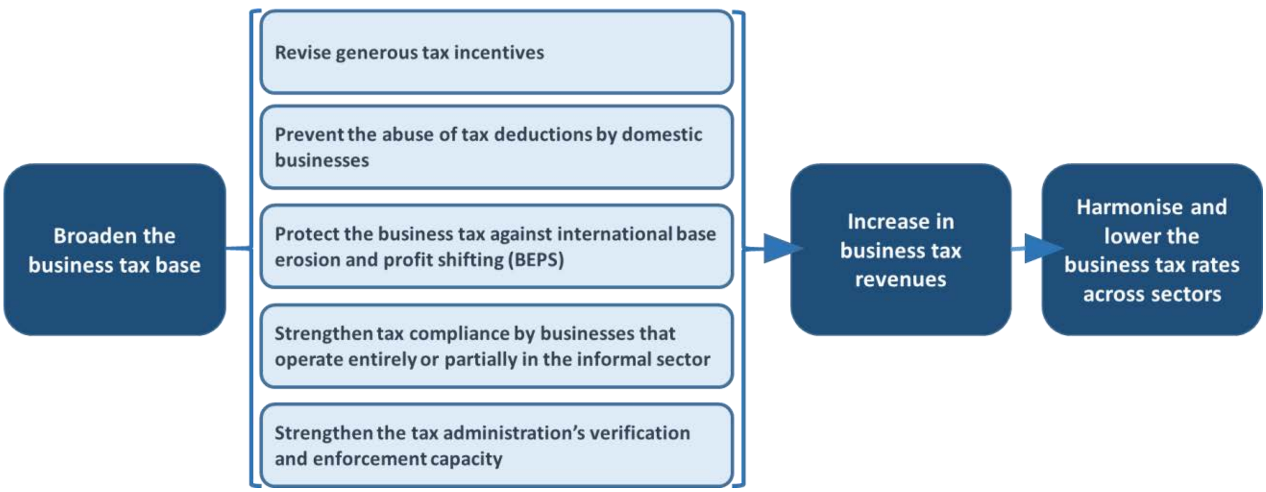
2 Broadening the business tax base and aligning tax rates across sectors

This chapter provides an in-depth assessment of Seychelles' business tax system. It first assesses the current business tax system. It then examines the impact of alternative business tax reform scenarios, and uses the results from this simulation exercise to formulate tax reform recommendations. The chapter also assesses international corporate tax provisions, the taxation of sole traders and partnerships, and turnover taxes.

Assessment of the current business tax system

The biggest challenge with Seychelles' business tax lies in its imbalance. While a few companies contribute a lot, most businesses and sectors pay little because of preferential tax rates and tax regimes, generous deductions, tax avoidance and evasion. Seychelles should aim at rebalancing its business tax burden by combining base broadening measures with a revision of tax rates. There are a number of ways in which the business tax base should be broadened. A substantial broadening of the tax base, in particular through better-targeted tax incentives and the introduction of corporate tax base protection measures would contribute to raising additional business tax revenues, but also ensure greater fairness in the distribution of the business tax burden. The tax base could be broadened by strengthening the tax administration's verification and enforcement capacity, as this would increase the number of businesses that operate within the formal economy. A broader business tax base could then enable the alignment of business tax rates across sectors as well as a decrease in business tax rates (Figure 2.1).

Figure 2.1. Approach to rebalancing Seychelles' business tax

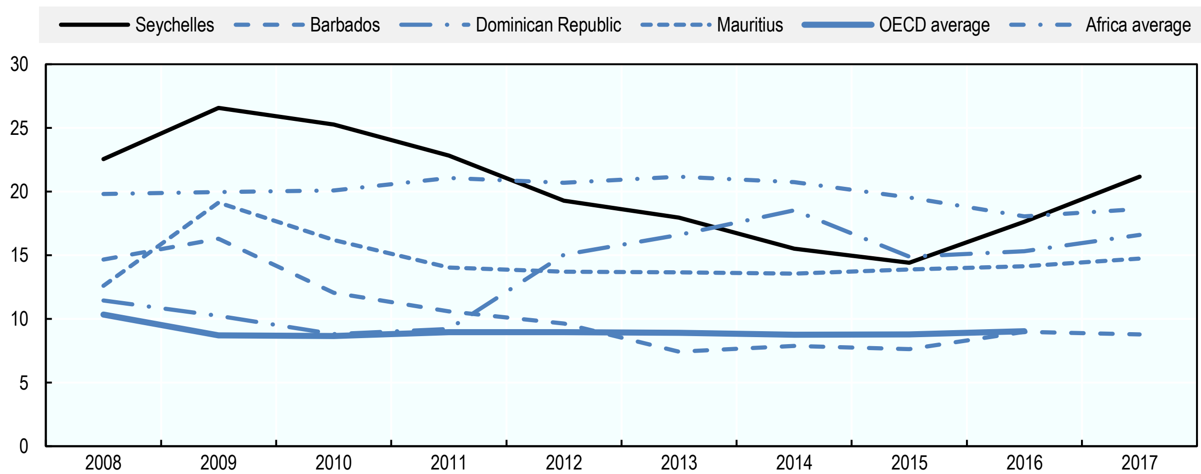


Business tax accounts for a significant share of tax revenues in Seychelles

Business tax is the third largest source of tax revenues in Seychelles, representing around 21% of the total tax take. Business tax revenues have remained relatively stable, with their share decreasing slightly from 23% to 21% of total tax revenues between 2008 and 2017. The share of the business tax in total tax revenues is higher than the African average and significantly higher than the OECD average, where the corporate income tax accounts for 19% and 9% of total tax revenues, respectively (Figure 2.2).

Figure 2.2. The share of the business tax in total tax revenues is comparatively high

Evolution of business tax revenues expressed as a percentage of total tax revenues



Note: Statistics for Seychelles do not include revenues from Corporate Social Responsibility Tax and Tourism Marketing Tax.
Source: Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

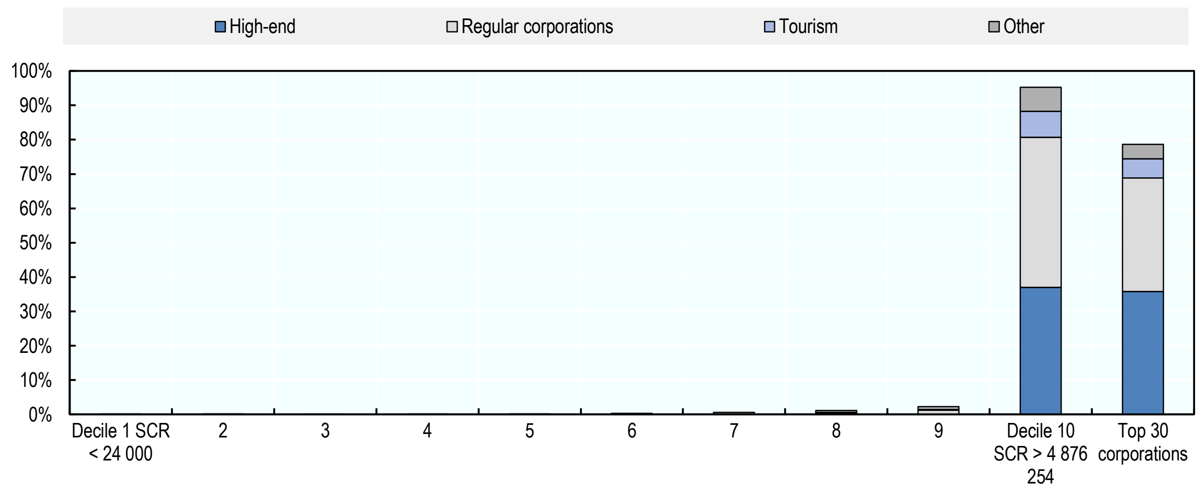
However, the business tax burden is highly concentrated on a small number of businesses and sectors

The business tax burden is highly concentrated on a small number of taxpayers. Indeed, 30 companies accounted for 79% of the business tax take in 2017 (Figure 2.3), while companies with turnover below SCR 870 000 (i.e. the bottom 70% or deciles 1 to 7 in Figure 2.3) only accounted for 1.3% of revenues. The 30 companies that contribute the most to business tax revenues are predominantly in the financial sector, wholesale trade and support activities for transportation (Figure A.1 in Annex A).

The tourism sector contributes only marginally to the collection of business tax revenues in comparison to its role in the economy. In 2017, tourism accounted for only 8% of business tax revenues while it accounted for 32.9% of total value added in the country and for 47% of total VAT collected as mentioned in Chapters 1 and 3, respectively (Figure 2.4).

Figure 2.3. Thirty companies accounted for 79% of the business tax take in 2017

Share of business tax revenue (regular business tax and presumptive tax) by turnover decile



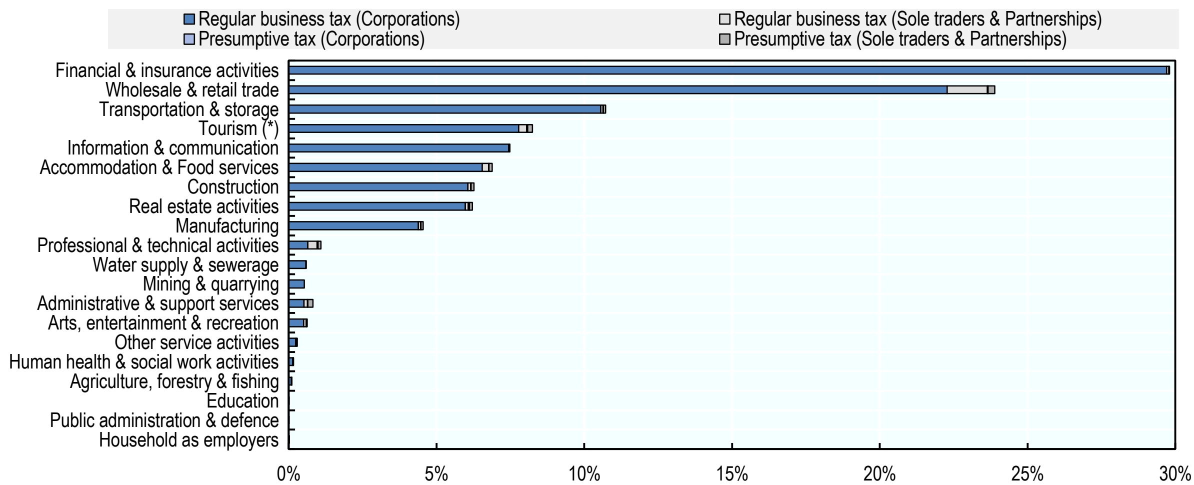
Note: Excludes revenue from rental of residential dwellings and Corporate Service Providers (CSPs).
All types of companies (incorporated or not) are taxed under the business tax but they are subject to different tax rate schedules (see Table 2.1).
High-end sectors: Telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers.
The tax schedule of regular corporations is described in Table 2.1.
Tourism is defined in line with the Eight Schedule of the Business Tax Act. This includes: accommodation, restaurants, air transport and ferries, boat charter, car hire, water sports operators and tour operators among others.
The category "other" includes revenue from sole traders and partnerships, medical service providers, companies with Special Licenses, companies in the Security Exchange.
Turnover deciles were calculated for all types of businesses that paid a positive amount of tax under the regular business tax and the presumptive tax.
Source: Calculations based on 2017 business tax and presumptive tax microdata

Statutory tax rates vary significantly across sectors

Businesses are subject to different statutory tax rates depending on their sector of operation and size. Seychelles has a progressive business rate structure for most sectors (Table 2.1.). The top statutory tax rate that regular corporations face (30%) is high by international standards. Indeed, it is significantly higher than both the OECD average corporate income tax (CIT) rate of 24% and the average CIT rate in African countries of 27% (Figure 2.5). Telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers, known as "high-end" sectors, are taxed under a different progressive rate structure, which has a 33% top statutory tax rate. On the other hand, businesses in tourism and fisheries - the two largest sectors in the economy- as well as agricultural businesses, private medical and educational services, and companies listed on the Seychelles Securities Exchange, are taxed at preferential rates. Finally, sole traders and partnerships have a special tax rate schedule within the business tax (Table 2.1.). Overall, most of the business tax revenues come from corporations under the regular tax rates and corporations in "high-end" sectors (Figure A.2 in Annex A).

Figure 2.4. The contribution of the tourism sector to business tax revenues is comparatively limited

Share of business tax revenue by sector in 2017



Note: ISIC classification.
(*) Tourism is defined in line with the Eight Schedule of the Business Tax Act. This includes: accommodation, restaurants, air transport and ferries, boat charter, car hire, water sports operators and tour operators among others.
Revenues from rental of residential dwellings are not included in the data as this activity is taxed on a monthly basis and corporations are not required to lodge an annual return. Revenue from these activities amounted to 0.26% of GDP in 2017.
The microdata does not include revenue from CSPs either. In 2017, business tax revenue from CSPs amounted to SCR 9 million.
Source: Calculations based on 2017 business tax and presumptive tax microdata

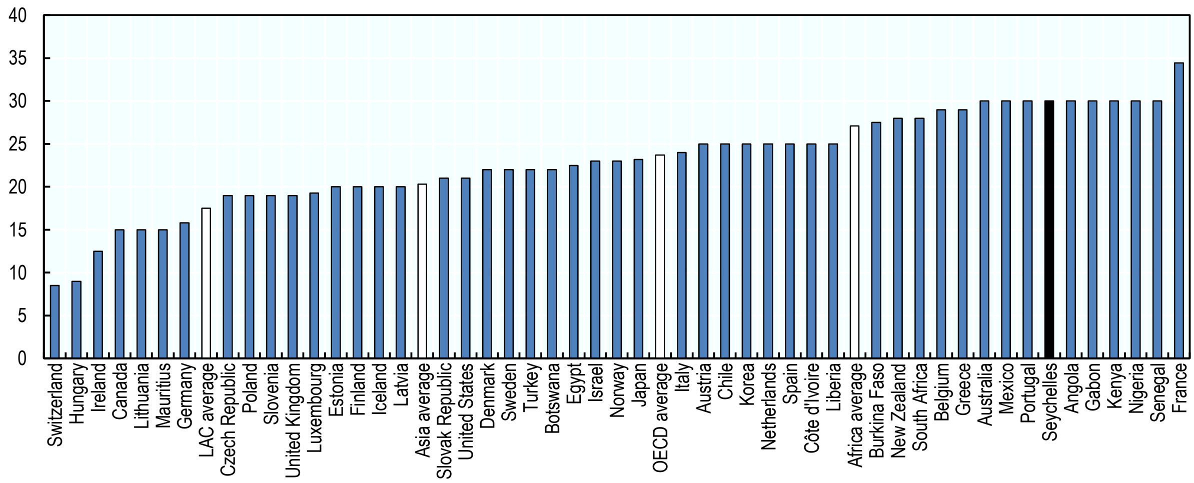
Table 2.1. Business tax rates depending on the sector of operation

	Taxable income (SCR)			
	<= 150 000	150 000 - 250 000	250 000 - 1 million	> 1 million
Regular corporations[1]	25%	25%	25%	30%
High-end sectors[2]	25%	25%	25%	33%
Tourism, agriculture and fisheries	0%	0%	15%	15%
Sole traders & partnerships	0%	15%	15%	30%
Companies listed on the Seychelles Securities Exchange	25%	25%	25%	25%
Private educational institutions	15%	15%	15%	15%
Private medical service providers	15%	15%	15%	15%

Note: 1. Includes state-owned companies that are not in high-end sectors.
2. Telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers.
The following sectors that are taxed preferentially are not included in the table:
Income from casino owners, insurance and reinsurance business and taxi owners is exempt.
A 15% tax on gross income is levied on the rent of residential buildings on a monthly basis.
Until 2018, Companies with Special Licenses (CSLs) were taxed at the rate of 1.5% on their worldwide taxable income. The regime was abolished and a grandfathering period until June 2021 was set for CSLs incorporated before October 2017.
Non-resident aircraft & ship owners are taxed at a rate of 3% on their turnover.
Businesses with turnover below SCR 1 million can choose to be taxed under the presumptive tax at a 1.5% rate on their turnover. This tax is described in section 2.6.
Source: Business Tax Act

