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OECD Tax Policy Reviews: Seychelles 2020

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Foreword

This report is part of the *OECD Tax Policy Reviews* series. *OECD Tax Policy Reviews* are intended to provide independent, comprehensive and comparative assessments of OECD member and non-member countries' tax systems as well as concrete recommendations for tax reform. By benchmarking countries' tax systems and identifying tailored tax policy reform options, the ultimate objective of the Reviews is to enhance the design of existing tax policies and to support the adoption and implementation of tax reforms.

This report was led by Sarah Perret and written jointly by Gioia de Melo and Sarah Perret, under the supervision of Bert Brys. The analysis in this report is based upon the tax system as it was in place on 1 December 2019. It largely relies on business taxpayer microdata, provided on a confidential basis by the Seychelles authorities. Access to the microdata allowed simulating the effects of different business tax reform scenarios. The analysis is also based on OECD statistics, tax modelling tools and information collected during two fact-finding and stakeholder consultation missions that took place in July and October 2019.

The authors of the report would really like to thank Damien Thesee (Principal Secretary, Finance Department) and Seylina Verghese (Director General, Tax and Financial Sector Policy Division) from the Ministry of Finance, Trade, Investment and Economic Planning of the Republic of Seychelles, as well as Fred Morel (Deputy Commissioner General), Luisa Woodcock (Director, Taxpayer Services) and Roseline Lepathy (Director, Compliance Programme and Policy) from the Seychelles Revenue Commission. The authors would also like to acknowledge the contributions of other colleagues and stakeholders in Seychelles, who actively participated in discussions during the missions and provided additional information in the drafting stage of the Review.

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Executive summary

Despite relatively robust growth in recent years, Seychelles faces a number of economic, social and environmental challenges including climate change, economic diversification, population ageing, inequality and enhancing the quality of public services. Many of these challenges will put additional pressure on public finances. In addition, Seychelles is planning major public investments to enhance infrastructure and strengthen resilience to climate change. As a result, the government of Seychelles will likely have to raise additional revenues in the medium to long run. Strengthening the tax system will be particularly important as the scope to use other sources of financing, including public debt and development aid, is relatively limited. Indeed, public debt levels, while drastically lower than a decade ago, remain relatively high, and grants from development banks and donor countries are expected to decline as a result of Seychelles' newly acquired "high-income" status.¹

Overall, Seychelles' total tax take is high compared to other African countries and comparable small island states. At 31.5% of GDP, Seychelles' tax-to-GDP ratio is the highest across all the African countries covered by the *OECD Global Revenue Statistics Database*. Seychelles also collects high tax revenues as a share of its GDP in comparison to other small and highly tourism-dependent island economies. This means that potential changes to the tax system need to be carefully assessed, to ensure that these do not hurt growth or fairness.

Seychelles' tax revenues predominantly come from indirect taxes and the business tax. VAT is the largest source of tax revenues, accounting for a third of total tax revenues in 2017. Other indirect taxes play a major role too, accounting for 30% of the tax revenues raised by Seychelles. The third largest source of tax revenues is the business tax, making up 21% of Seychelles' total tax take. Personal income tax accounts for about 14% of total revenues, but revenues from social security contributions are low. Property and environmentally related taxes, on the other hand, represent only a very small share of total taxes raised. This suggests that these taxes could play a more significant role in Seychelles' tax system.

The business tax burden is highly concentrated on a small number of taxpayers. Indeed, 30 companies accounted for almost 80% of the business tax take in 2017, while companies in the bottom 70% accounted for only 1.3% of business tax 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. On the other hand, some businesses contribute only marginally to the collection of business tax revenues in comparison to the role they play in the economy. For instance, the tourism sector accounted for only 8% of business tax revenues in 2017, while it accounted for 33% of total value added in the country and for 47% of total VAT collected.

This imbalance in the business tax burden results in large part from a combination of differentiated tax rates across sectors and generous tax base provisions targeted at specific sectors. Businesses are subject to different statutory tax rates depending on their sector of operation and size. Businesses under the regular regime as well as in "high-end" sectors (telecommunications service providers, banks, insurance companies, and alcohol and tobacco manufacturers) are taxed at progressive rates that are high in comparison to other countries. On the other hand, preferential tax rates are granted to businesses in tourism, fisheries and agriculture, as well as to private medical and educational service providers and

companies listed on the Seychelles Securities Exchange. Companies in International Trade Zones (ITZs) are fully exempt from business tax. Seychelles also provides generous tax deductions, including accelerated and enhanced tax depreciation allowances to businesses operating in tourism, fisheries and agriculture. Companies have used these generous deductions to significantly reduce their taxable income, often to negative values. The amount of deductions claimed under enhanced and accelerated depreciation allowances is particularly striking: the report finds that the tax depreciation allowances used by corporations in the tourism sector amounted to an average of 132% of turnover in 2017.

The imbalance in the business tax burden also results from tax evasion, particularly among smaller businesses, and tax avoidance by companies that are part of multinational groups. Informality remains an issue in Seychelles, with evidence that some businesses are not adequately reporting their activities and income. More importantly from a revenue-raising perspective, larger companies that are part of multinational groups can easily reduce their effective tax burdens through international tax planning as Seychelles' current international tax rules do not effectively protect its corporate tax base.

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 could be broadened. First, efforts could be made to revise and better target tax incentives, including the business tax exemption under the ITZ regime and the generous tax depreciation allowances granted to businesses in specific sectors. Second, measures should be put in place to prevent the erosion of the corporate tax base through international profit shifting. These measures would contribute to raising additional business tax revenues and to enhancing the fairness of the business tax. The tax base could also be broadened by strengthening the tax administration's verification and enforcement capacity, which would create greater incentives for businesses to operate in the formal economy. A broader business tax base could then contribute to financing an alignment and an overall decrease in business tax rates.

Using business taxpayer microdata, the report simulates the impact of different business tax reform scenarios aimed at reducing differences in tax rates across sectors. Such reforms would involve lowering statutory tax rates, and in doing so, lower the tax burden on many operators that currently face high tax rates, and increasing overall levels of taxation on businesses in sectors that currently contribute little to the collection of revenues. Each business tax reform scenario is assessed in light of its impact on tax revenues and businesses' effective tax rates. The exercise concludes that a unified progressive tax rate schedule applying to all sectors (including those that are currently taxed at preferential rates, but excluding the "high-end" sectors, which would remain taxed under the existing regime) could ensure a fairer distribution of the business tax burden across businesses. The analysis suggests that a unified business tax rate schedule across sectors that would tax profits below SCR 1 million at 15% and profits above that level at 25% could contribute to levelling the playing field across sectors and to lowering tax rates for smaller businesses, without losing much revenue.

The report also examines and provides recommendations on the other taxes that bear on businesses. Regarding the simplified presumptive tax regime, which levies a 1.5% tax on the turnover of small businesses and currently covers 68% of companies, the report recommends maintaining the eligibility threshold at SCR 1 million, but suggests that higher presumptive tax rates for services or professionals may be worth considering. Enhancing the monitoring of the presumptive tax is also advised. Regarding the corporate social responsibility tax (CSRT) and the tourism marketing tax (TMT), the report recommends making them creditable against the business tax in the short run and, in the medium run, if the business tax base is broadened, eliminating them as these taxes on turnover have distortive effects. Administrative improvements are also recommended, with a focus on encouraging electronic tax filing and reinforcing the tax administration's verification and enforcement capacity, in particular through a greater use of third-party information and an automated risk-based audit system.

The report finally emphasises the need to look at the overall tax system and to improve the design of non-business taxes. While Seychelles has a relatively well-designed VAT system, improvements could

include removing VAT exemptions for fuels (with possible compensation targeted at low-income households), lowering the VAT registration threshold if the capacity of the tax administration is strengthened, broadening the VAT base by ensuring the taxation of foreign business-to-consumer (B2C) supplies of services and intangibles, and involving digital platforms in the collection of VAT. To address environmental challenges and raise revenues, the report also recommends the introduction of a broad-based low-rate carbon tax. The report also briefly assesses the personal income tax system and provides a number of reform recommendations, most notably aimed at broadening the tax base and, in the medium to long run, at modernising the system through the introduction of an end-of-year tax declaration. The report also suggests that personal capital income, in particular dividends at the shareholder level, could start being taxed in the medium run, particularly if the business tax rates are lowered as recommended in this report.

Notes

¹ Seychelles graduated to high-income status according to World Bank standards in 2015.

1

Overview of key economic and tax challenges

This chapter provides an overview of Seychelles' main economic and tax challenges. It starts by looking at Seychelles' macroeconomic performance in recent years and identifies the most significant economic and social challenges that Seychelles will need to address in the near to medium future. The chapter then examines Seychelles' tax revenues, looking at their overall level and their composition over time. This first chapter is intended to provide useful background to the tax policy assessment and recommendations presented in the following chapters.

Macroeconomic performance

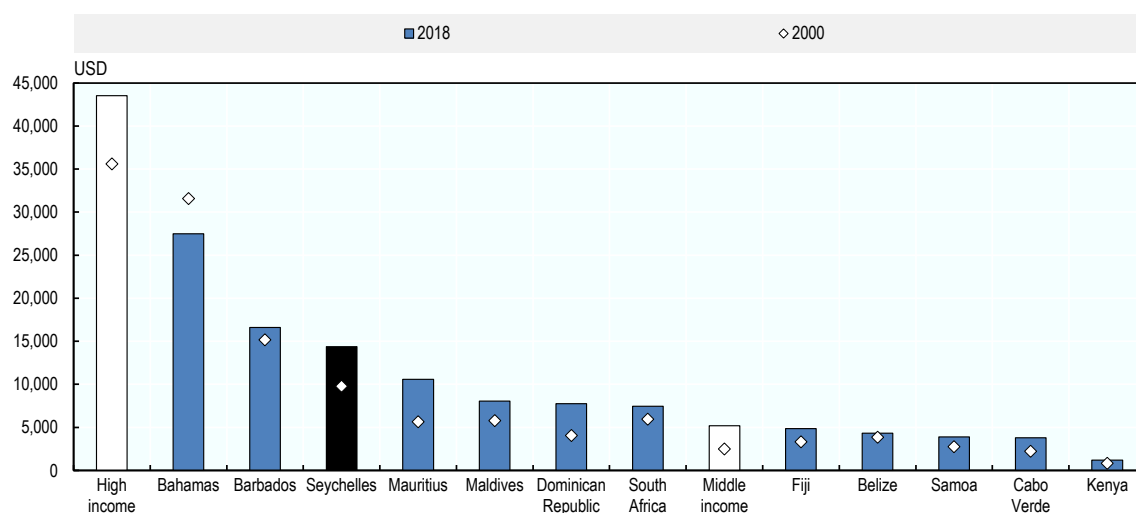
Seychelles is one of the smallest countries in the world, both in terms of population and land size.

