3 Improving the design of non-business taxes

This chapter examines non-business taxes in Seychelles, including the value-added tax, environmentally related taxes, the personal income tax, social security contributions and property taxes. The chapter assesses how these taxes currently function and provides a number of tax reform recommendations to help improve their design from an efficiency, equity, and administrative perspective.

The value-added tax

In general, as discussed in Chapter 1, the Seychelles tax system relies heavily on consumption taxes. Overall, consumption taxes accounted for 63.5% of total tax revenues in 2017. In comparison, consumption taxes make up about a third of total taxation on average in OECD countries and about 54% of total tax revenues on average in African countries. Among consumption taxes, VAT plays the biggest role, accounting for 33% of total tax revenues, but other taxes on goods and services are also significant. This section assesses the VAT system and provides a number of recommendations to enhance its design and implementation.

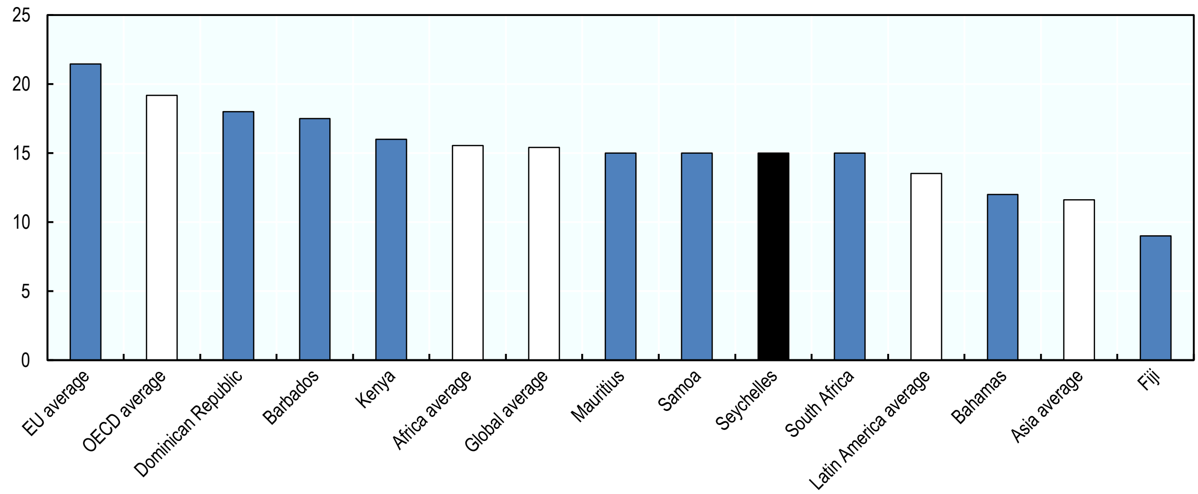
Seychelles introduced a value-added tax in 2013

VAT was introduced in 2013 to replace the Goods and Services Tax (GST). VAT became effective as from 1 January 2013, replacing GST, which was levied on the importation of all goods, as well as on the sales turnover of specified manufacturers of goods produced in Seychelles and on specified service providers. GST had cascading effects, given that it was levied at multiple stages and did not allow deductions for the GST paid on inputs. By contrast, under the recently introduced VAT, a VAT registered business is allowed to offset the VAT paid on its inputs against the VAT collected from its customers, and remits the difference to tax authorities. In cases where input VAT exceeds output VAT, a VAT credit arises, which can either be carried forward or refunded by tax authorities. Seychelles' VAT follows the core features of a well-designed VAT, which prevent cascading effects and ensure that VAT is a tax on final consumption (Box 3.1). Seychelles' VAT has other advantages compared to the previous GST system. In particular, issues of tax evasion on imported products, through the underreporting of the value of goods arriving in containers, is minimised under Seychelles' VAT system, given that VAT is more broadly applied than GST to the later stages of supply chains.

Seychelles' standard VAT rate is close to the African average and similar to standard VAT rates in comparable countries. Seychelles levies VAT at a standard rate of 15%. As shown in Figure 3.1, standard VAT rates largely follow regional patterns. Seychelles' VAT rate is close to the African average. It is also close to the worldwide average. On the other hand, Seychelles' VAT rate is lower than the averages for European and OECD countries and higher than standard VAT rates in Asian countries. Seychelles does not have reduced VAT rates, but as explained below, provides exemptions instead.

Figure 3.1. Seychelles' standard VAT rate is close to the African average

Standard VAT rates (%) in selected countries and regions



Source: KPMG Indirect tax rate tables.

Seychelles' VAT system is relatively broad-based

VAT has become the main source of tax revenues in Seychelles and is primarily collected by the tourism sector. VAT accounts for a third of total tax revenues in Seychelles (Chapter 1). The biggest share of VAT revenues comes from the tourism sector (including accommodation and food services, as well as other tourism-related activities), with the sector contributing overall close to half of total VAT receipts (Figure 3.2). This makes sense given the tourism sector's share of Seychelles' total value added (see Chapter 1).

Subjecting tourism to VAT at the standard rate is a good policy approach. Indeed, as mentioned, tourism is the sector that accounts for the greatest share of value added in the country so levying VAT at the standard rate on tourism ensures that VAT is levied on a broad base. In addition, since final consumption of tourism activities (by tourists) takes place in the country, levying the VAT on those activities is consistent with the application of the destination principle as recommended by the International VAT/GST Guidelines. There are additional arguments for taxing tourism-related services at the standard VAT rate. Reduced VAT rates on tourism-related services tend to be regressive, as OECD evidence shows that they benefit the rich vastly more than the poor both in aggregate and proportional terms (OECD/KIPF, 2014[1]). Moreover, VAT rate cuts rarely translate into equivalent decreases in prices.

Box 3.1. The main features of a VAT

Although there is a wide diversity in the way VAT systems are implemented, VAT can be defined by its purpose and its specific tax collection mechanism. The *OECD International VAT/GST Guidelines* (2015) provide an overview of the core features of VAT, which are summarised below.

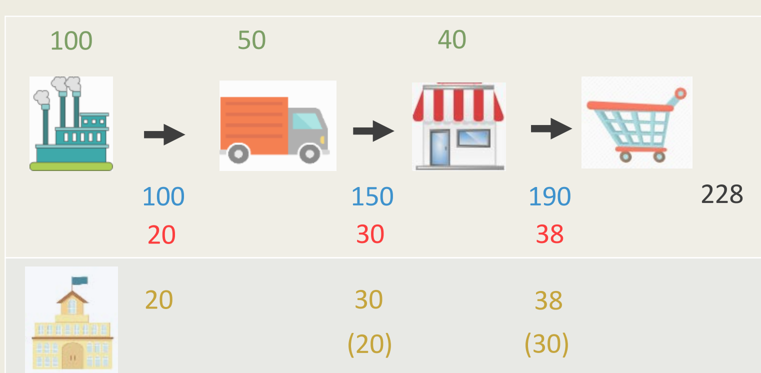
A broad-based tax on final consumption

- A VAT is a tax on final consumption by households as, in principle, only private individuals, as distinguished from businesses, engage in the consumption at which a VAT is targeted. A necessary consequence of the fundamental proposition that a VAT is a tax on final consumption by households is that the burden of the VAT should not rest on businesses.
- As a broad-based tax, the VAT is distinguishable from excises targeted at specific forms of consumption such as the purchase of gasoline or alcohol.

The staged collection process

- VAT is collected by businesses through a staged process on the "value added" at each stage of production and distribution. Each business in the supply chain takes part in the process of controlling and collecting the tax, remitting the proportion of tax corresponding to its margin i.e. on the difference between the VAT imposed on its taxed inputs and the VAT imposed on its taxed outputs (see Figure below).
- In general, jurisdictions with a VAT allow the deduction of VAT on purchases by all but the final consumer. This design feature gives to the VAT its essential character in domestic trade as an economically neutral tax. The full right to deduct input tax through the supply chain, except by the final consumer, ensures the neutrality of the tax, whatever the nature of the product, the structure of the distribution chain, and the means used for its delivery (e.g. retail stores, physical delivery, Internet downloads). As a result of the staged payment system, VAT thereby "flows through the businesses" to tax supplies made to final consumers. In practice, however, the right to deduct input tax may be restricted in a number of ways. Some are deliberate and some result from imperfect administration.

VAT's staged collection process – domestic supplies



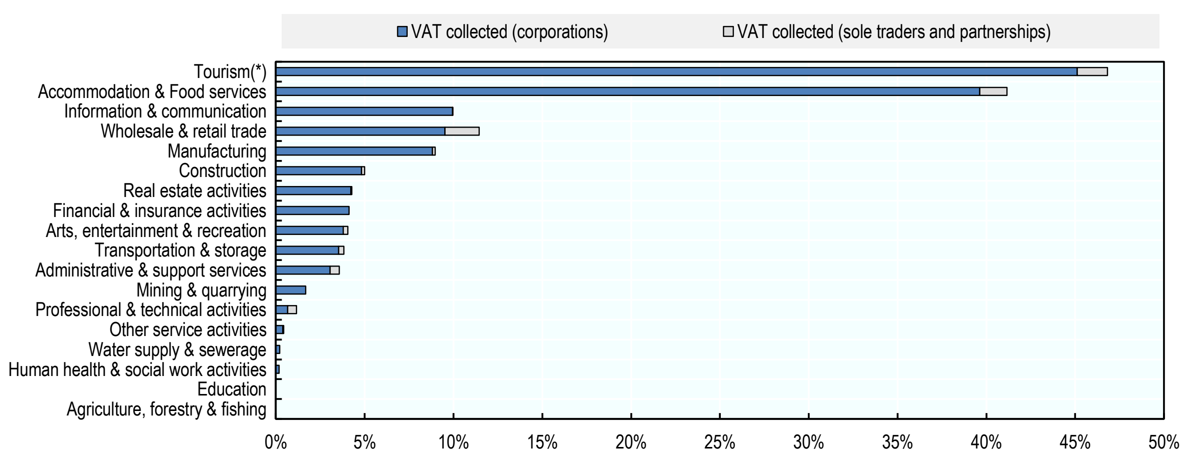
Green = Value-added
Blue = Net price
Red = VAT
Black = Final consumer price
Gold in brackets = Credit for input VAT

The destination principle in international trade

- According to the destination principle, the VAT taxing rights on cross-border supplies are to be allocated to the jurisdiction where the use or final consumption occurs. For cross-border supplies of goods, the tax is collected where the goods are imported. For supplies of services and intangibles, according to the OECD International VAT/GST Guidelines, taxation should occur where the business customer has located its permanent business presence for business-to-business supplies. For business-to-consumer supplies, the Guidelines recommend that the taxing rights over "on-the-spot supplies" be allocated to the jurisdiction in which the supply is physically performed; and that the taxing rights over all other supplies and services be allocated to the jurisdiction in which the customer has its usual residence. These include remote supplies of services and digital products over the Internet (e.g. apps, streaming of music and movies, online gaming) by foreign suppliers. The Guidelines recommend that these foreign suppliers be required to register and remit VAT in the jurisdiction of taxation and that countries implement a simplified registration and compliance regime to facilitate compliance for non-resident suppliers.