Figure 2.5. Seychelles' top statutory business tax rate is high by international standards

Top combined (central and sub-central) statutory corporate income tax rates across countries in 2018



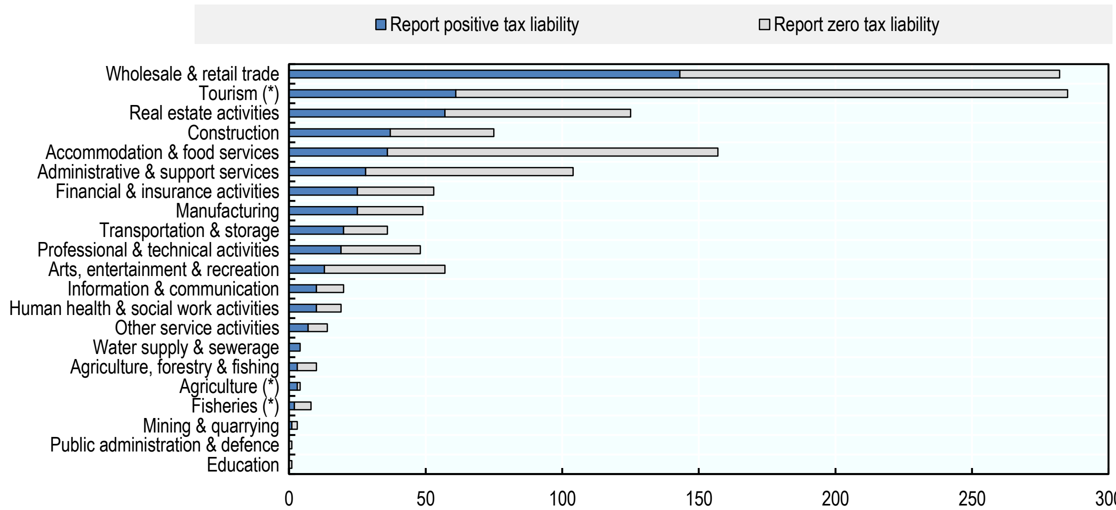
Note: The OECD Corporate Tax Statistics Database considers the top statutory rate for corporations under the regular tax schedule in Seychelles.
Source: OECD Corporate Tax Statistics Database.

A large share of corporations report a zero tax liability

Among corporations taxed under the business tax, only 41% reported a positive tax liability. In 2017, 1 058 corporations were taxed under the business tax, of which only 438 reported a positive tax liability. Moreover, only 61 corporations in the tourism sector and 2 in the fishing sector reported a positive tax liability (Figure 2.6). The share of companies reporting a positive tax liability varied widely across sectors, with the education and tourism sectors recording among the lowest shares of corporations with a positive tax liability (0% and 21%, respectively) (Figure A.3 in Annex A). As for sole traders and partnerships taxed under the business tax, 37% reported a positive tax liability (Figure A.5 in Annex A).

Figure 2.6. Most corporations under the business tax report a zero tax liability

Number of corporations by tax liability status and sector



Note: Excludes Companies with Special Licenses, Corporate Service Providers, non-resident aircraft and ship owners and exempt companies. Corporations deriving income from the rental of residential buildings are taxed at 15% on their gross rental income on a monthly basis. If these companies do not carry out other activities such as commercial rent but still lodge and annual return, the SCR assigns a zero tax liability in their annual tax return. In 2017, there were 9 corporations in this situation.
(*) Defined in line with the Business Tax Act.
Source: Calculations based on 2017 business tax return microdata.

Taxable income is very often reduced to negative values because of large tax deductions

Seychelles' enhanced and accelerated depreciation allowances for capital investments in tourism, agriculture and fisheries are generous by international standards. Seychelles provides enhanced and accelerated tax depreciation allowances for businesses in tourism, agriculture and fisheries, which can be carried forward for five years and amount in total to 145% of expenses (Table 2.2.). These allowances are very generous by international standards. For instance, in OECD countries, such significant enhanced depreciation measures are typically provided for investments in R&D or energy-efficient technology or capital. Investment in hotel buildings in Seychelles benefit from preferential tax treatment: the costs of investments in hotel buildings can be written off over a period of 9 years compared to 25 years for investments in other business buildings (Table 2.3). Moreover, hotels can deduct 125% of the actual expenses related to hiring musicians, which constitutes another generous tax deduction. Last but not least, a 20% straight line deduction for tangible assets (in any sector) is also quite high by international standards and compared to economic depreciation (Table 2.3).

In general, cost-based business tax incentives are preferable to profit-based incentives, but these should be well targeted. Cost-based incentives, such as accelerated and enhanced tax depreciation allowances, are preferable to profit-based incentives, as expenditure-based incentives are targeted at lowering the cost of acquiring capital. Cost-based incentives make a greater number of investment projects more profitable at the margin. That is, they may generate investments that would not otherwise have been made. Furthermore, potential additional investment per unit of revenue forgone is higher for cost-based incentives, since the benefits are granted conditional upon capital investments. However, these incentives are poorly targeted in Seychelles, in particular as there are no restrictions on qualifying assets, other than the exclusion of buildings, which themselves benefit from a separate preferential treatment. Enhanced tax depreciation allowances could be better targeted by restricting their use to investments in specified productive assets and energy-efficient capital. For other assets, it would be advisable to maintain accelerated depreciation but only up to 100% of the cost of the investment.

Table 2.2. Tax depreciation rates

Depreciation allowable on capital investments other than buildings for farming, fisheries and tourism operators

Year	Rate
1	45%
2	40%
3	30%
4	20%
5	10%
Total	145%

Source: Business Tax Act, Eight Schedule.

Table 2.3. General annual tax depreciation rates

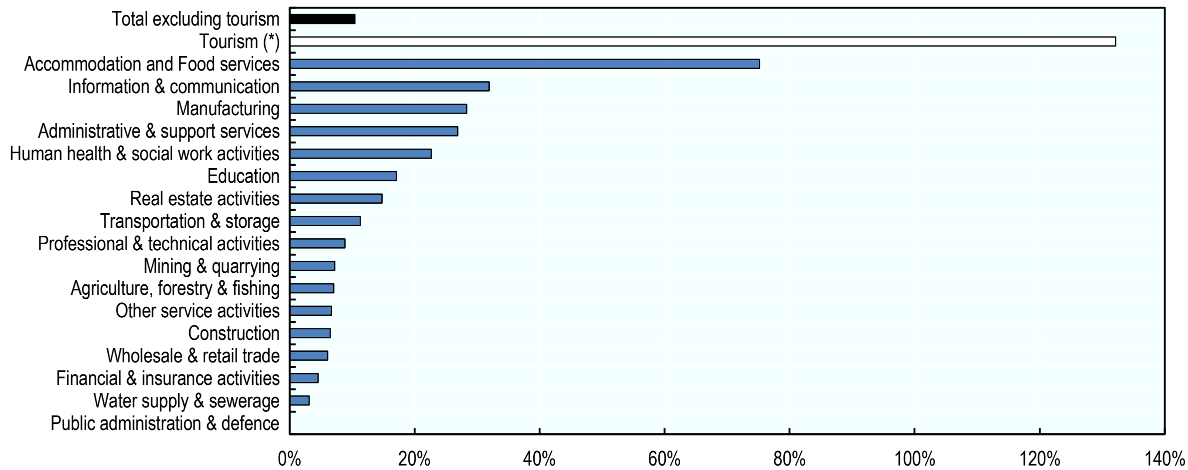
Depreciable assets costing SCR 100 000 or less	100%
Computers, R&D expenditure, data handling equipment and approved environmental machinery	40%
Hotels	20% first tax year, 10% subsequent years
Business buildings, ships, aircraft and submarine cable systems	4%
Other	20%

Source: Business Tax Act, Third Schedule.

The tourism sector's business tax base is significantly narrowed by these generous tax incentives. In 2017 depreciation deductions used by corporations in the tourism sector amounted to an average of 132% of their turnover (Figure 2.7 and Figure A.6 in Annex A). Overall, 44 corporations in the tourism sector reported depreciation deductions that exceeded 50% of turnover and a zero tax liability. Corporations that rent sail boats, guest houses and small 5 star hotels show the largest level of depreciation deductions (Figure 2.8). The amounts claimed as depreciation allowances reflect a combination of Seychelles' generous tax allowances and high levels of investments in some sectors (e.g. corporations that rent sail boats). However, in some cases, they may also reflect a potential over-reporting of investment or a mischaracterisation of capital expenditure (e.g. maintenance costs recharacterised as capital investments). Closely monitoring the use of tax incentives to prevent potential abuse or fraud is highly advised.

Figure 2.7. Generous depreciation allowances significantly narrow the business tax base in the tourism sector

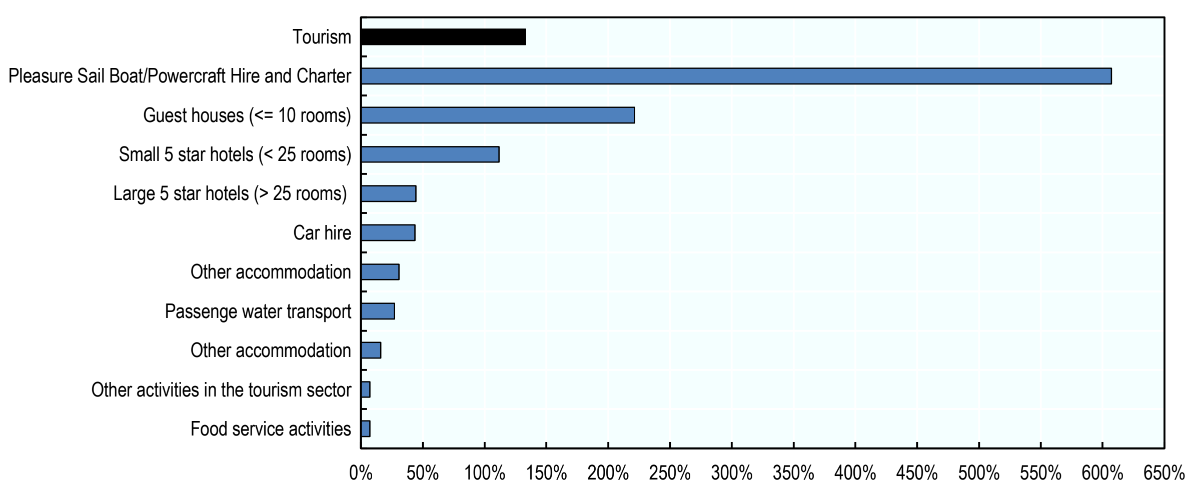
Corporations' average depreciation allowances as a percentage of turnover by sector



Note: ISIC sectors.
(*) Tourism is defined in line with the Eight Schedule of the Business Tax Act. This includes accommodation, restaurants, air transport and ferries, boat charter, car hire, water sports operators and tour operators among others.
Excludes Corporate Service Providers, Companies with Special Licenses, non-resident aircraft and ship owners and exempt companies.
Source: Calculations based on 2017 business tax return microdata.

Figure 2.8. Depreciation allowances are substantial, especially among corporations that rent sail-boats, guest houses and small 5 star hotels

Corporations' average depreciation allowances as a percentage of turnover in the tourism sector



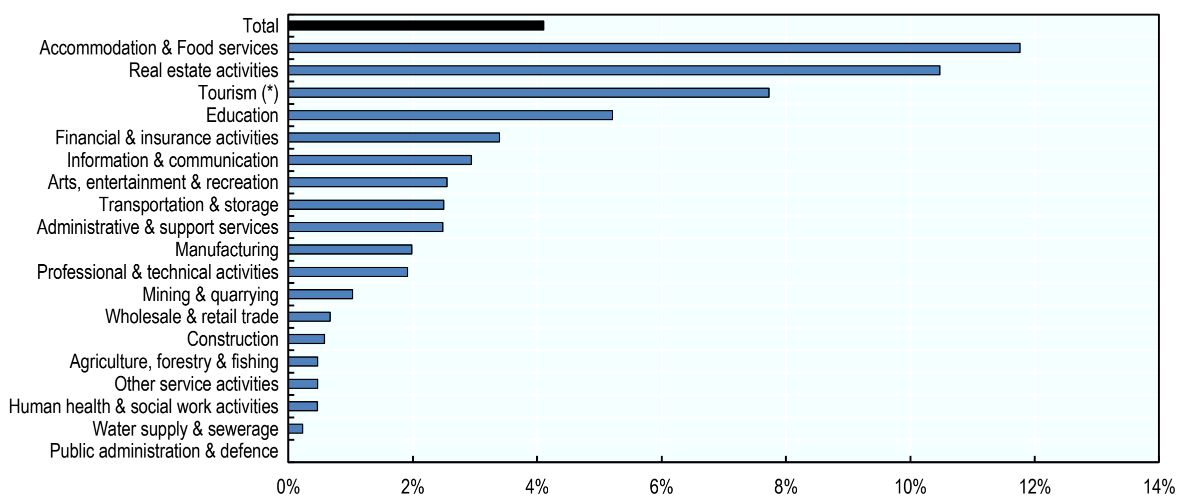
Note: Tourism is defined in line with Business Tax Act.
Source: Calculations based on 2017 business tax return microdata.

Interest expense deductions are large in the accommodation and real estate sectors. On average, interest payment deductions in the accommodation and real estate sector exceeded 10% of turnover

(Figure 2.9). To prevent corporate tax base erosion and profit shifting through excessive interest expense, the OECD/G20 BEPS project (Action 4) identified rules to link entities' net interest deductions to their level of economic activity within a jurisdiction, measured using taxable earnings before interest income and expense, depreciation and amortisation (EBITDA). More specifically, the recommended approach under BEPS Action 4 is to limit the deductibility of interest payments to a ratio ranging from 10% to 30% of EBITDA (see Section 2.4). In Seychelles, when considering solely corporations with positive EBITDA, the real estate sector stood out with particularly high average ratios of interest expenses to EBITDA (159%) followed by the manufacturing sector (Figure 2.10). Indeed, 13 real estate corporations and 7 corporations in the manufacturing sector exhibited interest expense levels above those recommended in BEPS Action 4. Seychelles is advised to monitor closely the drivers of high leverage ratios in some sectors. In addition, many corporations, especially in the financial and the tourism sectors, reported high amounts of other operating expenses compared to their turnover levels (Figures A.7 and A.8 in Annex A).

Figure 2.9. Interest expense deductions are large in the accommodation and real estate sectors

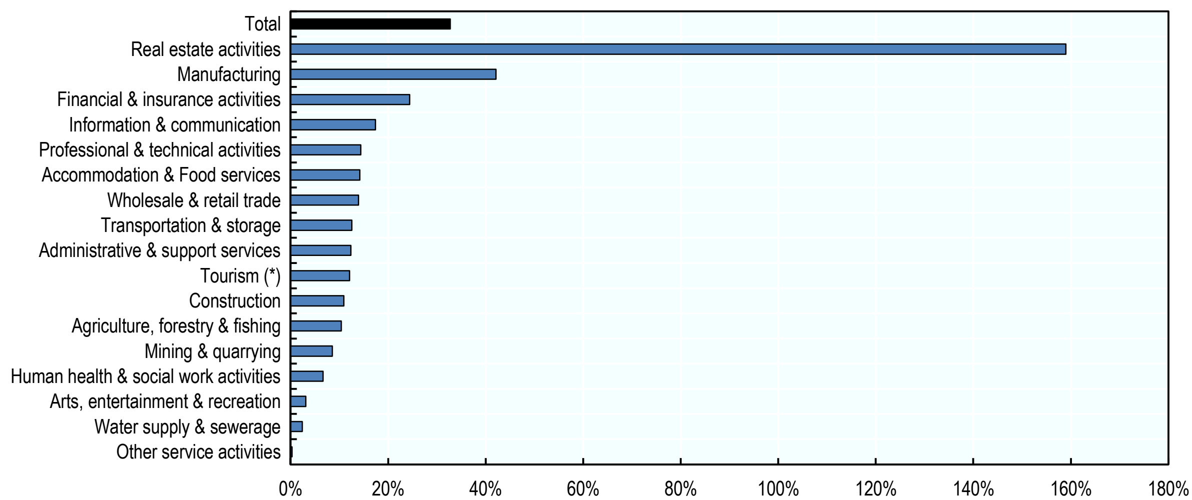
Corporations' average interest expense deductions as a percentage of turnover by sector



Note: Excludes Corporate Service Providers, Companies with Special Licenses, non-resident aircraft and ship owners and exempt companies. Two manufacturing companies were excluded because of extremely high ratios (TIN 1184, 1241).
Source: Calculations based on 2017 business tax return microdata.