Seychelles' total population was 95 843 in 2017. While the country is made up of 115 islands, the vast majority of the population lives on the island of Mahé (around 86% of the population), and the islands of Praslin and La Digue, which together account for 11% of the population (World Bank, 2017^[1]). The land surface of Seychelles is very small in absolute terms (about 500 km²) and the ratio of arable land per person is among the lowest in the world. On the other hand, Seychelles controls a very large body of water, with an exclusive economic zone (EEZ) of approximately 1.4 million km² (World Bank, 2017^[1]).

Seychelles has a comparatively high level of GDP per capita. At USD 14 385 (in constant 2010 USD) in 2018, Seychelles' GDP per capita was above GDP per capita levels in most of the comparator countries¹ shown in Figure 1.1. In 2016, Seychelles also had the highest GDP per capita in Africa². As a result of its good performance, Seychelles reached "high-income" status according to World Bank standards³ in 2015, becoming the second African country to be included in that category. Nevertheless, Seychelles' GDP per capita remains low in comparison to more advanced economies and GDP per capita alone is an insufficient indicator of a country's economic health, particularly for an island state with a small population and a high vulnerability to external shocks (see below).

Figure 1.1. Seychelles has a comparatively high GDP per capita

GDP per capita, constant 2010 USD

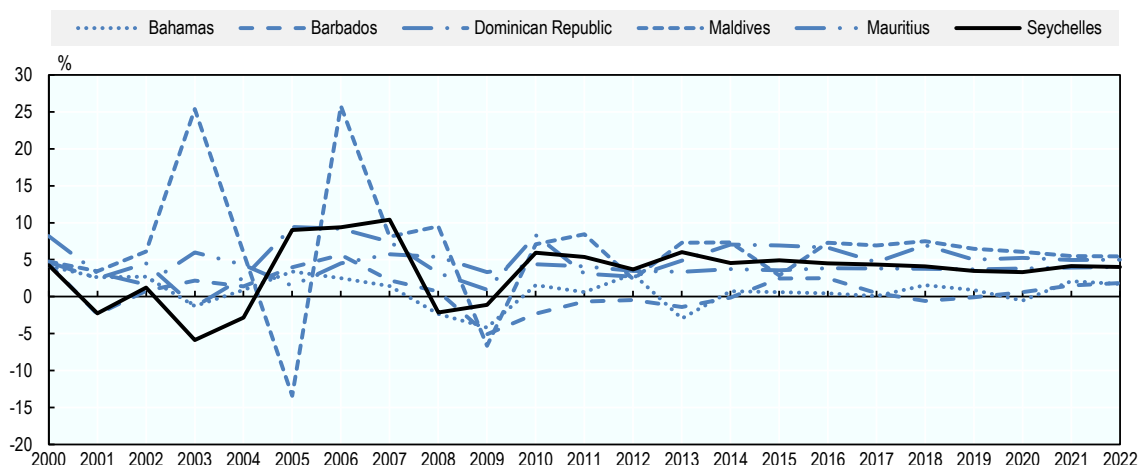


Source: World Bank Development Indicators.

In recent years, growth has been relatively robust and stable. Real GDP growth was estimated at 4.1% in 2018, against 4.3% in 2017 (IMF, 2019^[2]). Growth in recent years has been driven primarily by the service sector – reflecting in particular greater earnings from tourism – and by increased output from the fishing industry (IMF, 2019^[2]). Prudent fiscal and monetary policies have also helped contain inflation and consolidate macroeconomic stability (African Development Bank, 2019^[3]). In comparison to other small island states, GDP growth in Seychelles has been close to the average in recent years and is expected to remain so over the next few years (Figure 1.2).

Figure 1.2. GDP growth in Seychelles has been relatively stable in recent years and close to the average in small island states

GDP growth (year-on-year percentage change)



Note: Projections after 2018.

Source: IMF World Economic Outlook Database.

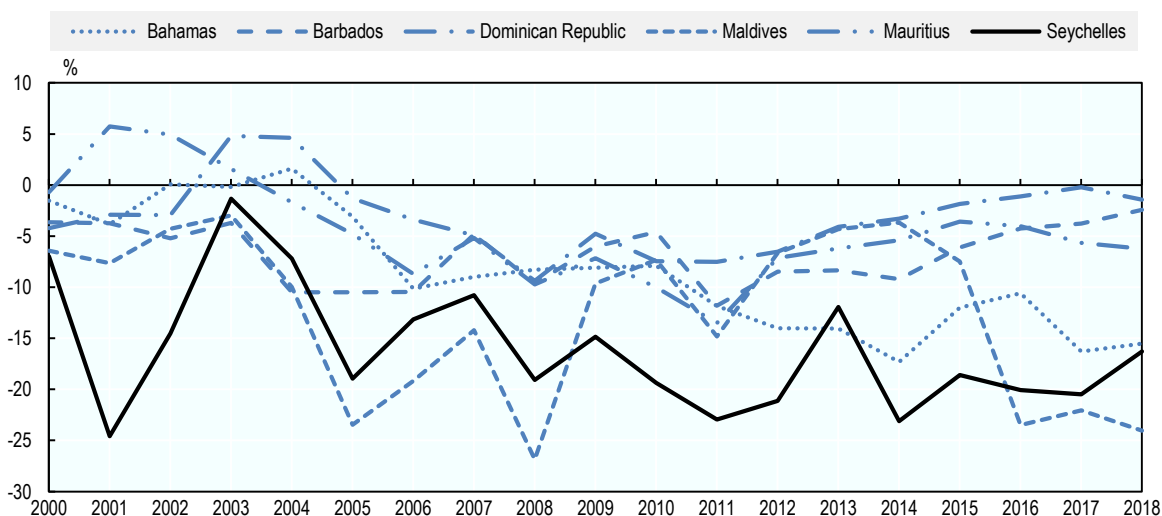
Seychelles' good economic performance in recent years has followed a period of significant instability, which culminated in the 2008 economic crisis and debt default. Seychelles defaulted on its sovereign debt in 2008, against the backdrop of severe macroeconomic imbalances, including large public budget deficits and a rapid escalation of the debt-to-GDP ratio to unsustainable levels, severe balance-of-payments constraints, and depleted international reserves. In response to the crisis, Seychelles turned to the IMF for emergency support and major reforms were initiated starting in late 2008. The economy started recovering in 2010–11 (Figure 1.2).

Regarding its external sector, Seychelles has recorded large current account deficits (Figure 1.3). Structurally, Seychelles is a net importing country. Its tourism industry requires significant levels of imports, while its domestic production and export capacity are constrained by land scarcity and high input costs. Seychelles' current account deficit is therefore high, at 17.6% of GDP in 2018 (African Development Bank, 2019^[3]). Seychelles' main trading partners, including both EU and Middle Eastern countries (primarily the United Arab Emirates), account for more than 60% of its total imports and exports (African Development Bank, 2019^[3]).

Seychelles' current account deficits have largely been financed by foreign direct investment (FDI). FDI flows as a share of GDP have been high in comparison to peer countries (Figure 1.4, Panel A). New hotel developments have largely driven annual FDI inflows in recent years (World Bank, 2017^[1]). Mauritius is by far the main source of FDI, representing more than 40% of inward foreign investment projects in 2018, followed by China and the United Arab Emirates (Figure 1.4, Panel B). The very high share of FDI inflows from Mauritius may suggest that a number of investments are routed through Mauritius to benefit from preferential double tax agreements (DTAs, see section 2.4). Seychelles also exhibits comparatively high levels of fixed capital investment (e.g. land improvements, plant, machinery, buildings) as a share of GDP compared to similar economies (Figure 1.5).

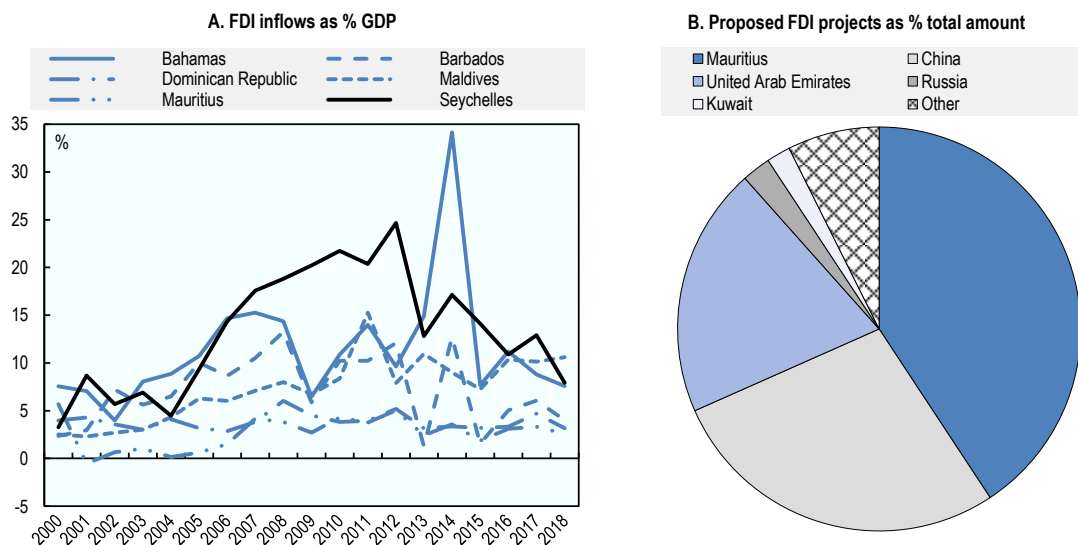
Figure 1.3. Seychelles records a large but narrowing current account deficit

Current account balances as a share of GDP in selected countries



Source: IMF World Economic Outlook Database.