Figure 3.2. The tourism sector collects close to half of total VAT revenues in Seychelles

Share of total VAT collected by sector



Note: ISIC sectors. Tourism defined in line with Business Tax Act.
Source: Business Tax microdata.

Seychelles has a number of VAT exemptions, but these are primarily targeted at basic necessities. As mentioned above, Seychelles does not have reduced VAT rates. However, many products that are considered as "basic necessities" and typically subject to reduced VAT rates in OECD countries, are subject to VAT exemptions in Seychelles (Table 3.1). Seychelles' VAT exemptions, primarily target agricultural and food products (fruits and vegetables, meat, dairy products, etc.) as well as other basic necessities (e.g. pharmaceutical products).

Table 3.1. Seychelles has a number of VAT exemptions, primarily targeted at basic necessities

List of VAT-exempt supplies
Fruits and vegetables
Cereals, coffee, tea, maté and spices
Meat
Fish
Dairy produce
Flour, bread, lentils, rice
Edible oils
Petroleum oils and petroleum gases
Pharmaceutical products
Sanitary pads and tampons
Infant products (formulae, juices, etc.)
Energy saving electric bulbs
Printed books, brochures, leaflets
Musical Instruments
Public Utility Services (water and electricity)
Public transportation
Construction of residential dwellings
Education services
Health and life insurance

In general, the use of reduced VAT rates or exemptions should remain limited. As with any preferential tax treatment, reduced VAT rates and exemptions narrow the tax base and reduce potential revenues. In Seychelles, there is no estimation of the overall revenue foregone from VAT exemptions, but the government estimated that it lost SCR 190 million, or about 1% of GDP, just from VAT exemptions on imports in 2018. Reduced VAT rates and exemptions have also been found to be poorly targeted instruments to support low-income households, even when they apply to basic necessities. At best, rich households receive roughly as much benefit – in absolute value – from a reduced rate as do poor households. At worst, rich households benefit vastly more than poor households. This result is unsurprising as better off households consume more, and often more expensive, products than poorer households. Thus, while poorer households may benefit from reduced VAT rates on necessities, the wealthier gain even more (OECD/KIPF, 2014[1]). Targeting support at low-income households is often best achieved through the transfer system (e.g. direct cash transfers), particularly in countries with well-developed social security systems.

VAT exemptions also create the risk of cascading taxation and can encourage the granting of further exemptions to prevent this issue. In order to alleviate the VAT burden on low-income households, Seychelles applies a VAT exemption to basic necessities rather than a reduced VAT rate. Unlike reduced VAT rates where suppliers charge the VAT to their customers at a reduced rate but keep the full right to deduct the VAT paid on their purchases, under the VAT exemption the suppliers do not charge any VAT to their customers but are not allowed to recover any VAT on their inputs. As a consequence, the input VAT becomes a cost for businesses selling VAT-exempt products. This input VAT will be embedded in the price of exempt products and businesses might either shift that extra tax burden onto their customers by raising sale prices or bear (part of) the cost of unrecovered VAT themselves through a reduction of their margins. Exemptions can also discourage investment, as sellers of VAT-exempt products will not recover the VAT paid on the purchases of new low-carbon emission vehicles or clean energy equipment, for instance. In some countries, this has led to pressures to grant further VAT exemptions on the inputs used by suppliers of VAT-exempt products.

Box 3.2. The distributional effects of reduced VAT rates in OECD countries

With the exception of Chile, all OECD countries have one or more reduced VAT rates to support various policy objectives. A major reason for the introduction of a differentiated rate structure is the promotion of equity. Countries have generally considered it desirable to alleviate the tax burden on goods and services that form a larger share of expenditure of the poorest households (e.g. basic food, water). Countries also often decide not to tax medicine, health services and housing at high rates. Reduced VAT rates have also been used to stimulate the consumption of "merit" goods (e.g. cultural products and education) and other non-distributional objectives such as promoting locally supplied labour-intensive activities (e.g. tourism) and correcting externalities (e.g. energy-saving appliances).

In general, VAT exemptions, zero-rates and reduced rates are not a well-targeted tool to support low-income households. Reduced rates that are implemented in countries for the distinct purpose of supporting the poor (i.e. to address distributional goals) typically do have the desired progressive effect. For example, reduced rates for basic food provide in general greater support to the poor than the rich as a proportion of household income or expenditure. However, despite this progressive effect, these reduced VAT rates are a very poor tool for targeting support to poor households. At best, rich households receive roughly as much benefit – in absolute value – from a reduced rate as do poor households. At worst, rich households benefit vastly more than poor households. This result is unsurprising as better off households can be expected to consume more, and often more expensive, products than poorer households. Thus, while poorer households may benefit from reduced VAT rates on "necessities" the wealthier gain even more.

Cash transfer programmes that cover the entire population, if well-functioning, are a more effective tool to compensate poor households for the VAT they have paid. If poor households can be compensated directly through a cash transfer programme, it is more efficient and fair to tax all goods and services at the standard VAT rate and compensate the poor directly through cash transfers (and/ or reductions in personal income taxes, etc.), especially if the standard VAT rate is not particularly high. It should immediately be noted, however, that compensating all (and only the) losers of a reform through a transfer programme might in practice be very difficult to achieve.

With regard to preferential VAT provisions for social, cultural and other non-distributional goals, richer households benefit considerably more from VAT exemptions and reduced rates. Those tax provisions often provide so large a benefit to rich households that the reduced VAT rate actually has a regressive effect – benefiting the rich more both in aggregate terms and as a proportion of expenditure. For example, reduced rates on hotel accommodation and restaurant food benefit the rich vastly more than the poor, both in aggregate and proportional terms, in all OECD countries in which they are applied. Similar results, but of less absolute magnitude, are found for reduced rates on books, cinema, theatre and concerts.

Finally, VAT rate differentiation might not be the best policy instrument to correct negative externalities. VAT rate differentiation may improve efficiency if it means that the private marginal costs of an activity are brought closer to the marginal costs for society. However, VAT is a blunt instrument for addressing environmental externalities, as it may be hard to target the actual source of pollution. For example, reduced rates on energy-saving appliances may boost demand or them and therefore stimulate the consumption of these goods. The reduced VAT rate may give incentives to shift from more to less energy-consuming items (consumers might replace their old refrigerator with a new one, for instance). However, this may also lead to an increase in the purchase of energy-intensive products (e.g. consumers may replace their old refrigerator with a new refrigerator and a freezer).

Source: (OECD/KIPF, 2014[1]).

Seychelles also provides VAT exemptions for certain fuels and for electricity generation and provision, which are more problematic. Seychelles provides VAT exemptions for fuels for domestic transport, fuels used for international transport and fuels used for electricity generation. The supply of electricity is also exempt from VAT (which explains why fuels used for electricity generation are exempt, as companies producing VAT-exempt electricity would otherwise not be able to deduct the VAT paid on their inputs). Granting preferential VAT treatment for certain fuels is common in many countries, although it is often granted in the form of reduced or zero VAT rates, allowing businesses to reclaim the VAT paid on their inputs (OECD, 2015[2]). Reduced VAT rates or exemptions on fuels tend to be poorly targeted tools, however. In addition to lowering potential revenues, they undermine the use of energy taxation to influence energy prices, running counter to effective environmental taxation, unless they are subject to appropriate excise taxes. Besides, just like other VAT exemptions or reduced rates, where they are used to address equity considerations, they tend to be poorly targeted instruments whose objectives are often best achieved through other measures (e.g. direct cash transfers) (Box 3.2).

Ideally, VAT exemptions for fuels should be removed, but in practice a careful approach is recommended. Regarding fuels used for domestic transport, levying VAT at the standard rate would come on top of already high excise taxes (see section 2.2) and further raise fuel prices (especially given that the excise is normally part of the VAT tax base). Regarding electricity, high electricity prices are a major concern for Seychelles and have been identified as one of the biggest obstacles to private sector growth (IMF, 2019[3]). Raising excise taxes on the energy inputs used for electricity generation (i.e. fuel oil), as recommended further, and levying VAT on electricity consumption could lead to very high electricity prices. In these circumstances, a staged approach may be needed. First, the non-tax factors that contribute to high electricity prices should be addressed. In particular, cross-subsidisation, which consists in charging higher prices to one type of consumers to artificially lower prices for another group, and effectively acts as an implicit tax, should be eliminated as it contributes to high electricity prices. Second, if the government decides to levy VAT on electricity, it could assess the distributional effects of such a reform and evaluate whether targeted income-tested payments or lump-sum transfers could be provided to compensate poor households. An alternative way to address distributional concerns could be to maintain exemptions only on small amounts of electricity consumption.