Figure 2.10. The real estate sector stands out with particularly high average ratios of interest expenses to EBITDA

Average corporations' interest expenses as a percentage of turnover by sector. Corporations with positive EBITDA



Note: Excludes Corporate Service Providers, Companies with Special Licenses, non-resident aircraft and ship owners and exempt companies.
Source: Calculations based on 2017 business tax return microdata.

Extensive tax deductions often reduce taxable income to negative values. Although it is difficult to disentangle the extent to which a low share of corporations reporting positive tax liability is due to low profitability, the fact that there is no positive correlation between turnover and taxable income suggests that generous tax incentives, tax avoidance and evasion strategies may play a role in reducing corporations' taxable income (Figures A.9 and A.10 in Annex A). In this context, base broadening measures could substantially help increase tax revenues. According to a rough estimation, measures that would reduce companies' total deductions (excluding the cost of goods sold and employees' salaries) by 10% while maintaining business tax rate schedules unchanged would increase business tax revenue by 0.7% of GDP (Table 2.4). However, it should be noted that these calculations aim at highlighting the extent to which deductions are used to reduce taxable income, but cannot be used directly to infer policy recommendations.

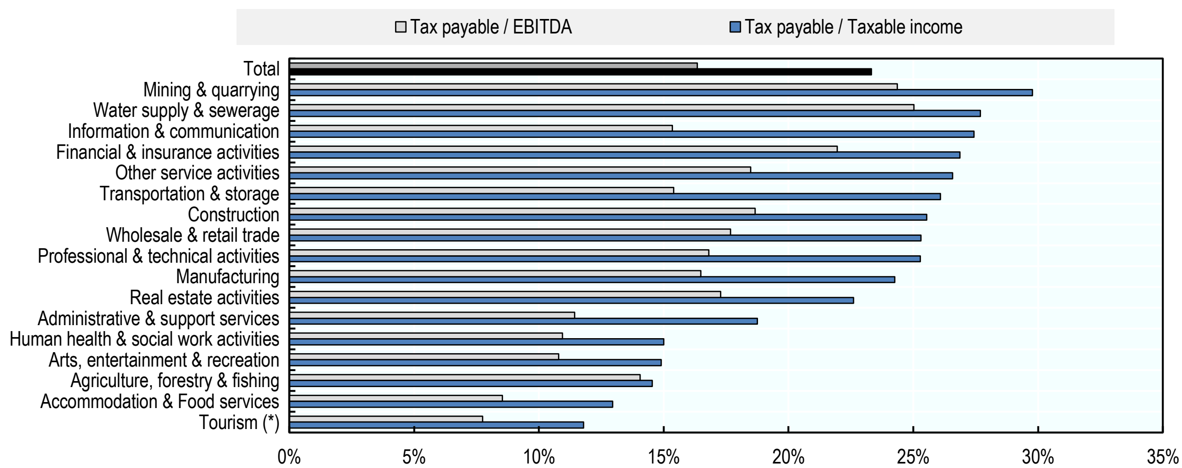
The differing statutory rates and tax base provisions across sectors explain the wide variations in businesses' backward-looking effective tax rates

Seychelles exhibits wide-ranging effective tax rates (ETRs) across sectors as a consequence of differential tax provisions. Backward-looking ETRs assess firms' effective tax burden (see Box 2.1 for a brief description). When measured as the ratio of tax payable to taxable income, the average effective tax rate for all corporations under the business tax was around 23% in 2017. However, ETRs varied widely across sectors (Figure 2.11, Table A.1 and Figure A.11 in Annex A), reflecting the fact that different statutory business tax rates apply to different sectors. Indeed, while average ETRs in the mining and quarrying sector were at around 30%, they stood at 12% in the tourism sector. The average effective tax rate for corporations under the regular schedule was estimated at 26% (the majority of the corporations under this schedule report profits below the 30% rate threshold). Instead, the average effective tax rate for corporations in "high-end" sectors was estimated at 30%.

When computed as the ratio of tax payable to EBITDA, ETRs summarise the combined effect of both tax rate and tax base provisions. Effective tax rates measured as the ratio of tax payable to EBITDA amounted to an average of 16%, significantly below average ratios of tax payable to taxable income due to the effect of tax base provisions such as depreciation allowances and interest deductions among others (Figure 2.11 and Table A.1 in Annex A). This is observed across all sectors. For example, effective tax rates for transportation and storage decrease from 26% to 15% when expressed relative to taxable income and EBITDA, respectively (Figure 2.11 and Table A.1 in Annex A), and similar decreases are observed for information and communication and professional and technical activities.

Figure 2.11. As a consequence of differential tax provisions and tax base provisions, effective tax rates vary widely across sectors

Backward-looking effective tax rates by sector

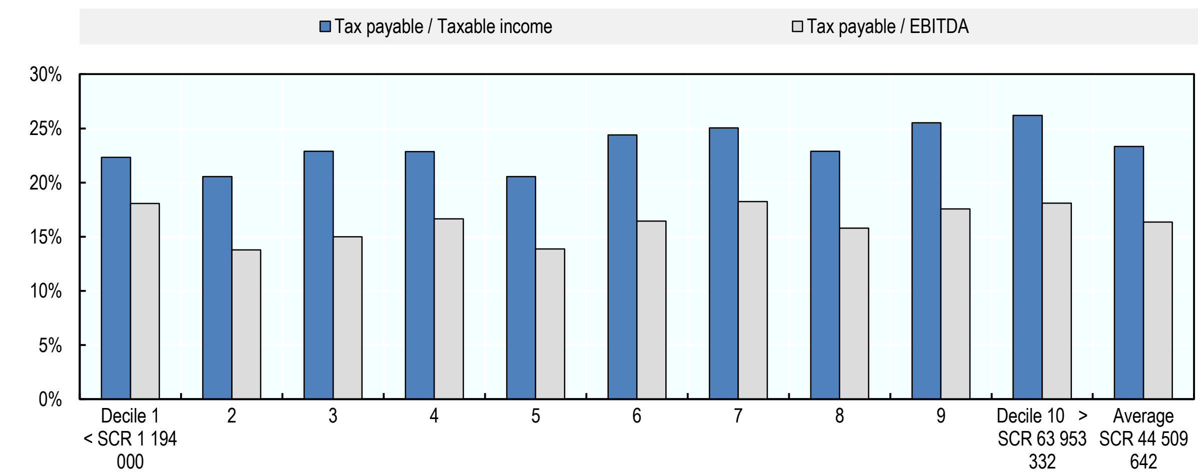


Note: The figure only includes corporations with a positive tax liability. It excludes Corporate Service Providers, Companies with Special Licences and exempt corporations. Tourism is defined in line with Business Tax Act.
Source: Calculations based on 2017 business tax return microdata.

Effective tax rates across turnover deciles do not show a progressive pattern due to the multiplicity of statutory tax rates and the more limited ability of businesses at low turnover levels to reduce their taxable income. Indeed, the ratio of tax payable to EBITDA for corporations with positive tax liabilities is the same (18%) for corporations with turnover levels below SCR 1 194 000 (decile 1) and corporations with turnover above SCR 63 953 332 (decile 10) (Figure 2.12).

Figure 2.12. Effective tax rates across turnover deciles do not show a progressive pattern despite progressive business tax rate schedules

Backward-looking effective tax rates by turnover decile



Note: Only corporations with positive tax liability are included. Excludes Corporate Service Providers, Companies with Special Licences and exempt corporations.
Unlike Figure 2.3, in this figure turnover deciles were calculated for corporations with a positive tax liability under the regular business tax.
Source: Calculations based on 2017 business tax return microdata.

Forward-looking ETRs capture information on tax rates and bases within a comparable framework

The composite forward-looking effective average tax rate (EATR) for Seychelles is high by international standards. EATRs measure the effects of taxation on projects earning economic rents (see Box 2.1 for a description). According to OECD estimates, the composite EATR, (that is, the average ETR across asset categories and sources of finance) in Seychelles is at 27.4%, the highest EATR among small islands except for Montserrat and Malta and the highest among African countries other than the Democratic Republic of Congo (Figure 2.13). This is mainly driven by Seychelles' high statutory tax rate compared to other countries. It should be noted that the model considers the top statutory tax rate for regular corporations (i.e. 30%). Hence, this does not reflect EATRs for sectors that benefit from preferential tax rates. This highlights the need for a broader business tax base that could then allow a decrease in top statutory tax rates.

Box 2.1. Backward and forward-looking effective tax rates

Effective tax rates (ETRs) summarise the combined effect of both tax rate and tax base provisions in a single measure reflecting the effective tax burden. Backward-looking ETRs assess (ex-post) firms' effective tax burden by means of tax returns or balance sheets. On the other hand, forward-looking ETRs estimate the effective tax burden on a hypothetical investment project taking into account the main characteristics of a country's corporate taxation (i.e. statutory tax rates and tax base allowances) in a given macroeconomic scenario. While forward-looking ETRs are built based on a hypothetical scenario, backward-looking ETRs may be affected by firms' tax planning activities as they are based on firms' effective tax liabilities. For this reason, the two type of measures may differ significantly.

Backward looking ETRs

Generally backward looking effective tax rates are calculated using businesses' tax payments. In this report, backward looking effective tax rates were calculated using tax payable data (i.e. the tax liability indicated in tax returns) rather than effective tax payments. This is due to the fact that tax payment information is missing for many companies and also because this data may not reflect the annual liability of a corporation as it may include arrears. In addition, the calculations only considered corporations with a positive tax liability (41% of corporations under the regular business tax). Different denominators were used to compute the ratios, namely: taxable income, income before interest expenses (EBIT), income before interest expenses and depreciation deductions (EBITDA) and turnover. Under a flat statutory rate, the ratio of tax payable to taxable income should be equal to the statutory tax rate. The other indicators show the impact of tax base provisions in reducing businesses' effective tax burdens when compared to the ratio of tax payable to taxable income.

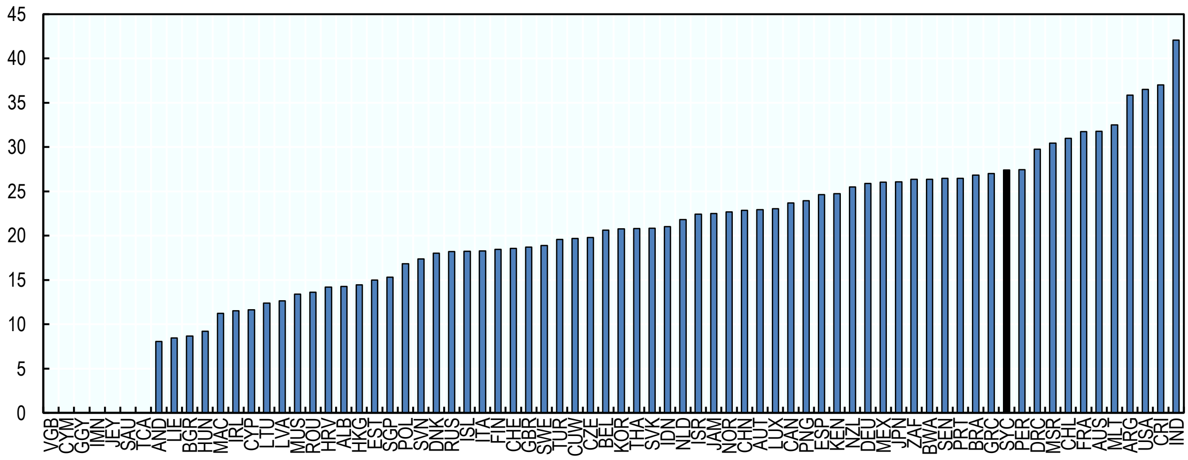
Forward-looking ETRs

Forward-looking ETRs are preferable to backward-looking ETRs if the aim of the analysis is to assess the impact of tax provisions on the incentives to invest and allow for comparisons across countries. OECD Corporate Statistics publishes forward-looking corporate effective tax rates for member countries and selected partner economies including Seychelles. Two types of forward-looking ETRs are calculated: effective marginal tax rates (EMTR), which measure the impact of taxation on marginal investments (i.e. how taxation increases the pre-tax of return required to break even) and effective average tax rates (EATRs), which measure the effects of taxation on profit earning projects. While EMTRs are used to analyse the impact of taxation on the incentives to expand existing investment in a given fixed location, EATRs are used to analyse discrete investment decisions between two or more alternative projects (e.g. when a multinational enterprise chooses to locate a plan in one jurisdiction). Composite ETRs are constructed averaging ETRs across asset categories and sources of finance (debt and equity).

The composite effective marginal tax rate (EMTR) was estimated at 15%, placing Seychelles somewhat closer to the middle of the ranking. EMTRs measure the extent to which taxation increases the pre-tax rate of return required for an investment project to break even, that is, they focus on firms making zero economic profits. The composite EMTR was estimated at 15%, placing Seychelles somewhat closer to the middle of the ranking (Figure 2.14). Given that EATRs measure the effects of taxation on profitable projects, statutory tax rates have a larger impact on the estimation of EATRs compared to EMTRs. Hence, the fact that Seychelles is situated closer to the middle of the ranking when computing the composite EMTR compared to the EATR results could be explained by the impact of tax depreciation rules. Indeed, Seychelles depreciation rule for tangible assets (20% straight line) is quite generous compared to other countries as well as compared to the economic depreciation rates assumed in the model.

Figure 2.13. The composite EATR for Seychelles is high by international standards

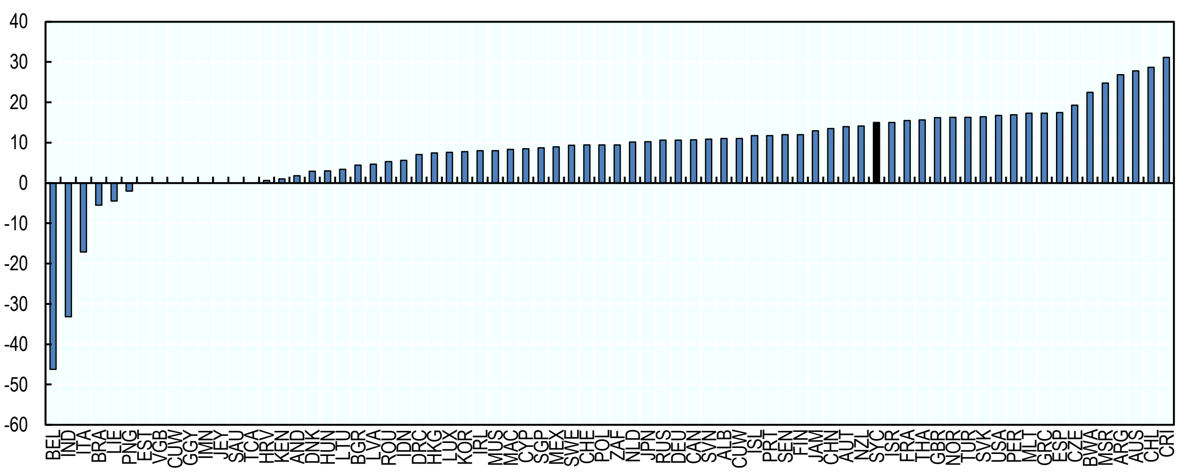
Composite effective average tax rate across countries. Calculations based on 2017 tax provisions



Note: Scenario assuming 5% real interest rate and 2% annual inflation rate.
Composite ETRs refer to average ETRs across assets types and sources of financing.
Source: OECD Corporate Tax Statistics.