Figure 1.4. Seychelles has received high levels of foreign investment, in particular from Mauritius

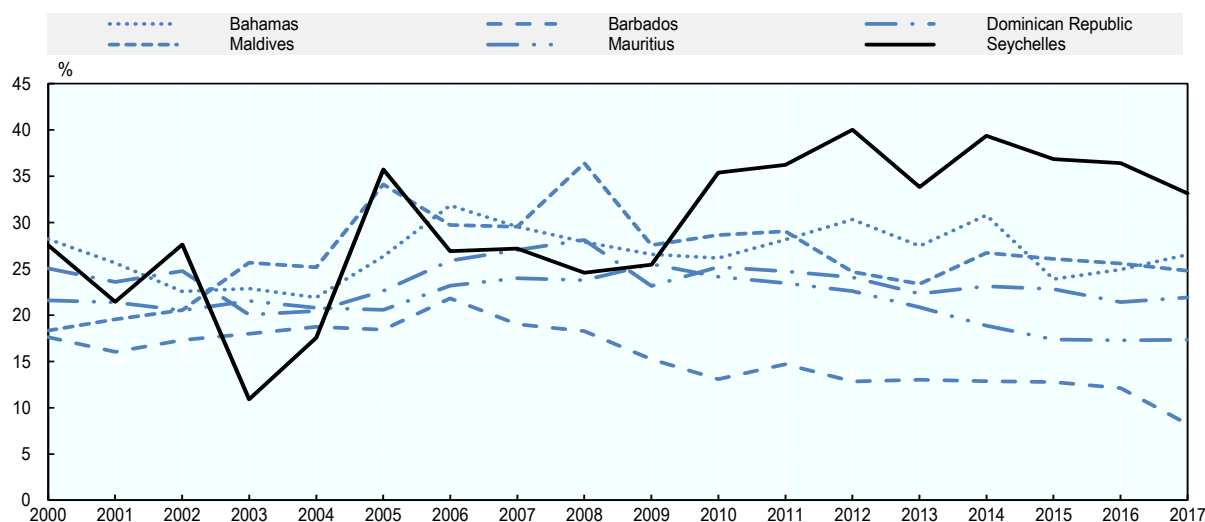


Note: The bulk of foreign investment to Mauritius is in the form of investment flows through special purpose entities or “global business companies” (GBCs) routed to third countries through Mauritius. As such, these flows are not recorded as FDI.

Source: UNCTAD and Seychelles Investment Bureau.

Figure 1.5. The level of fixed investment in Seychelles has been comparatively high

Gross fixed capital formation as a share of GDP



Source: UNCTAD.

Economic projections for the coming years are positive, but growth is expected to slow and Seychelles faces potential downward risks. Economic growth is projected to be around 3.3% in 2019 and 2020, with services remaining the main engine of growth. On the demand side, growth is expected to continue being underpinned by robust investment, projected to reach 34.6% of GDP in 2019 and 36.1% in 2020 (African Development Bank, 2019^[3]). However, Seychelles is facing a number of downwards risks. Domestically, the recent expansionary fiscal measures could contribute to inflationary pressures (African Development Bank, 2019^[3]). A slowdown in the construction sector, resulting from the moratorium on large hotels (projected to remain in place until the end of 2020), may also negatively affect FDI and growth. External downward risks include Seychelles' vulnerability to economic uncertainties in the Eurozone, its main source of tourism, as well as the rising trend in international fuel prices (African Development Bank, 2019^[3]). As an island state, Seychelles is also exposed to climate-related risks. All these potential risks come on top of more structural factors of vulnerability, including Seychelles' small size, relative isolation and limited natural resources.

Challenges ahead

Seychelles will need to innovate and diversify its economy

Tourism and fisheries are by far the two main sectors of the economy. Tourism, including accommodation and food services as well as other services, accounts directly for about a quarter of total GDP and employment (Figure 1.6, Panels A and C) and indirectly for significantly more (World Bank, 2017^[1]). Seychelles has experienced strong growth in the tourism sector, with the doubling of the number of tourists since 2008 and tourist arrivals exceeding 300 000 for the first time in 2016 (World Bank, 2017^[1]). Fisheries are the second major pillar of the Seychelles economy, with canned tuna accounting for 92% of total exports (Figure 1.6, Panel B). However, there is limited value added domestically as canned tuna is a low-value product processed in a Free Trade Zone. There are also limited links between international operators and artisanal fishing operators usually involved in short value-chains (World Bank, 2017^[1]).

While tourism and fisheries have experienced sustained growth in recent years, innovation has been limited. Growth has been primarily factor-driven, in particular thanks to high levels of investment

(see above) and an influx of foreign labour. Productivity improvements, on the other hand, have been limited. Such factor-driven growth will be difficult to sustain at similar rates in the future, calling for a shift towards more productivity-led growth (World Bank, 2017^[1]). A transition towards growth driven by productivity gains will require policies to promote innovation, skills development and greater links between foreign and local operators, which could ultimately lead to the generation of greater value-added in tourism and fisheries.

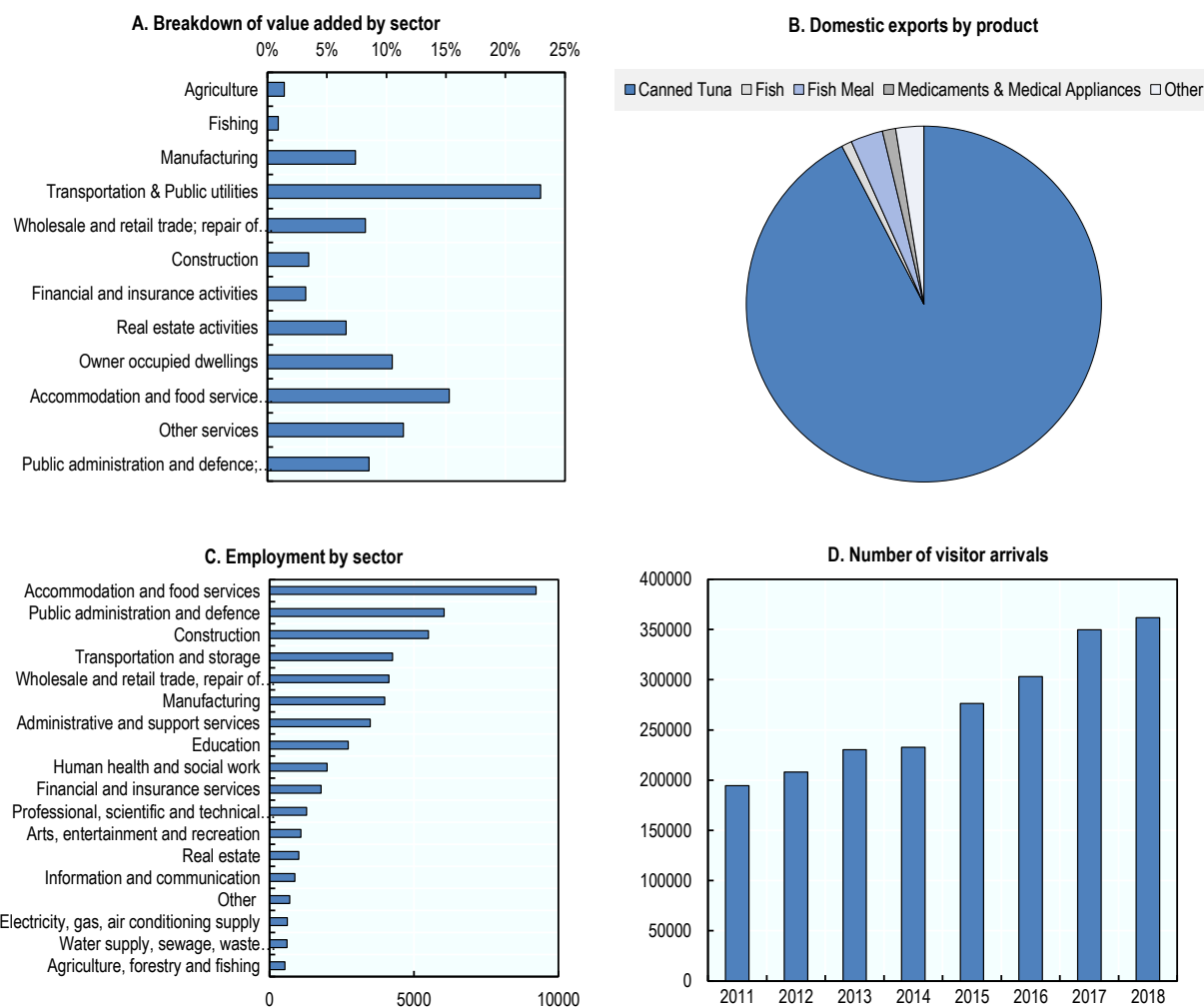
Excessive dependence on tourism and fisheries also exposes the country to economic and environmental risks. As mentioned above, Seychelles is vulnerable to economic uncertainties in Europe, which constitutes the main source market for its tourism sector. Tourism and fisheries also have detrimental environmental consequences, which may not entail risks in the short-term but may make Seychelles more vulnerable in the long run. There are sustainability concerns in the fisheries sector, with some evidence in particular of overfishing and declining catch rates for some species of fish (World Bank, 2017^[1]). In the tourism sector, a moratorium on new large hotels has been introduced until 2020, reflecting concerns about the environmental footprint of the sector (World Bank, 2017^[1]).

Economic diversification would contribute to reducing vulnerability and supporting growth. Other sectors may have potential in Seychelles, including the sustainable management and use of the “blue economy” given the marine ecosystem and brand name of Seychelles (World Bank, 2017^[1]). The government has embarked on an ambitious “blue economy” agenda, which is in line with UN Sustainable Development Goals. Other sectors, in particular those with limited needs for a large physical presence, due to the scarcity of land, may also have potential. Previous assessments have highlighted that there is significant scope for further developing the ICT sector, for instance (World Bank, 2017^[1]).