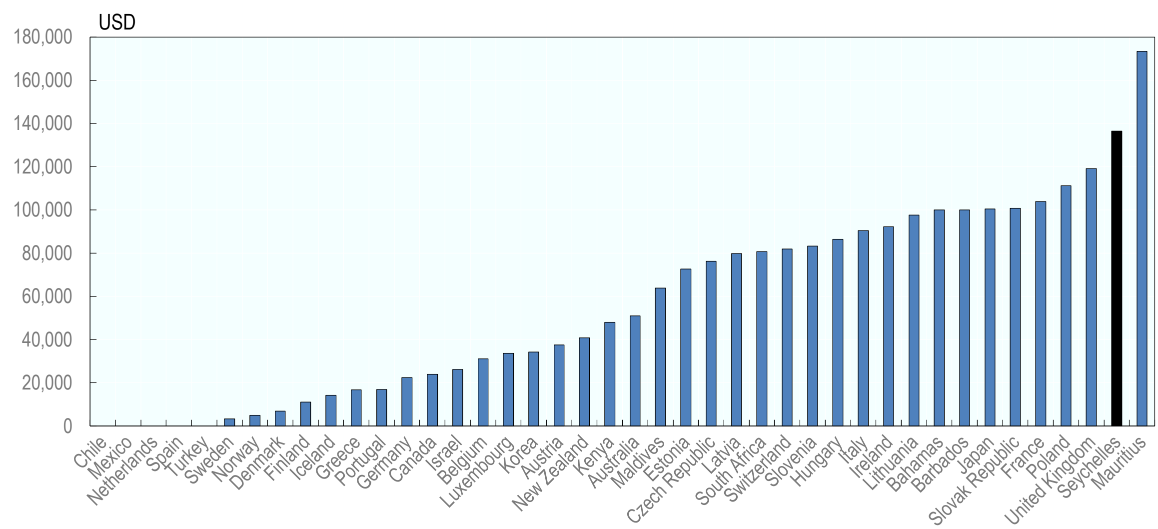
The VAT registration threshold is comparatively high

In general, setting the VAT registration threshold at an adequate level is a complex task. The main reason for excluding small businesses from the VAT system is that compliance costs for small businesses may be disproportionate compared to their turnover, and that the costs for the tax administration of having very small businesses pay VAT may be disproportionate compared to potential VAT revenues. On the other hand, a VAT registration threshold introduces competitive distortions between small businesses under and above the threshold. Overall, the VAT registration threshold should minimise competitive distortions and be set so that the revenues collected are higher than the administrative costs of ensuring that small businesses properly collect and remit VAT. In general, a higher threshold is considered more appropriate in countries where the tax administration tends to be weaker.

Seychelles' VAT registration threshold is comparatively high. Any person whose annual turnover is equal to or greater than SCR 2 million must register for VAT purposes. Businesses with an annual turnover below SCR 2 million can opt to voluntarily register for VAT. Although it was already significantly reduced from its initial level of SCR 5 million, the current VAT registration threshold of SCR 2 million remains high. Indeed, 84% of total businesses are currently below the VAT threshold (53% of corporations and 93% of sole traders and partnerships). The VAT registration threshold is also high in international comparison (Figure 3.3). VAT-registered businesses, particularly in the tourism sector, have complained about being at a disadvantage because of competition from non-VAT registered businesses. Indeed, a number of VAT-registered businesses have explained that they cannot fully pass on the VAT burden to their customers, as would normally be expected, because customers would simply choose services supplied by non-VAT registered operators. Thus, to be able to face competition from non-VAT registered businesses, VAT-registered businesses end up bearing at least a part of the VAT burden themselves by charging lower pre-tax prices. Reducing the VAT registration threshold would contribute to levelling the playing field between businesses.

Figure 3.3. Seychelles has a comparatively high VAT registration threshold

Compulsory VAT registration thresholds expressed in USD



Source: OECD Tax Database and KPMG.

In the short run, the VAT registration threshold could be maintained at its existing level, but the government could consider lowering it in the longer run. Given the existing capabilities of the tax administration and the compliance costs faced by businesses, the VAT registration could be kept at SCR 2 million in the short run. As the tax administration's capacity becomes stronger in the longer run, Seychelles could consider lowering the VAT exemption threshold. In addition, with the rise of the sharing economy and the possible increase in the number of small operators below the VAT registration threshold, the revenue loss and distortions caused by a relatively high VAT registration threshold might become more problematic. The authorities of Seychelles have estimated that the revenue increase from lowering the VAT threshold to SCR 1 million would be SCR 37.3 million, but this figure could increase in the future with the rise in the number of small operators participating in the sharing and gig economy.

A lower VAT registration threshold could also be accompanied by VAT simplification measures. A possibility would be the introduction of a VAT flat rate scheme. A flat rate scheme allows eligible businesses (e.g. below a certain turnover threshold) to apply a fixed and lower VAT rate, typically to turnover, to determine VAT due (OECD, 2015[4]). In principle, under such schemes, businesses give up the right to reclaim VAT on their inputs. Businesses therefore keep the difference between what they have charged their customers and what they pay to the tax administration. Variable flat rates may be applied, and are intended in most cases to reflect the average VAT rate in specific industries or sectors after taking into account the recovery of VAT on inputs. From a tax compliance perspective, a major advantage of these schemes for small businesses is that they are not required to keep detailed records of sales and invoices. However, creating a special regime that may over-compensate small businesses provides new opportunities for tax avoidance and evasion and may reduce firms' incentives to grow. Alternative measures may be preferred to simplify compliance and administration, including for instance less frequent filing of VAT returns and simplified accounting methods.

Some businesses have reported VAT related cash-flow difficulties

Some businesses have complained about cash-flow issues related to VAT, although Seychelles has measures in place to address these issues. VAT can generate cash-flow difficulties for businesses, in particular on imports where VAT is paid before business operations. To address this issue, Seychelles introduced a deferred payment facility, which allows VAT-registered businesses to defer the payment of VAT on imports of large capital items. The measure also applies to construction materials supplied for new investments (e.g. the construction of a new hotel) and major renovations. This means that VAT is not paid at customs, but reported by the importing business on its next VAT return. In addition, for first-time investments, input VAT can be refunded in the same month.

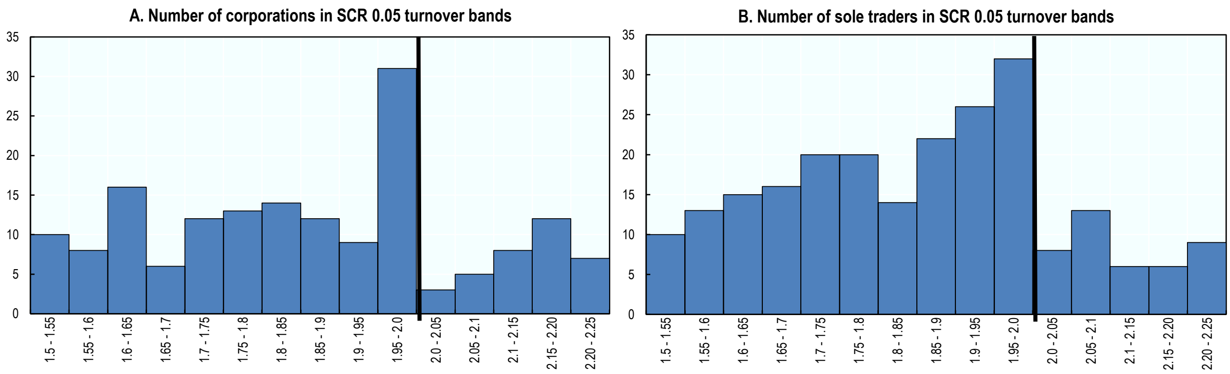
The system for VAT refunds appears well designed, but options could be considered to speed up the process for low-risk companies. An efficient VAT refund system is an essential part of a well-functioning VAT system. For businesses, delays in VAT refunds imply an opportunity cost in terms of the time value of money and can generate significant cash-flow difficulties. In Seychelles, if the amount of input tax (VAT on purchases) recoverable in a period is greater than the amount of output tax due (VAT on sales) for the period, a refund may be claimed where a VAT credit has been carried forward for two consecutive VAT periods and exceeds SCR 10 000 at the end of the third VAT period by a compulsorily registered taxable person. For exporters and suppliers of zero-rated supplies or investors, however, a refund may be claimed where a VAT credit exceeding SCR 10 000 is reported on a monthly VAT return. VAT credits below SCR 10 000 are carried forward. Since 1 September 2014, the statutory period to process any VAT refund was reduced from 45 to 30 days. In practice, the period may vary, but efforts are made to meet the statutory period for new investors. A possibility to help enhance the efficiency of VAT refunds even further could be to introduce a system that would identify low-risk businesses and refund them faster (e.g. “star-based” VAT refund system in Mexico).

Informality and VAT fraud remain a challenge

VAT fraud takes many forms. Common forms of VAT fraud involve businesses that should be registered for VAT not registering, by remaining completely informal, artificially splitting activities into smaller businesses or under-reporting sales to remain under the compulsory VAT registration threshold. In Seychelles, there is evidence of companies “bunching” below the SCR 2 million compulsory VAT registration threshold (Figure 3.4). Non-compliance may also occur with VAT-registered businesses: some may for instance under-report taxable supplies (e.g. through automated sales suppression devices or “zappers”) or overstate purchases for which they can deduct input VAT (through false invoices); others may even disappear without remitting VAT to the government.

Figure 3.4. There is evidence of businesses "bunching" below the SCR 2 million compulsory VAT registration threshold

Number of corporations and sole traders in SCR 0.05 million turnover bands



Source: Business tax and presumptive tax microdata.

In theory, VAT can incentivise informal businesses to become formal, but this does not always happen in practice in Seychelles. VAT increases the tax burden on the informal sector as informal businesses might have to pay at least some VAT on their inputs, which they are not entitled to deduct. This is especially true if goods are imported, as VAT is collected at the border when goods enter the country. VAT collected on imports effectively becomes a tariff for informal businesses while VAT-registered firms can reclaim the VAT they paid on their imports. The ability to recover input VAT may give informal businesses a strong incentive to become formal, creating positive "chain effects" (de Paula and Scheinkman, 2010). In Seychelles, most goods have to be imported, but a number of the products used as inputs by small businesses, in the tourism sector for instance (e.g. food, fuel), are VAT-exempt, which means that there might be little VAT paid on imported inputs that needs to be recovered and therefore that the incentives to become formal are more limited. Informal businesses then compete with formal VAT-registered businesses. To face competition from informal businesses that are not registered for VAT and therefore do not charge VAT, formal VAT-registered businesses often end up bearing at least a part of the VAT burden themselves by charging lower pre-tax prices.

Addressing the issue of businesses not registering for VAT when they should requires a combination of incentives and sanctions. First, efforts should be made to communicate about how the VAT works, as the lack of information and knowledge about the functioning of the VAT system seems to be a significant issue for small businesses in Seychelles. Measures could also be considered to ease tax compliance for small businesses (see above). In parallel, the tax administration's verification and enforcement capacity should be reinforced. Finally, as described in more detail below, involving digital platforms in the collection of VAT may contribute to addressing the issue.

An advisable strategy for Seychelles would also be to introduce modern risk-based analysis tools. Risk-based approaches enable tax authorities to better identify high-risk businesses and fraudulent behaviours and therefore contribute to targeting limited government resources more effectively. The risk-based analysis system can be based on crossing digitalised data collected by tax authorities with data from other sources, including data from the customs administration, data from real estate and vehicle registers, data from different business databases, etc. In this context, machine learning can also be a very powerful tool to uncover hidden patterns in the existing data.

