funding cannot be channeled through entities in listed jurisdictions. Second, inclusion in the EU List may have an impact on other relevant legislative proposals, for example, the automatic reporting of tax schemes routed through a listed country, as well as stricter reporting requirements for multinationals with activities in listed jurisdictions under the public CbCR proposal. Third, there are sanctions at the national level of EU Member States against listed jurisdictions, such

¹⁶ The minimum standards are: (a) BEPS Action 5 on Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance; (b) BEPS Action 6 on Preventing the Granting of Treaty Benefits in Inappropriate Circumstances; (c) BEPS Action 13 on Transfer Pricing Documentation and Country-by-Country Reporting; and (d) BEPS Action 14 on Making Dispute Resolution Mechanisms More Effective

as increased monitoring and audits, WHTs, special documentation requirements and anti-abuse provisions.

25. The EU listing criteria fall within three broad categories: transparency, fair tax competition, and BEPS implementation. Under the transparency criterion, a jurisdiction must: (i) comply with international standards on AEOI and exchange of information on request (EOIR); and (ii) ratify the OECD Multilateral Convention or sign bilateral agreements with all EU Member States to facilitate the exchange of tax information. With regards to fair tax competition, there must not be any harmful tax regimes in the jurisdiction that go against the EU’s Code of Conduct or the FHTP. A jurisdiction must also implement the four minimum standards under BEPS to avoid inclusion in the EU List.

26. Belize was included by the EU Code of Conduct Group (COCG) in the EU List on March 12, 2019 and, following commitments and actions by Belize, the Council of the EU decided on November 8, 2019 to remove Belize from the list. While Belize had reformed the IBC and EPZ regimes identified as harmful by the EU in 2017, the reform was considered insufficient. The COCG cited the following as reasons for considering Belize to be a non-cooperative jurisdiction for tax purposes: (a) the lower rates of tax applicable to IBCs and DPA companies; (b) the tax exemption for foreign source income accorded only in respect of transactions carried out with non-residents and not contained by appropriate anti-abuse measures; and (c) apart from the IBC regime, the absence of substance requirements under the IBTA for companies that also enjoy the foreign source income exemption. In response to some of the concerns raised by the COCG, Belize has on October 11, 2019 enacted a new Economic Substance Act, 2019 (No. 15 of 2019) that is broadly similar to those enacted by Bermuda and the British Virgin Islands, as well as corresponding amendments to, inter alia, the IBC Act, the IFSC Act and the IBTA to require compliance with the economic substance conditions under the new law, including the imposition of annual tax reporting requirements for nonresident IBCs.

Reform Developments in Response to Digitalization

27. Work relating to corporate taxation in the digital economy by the Inclusive Framework may result in significant changes to the international tax architecture that will affect all multinationals, regardless of whether they are in the digital business. On May 31, 2019, the Inclusive Framework agreed on a work program in achieving a new global consensus on resolving challenges in the taxation of multinational enterprises arising from the digitalization of the economy by the end of 2020. The work program (OECD, 2019), which was formally approved by the G20 countries on June 9, 2019, comprises of two pillars:

- (a) Pillar One will address “nexus, data, and characterization” challenges arising from digitalization by reallocating taxing rights to market jurisdictions. On October 9, 2019, the OECD released for public consultation a document containing high-level outlines of a ‘Unified Approach’ for resolving Pillar One issues. Key features of the Unified Approach include a new taxing right (“Amount A”) to be allocated to market jurisdictions, even in the absence of physical presence, subject to certain company size thresholds. Additionally, a

fixed remuneration for baseline marketing and distribution functions taking place in the market jurisdiction (“Amount B”) is introduced, and binding and effective dispute prevention and resolution mechanisms (“Amount C”).

- (b) Pillar Two will explore the design of a Global Anti-Base Erosion (GloBE) proposal ensuring a minimum level of taxation of multinationals globally, both for in and outbound investment, to address residual BEPS concerns and limit the impact of tax competition.

28. While the details of the work program are still open, and likelihood of adoption of the various components is unclear, any reforms will ultimately affect Belize. To assert any new taxing right arising from Pillar One will require amendments to Belize’s domestic tax legislation and DTAs in the future. In this regard, a set of profit allocation rules will have to be decided upon for the proper quantification of profits reallocated to the market jurisdiction. A new nexus rule that is not dependent on physical presence will also need to be designed. Similarly, the GloBE proposal under Pillar Two, if adopted, will have to be implemented through changes to both domestic tax law and DTAs. Even if Belize does not implement such rule itself, it would be affected by others, with an important question of whether other countries would give credit for any business tax paid in Belize.