Despite significant efforts, public debt levels remain relatively high

Seychelles has seen a drastic reduction in its public debt in the last decade. As mentioned previously, the sovereign default of 2008 occurred in a context of severe macroeconomic imbalances, exacerbated in 2007-08 by the rise in global fuel and food prices, which led to an increase in imports costs and inflation. The authorities missed their payments on commercial foreign debt and the sovereign credit rating of the country was downgraded to selected default by Standard and Poor's (World Bank, 2017^[1]). The government sought a significant restructuring of its debt and embarked on an IMF-supported economic and financial programme. Since then, the country has followed contractionary fiscal policies and recorded primary budget surpluses (Figure 1.8). Overall, the country's gross public debt-to-GDP ratio has been reduced drastically from 190% in 2008 to an estimated 60% for 2018 (Figure 1.7). The increase in domestic resource mobilisation and improvements in public budgets were achieved in large part through new taxes.

Figure 1.6. Seychelles relies heavily on tourism and fisheries



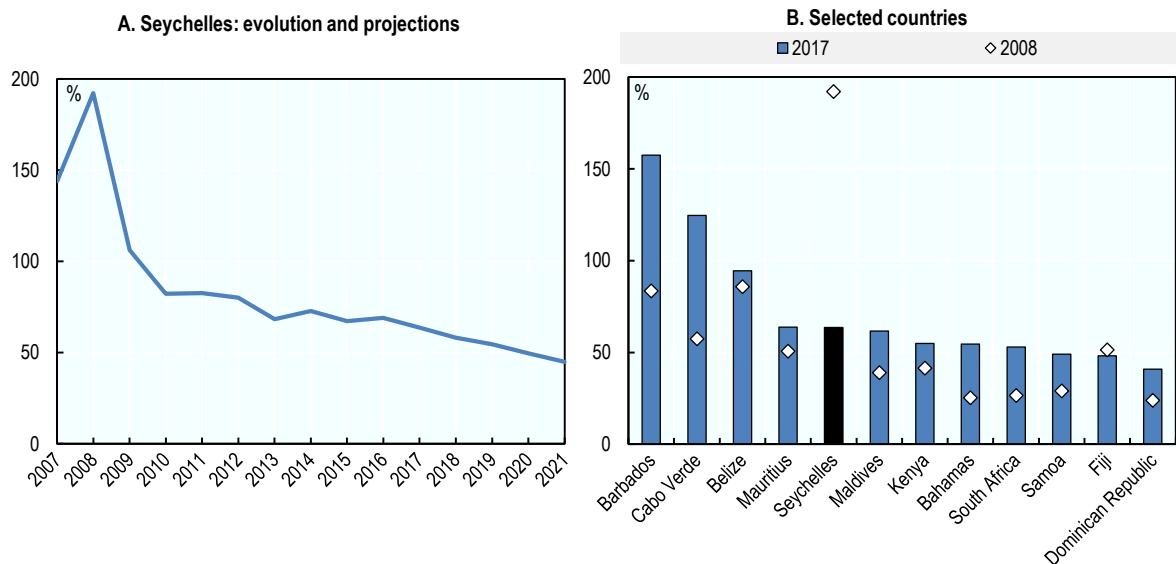
Note: 2017 data in Panel A, 2015 data in Panel B, 2018 data in Panel C, and 2019 data in Panel D.

Source: Seychelles Central Bank and National Bureau of Statistics.

Seychelles' current public debt levels remain high, however, and the government is pursuing efforts to reduce its debt-to-GDP ratio. While comparable countries often present similar or higher levels of public debt-to-GDP ratios, Seychelles' current debt burden remains high: the country spent about 8% of its expenditure outlays (or about 10% of its tax revenue) on interest payments in 2018 (IMF, 2019^[2]). The government's objective is to bring the debt-to-GDP ratio below 50% by 2021.

Figure 1.7. Seychelles' public debt-to-GDP ratio has been significantly reduced and is now much closer to levels in peer countries

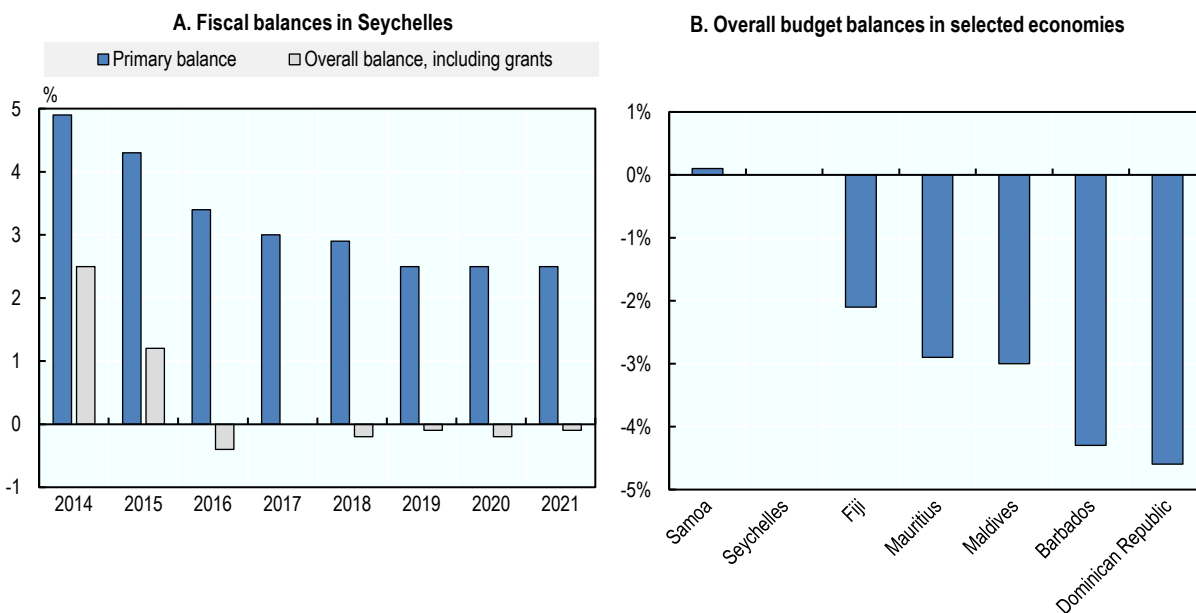
Gross general government debt as a share of GDP



Note: IMF projections from 2018.
Source: IMF World Economic Outlook Database.

Figure 1.8. Seychelles has maintained fiscal discipline in recent years

Fiscal balances as a share of GDP



Note: Primary balances refer to government net borrowing or net lending, excluding interest payments on consolidated government liabilities.
Source: IMF World Economic Outlook Database and Article IV reviews.

Seychelles is vulnerable to climate change and other environmental risks

Seychelles is vulnerable to climate change, particularly to the effects of rising temperatures and sea levels. Rising sea levels are already affecting Seychelles. Indeed, sea levels are estimated to rise by 2.3 mm every year, which leads to coastal erosion and flooding, impacting roads and tourism-related infrastructure. Rising sea levels are also expected to increase salination and reduce fresh water supply (IMF, 2017^[4]). The increases in temperature have also led to coral bleaching and more extreme rainfall has caused significant crop losses in the last decade (IMF, 2017^[4]).

While Seychelles has made clear efforts towards enhancing its resilience to climate risks, further measures and investments will be needed, which will in turn put pressure on public finances. Seychelles has made more progress towards climate change preparedness than most other small island states (IMF, 2017^[4]). In particular, its Nationally Determined Contribution (NDC) submission under the Paris Agreement involved a “balanced mitigation and adaptation strategy, accompanied by costed investment plans” (IMF, 2017^[4]). Nevertheless, the financing required for the planned investments is substantial and there is no clear timeline for the implementation of these projects.

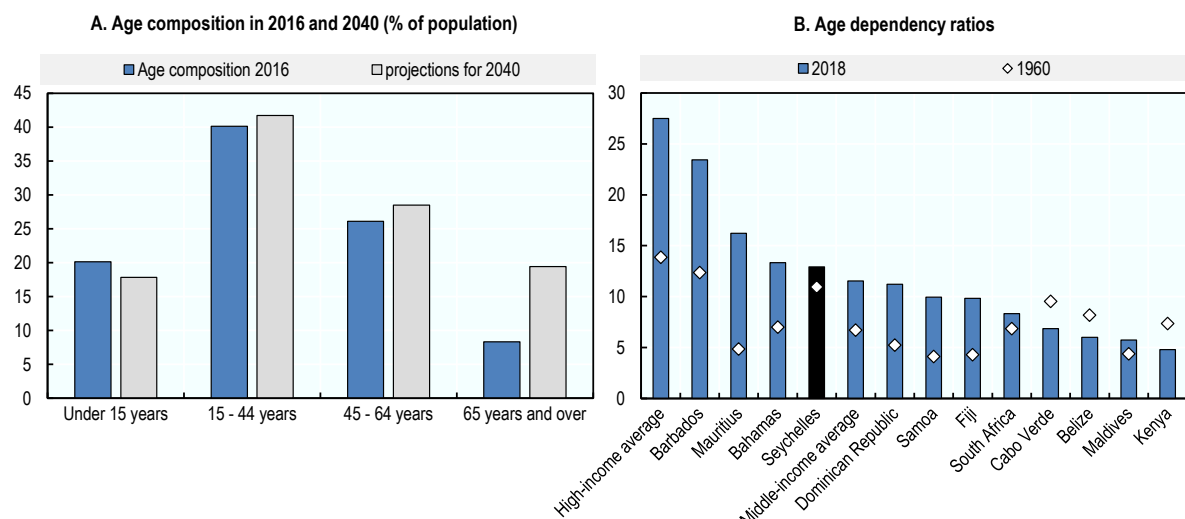
As mentioned as well, Seychelles faces other environmental challenges, in part linked to the environmental footprint of its main sectors. In the fishing sector, there are signs of overexploitation of certain species (see above). There have also been concerns about the impact of rapid developments in the tourism sector (see above).