More sophisticated tools can also be put in place to tackle fraud by VAT-registered businesses, but these might be too costly from an administrative and compliance perspective for Seychelles. For instance, data recording technology can be used to address sales suppression. At a basic level, sales suppression can be as simple as not recording some cash sales. More sophisticated methods have also become prevalent, with sales suppression being undertaken through electronic tools that can alter evidence of transactions whether paid in cash or card, without leaving a trace of the alteration. The most common counter-suppression tool used to address electronic sales suppression is data recording technology, which records and secures the sales data as the transaction occurs and stores it in a manner that is tamper proof. As an additional feature, these tools are also being used to send data automatically to the tax authority, connecting cash registers online to their data server systems. Mandatory electronic invoicing is another tool, which addresses false invoicing (e.g. over-reporting deductions or falsifying invoices to mask non-deductible personal expenses as legitimate deductions). This includes two different elements: requiring businesses to maintain electronic accounts/electronic invoicing systems (which facilitates control by tax administrations) and the (near) real-time communication of all invoicing data to tax administrations. While the results from these more sophisticated tools have been encouraging (OECD, 2017[5]), they require significant capacity within the tax administration and impose large compliance burdens on businesses. They might therefore not be appropriate, at least in the short run, in the context of Seychelles.

Finally, compliance awareness among customers might also be increased through measures such as a receipt lottery. Encouraging customers to ask for receipts when they buy products and services raises awareness amongst the public of the risk of tax evasion and tax fraud, and enables them to act as an enforcement mechanism, giving businesses an incentive to comply. An extra incentive can apply where customers can enter their receipt into a lottery or accumulate points for each receipt submitted, giving them a chance to win a prize. Examples of such lotteries have been put in place in Colombia, Portugal and the Slovak Republic (OECD, 2017[5]).

Existing VAT rules are not adapted to increasing digitalisation and online sales

Regarding cross-border trade in services and intangibles, Seychelles does not have rules in place to levy VAT on inbound digital supplies. Seychelles could broaden its VAT base by ensuring the taxation of inbound digital supplies, in line with the OECD International VAT/GST Guidelines. Indeed, according to the OECD International VAT/GST Guidelines, taxing rights on cross-border business-to-consumer (B2C) supplies of services and intangibles (including digital supplies, e.g. apps, streaming of music and movies, online gaming) are to be allocated to the jurisdiction in which the customer has its usual residence. The OECD Guidelines recommend that these foreign suppliers be required to register and remit VAT in the jurisdiction of taxation and that countries implement a simplified registration and compliance regime to facilitate compliance for non-resident suppliers.

Regarding cross-border sales of goods, most countries, including Seychelles, introduced VAT relief regimes for imports of low-value goods, as the costs of collecting VAT on those items were often likely to outweigh the VAT actually collected. At the time when most of these relief regimes were introduced, online shopping did not exist and the level of imports benefitting from the relief was relatively small. However, there has been a significant and rapid growth in the volume of imports of low-value goods subject to these VAT relief regimes. This has resulted in large potential VAT revenues not being collected and growing risks of unfair competition for domestic retailers that are required to charge VAT on their sales to domestic consumers. Seychelles has such a VAT relief regime in place for goods imported for personal use below a value of SCR 3 000.

Digitalisation is pushing governments to revise their VAT rules on cross-border trade in low-value goods. A number of countries are now removing or considering the elimination of VAT relief regimes for imports of low-value goods. Australia was the first OECD country to implement a reform to collect VAT on imports of low-value goods, effective as of July 2018, and has already reported revenues amounting to AUD 81 million in the first quarter of operation of the regime. New Zealand has introduced a similar regime in 2019 and the European Union announced its introduction in 2021. Seychelles may wish to assess whether the current VAT relief regime for imports of low-value goods poses issues. In particular, authorities could evaluate the extent to which the VAT relief regime puts domestic businesses at a competitive disadvantage and how much VAT revenue they forego because of that measure.

These changes imply an increased role for digital platforms. Removing the VAT exemption for imports of low-value goods without accompanying measures is likely to be counter-productive, as customs would have to control more consignments with knock-on effects for other functions. Therefore, smarter solutions, in particular involving digital platforms, are needed. Involving digital platforms could imply, for instance, that if goods are purchased via an online marketplace, the online marketplace will be treated as the supplier of the goods and will therefore be responsible for collecting and remitting the VAT. Similarly, in implementing the approach recommended in the OECD Guidelines for cross-border B2C supplies of services and intangibles, countries are increasingly examining the role that digital platforms can play in the collection of the VAT. Several jurisdictions have already introduced or announced the introduction of measures involving the digital platform in the collection of VAT on sales of digital services via platforms. A key reasoning behind this approach is that the platform is viewed as taking the role of a 'store' with an offering of different supplies and in many cases act as the sole point of contact with the end consumer (OECD, 2019[6]). A recent OECD report provides practical guidance to tax authorities on new measures to make digital platforms liable for the VAT on sales made by online traders through them, along with other measures that include data sharing and enhanced cooperation between tax authorities and digital platforms (Box 3.3).

In addition to digital platforms involved in the supply of B2C cross-border supplies, online booking platforms could be involved in the collection of VAT on the sales that they facilitate. In this case, for example, the VAT could be levied on the price inclusive of the booking platform's margin. Involving booking platforms in the collection of VAT would also help address informality. Under a system where digital platforms would be fully liable for collecting and remitting VAT, VAT would be imposed on all online sales, including those by informal suppliers operating through a platform. A threshold could be set at the platform level, under which no VAT would be levied. As mentioned above, digital platforms could also provide information to the tax administration, as third party reporting is a key way to strengthen tax compliance.

Box 3.3. OECD report on "The role of digital platforms in the collection of VAT/GST on online sales"

The OECD has provided guidance in the *International VAT/GST Guidelines* (the "Guidelines") to jurisdictions wishing to collect VAT on cross-border supplies of services and intangibles (OECD, 2017[7]). The Guidelines include recommended rules and mechanisms for the effective collection of VAT on business-to-consumer (B2C) supplies of services and intangibles (including digital supplies) by foreign suppliers. The Guidelines were complemented by the 2017 report on *Mechanisms for the effective collection of VAT/GST* (OECD, 2017[8])where the supplier is not located in the jurisdiction of taxation and the 2019 report on *The role of digital platforms in the collection of VAT/GST on online sales* (OECD, 2019[9]), which provide guidance on implementation to jurisdictions. (OECD, 2019[6]).

It was indeed recognised that platforms may significantly enhance the effectiveness of VAT/GST collection given their important role in generating, facilitating and/or executing online sales. In fact, a number of jurisdictions have already implemented measures to involve digital platforms in collecting VAT/GST on online sales and have reported positive outcomes in securing tax revenue. Other jurisdictions are considering the introduction of such measures. These reports of course do not aim to provide detailed prescriptions for national legislation, but rather seek to present a range of possible approaches as a reference point to assist policy makers.

Environmentally related taxes

Tax policies can help governments address the mounting environmental challenges they are faced with, including climate change, threats to biodiversity, air pollution and waste management. By increasing the relative prices of environmentally harmful goods, taxes can directly address the market failure that causes markets to ignore environmental costs, and ensure that producers and consumers take these costs into account in spending decisions. Taxes are not only an effective tool to reduce pollution and other environmentally harmful behaviours but, by shifting the decision of how to best adapt behaviour towards consumers, taxes also minimise the costs at which these reductions are achieved. In many cases, tax reforms that improve the environmental effectiveness of taxes while maintaining revenue-raising capacity are possible.

Environmentally related taxes include any compulsory, unrequited payment to general government on tax bases that are deemed of particular environmental relevance. Tax bases include – but are not limited to – energy, transport, waste and chemicals. The underlying policy intent for using these taxes can vary and differs strongly across the different environmentally related tax bases. For instance, while energy taxes are usually levied with revenue-raising objectives in mind, taxes on waste or chemicals tend to be introduced to steer consumers towards more environmentally friendly behaviours.

In Seychelles, energy excise duty rates vary widely across sectors. At a rate of SCR 8.5 per litre, the excise tax on gasoline is comparable to excise tax rates in many OECD countries (Figure 3.5). Diesel is taxed at the same rate. However, in OECD countries, these fuels are also subject to VAT, so the overall tax burden is higher. Other taxes on energy are considerably lower. In particular, fuel used for power generation by the Public Utilities Corporation (PUC) is taxed only at SCR 0.50 per litre (Table 3.2). This is problematic from an environmental perspective, as Seychelles' electricity generation relies almost exclusively on fuel oil and constitutes the largest source of carbon emissions in the country. The situation is not that uncommon, however, as countries rarely tax the energy inputs used for electricity generation to avoid raising the price of electricity.

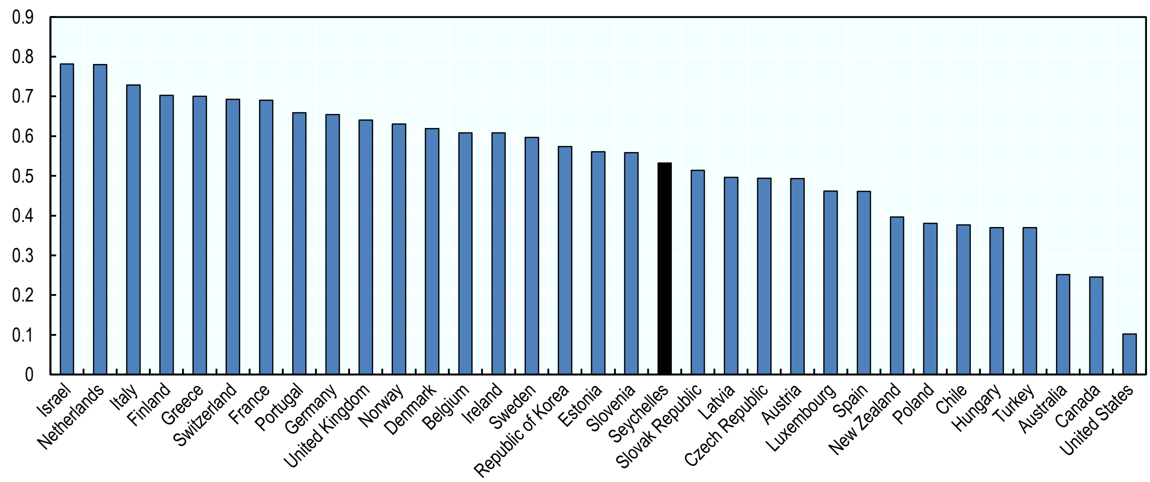
Table 3.2. Energy excise tax rates per litre of fuel

	SCR per litre
Fuel Oil	4
Gasoil	8.5
Jet A-1	8.5
Kerosene	8.5
Mogas	8.5
LPG	1
Lubricants	5.5
Avgas	2.5
Public Utilities Corporation (PUC)	0.5
Seychelles Public Transportation Corporation (SPTC)	0

Source: Ministry of Finance, Trade Investment and Economic Planning.