Figure 2.14. The composite EMTR is closer to the international average

Composite effective marginal tax rate across countries. Calculations based on 2017 tax provisions



Note: Scenario assuming 5% real interest rate and 2% annual inflation rate.
Composite ETRs refer to average ETRs across assets types and sources of financing.
In 2017, Belgium, Brazil, Italy, Liechtenstein and Turkey had an allowance for corporate equity in place. It is assumed that notional interest deductions are equal to the nominal interest consistent with the modelling assumptions.
Source: OECD Corporate Tax Statistics.

Redesigning the business tax

The OECD's business tax reform proposals largely aim at rebalancing the business tax burden

Business tax rates should be harmonised across sectors in order to ensure a more evenly distributed business tax burden. This would entail lowering statutory tax rates on many operators while increasing tax levels on those that currently contribute little to the collection of revenues. This section is largely based on a modelling exercise, which assesses the impact of different business tax reform scenarios that harmonise and lower business tax rates across sectors. The impact of the different business tax rate scenarios on tax revenues and businesses' effective tax rates was estimated using 2017 tax return microdata (the modelling exercise is described in Box 2.1). Table 2.4 reports the impact of the different business tax rate scenarios on tax revenues focusing exclusively on corporations. Scenarios for sole traders and partnerships as well as companies under the presumptive tax are discussed further in Section 2.5.

Box 2.2. Description of the modelling exercises

As part of this Review, the OECD secretariat modelled the impact of different business tax reform scenarios that harmonise and lower business tax rates across sectors. The modelling exercise consists of simulations based on tax return microdata from 2017. It should be noted that the estimations are static and do not take into account behavioural changes (e.g. level of investment or taxable income elasticities) that reforms may trigger. In this way, they provide short-term estimates. Furthermore, these exercises do not consider the combined effect of other policy recommendations included in this report, such as the corporate tax base broadening and protection measures, which may have significant implications for tax revenues and effective tax rates.

The simulations exclude a number of entities. Companies with Special Licences are excluded because no information was available on their source-based income. These companies were taxed at a rate of 1.5% on their worldwide taxable income in 2017. However, this regime was repealed in December 2018. From July 2021 onwards, these companies will be taxed under the regular business tax schedule on their income generated in Seychelles. As no information was available on their source-based income for 2017, they have been excluded from the simulations. Non-resident aircraft and ship owners are also excluded given that they are taxed based on turnover without submitting additional information to the tax administration. Finally, the taxation of income from residential rent is not considered in the modelling exercise either. This is due to the fact that income from residential rent is taxed at a rate of 15% on gross income on a monthly basis. Hence, real estate corporations that carry out exclusively residential rent activities generally do not lodge a business tax return on an annual basis. Real estate corporations that carry out both residential and commercial rent activities do lodge the annual tax return but deduct income from residential rental as exempt income. Hence, positive taxable income from these corporations (considered in the modelling) does not include income form residential rent.

Overall, the modelling exercises described in this section consider 497 corporations with positive taxable income in 2017. Given the significance of the "high-end" sectors (i.e. telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers) in terms of revenue raised, most scenarios assume that the 23 corporations in these sectors that reported positive taxable income in 2017 remain taxed at current rates. Corporations in the other sectors are assumed to be taxed under a single business tax schedule. These include: regular corporations (currently taxed at 25% for taxable income below SCR 1 million and 30% for the remainder); corporations in the tourism, agriculture and fishing sectors; medical service providers; companies listed on the Seychelles Securities Exchange and Corporate Service Providers which, are currently taxed on fees they charge (see Table 2.1. for the tax rates that currently apply).

Table 2.4. Revenue effects from business tax reform scenarios for corporations

SCR million and as a percentage of GDP. Simulations based on tax return microdata from 2017

		Flat tax rates incl. High end sectors		Flat tax rates excl. High end sectors			Progressive tax rate schedule excl. High-end sectors								Business tax base broadening
Current regime	**Current**	**a) 15% flat rate**	**b) 25% flat rate**	**c) 15% flat rate**	**d) 20% flat rate**	**e) 27% flat rate**	**f) SCR 1 million 10%, Remainder 20%**	**g) SCR 2.5 million 15%, Remainder 25%**	**h) SCR 1 million 15%, Remainder 25%**	**i) SCR 250,000 10%, 250,000-1 million 20%, Remainder 25%**	**j) SCR 500,000 15%, Remainder 25%**	**k) SCR 2 million 15%, Remainder 30%**	**l) SCR 2.5 million 20%, Remainder 30%[1]**	**m) SCR 250,000 15%, 250 000-1 million 20%, Remainder 30%**	**n) Deductions reduced by 10%[1]**
Regular companies[2]	497	253	422	253	338	456	319	390	403	406	410	464	475	484	590
Tourism, agriculture & fisheries[3]	50	51	86	51	69	93	63	77	81	81	82	91	94	97	68
High-end sectors[4]	383	175	292	383	383	383	383	383	383	383	383	383	383	383	449
Medical service providers[5]	1	1	2	1	1	2	1	1	1	1	1	1	1	1	1
Companies listed on the Security Exchange[6]	9	6	9	6	7	10	7	9	9	9	9	10	10	11	15
Corporate Service Providers[7]	11	9	14	9	11	15	9	10	11	12	13	11	13	14	0
Total revenues (SCR million)	951	495	825	703	810	959	781	870	888	892	898	961	976	989	1123
Revenue change (SCR million)		**-456**	**-126**	**-248**	**-142**	**8**	**-170**	**-81**	**-63**	**-60**	**-53**	**9**	**25**	**38**	**172**
Revenue change (% GDP)		**-2.0%**	**-0.5%**	**-1.1%**	**-0.6%**	**0.0%**	**-0.7%**	**-0.4%**	**-0.3%**	**-0.3%**	**-0.2%**	**0.0%**	**0.1%**	**0.2%**	**0.7%**

1. Total deductions (excluding the cost of goods sold and employees' salaries) reduced by 10%. All other provisions remain unchanged.
2. Current regime: SCR 1 million 25%, Remainder 30%.
3. Current regime: SCR 250 000 0%, Remainder 15%.
4. Current regime: SCR 1 million 25%, Remainder 33%.
5. Current regime: 15%.
6. Current regime: 25%.
7. Current regime: a) 15% of fees in respect of incorporation or registration; b) 7.5% of fees in respect of annual renewal of license and c) 5% of all other fees. The baseline scenario includes revenues from fees charged.

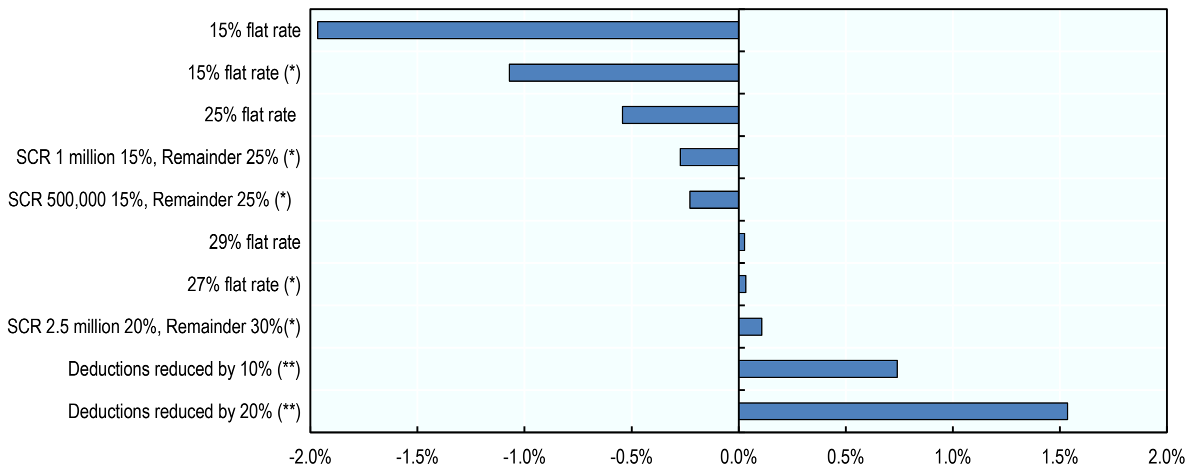
The exercises consider a total of 497 corporations in the sectors described above that in 2017 reported positive taxable income.

Source: Calculations based on 2017 business tax return microdata.

The analysis suggests that taxing all corporations at a flat rate while maintaining revenue neutrality would require a very high tax rate. Indeed, if Seychelles wanted to apply a flat business tax rate to all corporations including those in "high-end" sectors and at the same time keep business tax revenues unchanged, the flat rate would have to be set at 29% (Figure 2.15). Introducing flat business tax rates of 15% and 25% would lead to substantial revenue decreases of 2% and 0.5% of GDP, respectively (Table 2.4 and Figure 2.15).

Figure 2.15. The revenue effects of the different business tax reform scenarios modelled vary widely

Revenue effects by business tax reform scenario as a percentage of GDP



Note: (*) These scenarios assume that the "high-end" sectors remain taxed at current rates.
(**) Base broadening scenarios assume deductions (excluding the cost of goods sold and employees' salaries) are reduced by 10% or 20%, respectively. All other provisions remain unchanged.
Source: Calculations based on 2017 business tax return microdata.

Seychelles could consider maintaining a higher business tax rate for "high-end" sectors, at least in the short run. "High-end" sectors pay a top statutory business tax rate of 33%, which is high by international standards. On the other hand, a 33% business tax rate is not exceptionally high when taking into account that capital income is not taxed at the individual shareholder level in Seychelles. Moreover, some of these "high-end" sectors benefit from significant market power and face relatively weak market competition, which results in economic rents that can be taxed at a higher rate. Businesses in these sectors are some of the biggest contributors to business tax revenue in Seychelles. Lowering the top statutory tax rate for "high-end" sectors to 30% or 25% would imply a revenue loss of 0.1% and 0.4% of GDP, respectively (Table 2.5). Seychelles is therefore advised to maintain the business tax rate for "high-end" sectors unchanged at least in the short run. In the medium term, if the revenue scenario is favourable, Seychelles could consider gradual reductions in the top statutory rates it levies on corporations in these sectors.

Table 2.5. Revenue effects and effective rates from scenarios for "high-end" sectors

Top statutory rate	Revenue cost (percentage of GDP)	Effective tax rate
33% (current)	-	30%
Reduction to 30%	-0.1%	28%
Reduction to 28%	-0.2%	27%
Flat 25%	-0.4%	25%

Note: High-end sectors: Telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers.
The modelling exercises reported in this table imply reducing the top statutory rate while maintaining the 25% rate for SCR 1 million of taxable income.
Effective tax rates are measured as the ratio of tax payable to taxable income.
Source: Calculations based on 2017 business tax return microdata.

If "high-end" sectors remained taxed at current rates, a slightly lower flat tax rate could be set for corporations in other sectors while still achieving revenue neutrality. Setting a flat tax rate for corporations operating in the other sectors and maintaining revenue neutrality would require a 27% flat rate. On the other hand, a 20% or 15% flat rate levied on all corporations other than those in "high-end" sectors would imply a revenue loss of 0.6% and 1.1% of GDP respectively (Table 2.4).

Seychelles could consider introducing a progressive business tax rate schedule unified across sectors other than high-end sectors

Moving to a unified progressive business tax rate schedule could lower tax rates for smaller companies while minimising revenue loss. A business tax rate structure where companies with lower profits are taxed on all of their profits at a lower rate and companies with higher profits are taxed on all of their profits at higher rates can have distortive effects as it may create negative incentives to remain under the income thresholds above which higher tax rates apply (i.e. a bunching effect). However, under a progressive schedule, where tax rates are lower on the first brackets of profits for all companies, this risk is lower as even businesses with high taxable income would be taxed at the lower rate on the first bracket of profits. Given that currently most of the business tax take is raised from a few companies with high turnover levels, introducing a progressive business tax schedule that applies to all corporations (other than those operating in "high-end" sectors) could be preferable to a flat rate. This would allow for a continuation of revenues raised from larger and/or more profitable companies while lowering tax rates for smaller and/or less profitable firms. The revenue effects from eight progressive schedules modelled (scenarios f – m) are shown in Table 2.4.

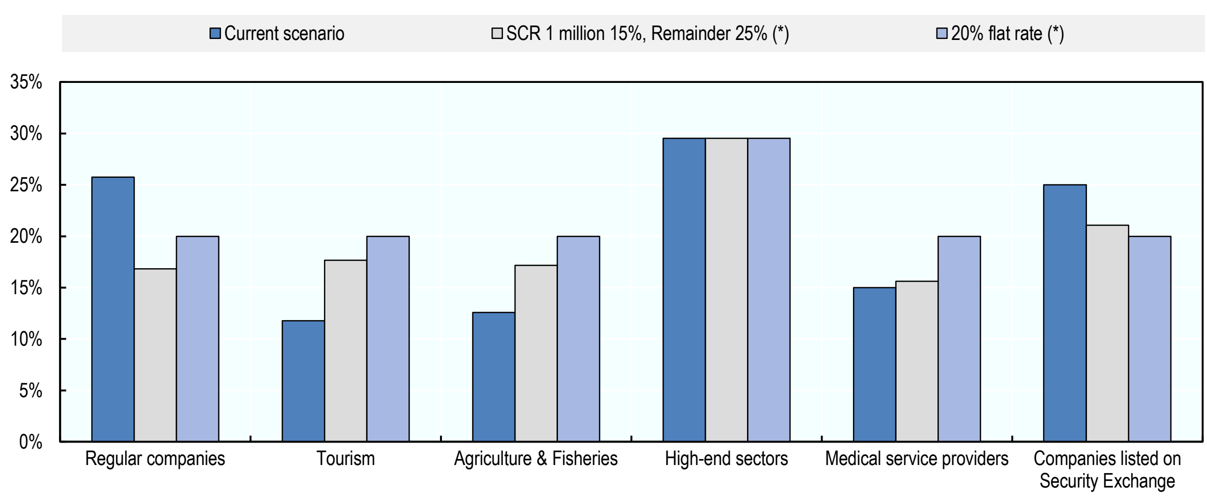
Seychelles could consider introducing a business tax rate schedule that would tax profits below SCR 1 million at 15% and profits above that level at 25%. This schedule would contribute to levelling the playing field across different sectors as well as lower tax rates for smaller corporations without losing much revenue. Estimates suggest that such a reform would imply a revenue decrease of 0.3% of GDP (Table 2.4 and Figure 2.15). However, it could likely be revenue neutral if some of the base broadening recommendations suggested in the report were implemented. Indeed, rough calculations suggest that the reform could be revenue neutral if corporations' total deductions under the proposed tax rate schedule were reduced by 3% (excluding the cost of goods sold and employees' salaries). The income threshold above which the 25% rate applies (currently at SCR 1 million) could also be considerably lowered, for instance to SCR 0.5 million, which, could raise revenues in the medium run due to business tax base broadening. Convergence towards this tax rate schedule could be implemented gradually.

For many businesses, such a tax rate schedule would entail a significant business tax reduction, and thereby create an incentive for additional investment. This tax rate schedule would reduce tax levels in particular on businesses that have lower profits, which currently face a high tax rate when they are taxed under the regular regime. On average, effective tax rates (defined as the ratio of tax payable to taxable income) on corporations currently taxed under the regular tax rate schedule would decrease from 26% to 17% while corporations listed on the Seychelles Securities Exchange would see their effective tax rates fall from 25% to 21% (Figure 2.16).