Seychelles will have to adapt its policies to population ageing

Seychelles’ demographic transition is relatively advanced. This results from the combination of a decline in the fertility rate, which started in the 1960s and stood at 2.2 in 2016, and an increase in life expectancy to 74.3 years. The number of people aged 65 and older has increased from just over 2 000 in 1960 to over 10 000 in 2010 (Ministry of Health and Social Affairs, 2016^[5]). The ageing of Seychelles’ population is projected to accelerate further over the next few decades, with a continuing decrease in the fertility rate and an increase in life expectancy. In particular, the share of the population aged 65 and older is expected to increase from 8.8% in 2016 to 18.4% in 2050 (Figure 1.9, Panel A) and the share of the elderly above 80 years old is expected to rise from 1.8% to 6% by 2050. In international comparison, Seychelles age-dependency ratio, which shows the ratio of older dependents (people older than 64) to the working-age population, is relatively high compared to comparable countries, but far below the average ratio for high-income countries (Figure 1.9, Panel B).

Population ageing will create direct pressure on public finances. On the one hand, population ageing will generate an increase in public expenditure on pensions, health and long-term care. On the other hand, it is likely to have a negative impact on tax revenues, particularly from taxes that bear on labour income (personal income tax and social contributions to the Seychelles Pension Fund). The government will have to assess and reinforce the sustainability of its tax and welfare system to the pressures caused by population ageing. Discussions about raising the retirement age from 63 to 65 are already ongoing (and the possibility for early retirement at 60 has already been eliminated), but additional measures are likely to be necessary.

Figure 1.9. Seychelles' demographic transition is relatively advanced



Note: In Panel B, data are shown as the proportion of dependents per 100 working-age population.

Source: Seychelles National Bureau of Statistics (Panel A) and World Development Indicators (Panel B).

Addressing the informal economy remains a significant challenge

The informal sector still represents a big share of the economy. Following a narrow definition of informal employment, the informal sector in the Seychelles is estimated to employ about 16% of the total labour force (Bhorat, Ewinyu and Yu, 2017^[6]). However, anecdotal evidence points to more prevalent informal employment. As described in Box 1.1, addressing informality should be a priority as a large informal sector can have significant negative economic, fiscal and social consequences.

Informality is particularly high in agriculture and fisheries, as well as in manufacturing and construction. Workers in the informal sector are disproportionately classified as unskilled or semi-skilled. While the formal workforce exhibits a relatively even gender balance, the informal sector is largely skewed towards men, with women accounting for less than 30% of informal workers. The average informal sector worker is slightly older than the average formal sector worker (41 years old, compared to 37). By sector, informal workers are predominantly employed in the primary and secondary sectors (namely agriculture and fisheries, as well as manufacturing and construction) (Bhorat, Ewinyu and Yu, 2017^[6]).

Poverty levels are relatively low but inequality is high

Poverty levels are low relative to other countries. Poverty, as defined for international comparison purposes, is low in Seychelles. The poverty headcount ratio at USD 5.50 a day is around 5%, far below poverty levels in Mauritius, Maldives and Dominican Republic (Figure 1.10, Panel A). The poverty rate using the poverty line of USD 3.10 per day is 2.5% (2011 Purchasing Power Parity, PPP). However, even though absolute poverty is low, relative poverty measured by the national poverty rate is significant (39.3% in 2013). This results from a much higher national poverty line, equivalent to about USD 13 per person per day (in 2011 PPP dollars). Other human development indicators point to Seychelles' relatively good performance. For instance, Seychelles ranked 63rd out of 188 countries on the Human Development Index, with a score of 0.782 in 2015 (World Bank, 2017^[11]).

Box 1.1. The consequences of informality

Informality can take different forms including informal self-employment, informal workers employed by firms, informal production by firms (i.e. “off-the-books” activities), or “envelope wages” (i.e. employers declaring the minimum wage as the taxable wage and providing the rest of their employees’ wages in cash). While the literature has long debated whether informality was the result of “exclusion”, meaning that informality is involuntary or a voluntary choice to “exit” the formal sector (Perry et al., 2007^[7]), both voluntary and involuntary forms of informality usually coexist. The varying forms of informality and its hidden nature make estimations of the phenomenon difficult.

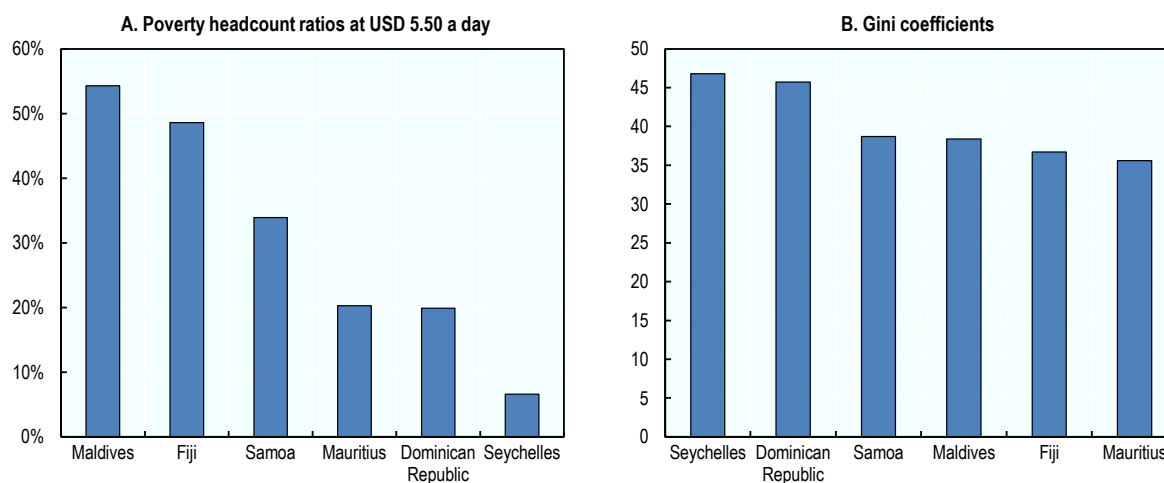
High levels of informality can have significant negative consequences for the economy. First, workers employed in the informal sector have limited access to social protection, inadequate contracts, comparatively lower wages, and are highly vulnerable when they lose their job or when they retire. High levels of informality may also reduce workers’ access to training, exacerbating skills shortages. This ultimately generates greater inequalities.

The informal sector also affects productivity and growth. Production in the informal sector often generates inefficiencies, either because firms limit their size below their optimal efficiency scale to avoid being detected or because they use outdated production technologies (Andrews, Caldera Sánchez and Johansson, 2011^[8]). The relative cost advantages enjoyed by informal firms may allow them to stay in business even if they are not productive (Andrews, Caldera Sánchez and Johansson, 2011^[8]). Firms operating in the informal sector also have a more limited access to finance which constrains investment and access to qualified labour.

A significant level of informal economic activity also has significant negative fiscal consequences. High levels of informality reduce the amount of tax revenue received by the government. Many informal workers may also be recipients of social benefits, adding to the fiscal burden on the state. This is not so clear-cut, however: it can be argued that taxing the informal sector has limited revenue potential because informal workers and businesses tend to generate limited income, but would entail high tax collection costs.

Finally, high levels of informality can result in an erosion of trust in public institutions and result in lower tax morale, which may lower revenues through other channels. Importantly, the larger the informal sector, the more incentives people have to remain or become informal (e.g. the larger the informal sector, the lower the fear of being sanctioned and the higher the impression that the informal sector is tolerated).

Figure 1.10. Seychelles' poverty levels are comparatively low, but income inequality is high



Note: For each country, the latest year with available data is used.

Source: World Bank.

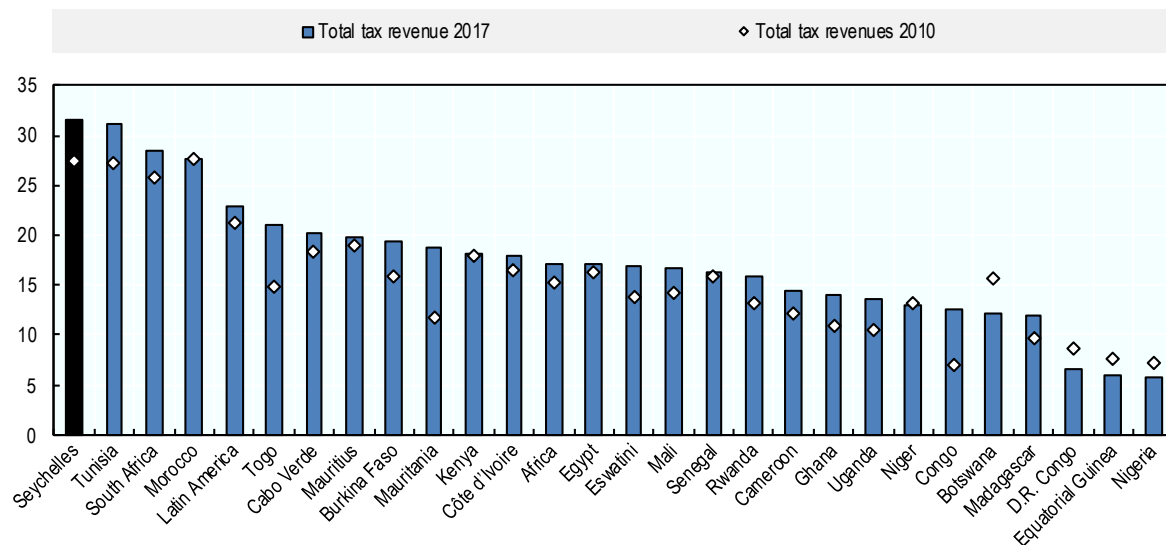
However, inequality remains a concern. Seychelles' Gini coefficient, which is a standard measure of income inequality that ranges from zero (when everybody has identical incomes) to 1 (when all the income goes to only one person), stood at 0.47 in 2012. While cross-country comparisons of inequality are difficult, Seychelles' Gini coefficient was higher than in most comparator countries, suggesting higher income inequality levels than in Mauritius or Maldives, for instance (Figure 1.10, Panel B).

Seychelles' tax-to-GDP ratio

Seychelles has a high tax-to-GDP ratio compared to similar countries. At 31.5% of GDP, Seychelles has the highest tax-to-GDP ratio among the African countries covered in the OECD Global Revenue Statistics Database (Figure 1.11). Seychelles also collects high tax revenues as a share of GDP in comparison to other small island economies that are highly dependent upon tourism. Figure 1.12 shows that Barbados is the only country among the selected small island states that collected more tax revenues as a share of GDP than Seychelles in 2017.