Figure 3.5. Seychelles' gasoline excise tax is in line with levels in OECD countries

Gasoline excise taxes per litre in EUR (1)



Note: (1) Exchange rates as at 1 September 2019.
Source: International Energy Agency, *Energy Prices and Taxes Database.*

The introduction of a carbon tax could be envisaged. A solution to encourage the decarbonisation of electricity generation and incentivise investments in low-carbon power sources (e.g. hydropower, wind power, solar energy) would be to introduce of a low rate broad-based carbon tax. An increasing number of jurisdictions levy explicit carbon taxes (OECD, 2019[10]). While there are different approaches to designing carbon taxes (Box 3.4), if such a tax were introduced in Seychelles, it could be integrated with existing excise duties. Indeed, most of the countries that currently have explicit carbon taxes collect them from fuel suppliers in the same way as fuel excise taxes. Countries that follow this fuel-based approach do not tax CO2 directly, but put a price on fossil fuels depending on the carbon content of each fuel and convert that price into regular commercial units, for instance by reference to kilogrammes for solid fuels, litres for liquid fuels, and cubic metres for gaseous fuels. For illustration purposes, Table 3.3 shows the equivalent of a carbon tax set at EUR 30 per tonne of CO2, which is a low-end estimation of the climate costs of a tonne of CO2, expressed in common commercial units. An alternative approach to introducing a carbon tax, which has been adopted by a few countries, is to tax CO2 emissions directly through an emissions-based system. This system has a number of advantages, but generally involves higher administrative and compliance costs than the more widely used fuel-based approach (for more details, see Box 3.4).

Table 3.3. The low-end carbon benchmark in common commercial units

Energy category	Low-end carbon benchmark (EUR 30 per tonne of CO_2)	
Coal and other solid fossil fuels	6.24 eurocent per kilogramme	SCR 1.01 per kilogramme
Fuel oil	8.94 eurocent per litre	SCR 1.44 per litre
Diesel	7.99 eurocent per litre	SCR 1.29 per litre
Kerosene	7.58 eurocent per litre	SCR 1.22 per litre
Gasoline	6.86 eurocent per litre	SCR 1.11 per litre
LPG	4.75 eurocent per litre	SCR 0.77 per litre
Natural gas	5.13 eurocent per cubic metre	SCR 0.83 per cubic metre

Note: OECD calculations based on IEA (2018), World Energy Statistics and Balances. The benchmarks shown are based on average carbon content of these energy categories across the 44 countries covered. Actual carbon emissions associated with combusting the respective fuel may vary depending on local fuel characteristics. The table excludes carbon benchmarks for other fossil fuels, non-renewable waste, and biofuels, as energy products' carbon content varies widely within these energy categories. The SCR/EUR exchange rates used for 2019 are from the Ministry of Finance, Trade Investment and Economic Planning.
Source: OECD *Taxing Energy Use 2019.*

The tax rates could be low in the first phase, and increase progressively. Indeed, in most of the countries that have introduced carbon taxes, tax rates have started at low levels. Seychelles could start with relatively low tax rates as well. The tax rates could then progressively increase towards the EUR 30 per tonne of CO_2 benchmark and beyond. In the case of gasoline, this would not imply an increase in existing rates, as approximately EUR 6.9 cents (or SCR 1.11) per litre is the excise tax rate that corresponds to a tax on carbon emissions of EUR 30 per tonne of CO_2.[1] For diesel, EUR 8 cents (or SCR 1.29) per litre corresponds to a tax of EUR 30 per tonne of CO_2. For these fuels, the introduction of a carbon tax would simply mean that part of the existing excise tax would be re-characterised as the carbon tax component of fuel excise taxes. In the power sector, however, the introduction of a carbon tax would raise current tax levels (although modestly if a low rate is applied in the initial stages) and encourage diversification towards cleaner energy sources.

The base of the carbon tax would have to be broad. In many countries, carbon tax bases are narrowed by a number of exemptions. Some countries exempt certain fuels (e.g. natural gas is exempt in Argentina and Mexico). Some countries exempt certain energy users from the carbon tax or offer reduced rates or refunds. Such measures are often put in place to address competitiveness or affordability concerns. In principle, however, there are better policy instruments available to address competeveness and affordability issues than carbon tax rate reductions or exemptions. In the case of Seychelles, the carbon tax base should be as broad as possible, and cover the power sector. Direct compensation mechanisms could be envisaged for the most vulnerable households affected by the increase in electricity prices. In the longer run, the diversification of energy sources may also contribute to stabilising and lowering electricity prices, by reducing the country's reliance on fuel oils whose prices depend on world market fluctuations.

For the implementation of a carbon tax to be successful, non-tax policy changes would need to be introduced as well. PUC imposes restrictions on the self-production of solar energy. While households are allowed to produce as much solar energy so as to equate their consumption (with any monthly excess production bought by PUC at the prevailing fuel marginal cost adjusted by a factor of 0.88 to account for network losses), commercial operators with power demand above 10 kW up to 100 kW, can only self-produce half of their total electricity consumption. Such restrictions would need to be removed in order to encourage much needed investment in low-carbon sources of electricity.

Box 3.4. The different approaches to designing carbon taxes

Fuel approach

The most common approach to carbon taxation has been to levy carbon taxes on specific fossil fuels, primarily oil, gas and coal, and their derivative products. Countries that follow this fuel-based approach do not tax CO_2 directly, but put a price on fossil fuels depending on the carbon content of each fuel and convert that price into regular commercial units, for instance by reference to kilogrammes for solid fuels, litres for liquid fuels, and cubic metres for gaseous fuels.

Under this approach, carbon taxes are collected from fuel suppliers in the same way as pre-existing fuel excise taxes, which lowers administrative and compliance costs. Indeed, the countries that have introduced a carbon tax have generally added it to already existing excise duties, either as part of the general excise duty (e.g. in France) or as a separate tax (e.g. in the Nordic countries).

Countries do not always impose carbon taxes on all fossil fuels. For instance, Argentina and Mexico exempt natural gas, which is generally considered as the cleanest fossil fuel. Iceland, on the other hand, exempts coal, even though it is among the most polluting fossil fuels (although it should be mentioned that Iceland only uses coal in the industry sector, and generally has a very clean energy mix). Countries may also exempt certain energy users from the carbon tax or offer reduced rates or refunds.

Direct emission approach

The other approach to carbon taxation consists in taxing CO_2 directly, by relying on the direct measurement of emissions from certain types of stationary installations/facilities. Given the need to measure (or calculate) emissions, these carbon taxes only apply to emitters above a certain emissions threshold or to installations that fulfil certain technological criteria. Countries that pursue such an emissions-based approach include for instance Chile, Estonia and Latvia.

One of the advantages of emissions-based approaches is that they can readily be extended to non-energy and non-CO_2 emissions, e.g. in agriculture or industry. On the other hand, administrative and compliance costs tend to be somewhat higher than with fuel-based approaches. Whether such differences in administrative and compliance costs are relevant in practice may depend on pre-existing reporting obligations for other purposes. Indeed, the additional effort of reporting carbon emissions for tax purposes may be negligible for facilities that already have reporting obligations for other reasons (e.g. requirements to measure emissions by Integrated Pollution Prevention and Control regulations or by national environmental codes). More generally, administrative and compliance costs become relatively less significant as carbon tax levels increase.

In practice, the choice between fuel-based and emissions-based carbon taxes will also be influenced by political and legal/ constitutional considerations. For instance, in many countries, fuel-based carbon taxes fall under the responsibility of finance ministries, whereas emissions-based carbon taxes (and emissions trading systems) may be under the remit of environment ministries.

Source: Taxing Energy Use 2019 and UN Committee of Experts on International Cooperation in Tax Matters.

Seychelles should also remove or at least scale back the remaining fuel tax concessions. A number of the fuel tax concessions granted through the 2003 Tax Incentive Act (TIA) are being progressively removed. Indeed, fuel tax concessions for TIA licensed operators in hire crafts, dive centres, tour operators, cruise ships, yacht/live aboard services and helicopter services, will be gradually reduced until 2020 when these will be fully liable to excise taxes on purchased fuel. However, other operators including for instance domestic air transportation operators, boat owners, and licensed ferry cargo services will continue to enjoy benefits. In addition, concessions will be maintained for licensed accommodations that are not connected to the PUC grid and use fuel to generate their own electricity. In general, fuel tax concessions should be scaled back (in particular the 100% concession for boat owners). For the licensed accommodations not connected to the PUC grid, concessions should cease to be applicable once those are connected.

With regard to vehicle taxation, Seychelles provides a preferential tax treatment to hybrid and electric vehicles. Motor vehicle purchases are taxed by engine size. Hybrid vehicles are subject to lower excise taxes, while electric vehicles are only subject to VAT. Before 2017, excise taxes on hybrid vehicles were significantly lower than for conventional vehicles, which led to a surge in hybrid car imports, and ended up partly offsetting the reduction in carbon footprint from switching to cleaner vehicles (IMF, 2017[11]). To address this issue, Seychelles decided to raise taxes on hybrid vehicles, although the new rates for hybrids are still lower than for conventional vehicles.

Similar practices are observed in many other countries. Indeed, countries are increasingly using vehicle taxes to influence consumer behaviour by modifying relative prices depending on the environmental characteristics of vehicles. The countries that have introduced such measures generally find that such vehicle tax changes are successful in changing behaviours, which often leads to larger than anticipated revenue losses. However, vehicle taxes are not the optimal tool to steer consumer behaviour towards cleaner driving habits, because they can only account for the average pollution profile of a vehicle, but not for the external costs related to driving behaviour, the amount or the place of driving. Overall, vehicle taxes have been shown to be a relatively expensive way to reduce emissions (Van Dender, 2019[12]). In addition to their cost, the benefits of tax preferences for cleaner vehicles should not be overestimated. The climate impact of tax preferences for electric vehicles depends on how clean the energy sources used to produce electricity are. Electric and hybrid vehicles also contribute to increasing the other external costs of road transport (congestion, accidents and road damage). Finally, granting preferential tax treatment to electric and hybrid vehicles tends to be regressive, as low-income households are less likely to purchase such vehicles.