On the other hand, such a harmonised tax rate schedule would raise tax burdens on the sectors that have been subject to a preferential tax treatment up until now. The proposed harmonised business tax rate schedule would increase tax levels on small and large corporations in the tourism, agriculture and fisheries sectors. Small businesses in those sectors would no longer be able to benefit from the tax-exempt threshold, as the zero-rate band would disappear under the proposed harmonised business tax rate schedule. Indeed, maintaining a zero-rate band for businesses in tourism, agriculture and fisheries sectors is not advisable because it generates strong distortions between sectors. It also provides yet another advantage to sectors that already benefit from generous depreciation allowances (see Section 2.1). The removal of the zero-rate band would affect a number of small businesses in the tourism sector as 30% of the corporations that reported positive taxable income in that sector were below the exemption threshold in 2017[1]. Under the proposed schedule, effective tax rates in the tourism sector would increase from 12% to 18%. The impact on small businesses in agriculture and fisheries would be much smaller. Indeed, there were no corporations in the agriculture and fisheries sectors reporting a positive taxable income below SCR 250 000. Furthermore, only three corporations in the agricultural sector and two corporations in the fisheries sector reported profits above that threshold. The proposed business tax rate schedule would also imply higher tax burdens for private medical and educational service providers (as these would be taxed at a higher rate for profits above SCR 1 million), as well as slightly higher tax burdens on Corporate Service Providers, compared to their current tax treatment (Table 2.4).

Figure 2.16. Effective tax rates would decrease for some sectors but increase for others under the proposed business tax rate schedule

Effective tax rates measured as the ratio of tax payable to taxable income under different scenarios

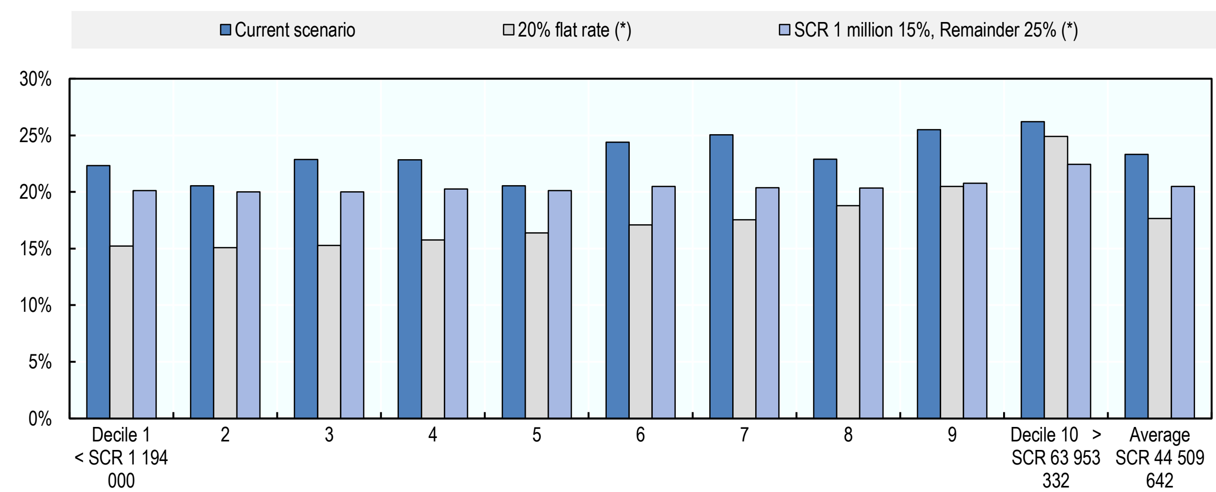


Note: Corporate Service Providers are not included in this figure as they are currently taxed on the fees they charge rather than on their taxable income.
(*) This scenario assumes that the "high-end" sectors remain taxed at current rates.
Source: Calculations based on 2017 business tax return microdata.

The suggested unified progressive tax schedule across all sectors other than high-end sectors would improve progressivity across turnover deciles as well as reduce the average effective tax rate across all corporations. Indeed, estimations suggest that the proposed schedule would decrease effective tax rates across all turnover levels and on average the effective tax rate would fall from 23% to 18% (Figure 2.17). Furthermore, as a consequence of having a unified progressive tax rate schedule across most sectors, effective tax rates would exhibit a progressive pattern across turnover levels, which is currently absent.

Figure 2.17. The proposed business tax rate schedule would improve progressivity across turnover deciles

Effective tax rates measured as the ratio of tax payable to taxable income across turnover deciles under different scenarios



Note: (*) This scenario assumes that the "high-end" sectors remain taxed at current rates.
Excludes Companies with Special Licenses, Corporate Service Providers, exempt companies and non-resident aircraft and ship owners. Turnover deciles were calculated for corporations with a positive tax liability under the regular business tax in the current scenario (2017). This excludes 55 corporations in the tourism sector that reported taxable income below the exemption threshold (SCR 250 000) in 2017.
Source: Calculations based on 2017 business tax return microdata.

In the medium term, Seychelles should aim at taxing all sectors under the same business tax rate schedule. As mentioned before, the rental of residential dwellings is currently taxed at 15% on the gross rental income on a monthly basis. In 2017, this tax raised 0.26% of GDP (twice as much as the revenue from the presumptive tax). The government recently announced that it intends to reduce the tax rate for this sector from 15% to 3% with the expectation that this reduction will be reflected at least partially in accommodation prices. However, the pass through of tax reductions on prices is generally limited (Benedek et al., 2015[1])For example, evidence suggests that VAT rate reductions mostly benefit firm owners ((Kosonen, 2015[2]); (Benzarti and Carloni, 2019[3]). Furthermore, there seems to be little justification for taxing corporations that rent out residential property at preferential rates. These reduced tax rates would benefit all kinds of residential rentals including luxury property. Moreover, the referred tax cut would create a large gap between the taxation of long and short-term property rental, which would likely induce owners to shift to long-term property rental. In this regard, Seychelles is advised to tax corporations that rent residential property for any duration under the same rate schedule as other corporations. Seychelles could also consider taxing non-resident shipping companies (currently taxed at 3% on their turnover) like any other business under the business tax in the medium term. These include some very large corporations. In addition, Seychelles is encouraged to eliminate business tax exemptions for casinos and taxi-owners and tax them under the regular business tax for turnover above SCR 1 million while having the option of being under the presumptive tax for turnover below this threshold.

International trade zones

Seychelles' International Trade Zone regime is very generous and should be phased out or scaled back

The incentives provided under the Seychelles International Trade Zone regime are numerous. Companies in International Trade Zones (ITZs) are exempt from business tax, import duties and VAT on capital equipment and raw materials. In addition, there is no withholding tax levied on dividends and interest remitted outside of Seychelles. Fees vary depending on the type of license but are in all cases very low, with the highest annual fee amounting to USD 2 700. There are currently 24 ITZ operators in Seychelles that employ 2 321 workers (approximately 4% of the total labour force in Seychelles). The biggest ITZ user is Indian Ocean Tuna, a tuna cannery that employs almost 2 000 workers. However, only 30% of the workers in ITZs are Seychellois. More importantly, data shows that 50% of ITZ companies employ less than five workers (including both expatriates and Seychellois), raising doubts about the extent to which real economic activities are being performed in some of these ITZs.

Seychelles is encouraged to remove the business tax exemption under the ITZ regime. Profit-based tax incentives, including corporate tax holidays, provide tax relief to firms that are investing and to firms that are not, in which case the incentive merely waives tax on profit from prior-year investment. Thus, there is wide scope for pure windfall gains (tax savings) to investors. In a first-best reform scenario, the business tax exemption should be repealed or at least limited in time, as it is not a well-targeted tax instrument to support investment. Besides, to be compliant with both WTO and EU rules (see below), if the ITZ regime is maintained, ITZ businesses will have to be granted access to the domestic market.2 The business tax exemption for businesses located in ITZs would then create a significant competitive disadvantage for regular tax-resident businesses and would generate incentives for all businesses to locate in an ITZ.

The current ITZ business tax exemption is also problematic in that it is not time-bound and not linked to any substance requirements. Tax incentives should be time-bound. One major advantage of a time-bound tax incentive is that its expiry provides for a natural point of evaluation, feeding into a periodic reconsideration of whether the incentive should be continued, reformed or repealed. Evidence also shows that when foreseen to be phased out in the near future, the investment effects of an incentive tend to be bigger than that of permanent incentives (IMF et al., 2015[4]). Sunset provisions should be included in the law as otherwise firms may seek to roll-over a tax holiday, either by negotiating a new holiday period or by incorporating a new firm that may apply for it. Substance requirements (e.g. minimum level of investment, minimum amount of operating expenditure, minimum number of full-time employees) should also be introduced.

The revision of ITZs and tax incentives must be done in light of tax reforms undertaken by other countries, in particular in relation to global minimum taxes. The 2017 US tax reform introduced a tax provision, the Global Intangible Low Taxed Income (GILTI), which constitutes a minimum tax on the profits of subsidiaries abroad controlled by US parent companies. Thus, under certain conditions, part of the income of a company resident for tax purposes in the Seychelles but controlled by a US parent company will be included in US taxable business income, reported to the US tax administration, and taxed up to 10.5% by the United States (13.125% after 2025). Therefore, if the taxation of profits in Seychelles is lower than the rate of the GILTI, it will be the US rather than the Seychelles that taxes these profits at the minimum rate. As a result, the Seychelles will implicitly transfer tax revenues from companies established in the Seychelles and controlled by American parent companies to the US tax administration. The effects will be even more significant if similar taxes are put in place in other countries or if a global minimum tax is adopted as part of the OECD solution to address the tax challenges arising from digitalisation (Pillar 2 of the OECD/G20 Inclusive Framework BEPS Programme of Work). In the presence of a global minimum tax, the Seychelles would face an incentive to increase effective tax rates (both within and outside of its ITZ regime) to at least the level of the minimum tax rate.

The European Union recently deemed Seychelles' ITZ regime harmful. The ITZ regime was recently amended to comply with OECD rules. Indeed, export services under the ITZ regime were one of the eight preferential tax regimes considered as harmful by the OECD Forum on Harmful Tax Policies (FHTP), which focused exclusively on movable activity. This regime was abolished in December 2018 and the changes made were found to be compliant with the Action 5 minimum standard of the OECD/G20 BEPS Project in January 2019. However, the Code of Conduct Group (COCG) for Business Taxation of the European Union identified manufacturing activities under the ITZ regime as harmful (these activities are out of scope from the OECD FHTP). The regime was classified as harmful based on two criteria. First, the preferential tax treatment can be granted only for transactions carried out with non-residents (goods exported or services provided to a place outside Seychelles). This means, advantages are ring-fenced from the domestic market, so they do not affect the domestic tax base. Secondly, the ITZ Act does not include any express requirement for a minimum level of economic activity or a substantial economic presence for the tax advantage to be claimed, which does not guarantee that tax benefits are provided strictly to real economic activities. The COCG requested Seychelles to either amend or abolish the regime by 31 December 2019 while existing licences can be grandfathered until 31 December 2022.

Aside from the business tax exemption, other changes could be made to the existing ITZ regime, with a focus on strengthening their monitoring and evaluation. Regarding indirect tax relief for ITZ companies, rules could be introduced to limit tax evasion opportunities. In this regard, the electronic tracking of goods entering and exiting the zones would be highly advisable to ensure that goods are not channelled through the ITZ to the domestic market free of VAT and excise duties. Seychelles is advised to enhance the reporting and evaluation of tax incentives. Even when they benefit from a tax holiday, companies should be required to file a tax return so that the government can assess the revenue forgone. Seychelles should report revenue forgone due to tax incentives provided under the ITZ regime on an annual basis to enhance transparency and enable accountability. Regular evaluations of the impact of the tax incentives provided under the ITZ regime are also key to measure the level of additional investment attributable to tax incentives and their overall cost-effectiveness. Finally, a re-evaluation of the ITZ license fees could be undertaken to assess their adequacy and potentially raise them.

International corporate tax base protection measures

Seychelles needs to make further progress on addressing Base Erosion and Profit Shifting (BEPS)

A comprehensive approach to protecting Seychelles' corporate tax base is necessary. Base erosion and profit shifting (BEPS) arises when businesses can exploit gaps and mismatches between different countries' tax systems: BEPS negatively affects tax revenues as well as the efficiency and the ability of tax systems to create a level playing field for all firms. Currently, there are ample opportunities in Seychelles for MNE groups to engage in BEPS. Furthermore, in order to prevent situations of double non-taxation that may arise under territorial tax systems, Seychelles should introduce the necessary anti-abuse rules. Base protection mechanisms include: controlled foreign corporation (CFC) rules, transfer pricing rules, substance requirements, thin capitalisation rules and other interest limitation rules discussed in more detail further ahead in this Section. In addition, the definition of participation exemptions (income that can be excluded or deducted from the domestic tax base) should receive careful consideration. A comprehensive approach to addressing simultaneously different BEPS behaviours is needed: indeed, if Seychelles only addresses some forms of tax avoidance, businesses will easily shift from one tax planning strategy to another.

Undertaken at the request of the G20 Leaders, the OECD/G20 BEPS Project provided 15 Actions to equip governments with the domestic and international instruments needed to tackle tax avoidance and ensure that profits are taxed where economic activities are performed and where value is created. The 15 Actions in the BEPS Project include four minimum standards as well as common approaches, best practices and new guidance in a number of areas (see Box 2.3). Working together in the OECD/G20 Inclusive Framework on BEPS, over 130 countries are implementing these 15 Actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

As a member of the Inclusive Framework on BEPS, Seychelles has agreed to implement the four minimum standards. These imply removing any harmful tax practices from its domestic tax regime (Action 5), amending its tax treaty rules to prevent treaty abuse (Action 6), implementing country-by-country reporting rules and exchanging the reports it receives from MNEs with other countries (Action 13), and working with other BEPS IF members to improve cross-border tax dispute resolution mechanisms (Action 14). Each of the four minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard a level playing field.

Regarding Action 5, eight preferential tax regimes were found to have harmful features in 2017. In the context of Action 5, the Forum on Harmful Tax Practices (FHTP) conducts reviews of preferential tax regimes to identify features of such regimes that can facilitate BEPS, and therefore have the potential to unfairly impact the tax base of other jurisdictions. The focus of the FHTP is on preferential regimes that provide benefits to geographically mobile business income (such as income from intangibles and financial and other services activities) which present a risk of BEPS outcomes. In 2017, various preferential regimes from Seychelles were assessed and eight were found to have harmful features because they were considered to be ring-fenced from the domestic economy and to lack substance. A preferential regime is considered ring-fenced if the jurisdiction protects its own economy from the regime, which provides a strong indication that a regime has the potential to create harmful spill-over effects. Substance requirements imply that in order to benefit from a preferential regime, the taxpayer must have engaged in the core income generating activities giving rise to the income.

In order to comply with the Action 5 standard, the Seychelles introduced legislative changes aimed at amending/abolishing the regimes reviewed by the FHTP. In particular, six regimes, namely International Business Companies (IBC), Companies Special License (CSL), International Trade Zone (ITZ) for the part related to IP aspects, Offshore Banking (OB), Non-domestic Insurance Business (NDIB) and Reinsurance Business have been abolished. Grandfathering in accordance with the FHTP requirements and deadlines (i.e. until June 2021) has been provided for the CSL, ITZ and NDIB. The International trade zone regime, in relation to the non-IP aspects, has been amended to remove benefits to geographically mobile business income and now it is out of the scope of the FHTP work. Grandfathering has been provided in accordance with the FHTP requirements and deadlines. Two regimes, i.e. Fund Administration Business and Securities Businesses under the Securities Act have been amended to meet the substantial activities requirements and they have been concluded as not harmful. Grandfathering has been provided in accordance with the FHTP requirements and deadlines. As such, the Seychelles is now compliant with the Action 5 standard.

Box 2.3. The OECD/G20 BEPS project and the Inclusive Framework on BEPS

The OECD/G20 BEPS project produced a 15-point Action Plan including minimum standards, common approaches, best practices and new guidance in the main policy areas.