E. Issues and Potential Reform Directions

Inefficiency of the Business Tax

29. With turnover as its base, the business tax is inefficient, discouraging investment, affecting industrial organization, and creating potential preferences for some industries. With a turnover tax, there is no allowance for investment costs, raising the cost of capital for physical investment (Box 2). Moreover, as interest is nondeductible, even debt-financed investment is discouraged. The cascading effect of turnover taxes encourages vertical integration for tax reasons. As tax rates differ across industries, some are likely preferred, unless these differences accurately compensate for cost differences. Firms operating in various industries have an incentive to structure their operations so that their main activity is subject to a low rate.

Box 2. The Cost of Capital Under Turnover Taxes

The cost of capital is the minimum return an investment has to yield to satisfy investors. In a world without taxation, this is simply the (possibly risk-adjusted) interest rate (r). A firm will invest in a capital good if the expected net return (p) equals the interest rate. If the capital good depreciates, the gross return will have to be higher to compensate also for depreciation (δ).

In a standard CIT system, profits are taxed at some rate τ and depreciation allowances worth in present value terms A are granted. Consider the return to an investment in one unit of capital that is kept in perpetuity.

The net present value of the rent (R) earned is:

$$R = -1 + \frac{(p + \delta)(1 - \tau)}{1 + r} \left(1 + \frac{1 - \delta}{1 + r} + \left(\frac{1 - \delta}{1 + r} \right)^2 + \left(\frac{1 - \delta}{1 + r} \right)^3 + \dots \right) + A = -1 + \frac{(p + \delta)(1 - \tau)}{r + \delta} + A$$

The cost of capital is that amount of p that just breaks even. It can be obtained by setting $R = 0$ and solving for p (and adding a tilde):

$$\tilde{p} = \frac{(1 - A)(r + \delta)}{1 - \tau} - \delta$$

In a world without taxes ($\tau = 0, A = 0$), this simplifies to r , as expected. In a tax system where the value of depreciation allowances equals exactly the true depreciation (i.e., $A = \tau\delta/(r + \delta)$), it comes out at $\tilde{p} = r/(1 - \tau)$. Hence, even a standard CIT system raises the cost of capital for investment. In a hypothetical cash flow system, where investment is deductible (and hence $A = \tau$), the cost of capital is again r , just as in the no-tax case.

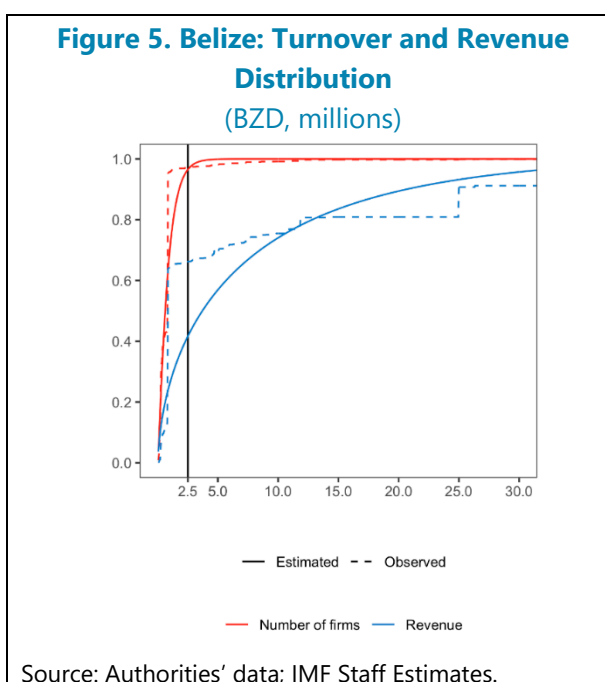
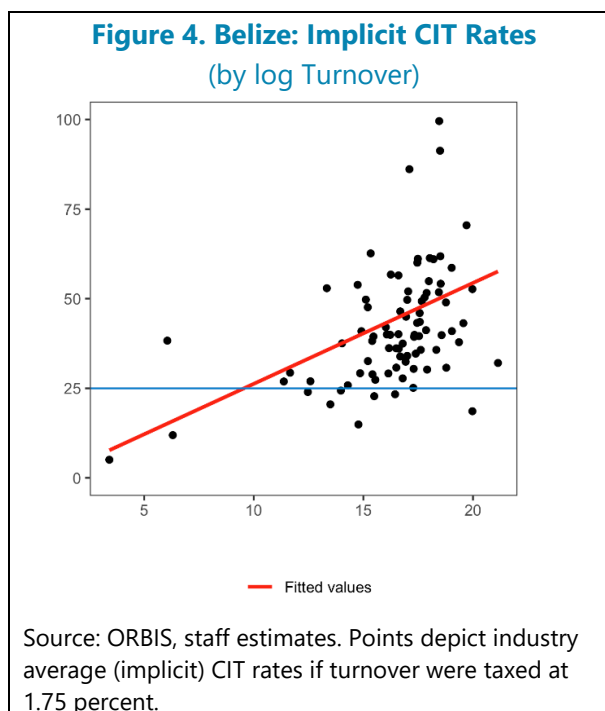
In a turnover tax system, however, there is neither a deduction for investment, as in the cash-flow system, nor for depreciation, as in a standard system ($A = 0$). At the same time the tax rate is lower, at t and it is applied to sales, so the ratio of gross sales to profit (k) becomes relevant. The cost of capital then turns into:

$$\tilde{p} = \frac{r + \delta tk}{1 - tk}$$

Suppose the turnover tax rate is chosen to accurately reflect the sales-profit ratio, so that $tk = \tau$. Then, the cost of capital is the same for non-depreciating goods as in a standard system, but for depreciating goods, it rises by $\tau\delta/(1 - \tau)$. For example, assuming an interest rate of 5 percent, the cost of capital for a good depreciating 20 percent per year is raised by 6.7 percentage points to 11.7 percent. The higher the depreciation, the greater the increase in the cost of capital.

30. The inefficiency cost should be weighed against the benefit of the business tax's low administrative and compliance costs. For tax purposes, firms only need to keep records of their sales, which is much easier than tracking all costs. Depreciation is particularly hard to calculate, as it requires keeping track of assets over various years. The very low uptake of the option to file income taxes voluntarily, even in cases where they are lower than business taxes, suggests that firms value the savings in compliance costs highly and are likely willing to tolerate paying higher taxes in some cases. Firm-level information on turnover to profitability ratios among Central and South American countries suggest that the implicit CIT rate of a turnover based tax at a rate of 1.75 percent typically exceeds 25 percent in the sample and reaches up to 70 percent for the largest entities (Figure).

31. Given the uncertainty about the cost-efficiency tradeoff, there is no urgency in transitioning to a CIT, but such transition would be feasible following preparatory actions. From a purely domestic assessment, the business tax could be kept in the short term. A more efficient CIT could easily be introduced by initially applying it only to companies that exceed a high turnover threshold. This would ensure that the administration would only have to deal with a small number of cases (Figure 5), and only the most sophisticated firms—who presumably already now require financial accounts for other purposes—would need to apply a more complicated system. Over time the threshold could be lowered, although small and medium-sized enterprises could be offered indefinitely the option of a turnover tax, as is the case in many other countries offering simplified regimes for that sector. The preconditions for introducing a CIT would be the introduction of anti-avoidance legislation, strengthening the tax administration, and educating relevant taxpayers. The nontaxation of capital gains should also be reconsidered in this context, especially for businesses, as it opens up avoidance opportunities through the recharacterization of income.



Revenue Leakage into Special Regimes

32. The special regimes have turned into an easily accessible parallel tax system with much lower tax rates and hence potential for massive revenue losses. In the past, special regimes already had major tax advantages, but were restricted to international investors. While the DPAs are still restricted to priority sectors, the IBC regime is available with minimal conditions. Any Belizean business can apply for IBC status and the tax rate drops dramatically. Only the smallest businesses will not find that useful, because they may not want to incur the compliance costs of preparing tax returns, given that special regimes use the income tax rather than business tax.