The reforms announced by the government seem to go in the right direction, with the exception of the tax treatment for electric vehicles. In the Budget Speech for 2020, the government has announced a few measures, primarily aimed at encouraging the use of electric vehicles. As of January 2020, in addition to increasing the levy on commercial vehicles to be on par with those applicable to private vehicles, the current levy on conventional motor vehicles will be raised to SCR 25 000 and the excise taxes on hybrid vehicles above 1 600 cubic centimetres will be aligned with those applicable to their conventional equivalents. The preferential tax treatment granted to electric vehicles will remain the same. Given that Seychelles relies on fuel oil to produce its electricity, the reduction in pollution and GHG emissions from promoting electric vehicles might be less significant than anticipated. On the other hand, the revenue loss and regressive effects could be significant. Overall, this calls into question the decision to maintain the existing preferential tax treatment for electric vehicles.

Finally, Seychelles has other small environmental levies, which have been considered successful. Seychelles has small environmental levies on beverages contained in PET bottles, cans and glass bottles, with refunds provided when the bottles and cans are returned to recycling centres. These measures have been viewed as successful. Similar types of measures have been introduced in other countries to steer consumers towards more environmentally friendly behaviours and have also generally been found to have a strong effect on behaviour, given the potentially large elasticity of the tax base, but public revenues from such measures tend to be modest.

Personal income taxes

The Seychelles operates a territorial personal income tax system. Personal income tax (PIT) is payable by residents and non-residents on their Seychelles-source income. This differs from the most common approach, where personal income is taxed on a worldwide basis, which means that residents are taxed on their worldwide income (unless excluded by a tax treaty), while non-residents are subject to tax only on their income sourced in the given jurisdiction. Worldwide taxation for personal income is much more prevalent around the world than territorial taxation (Shum, Fay and Lui, 2017[13]).

A major reform was introduced in 2018, making the personal income tax progressive, but the new system poses problems

Progressive PIT rates replaced the flat rate in 2018. In July 2018, a new progressive PIT rate schedule entered into effect, replacing the previous flat 15% rate. The new PIT schedule provides for a zero-rate bracket, and three progressive tax rates: 15%, 20% and 30% (Table 3.4). The objective of shifting to a progressive system was to address persistently large income disparities, which were identified in a household survey preceding the adoption of the reform (IMF, 2015). By setting the top PIT rate at the same level as the top general business tax rate (30%), the other objective was to reduce tax arbitrage opportunities for taxpayers.

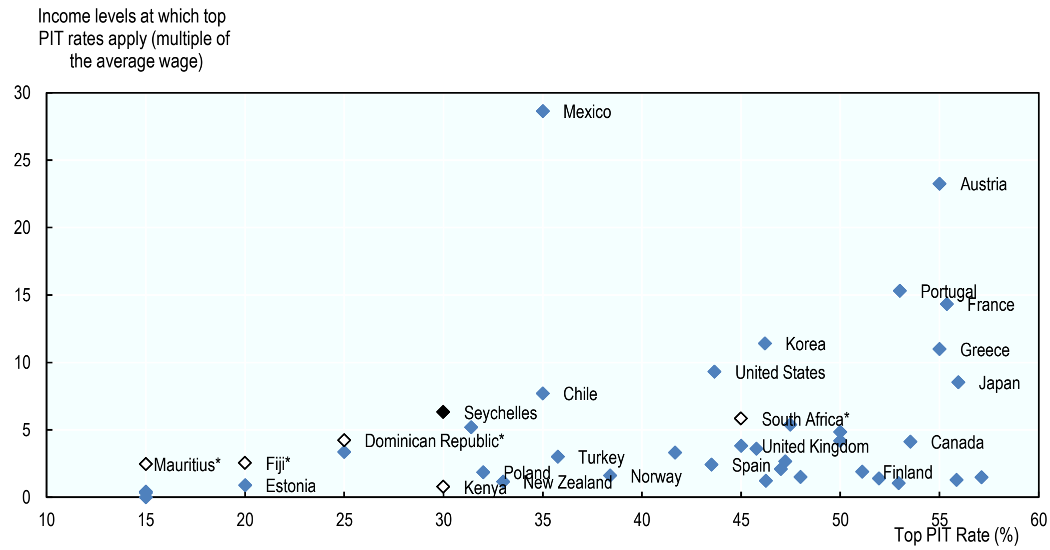
Table 3.4. Personal income tax rates on employment income for Seychelles citizens

Monthly income bracket (SCR)	Marginal tax rate
Up to 8 555.50	0%
8 555.51 – 10 000.00	15%
10 001.00 – 83 333.00	20%
Over 83 333.00	30%

Source: Ministry of Finance, Trade Investment and Economic Planning.

The new top PIT rate is significantly higher than the previous flat 15% rate, but remains below top PIT rates in more advanced countries and starts applying at a relatively high level of income. Seychelles' top PIT rate is lower than top PIT rates in most OECD countries (Figure 3.6). Compared to other small island states, Seychelles' top PIT rate is higher, but it also starts applying at higher income levels. Indeed, in Seychelles, the top PIT rate of 30% starts applying at an income level equivalent to more than six times the average wage, while the top PIT rates in Mauritius, Fiji or Dominican Republic, which are lower, also apply to lower levels of income measured as multiples of their domestic average wages. This is likely to mean that, while the top PIT rate is higher in Seychelles, it applies to a smaller share of the population than the lower top PIT rates in other small island states.

Figure 3.6. Top personal income tax income thresholds and rates

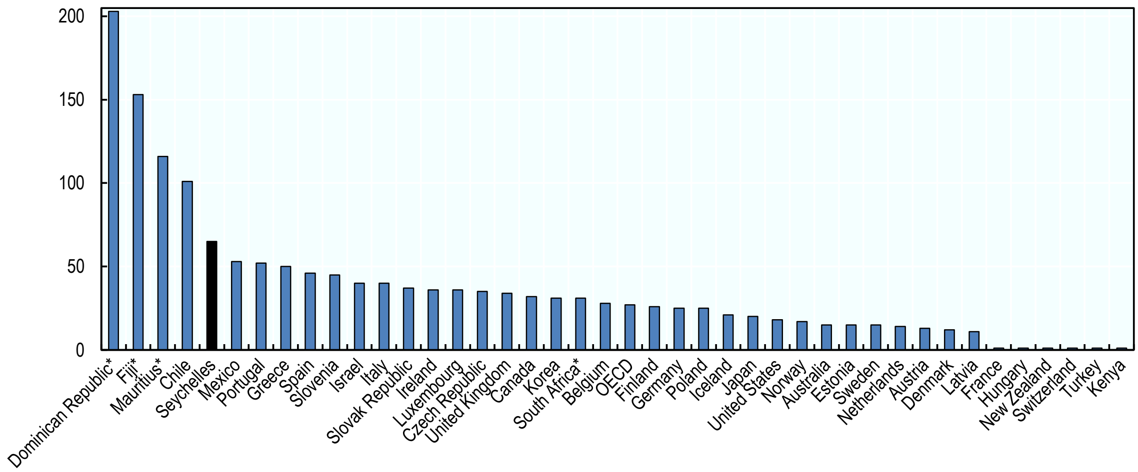


Note:*Overall average wage (including both public and private sector wages).
Source: OECD, National Statistics Offices, and International Bureau of Fiscal Documentation (IBFD).

The 2018 reform had the consequence of significantly narrowing the PIT base. The new zero-rate band exempts from tax a significant share of wage income for citizens of Seychelles. Seychellois workers earning the average wage enjoy a tax exemption of more than 60% of their wage earnings, which is high in particular in comparison to PIT thresholds in more advanced economies (Figure 3.7). The zero-rate band implies that low-income workers do not pay income tax (and that high-income earners do not pay any tax on a portion of their earnings), but benefit from social benefits as public social expenditure is financed through general taxation. The introduction of the zero-rate band also significantly narrowed the 15% rate income band. In addition, the value of the zero-rate band increases with taxpayers' marginal PIT rates, which implies that high-income earners benefit more from the exemption than low-income workers do. To address this issue, a number of countries have moved away from tax allowances and zero-rate bands, and have introduced tax credits instead. As introducing tax credits is difficult in the absence of an end-of-the-year PIT declaration (see below), the government could instead consider narrowing the scope of the zero-rate bracket.

Figure 3.7. Seychelles' personal income tax threshold is high in comparison to OECD countries

Personal income tax thresholds expressed as a share of the average private sector wage in each country



Note:*Overall average wage (including both public and private sector wages).
Source: OECD, National Statistics Offices, and International Bureau of Fiscal Documentation (IBFD).

As a result of the new PIT rate schedule, a vast majority taxpayers have seen their tax burdens reduced and tax revenues have declined. The changes introduced in 2018 are thought to have benefitted around 98% of Seychellois (Ministry of Finance, 2017[14]). More specifically, the government estimates that only 1.7% of Seychellois taxpayers are paying higher taxes compared to 2016, while 43.7% pay less tax and 54.7% do not pay any tax. This has implied a decline in revenues from PIT, which now accounts for about 12% of total tax revenues, against around 16% previously. This also means that even if the tax rates have become significantly more progressive, the redistributive effect of the reform might be low, because the revenues raised through the personal income tax are significantly lower. Lower revenues from PIT are also likely to put pressure on the financing of the social welfare system.

Seychelles also has separate PIT rate schedules for citizens and non-citizens. The difference between the two PIT rate schedules is that non-citizens are not entitled to the tax-free threshold and are taxed at 15% from the first rupee they earn. The introduction of two separate schedules was aimed at targeting support to Seychellois citizens, but it is uncommon to have such separated schedules and there is not much justification for such discrimination.

Seychelles operates a final monthly PIT withholding

Seychelles levies PIT on employment income through a final monthly withholding system. PIT is withheld at source by the employer on a monthly basis and is considered final. This differs from practice in other countries, where PIT is withheld but where taxpayers have either the obligation or the option to file an annual tax return. Requiring or allowing for an annual PIT declaration is justified by the fact that most countries provide PIT allowances or tax credits targeted at specific categories of taxpayers.