- Minimum standards were agreed upon in the areas of fighting harmful tax practices (Action 5), preventing treaty abuse (Action 6), Country-by-Country Reporting (Action 13) and improving dispute resolution (Action 14). Each of the four minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field.
- A common approach, that facilitates the convergence of national practices by interested countries, was outlined to limit base erosion through interest expenses (Action 4) and to neutralise hybrid mismatches (Action 2). Best practices for countries which seek to strengthen their domestic legislation were provided on the building blocks for effective controlled foreign company (CFC) rules (Action 3) and mandatory disclosure by taxpayers of aggressive or abusive transactions, arrangements or structures (Action 12).
- The permanent establishment (PE) definition in the OECD Model Tax Convention was modified to restrict inappropriate avoidance of tax nexus through commissionaire arrangements or exploitation of specific exceptions (Action 7). In terms of transfer pricing, important clarifications have been made with regard to delineating the actual transaction, and the treatment of risk and intangibles. More guidance has been provided on several other issues to ensure that transfer pricing outcomes are aligned with value creation (Actions 8-10).
- The changes to the PE definition, the clarifications on transfer pricing, and the guidance on CFC rules are expected to substantially address the BEPS risks exacerbated by the digital economy. Value Added Taxes (VAT) will now be levied effectively in the market country facilitating VAT collection (Action 1).
- The multilateral instrument (MLI) modifies the application of bilateral tax treaties to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies.

The tax challenges of the digitalisation of the economy were identified as one of the main areas of focus of the Base Erosion and Profit Shifting (BEPS) Action Plan, leading to the 2015 BEPS Action 1 Report (OECD, 2015[5]). Concrete proposals by IF members to re-design the international tax system were classified into two Pillars. Pillar One focuses on the re-allocation of taxing rights and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules. Pillar Two (also referred to as the "GloBE" proposal) seeks to comprehensively address remaining BEPS challenges by ensuring that the profits of internationally operating businesses are subject to a minimum rate of tax.

Progress has been made on country-by-country (CbC) reporting. Under BEPS Action 13, multinational enterprises (MNEs) with consolidated group revenue of EUR 750 million or more in the preceding fiscal year are required to prepare a CbC report on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates and to submit the CbC report to the tax administration of the jurisdiction where its ultimate parent entity (UPE) is tax resident. The tax administration then shares the CbC report with the tax administrations of the jurisdictions where the MNE operates for the purpose of BEPS risk assessment. Seychelles approved CbC reporting regulations establishing that MNEs that have an UPE resident in Seychelles have to file an annual report starting in December 2019. As it is unlikely that MNEs parented in Seychelles meet or exceed the EUR 750 million revenue threshold, the Seychelles tax administration may not receive any CbC reports. However, Seychelles should benefit from the exchange of CbC reports from MNEs with foreign affiliates in Seychelles (filed with the tax administration of the jurisdictions of residence of the UPEs).

As for the minimum standard to improve cross-border tax dispute resolution, Seychelles has requested deferral from the peer review process until 2020. Many tax treaties between jurisdictions contain a Mutual Agreement Procedure (MAP) provision providing for a process used to resolve disputes regarding the application and interpretation of tax treaties, notably to ensure that taxpayers entitled to the benefits of the treaty are not subject to taxation by either of the Contracting States which is not in accordance with the terms of the treaty. Article 25 of the OECD Model Tax Convention provides a mechanism through which the competent authorities of the Contracting States may resolve these issues on a mutually-agreed basis. Despite the widespread existence of this provision in tax treaties, further effort is needed to ensure that access to MAP is available and to increase efficiencies and improve the timeliness of the resolution of double taxation disputes. In order to comply with the minimum standard, IF members have committed to be subject to a peer review process. Seychelles has deferred the peer review to 2020. In the meantime, Seychelles should start the preparation work to be compliant with the minimum standard and, in any case, it should report statistics in accordance with the agreed framework for reporting of MAP statistics on an annual basis.

Seychelles has signed the Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), but has not ratified it yet. The MLI, concluded by over 100 jurisdictions in November 2016, allows jurisdictions to swiftly implement measures to strengthen existing tax treaties and protect governments against tax avoidance strategies that inappropriately use tax treaties to artificially shift profits to low or no-tax jurisdictions. The MLI includes the treaty-related minimum standards – treaty abuse (Action 6) and mutual agreement procedures (Action 14) – as well as other measures against treaty abuse (Action 6) and against hybrid mismatch arrangements (Action 2) and a strengthened definition of permanent establishment (Action 7). As of December 2019, the MLI covered 92 jurisdictions and 37 jurisdictions had deposited their instrument of ratification, acceptance or approval to the Depositary (the OECD Secretariat).

In addition to ratifying the MLI, Seychelles is encouraged to revise some of its double tax treaties to prevent double non-taxation. Seychelles has signed a number of double tax agreements (DTAs), which may fail to prevent base erosion. Some tax treaties with low-tax jurisdictions provide for 0% withholding tax rates on outgoing dividends, interests and/or royalties (see Table A.2 in the Annex). Base erosion through fees for technical services has also been reported as a major BEPS concern in the tourism sector.

Regarding transfer pricing, Actions 8-10 seek to align transfer pricing outcomes with the value creation of the MNE group. Transfer pricing rules, which are used for tax purposes, are concerned with determining the conditions, including the price, for transactions within an MNE group resulting in the allocation of profits to companies within the group in different countries. The standard approach is to treat each enterprise within the MNE group as a separate entity. To do so, individual group members must be taxed on the basis that they act at arm's length in their transactions with each other. Actions 8-10 clarify and strengthen the existing Transfer Pricing Guidelines, including through revised guidance on the application of the profit split method and an approach for the appropriate pricing of hard-to-value-intangibles within the arm's length principle to ensure that the results are dictated by economic reality. These changes will reduce incentives for MNEs to shift income to shell companies with few if any employees and little or no economic activity, which seek to take advantage of low or no-tax jurisdictions.

Seychelles should rapidly introduce transfer pricing rules in line with the OECD Transfer Pricing Guidelines to protect its tax base. Seychelles only has one provision on transfer pricing in its Business Tax Act, but no regulation in place. The provision allows for the establishment of such regulation. In addition, there is a provision that limits the deductibility of management fees, royalties and technical assistance fees paid to non-resident persons up to 3% of turnover.

Seychelles could consider introducing interest limitation rules, in line with BEPS Action 4. BEPS Action 4 aims at limiting base erosion through the use of excessive interest deductions. Action 4 establishes rules that link an entity's net interest deductions to its level of economic activity within the jurisdiction. This approach includes three elements: a fixed ratio rule which limits an entity's interest deductions to a percentage of its earnings before interest, taxes, depreciation and amortisation (EBITDA); a group ratio rule which may allow an entity to deduct more interest expense depending on the relative net interest/EBITDA ratio of the worldwide group; and targeted rules to address specific risks. A number of Inclusive Framework members have adopted interest limitations rules or are in the process of aligning their domestic legislation with the recommendations of Action 4. The recommended rule puts a limit to interest payments ranging from 10% to 30% of EBITDA. Given the relatively low level of interest payments that are currently deducted by businesses on average in the Seychelles, the maximum allowed deduction could be kept relatively low (i.e. closer to 10% than 30%).

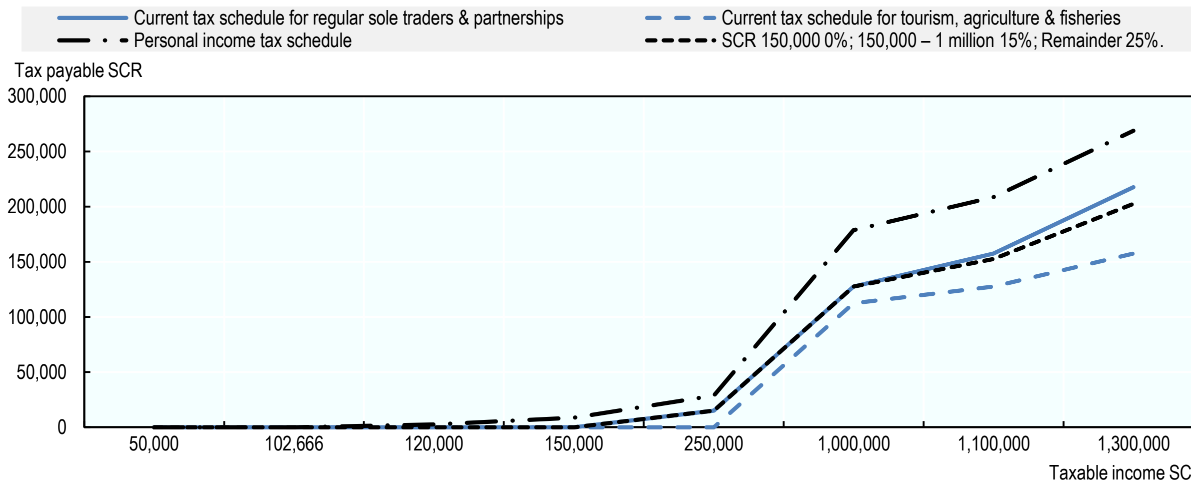
Finally, controlled foreign company (CFC) rules in line with BEPS Action 3 could also contribute to protecting Seychelles' corporate tax base. CFC rules respond to the risk that taxpayers can strip the tax base of their country of residence by shifting income into a foreign company that is controlled by the taxpayers. Seychelles does not have such CFC rules. BEPS Action 3 sets out recommendations in the form of building blocks for the design of effective CFC rules, which include the definition of a CFC, exemptions and thresholds, approaches for determining the type of income subject to the rule, computation of CFC income, the attribution of CFC income to shareholders and measures to eliminate the risk of double taxation. By mid-2019, almost 50 OECD/G20 Inclusive Framework countries had enacted CFC rules.

Sole traders and partnerships

In Seychelles, individual business and professional income is subject to the same rules as business income derived by companies. This differs from common practice in most countries, where sole traders are taxed on their business income (after deducting expenses) under the personal income tax (PIT). In addition, unlike many countries, partnerships are not transparent for tax purposes. Hence, taxable profits are taxed at the partnership level rather than at the level of each individual partner. Furthermore, the tax rate schedule applicable to these companies is more favourable than the personal income tax rate schedule for employees, as the former benefit from a higher tax exemption threshold and a lower tax rate on certain income brackets (Figure 2.18). The differential tax treatment for unincorporated businesses relative to employees is even more pronounced in tourism, agriculture and fisheries where unincorporated businesses are taxed under the same regime as corporations. Such preferential treatment could encourage artificial self-employment, although there are also greater risks and fewer benefits associated with self-employment, which may justify a higher tax exemption threshold and reduce the attractiveness of self-employment.

Figure 2.18. The tax rate schedule applicable to unincorporated businesses is more favourable than the one for employees

Sole traders and partnerships' tax liability by income level current and alternative schedules



Note: The tax rate schedule for regular sole traders and partnerships is: 0% up to SCR 150,000, 15% on SCR 150,000 – 1 million, 30% on the remainder.
The tax rate schedule for companies that operate in the tourism, agriculture and fisheries sectors is: 0% up to SCR 250,000 and 15% on the remainder.
The personal income tax rate schedule is: 0% up to SCR 102,666, 15% for SCR 102,666-120,000, 20% for SCR 120,000 -1 million, 30% on the remainder.
Source: Own calculations.

Among the sole traders and partnerships that are taxed under the business tax, most report a zero tax liability. As discussed below, companies with a turnover below SCR 1 million, regardless of their legal form, can opt to be taxed under the simplified presumptive tax regime, and in fact, most sole traders and partnerships in Seychelles are taxed under the presumptive tax (80%). Among the minority of sole traders and partnerships registered under the business tax (988 businesses in total in 2017), only 367 businesses reported a positive tax liability. Most entities reporting a positive tax liability operate in the wholesale and retail trade sector and to a lesser extent in the tourism sector (Figures A.4 and A.5 in Annex A).

In the short run, unincorporated businesses could be taxed under the proposed tax rate schedule for corporations. One option would be to fully align the tax rate schedule that applies to sole traders and partnerships to the proposed business tax rate schedule (15% on the first SCR million of profits, 25% on the remainder). This change would slightly increase revenue while effective tax rates would increase from 7.9% to 15.2%, as the tax exemption thresholds that sole traders and partnerships currently benefit from -either under their regular tax schedule or the tax schedule for the tourism, agriculture and fisheries sectors- would be eliminated (Table 2.6 and Figure 2.19). Another option could be to maintain the tax exemption threshold that sole traders and partnerships benefit from at its current level. Taxing sole traders and partnerships with taxable income between SCR 150 000 and SCR 1 million at 15% and the remainder at 25% would slightly reduce revenue relative to the current situation, while effective tax rates would remain virtually unchanged. A third option would be to maintain a tax exemption threshold for sole traders and partnerships, but to set it at a slightly lower level compared to its current level, that would match the level of the personal income tax exemption threshold (SCR 102 666). In this third scenario, revenues would increase slightly relative to the current situation and effective tax rates would see a minor increase (Table 2.6 and Figure 2.19).

Ideally, unincorporated businesses should be taxed under the personal income tax as is done in most countries. Nonetheless, this change could only be implemented in the medium term, when the personal income tax is turned into a modern system with an end of the year declaration. If all existing sole traders and partnerships were taxed under the personal income tax, this change would imply a revenue increase of 0.045% of GDP (Table 2.6). This small increase in revenue results from the increase in tax rates and the lower tax exemption threshold if sole traders and partnerships became taxed under the personal income tax. In fact, the share of unincorporated businesses (excluding those under the presumptive tax) that would pay tax would increase from 37% to 51% and the effective tax rate for these entities would rise to 10.6% (Figure 2.19). However, if the business tax rate cuts proposed in this Chapter were introduced and unincorporated businesses were taxed under the personal income tax schedule, sole traders and partnerships with taxable income above SCR 1 million would have an incentive to incorporate and be taxed under the business tax, which suggests that the revenue increase shown in Table 2.6 might be slightly overestimated. Tax-induced incentives to incorporate could nevertheless be reduced through the introduction of a moderate tax on dividends and capital gains at the individual shareholder level (see Chapter 3).

Table 2.6. Revenue effects of reform scenarios for sole traders and partnerships

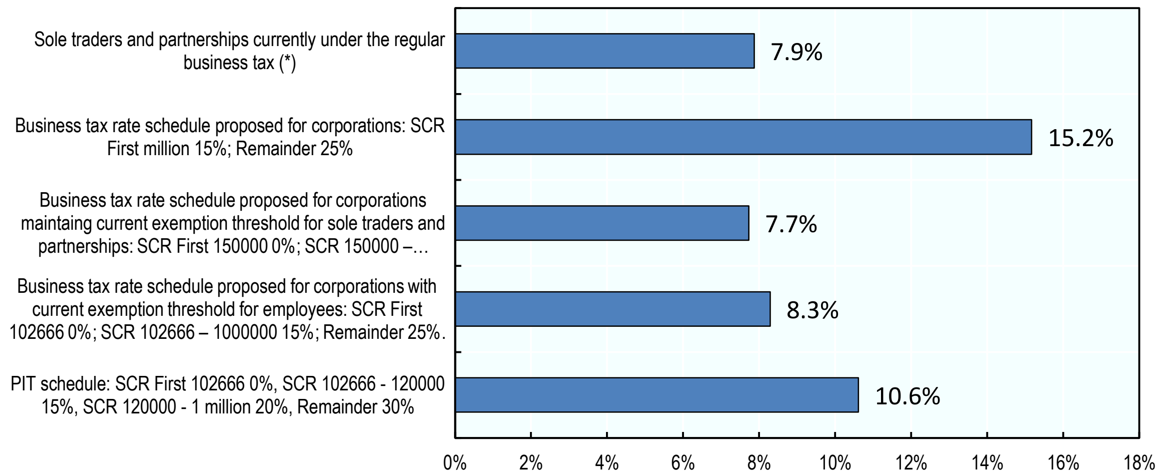
SCR million and as a percentage of GDP

	Current	SCR million 15%; Remainder 25%.	SCR 150 000 0%; 150,000 – 1 million 15%; Remainder 25%.	SCR 102 666 0%; 102,666 – 1 million 15%; Remainder 25%.	Current personal income tax rate schedule
Revenue (SCR million)	32	45	30	34	43
Revenue (% of GDP)	0.1%	0.2%	0.1%	0.1%	0.2%
Revenue change (% of GDP)		0.054%	-0.010%	0.006%	0.045%

Note: Revenue estimates were adjusted by nominal GDP growth to reflect the Ministry of Finance forecast for 2019.
Excludes exempt companies.
Personal income tax schedule: SCR 102 666 0%; SCR 102 666 – 120 000 15%; SCR 120 000 – 1 million 20%, Remainder 30%.
Source: Calculations based on 2017 business tax return microdata.