Figure 1.11. Seychelles has the highest tax-to-GDP ratio in Africa

Tax revenues as a share of GDP in 2010 and 2017

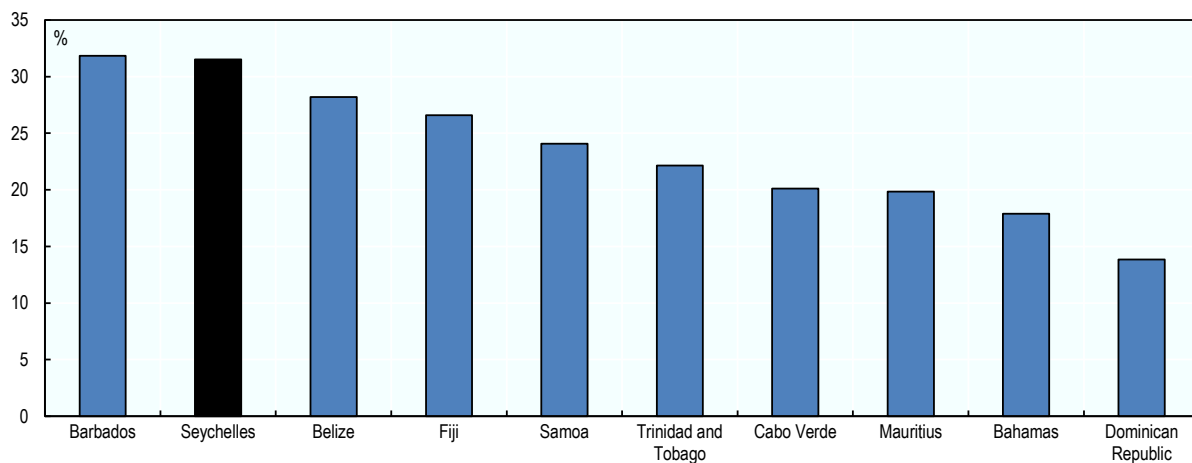


Note: The African countries that are not included in the figure are not covered by the OECD Global Revenue Statistics Database.

Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

Figure 1.12. Seychelles collects high tax revenues in comparison to other small island states

Tax revenues as a share of GDP in 2017 in selected small island states



Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

Tax revenues as a share of GDP have increased in the last decade. Tax revenues as a share of GDP have increased from 27.5% in 2010 to 31.5% in 2017. This reflects to a large extent the government's efforts to mobilise additional domestic resources, in particular through the adoption of significant tax reforms (Box 1.2) to consolidate public budgets. The increase in the collection of tax revenues in 2017 was above expectations, largely thanks to strong growth in business tax revenues (from 5.5% to 6.7% of GDP between 2016 and 2017). Key factors behind this significant growth in business tax revenues included higher profits in major companies (such as SEYPEC), as well as a lower level of refunds (Budget strategy and outlook 2018). Recent reforms are expected to further boost tax revenues and to offset an anticipated

decline in business tax receipts due to the payments of tax arrears in 2018. These reforms include the reduction in fuel tax exemptions for the fishing and tourism sectors, the introduction of a sugar tax on beverages and the planned introduction of a property tax on residential property owned by non-residents.

Box 1.2. Seychelles introduced major tax reforms in the last decade

2009:

- Introduction of progressive business tax rates and of a 15% withholding tax on interest and dividend income

2010:

- Introduction of a flat-rate personal income tax, replacing social security contributions
- Revision of import tax rates and introduction of an excise tax regime

2013:

- Introduction of a value-added tax (VAT), replacing the Goods and Services Tax (a sales tax)
- Introduction of a presumptive tax on turnover
- Introduction of the Tourism Marketing Tax and the Corporate Social Responsibility Tax

2017:

- Introduction of progressivity in the personal income tax (implemented in 2018)

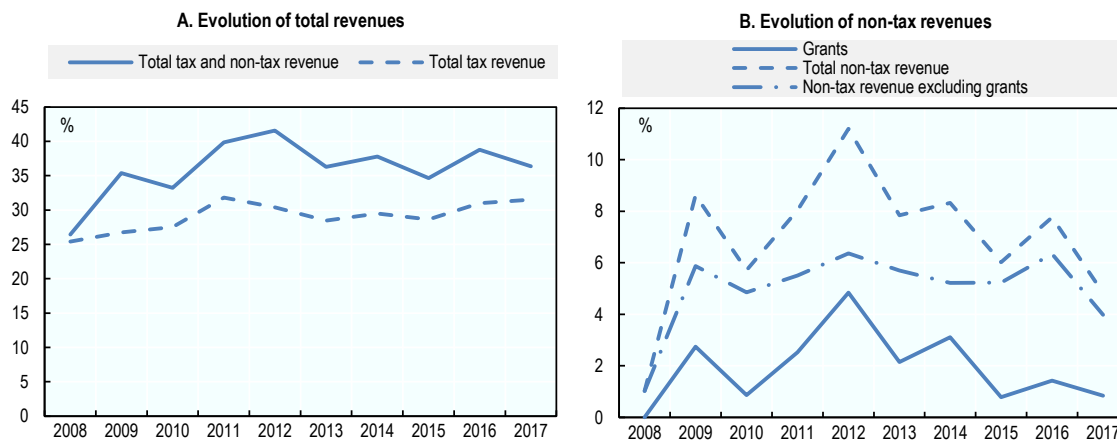
2018:

- Revision of preferential tax regimes, to align them with the minimum standard on countering harmful practices (Action 5) of the OECD/G20 Base Erosion and Profiting Shifting project.

In the future, the tax-to-GDP ratio may need to increase further. As mentioned above, the government of Seychelles has committed to further reducing its public debt to 50% of GDP by 2021. In addition, the government has announced major public investment plans to enhance infrastructure and strengthen resilience to climate change. According to the IMF (2019), financing these projects will require a 2.5% of GDP primary budget surplus, public-private partnerships, and access to external grants. However, access to grants from development banks and donor countries might be more difficult than in the past, especially given Seychelles' recent graduation to "high-income" country status. Indeed, Figure 1.13 Panel B shows a sharp decrease in grants since 2012. This may suggest that a greater share of funding for these projects may have to come from taxation.

Figure 1.13. Seychelles' total revenues have increased in the last decade, but revenues from grants have declined sharply since 2012

Evolution of total tax revenues as a share of GDP (Panel A) and evolution of non-tax revenues (Panel B)



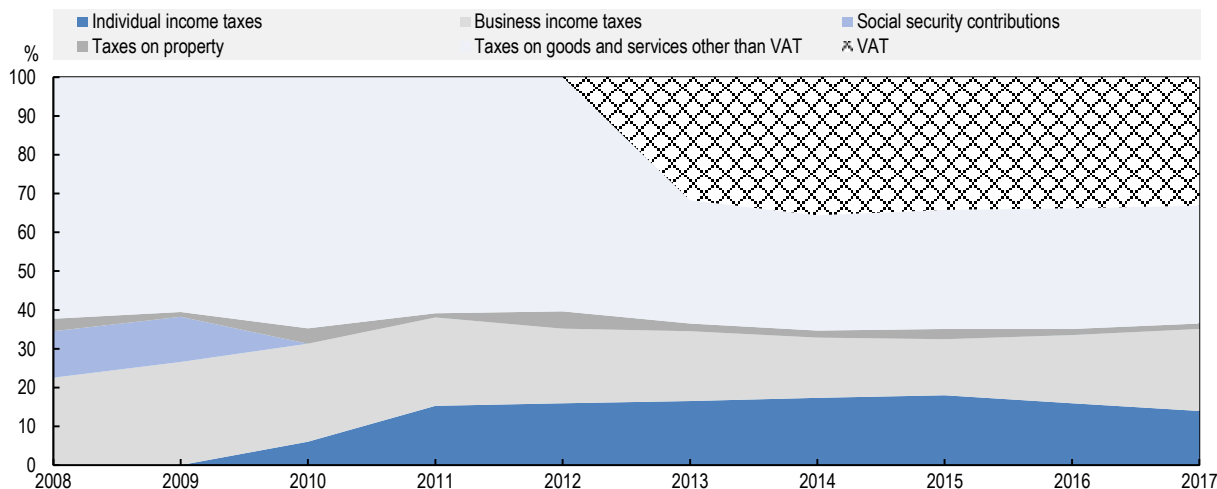
Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

The composition of Seychelles' tax revenues

Seychelles' tax revenues predominantly come from indirect taxes and the business tax. VAT is the largest source of tax revenues, accounting for a third of total tax revenues in 2017. Other indirect taxes play a major role too, accounting for 30% of the tax revenues raised by Seychelles. The third largest source of tax revenues is the business tax, making up 21% of Seychelles' total tax take. Personal income tax accounts for about 14% of total revenues. Property taxes, on the other hand, represent only a very small share (just over 1%) of total taxes raised.