Seychelles' final PIT withholding system worked well when the PIT rate was flat, but the introduction of the zero-rate band and the progressive rate schedule have led to difficulties. Indeed, a final PIT withholding system has the benefit of being relatively easy to administer and to comply with, as employees are not directly in contact with the tax administration. Such a system has been possible because Seychelles does not provide PIT allowances or tax credits, and worked well when everyone was taxed at the rate of 15%. However, the introduction of the zero-rate band and the progressive PIT rate schedule have led to difficulties. For instance, a taxpayer with fluctuating income might be taxed in a given month, but not the following one, whereas smoothing that taxpayer's income over the year may have resulted in him or her paying lower taxes or not having to pay any tax. Workers who are paid late may also face issues as they may be taxed on their regular salary as well as on the part of their salary that should have been paid earlier but was paid late, which might bring them into a higher tax bracket. More generally, Seychelles' current system does not allow targeting tax provisions at specific categories of taxpayers. While this is currently not an issue, Seychelles may wish to use the PIT system in the future to target provisions at specific taxpayers.

In the medium to long run, taxpayers could be given the option to file a tax return at the end of the year. This would allow correcting for the over or under-payment of PIT. For workers with multiple jobs, such a system would allow adding their different sources of income together, as opposed to taxing each source separately and benefitting each time from the tax-free threshold. It would also help address the issues mentioned above, by smoothing earnings over the whole year for workers with fluctuating income. A modern PIT with an end-of-year declaration would also allow the government to use PIT provisions to support specific categories of taxpayers in the future (e.g. workers with children). However, this would require putting in place a system in which employees have tax identification numbers (TINs) and direct contact with the tax administration. Thus, such a reform could only be envisaged in the medium to long run.

There are some sectors where the implementation of the personal income tax remains problematic and where an alternative lump-sum payment may be worth considering. For workers in certain sectors where earnings tend to fluctuate a lot (e.g. fishermen, musicians), there may be some benefit to charging a fixed lump-sum. Indeed, fluctuating income makes it difficult for employers to withhold PIT on a monthly basis in particular given that the PIT rate schedule is progressive (see above). In addition, these workers might have several employers in a given month, in which case income is to be reported and taxed separately by each employer, benefitting each time from the zero-rate band. An alternative solution could be to levy a fixed monthly (or quarterly) lump-sum amount, whose payment could be required for workers to be allowed to work. Without a formal proof of the payment of the lump-sum tax, the worker would not receive a licence to work in that specific sector. In the past, a fixed-lump sum system existed for fishermen employed by boat owners, but the fee was very low (SCR 100). If such a system were to be reintroduced, the lump-sum amount would need to be set at a higher level (e.g. one possibility to establish the lump-sum amount would be to multiply the average monthly salary earned in the sector by the corresponding tax rates under the personal income tax rate schedule).

The PIT base is narrowed by a number of exemptions

The PIT base is narrowed by a number of exemptions, which lower potential revenues and enable tax-minimising remuneration packages. These include various types of remunerations and compensations (subject to certain conditions) including: bonuses; service charges that are added to customers' bills in the tourism sector and shared amongst the employees; gratuity payments, received by an employee for their continuous employment (e.g. every 5 years); overtime; 13th month pay; and end of contract payments (see Box 3.5).

On the other hand, Seychelles does not provide any PIT allowances or credits. Aside from the tax-free threshold, there are no PIT allowances. Seychelles does not have any PIT credits either. This differs from common practice in many countries, where tax provisions are provided in the form of PIT allowances and PIT credits to support specific categories of taxpayers, in particular to lower the tax burden on families with children.

Benefits received by employees in kind are taxed under the non-monetary benefits tax and payable by employers, but many exemptions are provided as well. Benefits in kind (e.g. motor vehicle, accommodation, utilities, meals, transport, etc.) are subject to the non-monetary benefits tax. The tax is payable by the employer at a rate of 20% on the value of the non-monetary benefits provided to an employee on a monthly basis. The tax is imposed on the fair market value of the non-monetary benefits, unless otherwise specified. However, there are many exemptions, in particular in the tourism sector (Box 3.5).

Seychelles should consider broadening the PIT base by removing or scaling back some of these exemptions, particularly the ones that are more likely to be regressive. The exemptions mentioned above limit the revenue potential of taxes on individuals, create distortions, and may reduce fairness as those best able to make use of exemptions tend to be those earning higher incomes. A close assessment of these exemptions would be needed, with a view to scaling back the most regressive ones. Such a reform would be in line with the general approach recommended by the OECD to enhance tax systems in a way that supports inclusive growth (Brys et al., 2016[15]).

Box 3.5. Exemptions from the individual income tax and the non-monetary benefits tax

Exemptions from the Individual Income Tax

- money received as a reimbursement for the employee's use of personal money for a motor vehicle, e.g. the company rents a car for work purposes and the employee uses their money to fuel the car
- money received as a reimbursement for using personal motor vehicle for work purpose
- per diem given by an employer to an employee when they travel for work purposes
- shoe allowance
- bonuses (subject to certain conditions)
- compensation given to employees after they cease employment with the company (subject to certain conditions)
- service charge, added to customers' bills to pay for the service that they received, and shared amongst employees in the tourism sector (subject to certain conditions)
- retirement pension given by the state and the Seychelles Pension Fund to retired individuals and invalid individuals
- gratuity payment received by an employee for their continuous employment, e.g. every 5 years
- overtime (subject to certain conditions)
- 13th month pay (subject to certain conditions)
- end of contract payment (subject to certain conditions)

Exemptions from the Non-Monetary Benefits Tax

- the provision of accommodation for business purposes for a maximum period of 3 months
- the provision of accommodation to an employee in the construction and tourism sectors
- utilities benefits (e.g. payment for bills such as electricity, water, telephone, cable television or Internet access) provided to employees in the tourism sector
- in-house benefits up to a maximum of 20% of basic salary per month
- the provision of meals to employees in the construction and tourism sectors
- a private car provided to an employee in the tourism sector for the purpose of commuting;
- medical expenses in respect of injuries or illness of an employee arising during the performance of his or her work or at his or her place of employment
- life insurance, where the sum insured does not exceed SCR 1 million per employee
- health insurance, if applicable to all employees
- cost of transportation provided to employees for the purpose of commuting
- moving costs provided by the employer at the start and conclusion of an employment contract;
- tuition fees and training costs, subject to criteria approved by the Minister (not applicable in the case of non-resident employees)

Personal investment income is generally not taxed in Seychelles

Most forms of personal capital income are not taxed in Seychelles, which creates distortions and reduces fairness as individual capital income is more lightly taxed than labour income. Dividends received from a Seychelles source are exempt from tax where the recipient is a Seychelles resident. This gives entrepreneurs an incentive to set up a company and remunerate themselves through untaxed dividends, especially in sectors that benefit from preferential business tax rates. Introducing a low tax on dividend income at the level of individual shareholders would be particularly advisable if the standard business tax rate is reduced (see proposals in Chapter 2). Similarly, there is no capital gains tax, which raises horizontal and vertical equity issues, and provides incentives to re-characterise income receipts as capital gains. For interest income, interest payments made to a resident individual are subject to a final withholding tax on the gross amount at the rate of 15%, but some forms of interest income are exempt. Overall, this suggests that Seychelles may consider taxing the forms of personal capital income that are currently not subject to any taxation.

In the longer run, the Automatic Exchange of Information (AEOI) could provide opportunities to move towards PIT on a worldwide basis. The AEOI, whereby jurisdictions obtain financial account information from their financial institutions and automatically exchange it with other jurisdictions on an annual basis (see below), could provide opportunities to move towards taxing individual income on a worldwide basis, as is common in many countries. Indeed, thanks to the progress made on the adoption of tax transparency standards on the exchange of information, in addition to providing information to other jurisdictions, Seychelles will also get information about its taxpayers' offshore holdings, which could in turn help Seychelles levy personal income taxes on taxpayers' worldwide income.

Seychelles has made significant progress on international tax transparency

Seychelles has been a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes since 2009. The Global Forum is the multilateral framework that promotes and oversees the implementation of two internationally agreed standards on the exchange of information for tax purposes: the Exchange of Information on Request (EOIR) and the Automatic Exchange of Information (AEOI). EOIR refers to a situation where the tax authority of one jurisdiction asks for particular information from the authority of another jurisdiction in connection with a tax inquiry or investigation. All Global Forum members have committed to implementing and being reviewed on the implementation of the EOIR standard. AEOI is a more recent global standard that was endorsed by the Global Forum in 2014. Under this standard, jurisdictions obtain information from their financial institutions on financial accounts held by non-residents and exchange that information with the jurisdictions of residence of the account holders, every year, without being preceded by a specific request.

The Seychelles received a "largely compliant" rating on EOIR in 2015, and a second Review is now underway. In the first Review, Seychelles received a "non-compliant" rating in Phase 2 of the Review in 2013 (OECD, 2013[16]). To address its non-compliant rating, Seychelles introduced a number of changes and requested a supplementary review in March 2015. Seychelles amended the International Business Companies Act (IBC Act) to abolish bearer shares and require that all share registers be kept at the IBC's registered office in Seychelles to enhance the effectiveness and efficiency of the FSA monitoring process. New provisions were introduced to require IBCs to submit an annual return and to increase the penalty fee in instances of non-compliance. In an effort to improve the availability of information relating to ownership and accounting records, in March 2015, Seychelles also introduced new obligations on International Corporate Service Providers (CSPs) to monitor the compliance of IBCs, Limited Partnerships and Foundations. Finally, Seychelles amended the double tax treaties that were not in line with international standards. As a result of these changes, Seychelles' status was upgraded to "largely compliant" in 2015. A second round of EOIR Peer Review was launched by the Global Forum on 5 December 2018 and is currently ongoing. The Review will assess Seychelles' legal and regulatory framework for tax transparency and the exchange of information as well as the practical implementation of that framework.