Figure 2.19. In the short run, unincorporated businesses could be taxed under the proposed tax rate schedule for corporations while maintaining the exemption threshold

Average effective tax rates for sole traders and partnerships currently taxed under the regular business tax: current and alternative reform scenarios



Note: Effective tax rates are measured as the ratio of tax payable to taxable income and are measured exclusively for entities with positive tax liability.
Excludes exempt companies.
(*) Includes sole traders and partnerships both under their regular schedule in the business tax as well as those operating in the tourism, agriculture and fisheries sector..
Source: Calculations based on 2017 business tax return microdata.

The presumptive tax

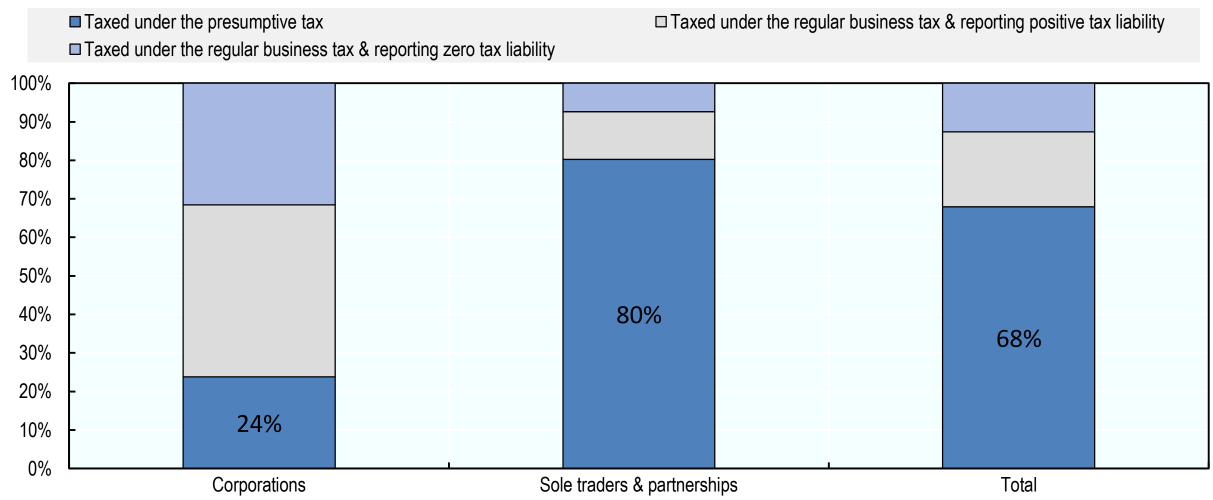
The design of the presumptive tax could be revised depending on the objectives it aims to achieve

Presumptive tax regimes may be used for different reasons. A presumptive tax presumes a different tax base than income in the calculation of the firm's tax liability. Usually, the main reason for implementing such a regime is simplification, particularly in relation to the compliance burden on small businesses (and the corresponding administrative costs of managing the tax and auditing taxpayers). Calculations according to a presumptive tax scheme may also provide taxpayers with greater certainty regarding their tax liabilities. Another important reason is to limit tax avoidance or evasion. If well-administered, these regimes are likely to have a strong signalling effect encouraging informal entrepreneurs to become compliant. This is accomplished only if the proxy of income on which the presumption is based is more difficult to hide than those forming the basis for accounting records (Thuronyi, 1996[6]). A presumptive tax can also be designed to ensure that a minimum level of tax is collected from small businesses.

A substantial share of companies are taxed under the presumptive regime in Seychelles. Companies in Seychelles with an annual turnover below SCR 1 million can choose to be taxed under the presumptive tax at a 1.5% rate on their turnover or to be taxed under the regular business tax. In 2017, 68% of total companies were taxed under the presumptive tax. Among sole traders and partnerships, about 80% of businesses were taxed under the presumptive tax regime, while the share was much lower among corporations, where only 24% of firms were taxed under the presumptive tax regime over the business tax (Figure 2.20). Among eligible companies (with turnover below SRC 1 million), 95% of sole traders and partnerships and 65% of corporations chose to be taxed under the presumptive tax regime. Given that the regime is optional below this threshold, businesses that have losses or low profit margins will prefer to be taxed under the business tax rather than the presumptive tax, which explains why 35% of corporations with turnover below the SCR 1 million threshold decide to file a business tax return.

Figure 2.20. Seychelles' presumptive tax covers a substantial share of companies

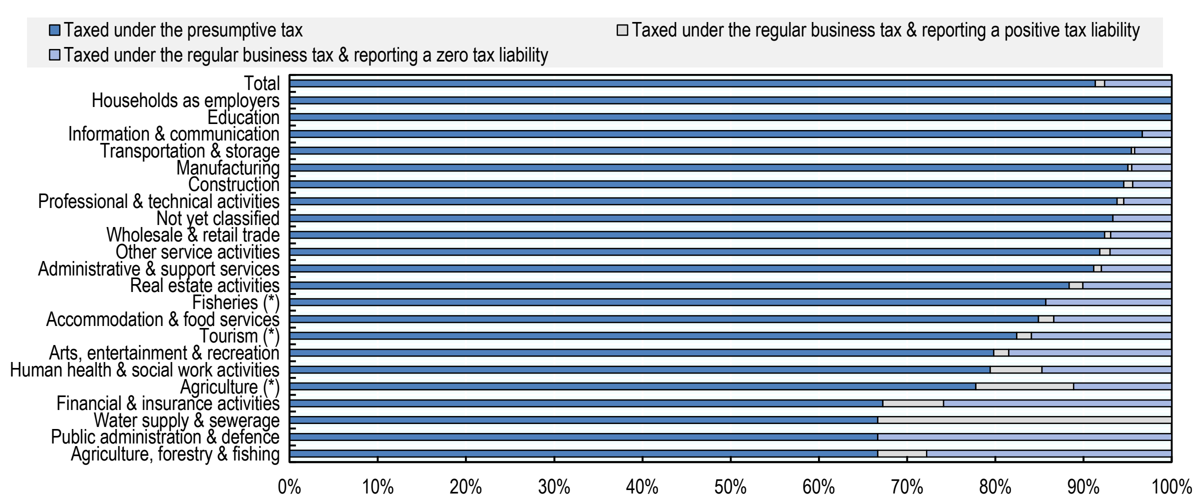
Share of companies by tax liability status and sector



Note: Includes both corporations and sole traders and partnerships. Excludes Corporate Service Providers, Companies with Special Licenses, exempt companies and non-resident aircraft and ship owners.
Source: Calculations based on 2017 business tax and presumptive tax microdata.

Figure 2.21. Companies that choose to be taxed under the regular business tax despite being under the presumptive tax threshold generally report a zero tax liability

Share of companies with turnover below SCR 1 million by tax liability status and sector

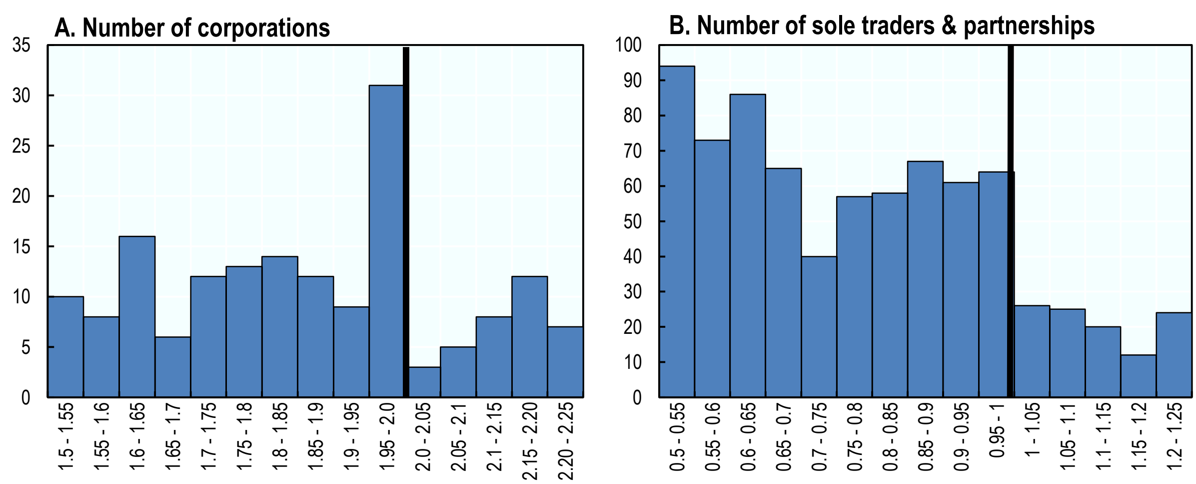


Note: Includes both corporations and sole traders and partnerships. Excludes Corporate Service Providers, Companies with Special Licenses, exempt companies and non-resident aircraft and ship owners. ISIC sectors.
(*) Defined in line with the Business Tax Act.
Source: Calculations based on 2017 business tax and presumptive tax microdata.

Evidence of businesses "bunching" below the presumptive tax threshold suggests a discontinuity in businesses' tax burdens between the presumptive and the regular business tax regimes. Presumptive taxes increase the risks of horizontal inequity if they generate a disproportionate burden on small firms or, on the contrary, if the tax burden is excessively low compared to the regular business tax. The latter can discourage firm growth or create incentives for firms to artificially remain below the presumptive tax eligibility threshold, underreporting turnover or artificially splitting their activities into separate businesses. In fact, the data shows some evidence of businesses "bunching" below the presumptive tax threshold (Figure 2.22). Companies reporting turnover slightly below the threshold operate mainly in retail trade, accommodation and real estate. To prevent businesses from underreporting their turnover, tax authorities could require businesses to report, along with their turnover, other indicators (e.g. salaries, energy costs, number of rooms in the case of accommodation services), which could then be relatively easily matched with turnover data to detect potential inconsistencies.

Figure 2.22. There is evidence of businesses "bunching" below the presumptive tax threshold

Distribution of companies around the SCR 1 million eligibility threshold (SCR 0.05 million turnover bands)

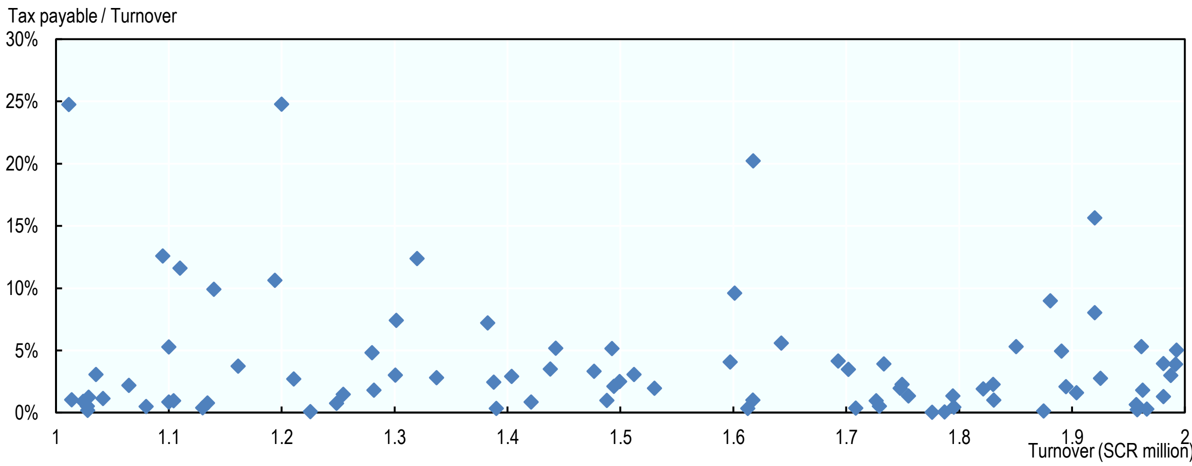


Source: Calculations based on 2017 business tax and presumptive tax microdata.

Avoiding sharp tax burden increases in the transition from the presumptive to the regular tax regime is critical. In order to compare tax burdens under the presumptive tax regime and the regular business tax and assess whether there is a significant increase when businesses switch from the presumptive tax regime to the business tax regime, the tax liability owed under the business tax can be expressed as a share of turnover. In this regard, in 2017 the ratio of tax payable to turnover for small corporations (with turnover levels above SCR 1 million but below SCR 2 million) under the regular business tax was on average 5% (Figure 2.23), pointing to a non-negligible discontinuity in businesses' tax burden between the two regimes. In fact, in a hypothetical firm whose business costs represent 80% of turnover, the ratio of tax payable to turnover would increase from 1.5% to 5% when turnover exceeds the presumptive tax threshold and the corporation is taxed at a 25% rate under the current regular tax schedule. This discontinuity would be substantially reduced if the business tax rate cuts proposed in this Chapter were introduced (the ratio of tax payable to turnover would be 3% for a firm with business costs equivalent to 80% of turnover and turnover levels below SCR 5 million).

Figure 2.23. A relatively high ratio of tax payable to turnover for small firms also points to a non-negligible discontinuity in businesses tax burden between the presumptive and regular regime

Ratio of tax payable to turnover for corporations taxed under the regular business tax and with turnover lower than SCR 2 million



Source: Calculations based on 2017 business tax return microdata.

Different presumptive tax rates for sectors that have very different profitability levels or a progressive presumptive tax could also contribute to reducing this discontinuity. Highly profitable firms with turnover below the eligibility threshold may prefer the presumptive tax regime to the regular business tax regime while less profitable firms may prefer the regular business tax regime instead. This may require having different presumptive tax rates for sectors that have very different profitability ratios such as higher rates for services or professionals. The presumptive tax could also be turned into a progressive tax, with rates increasing with turnover.

The presumptive tax threshold should be maintained at the current level. The level of the threshold itself is an important feature of the presumptive tax that needs to be assessed. Many countries have aligned their presumptive tax threshold with their VAT threshold. This increases simplicity by avoiding the use of multiple thresholds. However, it can also create a significant cliff-edge effect whereby going over the threshold significantly increases tax compliance costs for small businesses as they suddenly become liable to both the regular business tax and the VAT. In addition, in Seychelles, if the presumptive tax threshold was aligned with the VAT threshold (i.e. raised from SCR 1 million to SCR 2 million), the share of businesses eligible for the presumptive tax would increase from 74% to 84% of total businesses.[3] Overall, keeping the compliance costs under the regular business tax regime as low as possible should be preferred over increasing the presumptive tax threshold. Instead, the aim should be to reduce the VAT threshold to a level significantly below the current SCR 2 million in the long run.

