

Guidelines for the Incentives under Part III of the Income Tax Act

1.0 Overview

The Income Tax (Amendment) (No.2) Act 2005 (No.9 of 2005) was passed into law by the National Parliament on the 16 November 2005. The Act consequentially amended the Income Tax Act (CAP123) to reflect the enactment of the Foreign Investment Act 2005.

Previously, the Income Tax Act granted the Commissioner of Inland Revenue (CIR) power, on the recommendation of the Investment Board, to approve investment incentives as set out in the 1st and 2nd Schedules to the Income Tax Act (1965). The Amendment substituted a new Part III of the Income Tax Act, which now gives the CIR the power to exempt from taxation any profits and income derived by an *investor* in conducting an *investment activity*. As before, the extent and period of the tax exemption are to be calculated in accordance with the formula in the First Schedule to the Income Tax Act.

Although the power to award investment incentives now lies solely with the CIR, the investment incentives that are available to investors are otherwise unchanged. Thus, the new Part III of the Income Tax Act continues to provide four forms of investment incentive:

- Section 11 allows the Commissioner to exempt from taxation profits and income derived in conducting an investment activity, for periods specified in Part I of the First schedule. [Tax Holidays]
- Section 12 allows additional exemptions for particular activities as specified in the Second schedule.
- Section 14 exempts any dividend paid by a company, or any interest paid by an investor who has been granted a tax holiday under section 11 from withholding tax.
- Section 15 deals with applications from 'approved mining companies'

In particular, Section 12 of the new Part III preserves income tax exemptions under section 12 available to:

- Tourist hotels, resorts and other tourist orientated projects [5 year exemption, a 50% diminishing value depreciation charge until fully expended and a 150% deduction for *overseas promotional programmes*]
- Export profits [for a period of between 3 and 6 years, in addition to a 150% deduction for promotion and marketing expenditure]
- Agriculture, Forestry, Animal Husbandry and Fisheries [profits for 5 of 10 years]
- Factory Construction [40% Depreciation in year one, then 5%pa thereafter]
- 200% deduction for costs of apprentices attending SICHE
- 200% deduction for local and overseas higher education courses
- 150% deduction for inter-provincial transport costs of transporting raw material and qualifying products.

While the Act provides an outline of the conditions and criteria for applications, it is appropriate, given the power now conveyed on the Commissioner of Inland Revenue, and the comments by the Minister of Finance about exemptions in launching Taxation reform in November 2005, to confirm operational guidelines to support the application of these legislative provisions. This document sets out how the Commissioner will undertake his statutory functions in applying this legislation.

2.0 Incentive legislation

The provisions contained in Part III of the Act are incentive provisions and as such are enabling provisions, or ones which encourage investment. The changes to Part III were made necessary by the reform of the Foreign Investment Regime, administered by the Department of Commerce. These changes removed the Foreign Investment Board and instead vested all responsibility for considering incentive applications with the CIR.

It does however need to be noted that shortly after passing the amendment act; the Government announced its intention to reform the tax system to address problems created by widespread exemptions and with the objective of creating a more level playing field for all businesses. These guidelines therefore reflect a more conservative tone than had they been recently enacted as new measures in their own right.

3.0 Qualifying Investments

The Commissioner has determined that tax holidays or tax relief on export profits, and the concessions under section 12, will only be considered for investors with capital inputs to major new projects or substantial business expansion, where the projects are for:

- New business investment in an activity not currently operating in Solomon Islands;
- Existing businesses operating in Solomon Islands, making new domestic investments that require a further capital investment of SBD 10,000,000 or more;
- Modernisation or expansion of existing business activities in Solomon Islands where the Capital investment will total SBD 5,000,000 or more.
- Rural community developments with investment of SBD 5,000,000 or more

The provisions of Part III of the Act are discretionary. In determining the application sections 11, 12 and 14 the Commissioner will have regard to ***whether it is in the national interest to forgo revenue that would otherwise be collected***. This national interest test is in addition to the conditions above.

Thus, the Commissioner will engage in a broad cost/benefit analysis that considers:

- The benefits to the national interest;
- The costs to the national interest (including the cost of foregone revenue, the economic costs caused by exemptions and the precedent created by granting the exemption); and
- The sustainability of these benefits and costs.

The Commissioner must also consider the:

- taxation compliance history of the applicant and any persons associated with the application;
- nature and amount of any other Government assistance being sort or received by the applicant;
- sustainability of the benefits beyond the expiry of any Government assistance granted under these provisions; and,
- nature of any benefits arising to rural communities through the activity.

These guidelines are designed to help the Commissioner implement this cost/benefit analysis in a **simple, timely and consistent way**. They should also assist prospective applicants in determining their eligibility.

4.0 Guiding Principle – 'Revenue forgone is in the National Interest'

4.1 **Benefits to the national interest** - In assessing how an investment may benefit the 'national interest', the Commissioner will consider how the investment contributes to development and economic growth. As a rule, economic growth is best fuelled by businesses competing on a level playing field, without exemptions. Consequently, the Commissioner will in general only consider investments with significant likely spillover benefits (or "positive externalities").

Important spillover benefits from an investment could include:

- Increased employment opportunities for Solomon Islanders. For the purposes of these provisions, the CIR has determined that at least 20 full time sustainable new jobs must be created for Solomon Islanders;
- Increased export of goods produced or manufactured in the Solomon Islands;
- Improved infrastructural assets for the country, at least 20% of which must be for the benefit of the community and available for continuous public use; and
- Increased taxation payments, either directly or indirectly for the investment, to Government within 5 years of the commencement of the investment activity.