Figure 1.14. The evolution of the composition of tax revenues reflects major reforms in Seychelles' tax system

Tax revenues from each type of tax expressed as share of total tax revenues



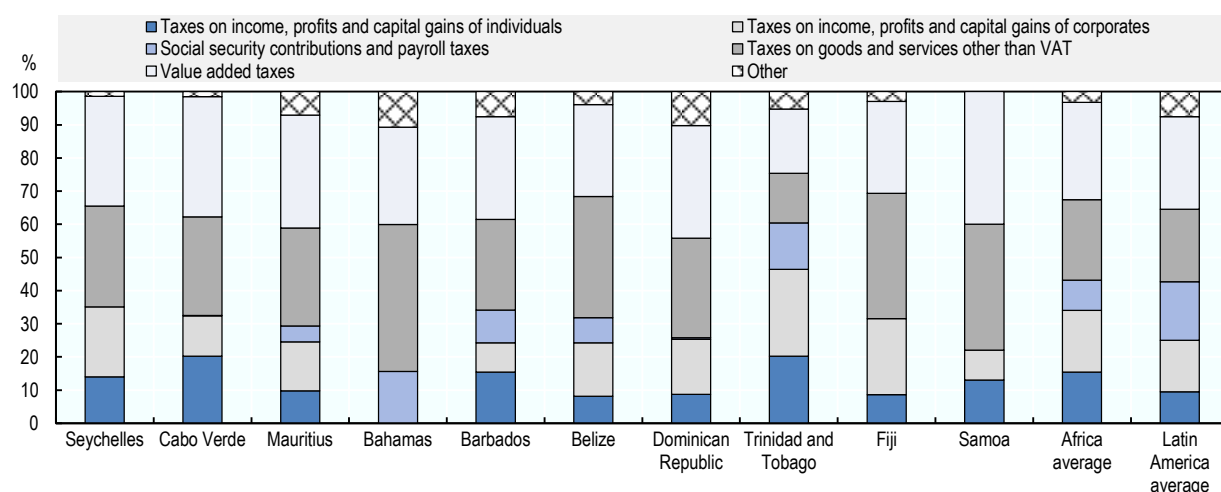
Source: OECD Global Revenue Statistics, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

The significant changes in the composition of Seychelles' tax revenues reflect the complete overhaul of the tax system over the last decade. Figure 1.14 clearly shows the introduction of the personal income tax in 2010, replacing social security contributions, as well as the introduction of VAT, replacing GST and becoming the largest source of tax revenues in Seychelles. Business tax revenues have remained relatively stable, with their share decreasing only slightly from 23% to 21% of total tax revenues between 2008 and 2017. Property tax revenues have also stayed relatively stable at a very low level throughout the period.

Despite Seychelles' high-income status, its tax structure is much closer to that of low or middle-income countries. Figure 1.15 shows that Seychelles' tax revenue mix is relatively similar to tax structures in low and middle-income countries and in other small island states, with a predominance of indirect taxes and corporate income tax. On the other hand, the composition of its tax revenues differs from that of more advanced countries, where personal income taxes and social security contributions typically play a major role.

Figure 1.15. Despite its high-income status, the composition of Seychelles' tax revenues is relatively similar to that of other small island states

Tax revenues from each type of tax expressed as a share of total tax revenues for selected small island states and regional country groupings in 2017



Source: OECD Global Revenue Statistics Database, https://stats.oecd.org/Index.aspx?datasetcode=RS_GBL.

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Notes

¹ Many of the figures in the report compare Seychelles with a number of relatively similar small-island states that are highly dependent upon tourism as well as a few African countries.

² <https://www.worldbank.org/en/country/seychelles/overview>.

³ The World Bank classifies the world's economies into four income groups — high, upper-middle, lower-middle, and low, based on Gross National Income (GNI) per capita (current USD).

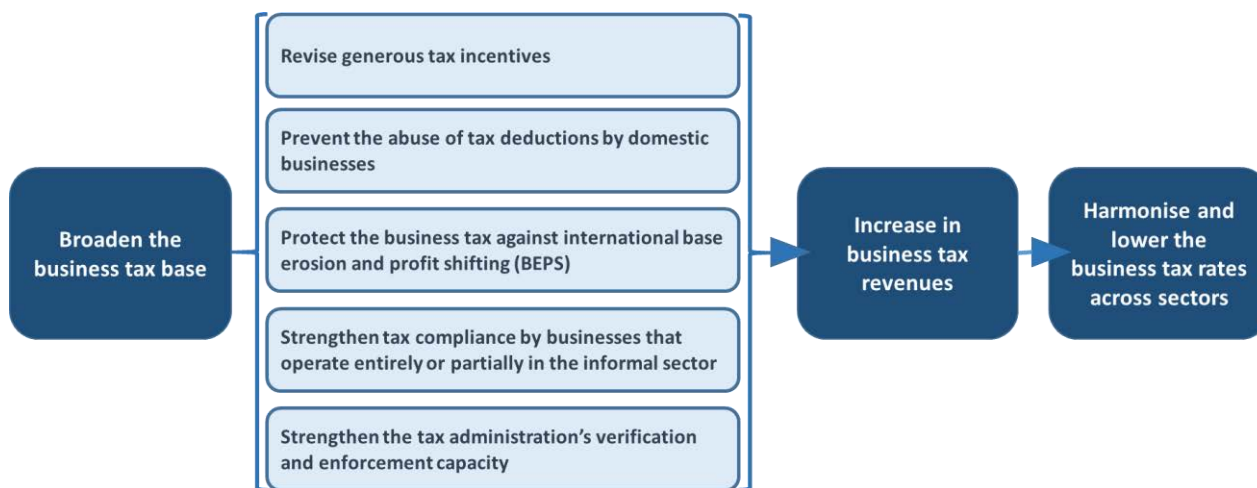
2 **Broadening the business tax base and aligning tax rates across sectors**

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

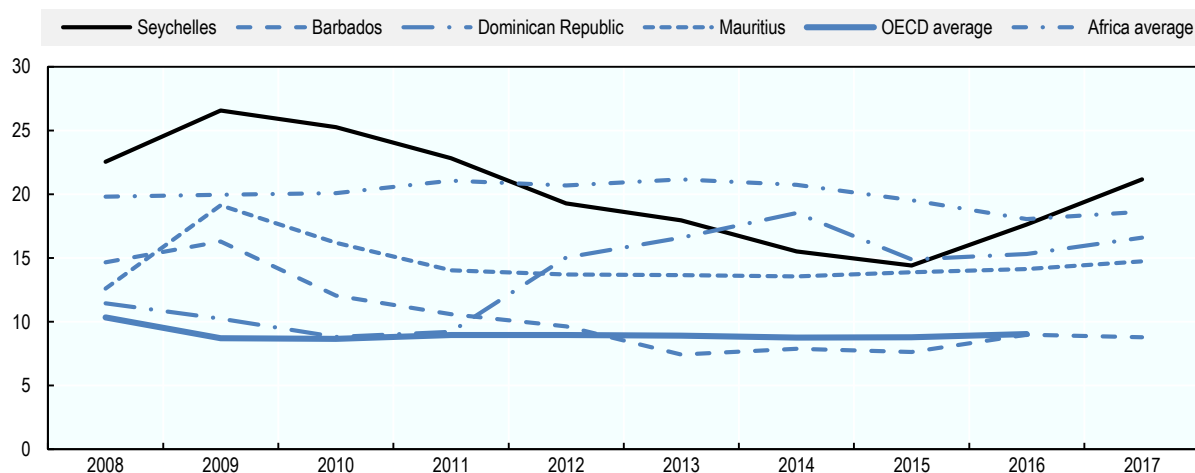


Business tax accounts for a significant share of tax revenues in Seychelles

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.

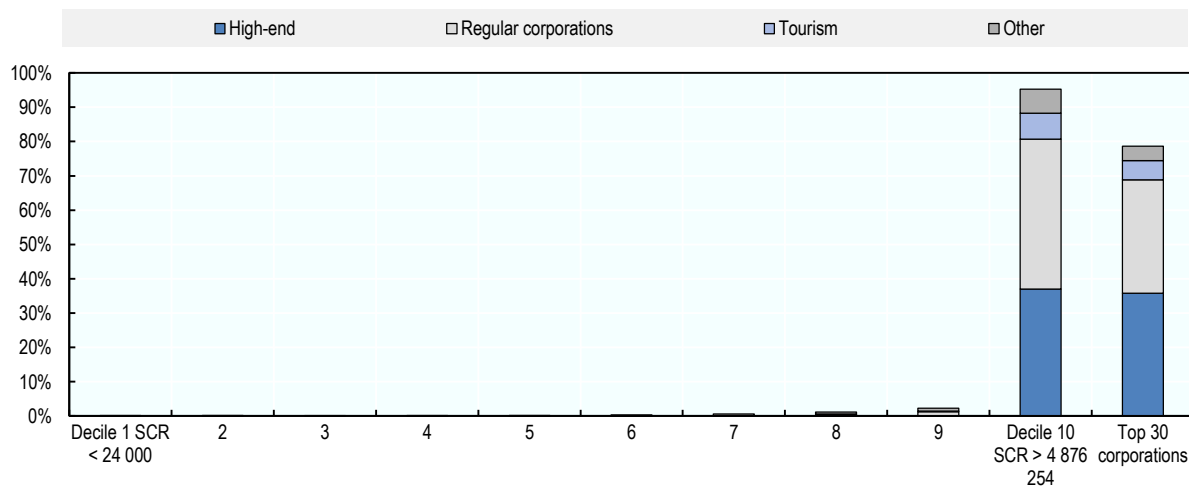
However, the business tax burden is highly concentrated on a small number of businesses and sectors

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.

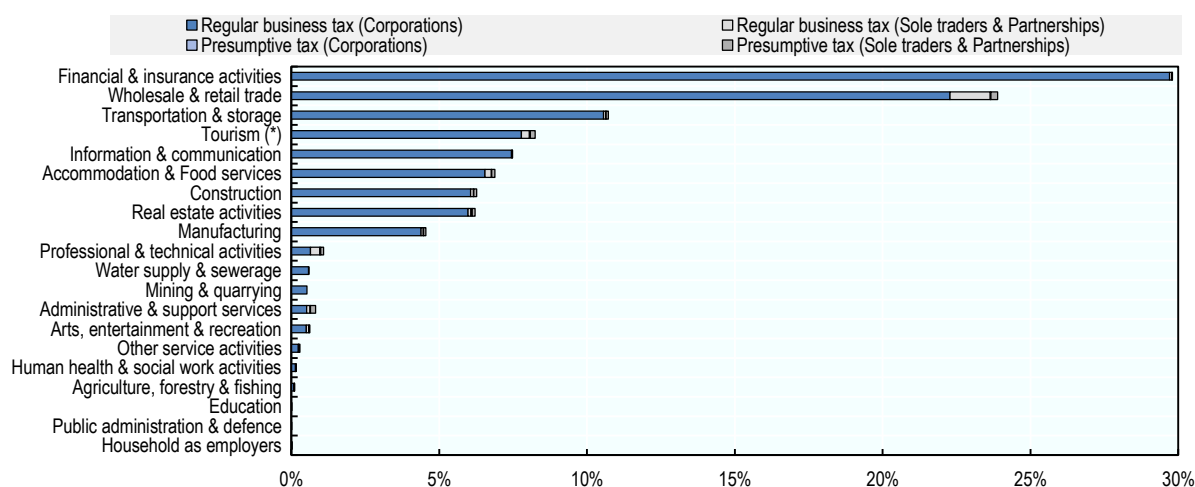
Source: Calculations based on 2017 business tax and presumptive tax microdata

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.