Table 2.7. Revenue effects from presumptive tax reform scenarios

Revenue from taxpayers with turnover below SCR 2 million. SCR million and as a percentage of GDP

	Baseline	Scenarios							
		a)	b)	c)	d)	e)	f)	g)	h)
Presumptive tax threshold	**SCR 1 million**	**SCR 1 million**	**SCR 1 million**	**SCR 1 million**	**SCR 1 million**	**SCR 1 million**	**SCR 2 million**	**SCR 2 million**	**SCR 2 million**
Presumptive tax rate	**1.5%**	**1.5%**	**2.5%**	**3.0%**	**2% Professionals**	**2% Services**	**1.5% < 1 million**	**1.5% < 1 million**	**1.5% < 1 million**
					1.5% Others	**1.5% Others**	**2.5% 1-2 million**	**2.5% 1-2 million**	**2.5% ST & P (*) 1-2 million**
									3% C 1-2 million
Optional	**Yes**	**No**	**Yes**	**Yes**	**No**	**No**	**Yes**	**Optional 1-2 million**	**No**
Revenue presumptive tax Corporations	2.7	4.3	5.4	2.7	4.5	5.5	4.7	6.0	16.5
Revenue regular business tax Corporations <= SCR 1 million	1.2	0.0	1.2	1.2	0.0	0.0	0.0	0.0	0.0
Revenue regular business tax Corporations SCR 1 - 2 million	5.6	5.6	5.6	5.6	5.6	5.6	0.9	0.9	0.0
Revenue presumptive tax Sole traders & Partnerships)	14.9	16.6	24.8	29.8	17.1	21.2	16.4	18.0	32.9
Revenue regular business tax Sole traders & Partnerships <= SCR 1 million	0.4	0.0	0.4	0.4	0.0	0.0	0.1	0.0	0.0
Revenue regular business tax Sole traders & Partnerships SCR 1 - 2 million	6.0	6.0	6.0	6.0	6.0	6.0	1.7	1.7	0.0
Total revenue from businesses below SCR 2 million	**30.9**	**32.5**	**43.5**	**45.8**	**33.2**	**38.4**	**23.7**	**26.6**	**49.5**
Revenue (% GDP)	**0.13%**	**0.14%**	**0.19%**	**0.20%**	**0.14%**	**0.17%**	**0.10%**	**0.11%**	**0.21%**
Revenue change (% GDP)		**0.01%**	**0.05%**	**0.06%**	**0.01%**	**0.03%**	**-0.03%**	**-0.02%**	**0.08%**

Note: Revenue estimates were adjusted by nominal GDP growth to reflect the Ministry of Finance forecast for 2019.
Scenarios in which the presumptive tax rate is increased below the current SCR 1 million threshold assume all current presumptive taxpayers remain in the regime given that for entities under this tax the only information available is turnover and therefore it is not possible to calculate whether they would benefit more from switching to the regular business tax regime.
There are 132 entities under the regular business tax with positive turnover that were not included in the simulations given that their tax return data was not available.
Source: Calculations based on 2017 business tax return microdata.

The different presumptive tax reform scenarios modelled would not have a significant revenues impact. Currently the presumptive tax raises very little revenue (0.13% of GDP in 2017). The different presumptive tax reform scenarios modelled (considering alternative tax rates, threshold levels and target groups) would not change revenues significantly, not even in the scenario where the regime would be made compulsory (Table 2.7). For the scenarios in which the presumptive tax regime remains optional, it is assumed that businesses will switch to the regime that minimises their tax burden given their turnover and taxable income. However, businesses are also likely to take into account compliance costs. That is, even if a small business would pay slightly more under the presumptive tax compared to the business tax, it might still decide to be taxed under the presumptive because compliance costs are much lower (no need for real accounting, etc.). In this regard, the revenue gains estimated could be biased downwards. Overall, there is room to either increase the presumptive tax rate or introduce a higher presumptive tax rate for sectors that have high profitability levels with the aim of reducing the discontinuity between the presumptive and regular business tax regimes. Nevertheless, these changes would not raise much revenue.

The presumptive tax should remain optional if the objective is to minimise compliance costs. If the presumptive tax is primarily used as a minimum tax, then it could be made compulsory below the threshold. However, such an approach might be questionable, as the minimum tax would only apply to businesses below the turnover threshold and might possibly impose a higher tax burden on businesses with a lower turnover. If the main objective of this regime is to reduce compliance costs, the presumptive tax should remain optional. Nonetheless, once small businesses choose a regime, it should apply for a certain number of years to avoid yearly shifts between the presumptive and the regular business tax regime.

Extending the cash accounting threshold to SCR 2 million could also contribute to simplification. Presumptive taxation is only one of the types of measures that can be put in place to simplify small businesses' tax obligations. Other measures include simplified accounting, reduced tax filing requirements and less frequent advance tax payments. Cash accounting for business tax purposes allows income tax to be paid on revenues only when cash is received and input costs to be claimed only when cash is paid out. Cash accounting therefore minimises cash flow difficulties for small businesses. Cash accounting is also simpler than accrual accounting, which requires accounting for expenses related to long-term assets (e.g. depreciation), inventory and pension liabilities on an accrual basis. In addition to having a clear rationale, these types of measures do not have the same negative implications in terms of distortions and revenue loss as a presumptive tax. In Seychelles, the eligibility threshold for cash accounting could be raised from SCR 1 million to SCR 2 million to extend that benefit to more small businesses under the regular business tax regime.

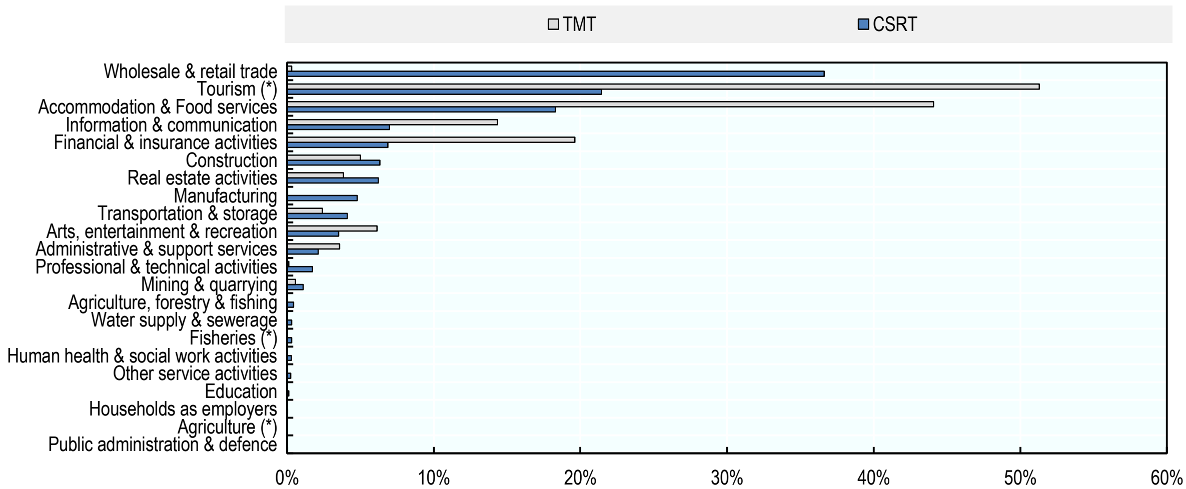
The corporate social responsibility tax and the tourism marketing tax

The CSRT and the TMT have been introduced to compensate for weaknesses in the business tax system, but they are distortive

Seychelles levies two taxes on turnover: the Corporate Social Responsibility Tax (CSRT) and the Tourism Marketing Tax (TMT). The CSRT and TMT are levied on a monthly basis at a 0.5% rate on companies with a turnover of at least SCR 1 million. While the CSRT is levied on all entities except those that are exempt under the business tax, the TMT targets mainly tourism operators, although other sectors, such as the financial and the construction sectors, are also subject to the tax (Figure 2.24). To some extent these taxes were introduced to compensate for existing weaknesses in the business tax system (while taxable income can be reduced through multiple tax planning strategies, turnover is more difficult to alter). These taxes have enabled the collection of tax revenues from businesses (in particular in the tourism sector) that consistently report losses. In fact, they raise non-negligible revenues: in 2017 the CSRT and the TMT raised 0.5% and 0.3% of GDP, respectively.

Figure 2.24. Most revenue raised by the TMT and CSRT comes from wholesale and retail trade, tourism and the financial sectors

Breakdown of total CSRT and TMT revenues by sector



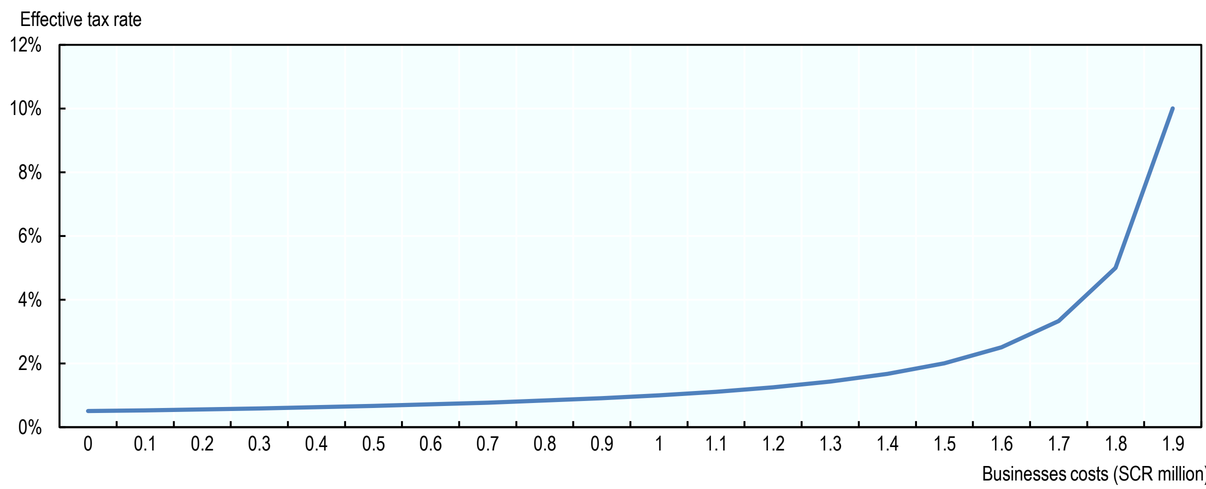
Note: ISIC classification.
(*) Sectors defined in line with Business Tax Act.
Source: Calculations based on 2017 business tax return microdata.

Taxes on turnover are distortive as they penalise low-profit margin businesses and induce businesses to operate in the informal economy. Taxes on turnover bear more heavily on companies with high business costs. Figure 2.25 shows how the effective tax rates on profits under the CSRT and the TMT for businesses with a turnover of SCR 2 million increase when business costs increase, i.e. when business profitability decreases. In fact, while the effective rate for a company whose costs represent 60% of turnover is only 1.25%, for businesses whose costs represent 95% of their turnover, the CSRT (or the TMT) impose a 10% effective tax rate on profits (Figure 2.25). In order to prevent having to pay these turnover taxes, businesses face an incentive not to declare their turnover at all. The CSRT and TMT might therefore have also an indirect negative impact on the VAT revenues and the PIT as they will also disincentive businesses to declare their payroll.

Seychelles could introduce changes to improve the functioning of these taxes in the short run, but consider eliminating them in the longer run, once the base of the business tax is broadened. As a first step, both taxes could be made creditable against the business tax. This would mean that the businesses that have a positive tax liability under the business tax could offset the CSRT or the TMT paid against their business tax liability. This would in effect turn the two taxes into types of alternative minimum taxes. On the other hand, businesses that do not have a positive tax liability under the business tax would not be able to recover the CSRT or the TMT paid. Regarding the TMT, consideration could be given to levying it on non-resident aircraft and ship owners operating in the tourism sector. In the long run, and if reforms are introduced to broaden the business tax base and to enhance the functioning of the business tax system, the government could consider eliminating these taxes given their distortive nature.

Figure 2.25. Taxes on turnover bear more heavily on companies with high business costs

Effective tax rates on profits under the TMT and CSRT for companies with a turnover of SCR 2 million when business costs increase



Note: Tax liability due by businesses under the TMT or the CSRT expressed as a share of business income. Let X=business costs/ turnover. Then, ETR = 0.005/(1-X).
Source: Own calculations.

Tax administration

Seychelles is advised to set up a multi-stakeholder group with representatives of different public bodies and the private sector with to the aim of adopting a strategy to address informality. Addressing informality and broadening the net of taxpayers should be a priority in order to avoid overburdening formal sector operators and prevent unfair competition. In the presence of relatively high informality, the solution to raise additional revenues often consists in increasing taxes on the formal sector, which reinforces the distortions between the formal and the informal economy and, in the longer term, generates additional incentives for businesses and workers to stay or become informal. Broadening the tax net to a larger number of taxpayers makes it possible to collect more revenues, while maintaining the tax burden on formal sector operators at a reasonable level. Broadening the tax net to informal operators will require strengthening the effectiveness of the tax system.

Enhancing the exchange of information between public bodies is a promising avenue. For instance, companies in the accommodation sector need to submit information to the Ministry of Tourism on the number of rooms they offer in order to obtain their license. Turnover levels declared could be monitored by combining the information on the number of rooms with data on average occupancy rates per year (estimated around 60%). In addition, tax compliance could become a pre-requisite for the renewal of licenses.

Electronic tax filing levels among businesses are low in Seychelles. Pursuing higher levels of electronic filing (and payment) by taxpayers would enable the SRC to reduce its costs and to improve the services they provide to taxpayers. Electronic filing also contributes to expanding the range of data that the SRC can collect and match with information from third party organisations. As discussed in Chapter 3, third party organisations such as digital platforms could provide information to the SRC, significantly contributing to strengthen tax compliance.

Seychelles is encouraged to introduce an automated risk-based audit system. Since it is impossible to control and check every single taxpayer, identifying high-risk taxpayers is an important element of well-functioning audit programmes. The SRC uses a risk-based audit system, but the process is not automated. In addition, while there should be 49 staff under the audit unit, only half of the positions (26) are currently filled. Adequate staffing is essential to reinforce the tax administration's verification capacity and ultimately enhance tax compliance.

Box 2.4. Tax policy recommendations

Regular business tax

Base broadening measures

- Better target enhanced tax depreciation allowances by restricting their use to investments in specified productive assets and energy-efficient capital.
- For other assets, maintain accelerated depreciation but only up to 100% of the cost of the investment.
- Closely monitor the use of tax incentives to prevent potential abuse or fraud.

Revision of the business tax rate schedule

- Reform and align the different business tax rate schedules by introducing a new progressive business tax rate schedule that applies uniformly to corporations across all sectors, with the exception of corporations in "high-end" sectors, which could remain taxed under existing rates at least in the short-run.

International Trade Zones

- Remove the business tax exemption under the ITZ regime.
- Strengthen the monitoring and evaluation of the ITZ regime.

International corporate tax base protection measures

- Introduce transfer pricing rules in line with the OECD Transfer Pricing Guidelines to protect the tax base.
- Consider introducing interest limitations rules and controlled foreign company (CFC) rules.
- Revise some of the double tax treaties to prevent double non-taxation.

Sole traders and partnerships

- Tax sole traders and partnerships under the proposed progressive business tax rate schedule in the short run.
- Tax sole traders and partnerships under the personal income tax in the medium run, when the personal income tax is modernised with an end-of-year declaration.

Presumptive tax

- Maintain the current presumptive tax threshold at SCR 1 million.
- Consider having higher presumptive tax rates for services or professionals.
- Extend the cash accounting threshold to SCR 2 million.

TMT and CSRT

- Make the TMT and the CSRT creditable against regular business tax.
- Consider eliminating the CSRT and the TMT in the medium term.

Tax administration

- Set up a multi-stakeholder group with representatives of different public bodies and the private sector with a view to adopting a strategy to address informality.

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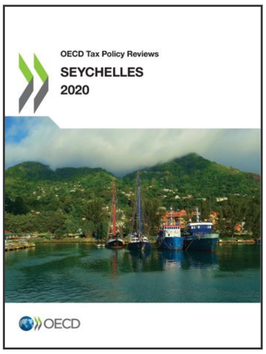
Notes

[1] All the scenarios involving a change in the business tax rate schedule assume that the 0% bracket for tourism, agriculture and fisheries would be eliminated. This would lead to a slight increase in the percentage of firms reporting a positive tax liability (from 41% to 44%).

[2] When revising tax incentives in general, it should be born in mind that tax incentives should not be linked to export performance (e.g. applied to the share of earnings from exports) in order to be compliant with the World Trade Organisation.

[3] Excludes Corporate Service Providers, Companies with Special Licenses, exempt companies and non-resident aircraft and ship owners.



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