Seychelles has also made significant progress on AEOI. In 2014, the Global Forum endorsed the AEOI standard, developed by the OECD in collaboration with G20 countries. To deliver a level playing field, the Global Forum launched a process under which 100 jurisdictions committed to implementing the AEOI standard in time to commence information exchanges in 2017 or 2018. Seychelles was among a group of 49 "early adopters" of the exchange of information under the AEOI standard, committing to starting the first information exchanges in 2017. The international legal basis for the AEOI was established in 2015, with Seychelles signing the Convention on Mutual Administrative Assistance in Tax Matters, followed by the Multilateral Competent Authority Agreement, which operationalises AEOI under the Common Reporting Standard (CRS). The CRS sets out the financial account information to be exchanged under the AEOI, the financial institutions required to report, the different types of accounts and taxpayers covered, as well as the common due diligence procedures to be followed by financial institutions. These requirements have been incorporated into Seychelles' domestic law to be able to enforce compliance by financial institutions. In 2018, Seychelles had exchanged 2017 financial account information under the AEOI with 55 partner countries, and in 2019 it exchanged 2018 data with 66 partner countries. It should be noted that these figures only refer to the exchanges that took place between jurisdictions, and do not provide an assessment of the quality of the information exchanged. This will be part of the Global Forum's reviews of the effectiveness of the implementation of the AEOI standard, due to start in 2020.

Social security contributions

Social security contributions (SSCs) were almost entirely replaced by PIT when PIT was introduced in 2010. Since 2010, Seychelles has been financing its social welfare system through revenues from general taxation instead of SSCs. The only SSCs that were maintained were contributions to the Seychelles Pension Fund (SPF). For employees, the employer and employee contributions both amount to 3% of the gross monthly wage, leading to an overall mandatory monthly contribution of 6%. The self-employed also pay an overall mandatory contribution of 6%. These contributions are withheld and remitted by employers to the SPF on a monthly basis. By contributing monthly for a continuous period of at least ten years prior to retirement or for any period of 20 years, with breaks in between, individuals qualify for a retirement pension. In contrast to common practice, employee SSCs are not deductible from taxable income under the personal income tax. This is a direct consequence of the lack of an end-of-year declaration of income (see Section 2.3). Overall, the SPF collected SCR 270 million, or about 1.3% of GDP, from mandatory and voluntary contributions in 2017 (for voluntary contributions, see discussion below).

There are arguments for shifting partly from SSCs to general taxation to finance social benefits. Financing social benefits through general taxation instead of SSCs can reduce the tax burden on labour income, particularly if social benefits are financed through taxes that do not bear solely on labour income. Reducing the tax burden on labour income through lower employer and employee SSCs can in turn provide greater incentives for employers to hire workers and for workers to participate in the labour market. In the case of Seychelles, moving from flat SSCs to a progressive PIT has also enhanced the system's progressivity.

In a changing world of work, financing social benefits partly through general taxation can also ensure that welfare support remains available for a large number of people. Indeed, structural changes in the economy due to digitalisation, automation and other trends are resulting in an increasing number of workers paying lower levels of SSCs (self-employed, temporary workers and workers with irregular working hours). This trend presents challenges for the sustainability of welfare systems financed primarily by SSCs.

At the same time, there are limitations to almost fully shifting the financing of social protection from SSCs to PIT. With the 2018 PIT reform, Seychelles' PIT base has been significantly reduced, which might not allow financing the same level of social protection. Besides, repealing SSCs almost altogether has broken the link between SSC payments and benefit entitlement, which reduces incentives for individuals to pay into the system, as they will be entitled to benefits anyway.

A good system gives incentives to contribute, but also ensures protection for those most in need, and can be achieved through a mix of contributory and non-contributory financing. Non-contributory schemes, which ensure basic, tax-financed social protection, are key to ensure a basic level of protection for everyone, in particular for those groups that do not have access to any other social protection mechanisms. On the other hand, contributory mechanisms, financed through SSCs, offer more lifestyle-preserving protection to those who paid into the scheme. In general, there are strong arguments for financing social benefits through general taxation when there is no strong link between the contributions made and the benefits received, as is the case with health insurance and family allowances (Brys et al., 2016[15]). On the other hand, there is a rationale for financing benefits for retirement, disability and unemployment, which tend to be more strongly related to earnings, in large part through SSCs.

In the case of Seychelles, however, the priority is to broaden the PIT base. As discussed in Section 2.3, the consequence of the 2018 personal income tax reform was to significantly narrow the PIT base. Indeed, the reform has implied a significant decrease in revenues from PIT as a share of total tax revenues (a decline from 16% to 12% of total tax revenues), which is likely to put pressure on the financing of social protection. To ensure that the financing of social protection remains adequate and that more people contribute into the system, the base of the PIT should be broadened.

In addition to the mandatory contributions, voluntary monthly pension contributions can be made. The scheme is intended to provide a flexible instrument to members of the SPF to save for their retirement. Individuals can decide how much they want to contribute and may increase, decrease or temporarily stop contributing at any time. As mentioned, employee pension contributions are not deductible, but the pension itself is not taxed when it is received by pensioners. There is a question as to whether there should be a limit on the contributions that can be made, as this may be seen as an additional untaxed benefit (see Section 2.3 on other PIT-exempt income and benefits). Instead, an alternative approach could be to cap the tax relief by introducing a limit on the amount of pension income that can be received tax-free.

Property taxes

Property taxes play a minor role in Seychelles. Property taxes accounted for only 1.4% of total tax revenues in Seychelles in 2017. In comparison, property taxes accounted on average for 1.6% of total tax revenues in African countries, 3.4% in Latin America countries, and 5.7% of total taxation in OECD countries (see Chapter 1). The only property taxes in place in Seychelles are the stamp duty and the sanction duty levied on property transfers. As opposed to many other countries, Seychelles does not have a recurrent tax on immovable property.

Immovable property taxes are an efficient form of taxation. In OECD countries, empirical analysis concluded that recurrent taxes on immovable property were the least damaging tax for long-run economic growth, compared to consumption taxes, other property taxes, personal income taxes and corporate income taxes (Johansson et al., 2008[17]). These empirical findings are consistent with the strong theoretical case for recurrent immovable property taxes. Recurrent taxes on immovable property can be an efficient form of taxation because the tax base – typically land and improvements – is highly immobile, and consequently there is limited behavioural response to the tax. The highly visible nature of immovable property also makes the tax harder to evade. In Seychelles, the scarcity of land constitutes another strong justification for the tax. Finally, a recurrent immovable property tax can act to some extent as a "benefits tax", if there is a strong link between the tax paid and the public services received by households. In the extreme, where taxes are directly linked to local public good provision, they effectively become a payment for services, and are therefore expected to have a smaller distortive impact on behaviour.

Seychelles will introduce a recurrent tax on foreign-owned residential properties. The government had initially envisaged levying a tax on all foreign-owned residential and company-owned properties. The plan was revised and the tax will now only be levied on foreign-owned residential properties. The tax will be levied at a rate of 0.25% on the market value of properties. The 2020 Budget introduced new exemptions for foreigners married to Seychellois and whose marriage is still subsisting (or whose spouse died after purchasing the immovable property) as well as for non-Seychellois who are first-time owners of a residential property and may apply in writing to the Commission General for an exemption for the year of the purchase. The tax is expected to come into force in 2020.

The proposed tax goes in the right direction, but raises some practical concerns. One of the concerns relates to the distinction between residential and commercial use, which may be blurry in practice. For instance, a house used as a self-catering business will be considered as commercial use, but a house used for renting will be considered as residential use. However, this issue will be addressed by ensuring that the property is taxed according to the use declared to and approved by the Planning Authority. Under the law, individuals cannot simply use their houses as a guesthouse or self-catering business if this was not the purpose for which approval was granted. If the owner wanted to use his/her house as a self-catering business, he would need to request the approval of the Ministry of Tourism, submit a change of use application to the Planning Authority (that will assess whether the property meets the requirements) and register with SRC for tax purposes. Only then would it be considered as a commercial property and be exempted from property tax. Property valuation is another concern. Indeed, market values need to be updated regularly to reflect the evolution of prices on the housing market and thereby maintain the fairness of the tax. However, given the fact that the Seychelles housing market is relatively thin (i.e. limited volume of transactions), this may be more difficult. Housing prices might also be more volatile than on a more liquid market. A possibility would be to tax only a certain percentage of the property value, thereby leaving some room for the various difficulties involved in correctly reflecting the market value of the property and reducing the likelihood of tax disputes.

Credible verification by the tax administration will also be key to ensure that the property tax is properly enforced. There might be concerns related to taxpayers' registration and estimations of property values. Foreigners purchasing new property will automatically be registered. However, individuals who have purchased property before the introduction of the tax will have to register to pay the tax, with a fine of SCR 50 000 for failing to register. Foreigners will also be required to submit proof of valuation to the tax administration. The system will thus require credible verification by the tax administration to prevent non-registration or under valuations.

Box 3.6. Tax policy recommendations

Value-added tax

- Remove VAT exemptions on fuels, but adopt a careful approach, e.g. by evaluating whether targeted income-tested or lump sum transfers could be provided to compensate poor households and/or whether exemptions could be maintained on small amounts of electricity consumption.
- Maintain the compulsory VAT registration threshold at its current level in the short run (SCR 2 million), but consider lowering it to SCR 1 million when the capacity of the tax administration has improved.
- Broaden the VAT base by ensuring the taxation of cross-border business-to-consumer (B2C) supplies of services and intangibles, in line with the OECD International VAT/GST Guidelines.
- Involve digital platforms in the collection of VAT, in line with recent OECD guidance.
- Consider the adoption of additional measures – in particular modern risk-based analysis tools – to address VAT non-compliance.

Environmentally related taxes

- Introduce a low-rate broad-based carbon tax, following a fuel-based approach, and progressively increase tax rates to levels that reflect the climate costs of carbon emissions.
- Remove, or at least scale back, the remaining fuel tax concessions.

Personal income taxes

- Broaden the personal income tax base by lowering the tax exemption threshold and by removing regressive tax exemptions.
- In the medium to long run, give taxpayers the option to file a personal income tax return at the end of the year.
- In the medium run to long run, consider taxing the forms of personal capital income that are currently not subject to any taxation, in particular dividends at the individual shareholder level.

Property taxes

- Introduce the recurrent tax on foreign-owned residential property as planned, but address practical issues (in particular regarding property valuation, e.g. by taxing only a certain percentage of the property value) and establish credible verification capacity by the tax administration.

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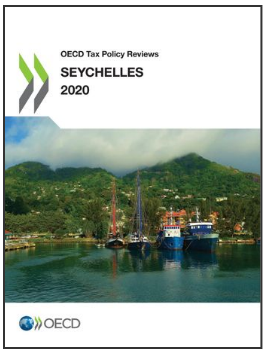
Notes

[1] These rates only reflect the climate costs of CO_2 emissions from transport fuels, but there are other negative externalities associated with transport fuels that are not taken into account in these rates (e.g. pollution, congestion).



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