4.2 **Cost of the exemption to the Government and the Economy** - tax exemptions cost government revenue. In addition, they create distortions in the economy by discouraging businesses or sectors of the economy that do not receive exemptions. In assessing the costs of the exemption, the Commissioner will consider both the revenue costs and also the likely costs to the economy.

The Applicant will need to provide the Commissioner with detailed information and evidence supporting the costs and benefits outlined in respect of the proposal. This could include:

- Copies of any cost benefit proposal, including Discounted Cashflow undertaken;
- Feasibility studies and project plans;
- Finance costing and cost of capital;
- Projections of overseas income or costs, supported by appropriate documentation;
- Detailed cash flow forecasts, together with sensitivity analysis on information contained; and
- Details of any resource planning or other consent applications sort.

4.3 **Taxation compliance history** - The Commissioner must consider the taxation compliance history of the applicant and any persons associated with the application. In general terms the Commissioner must be satisfied that the applicant is an organisation that has met its taxation obligations, or will meet its future taxation obligations. These include lodging all returns by the due date, paying any outstanding taxation in a timely manner, correctly accounting for any PAYE or Goods Tax, and filing an accurate annual Income tax return containing all assessable income and correctly deductible expenses.

4.4 **Total Cost to Government** - Total amount of fiscal assistance being provided by the Government through these and other incentive provisions, and how that cost compares to the total investment by the investor, and the likely benefits that will be received must be considered. The precedent created by any decision and the wider impacts of the decision on others operating in that industry, or any related industry must be taken into account.

4.5 **Sustainability** - In assessing the sustainability of the benefits of an investment and the costs of incentives, the Commissioner will also consider whether the business and the spillover benefits it provides, are likely to continue once incentives cease.

Further in respect of any application for the extraction of natural resources or forestry, the Commissioner must have regard to the impact on the environment and in particular, in the case of forestry extraction how reforestation is to occur.

4.6 **Non-Transferable** - Tax holidays or any other incentives that have been granted in accordance with these guidelines are only available to the applicant for the project nominated in the application and can not be transferred to any other project or person.

4.7 **Term of Tax holiday** - all exemptions granted shall be for a prescribed period. In assessing such period the Commissioner shall have regard to the forgoing principles. However no exemption shall unless specified by Statute, be for a period of more than 3 years.

4.8 **Transparency and Accountability** - Every three months, the Commissioner will publish the following details of all decisions on incentives granted. The:

- Name and address of the investor;
- Nature of their business activity;
- Nature and period of the incentives granted; and
- Reason for granting the exemption.

5.0 Application of the Act

5.1 Section 11

Under section 11 for a tax holiday or for tax relief on export profits to be granted, the Commissioner must:

- Ensure the criteria specified in the First Schedule regarding the amount of local value added through the investment activity or enterprise are met.
- Make a determination (using the calculation method specified in Part II of the First Schedule) of the level of local value added from ex-factory sales of the products and classify the investment or enterprise according to the categories in Parts I and III of the First Schedule.

If satisfied that the investment or enterprise meets the specified level of local value added, the Commissioner will agree to the one-off offer of an income tax holiday of the period specified in Part I of the First Schedule. In the case of an application for tax relief on export profits, if he is satisfied that the investment or enterprise meets the specified level of local value added in Part III, the Commissioner will agree to tax relief for the relevant time period specified in Part III of the First Schedule.

In relation to enterprise type 5 of Part I of the First Schedule involving a capital investment not less than SBD 10 million, the Commissioner will offer an income tax holiday of a period equal (to the nearest tax year) to the time that it takes for the enterprise to recover

their costs of capital, and in any case no more than a period of 10 years, whichever is the lesser.

5.2 Section 12

The exemptions under this section are additional to those under section 11. The Commissioner shall determine which part of the 2nd schedule applies to the applicant, and where discretions exist, the extent to which that part of the schedule applies, having regard to information set out above. In order to do this, the Commissioner may ask the investor to provide additional information.

5.3 Section 13

The Commissioner may withdraw exemptions granted under sections 11 or 12, if the investor contravenes the Tax Act or the Foreign Investment Act. The Commissioner must follow the process outlined in Section 13 which outlines the process that must be followed to allow the investor with the opportunity to express why the exemption should not be withdrawn.

If the Registrar cancels a certificate of registration under section 23 of the Foreign Investment Act, exemptions under sections 11 and 12 are withdrawn simultaneous with the cancellation taking effect.

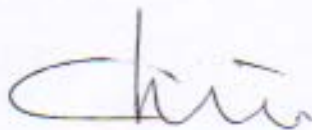
6.0 Exemptions Committee

All applications for Income Tax (and Goods Tax) exemptions will be considered by the Inland Revenue Division Exemptions Committee.

The Committee is chaired by the Assistant Deputy Commissioner (ADC), Large Taxpayer and Small Business Sections. Other members include:

- the Deputy Commissioner;
- the second ADC, Large Taxpayer and Small Business Sections; and
- two senior compliance offices.

The Committee will meet regularly and it will base its recommendations on the Income Tax and Goods Tax Exemption Guidelines. The Committee's recommendations will then be forwarded to the Minister of Finance for decision.



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Approved, Hon. Gordon Darcy Lilo
(A/g Minister of Finance)

27, 06, 2006

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Date