33. Conditions offered in special regimes could be tightened and equalized with the general tax system while maintaining an overall attractive system. For international activities of IBCs, the low tax rate is of no relevance, given the territorial system. Hence aligning the tax rate with the standard rate would not drive IBCs away, while removing much of the revenue leakage risk from domestic businesses. Avoidance risk would still exist given the interaction of income taxes in the regimes and business taxes outside. This could be addressed either by applying also the business tax in the regimes, or passing anti-avoidance legislation, covering transfer prices and interest payments between standard enterprises and those in regimes. In the DPAs, where there may in some cases be a policy reason for lower taxation, more effective incentives could be considered, such as investment allowances, instead of reduced rates.¹⁷ Moreover, special regimes contain various redundant exemptions, such as for foreign-source income, even though the standard system is already territorial.

34. Exemptions that are de facto already widespread and increase efficiency could more effectively be offered directly in the tax code. Dividend tax revenues are low, averaging around 0.1 percent of GDP, given exemptions both under special regimes and for selected large dividend payers. Exempting dividends generally would not cost much, while removing the debt bias, that is currently created by the nontaxation of interest (even though there is no debt bias at the corporate level for those firms that are under the business tax). Moreover, it would address avoidance strategies through capital gains, which are exempt. The continuation of the reduction in customs duties, especially for intermediate and capital goods, will reduce the need for granting exemptions.

Tax Competition, Profit Shifting, and International Measures

35. Pressures from tax competition and profit shifting are likely to intensify. Profit shifting out of Belize by resident companies has been effectively prevented by the business tax, which does not allow deductions. With the new option to be under a CIT-based structure, such as an IBC, these problems will come to the fore and require anti-avoidance legislation to address them. This includes international transfer pricing regulations, thin capitalization rules, and possibly a controlled foreign

¹⁷ For options of effective and efficient use of tax incentives, see IMF, OECD, UN, and World Bank (2015) and literature cited therein.

company (CFC) regime. Tax competition may also intensify with some countries in the region unifying their onshore and offshore rates at a low overall rate.

36. Global moves toward minimum taxation, however, could counteract this and reduce competitive pressures. If all countries of residence of significant investors in Belize applied a minimum tax, for example as contemplated under the GloBE proposal, there would be no reason anymore to reduce taxes below that minimum level. While the rate of such minimum tax is not yet known, the current IBC and DPA regimes, for example, are very likely to be below any conceivable level. To avoid double taxation of investors in Belize, it is important to watch developments and ensure that the business tax is counted among the taxes meeting minimum taxation levels. This may require reforms, although it is impossible to tell at the moment.

37. The advantages of offering special regimes may be reducing, requiring a strategy for a future system less reliant on them. As noted, the need to avoid ring-fencing increases the cost, because of domestic revenue leakages into special regimes. International efforts, both coordinated and unilateral, increase the costs for businesses using nontransparent and low tax structures, and as noted, registrations in the IBC regime are already declining. The CFZ regime is equally under pressure, creates potential leakage to the domestic economy, and offers very limited benefits to Belize. While the ultimate outcome of recent developments remains uncertain, scenarios that do not include special regimes should be one of the options contemplated.

Digitalization

38. Sales without physical presence, along with other phenomena, have raised the question of whether the allocation of profit taxing rights under current international norms should be reconsidered. These issues are controversial and have not yet reached consensus. An active work program is under way under the Inclusive Framework and could yield future changes, which would provide Belize an opportunity to ascertain taxing rights regarding certain digital transactions.

39. More immediate consideration should, however, be given as to how the GST can be effectively collected from digital transactions, including the importation of goods through digital platforms and the purchase of digital services by businesses and consumers in Belize. The destination principle is well-established as the international norm for indirect taxes on digital transactions, and the use of the reverse charge or self-assessment mechanism in collecting GST from B2B transactions is generally recommended by the OECD VAT/GST Guidelines. As for B2C transactions, the imposition of GST-collection responsibility on digital platforms coupled with a simplified registration and compliance mechanism should be explored to free up valuable resources of Customs to pursue other more important functions. Given the prevalence of low-value imports in the digital economy, there should be no exemption or threshold for low-value import. These measures, taken together, could assist in the collection of GST on such transactions more effectively.

References

IMF, OECD, UN, and World Bank, 2015, "Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment," IMF Policy Paper.

IMF, 2019, "Corporate Taxation in the Global Economy," IMF Policy Paper.

OECD, 2019, "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy," OECD/G20 Inclusive Framework on BEPS, OECD, Paris