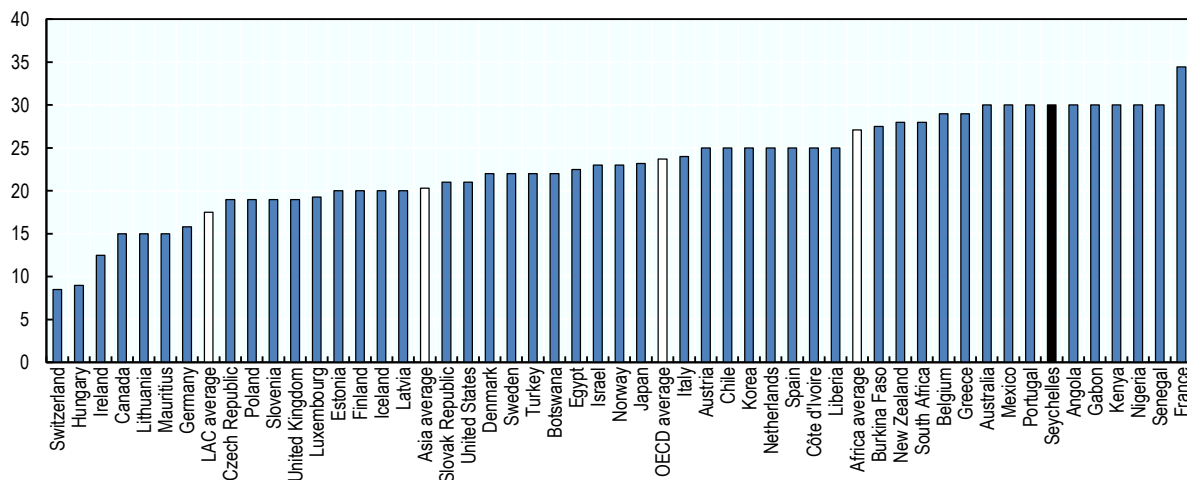
Non-resident aircraft & ship owners are taxed at a rate of 3% on their turnover.

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.

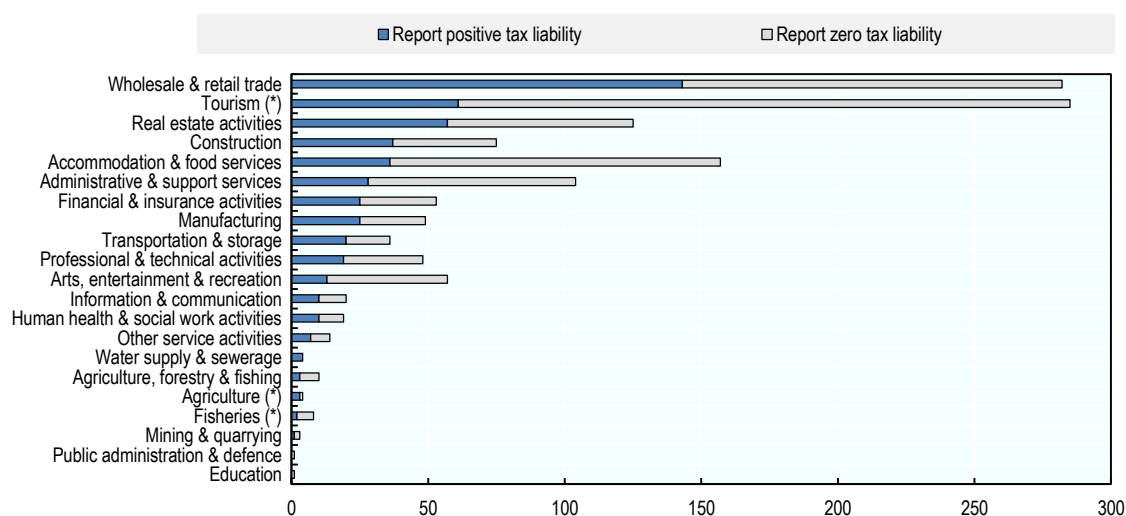
Source: OECD Corporate Tax Statistics Database.

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%

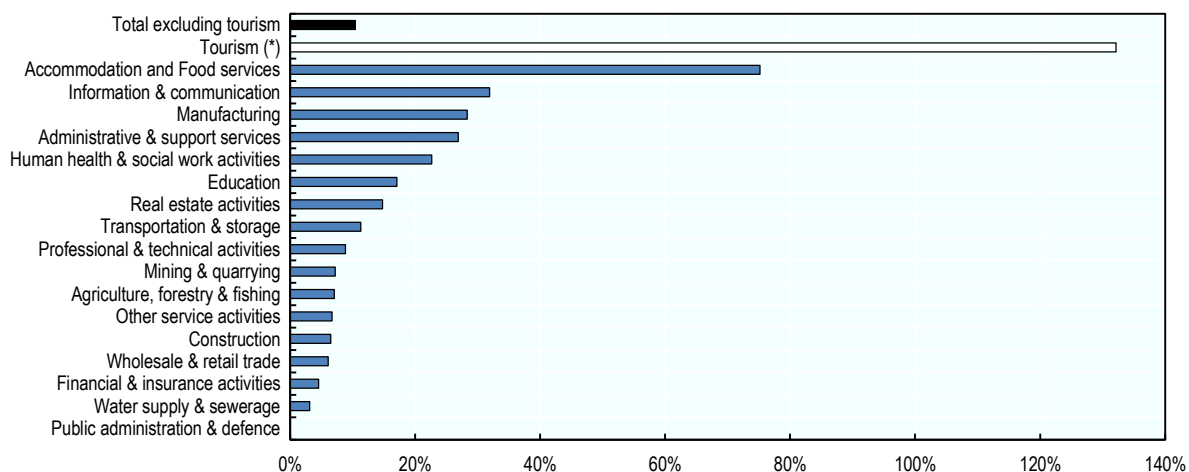
Source: Business Tax Act, Third Schedule.

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.

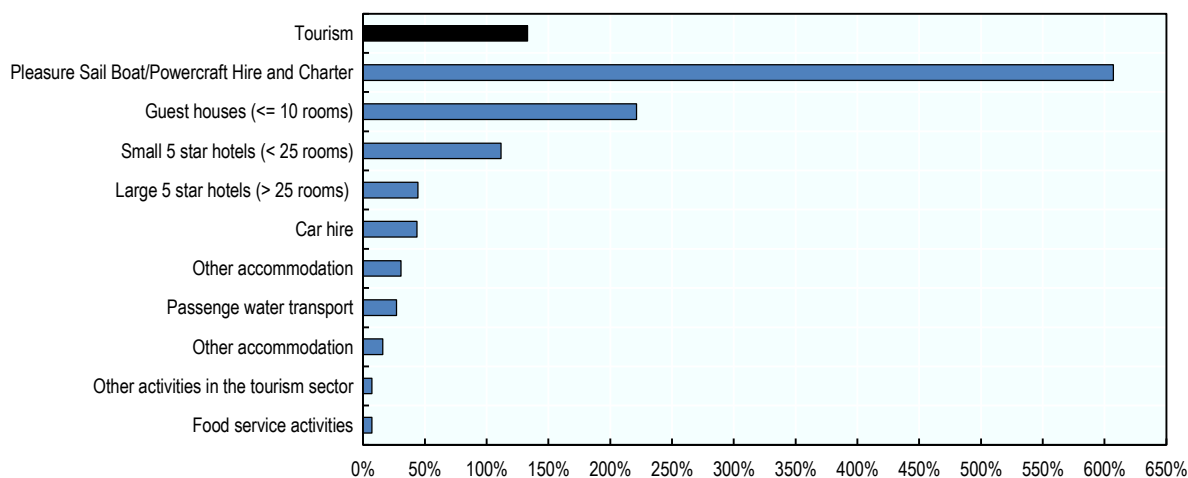
(*) Tourism is defined in line with the Eight Schedule of the Business Tax Act. This includes accommodation, restaurants, air transport and ferries, boat charter, car hire, water sports operators and tour operators among others.

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 sailboats, 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.

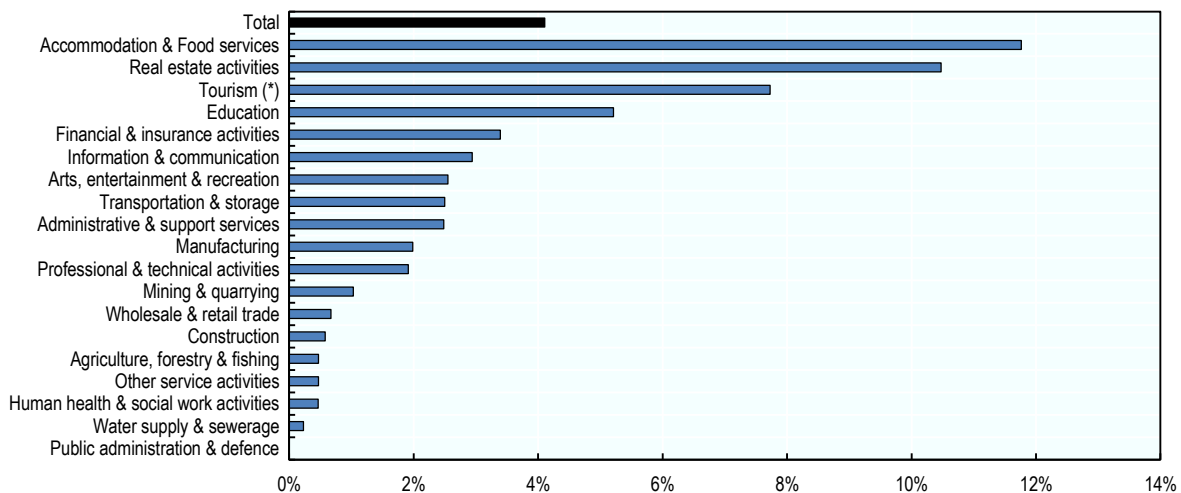
Source: Calculations based on 2017 business tax return microdata.

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

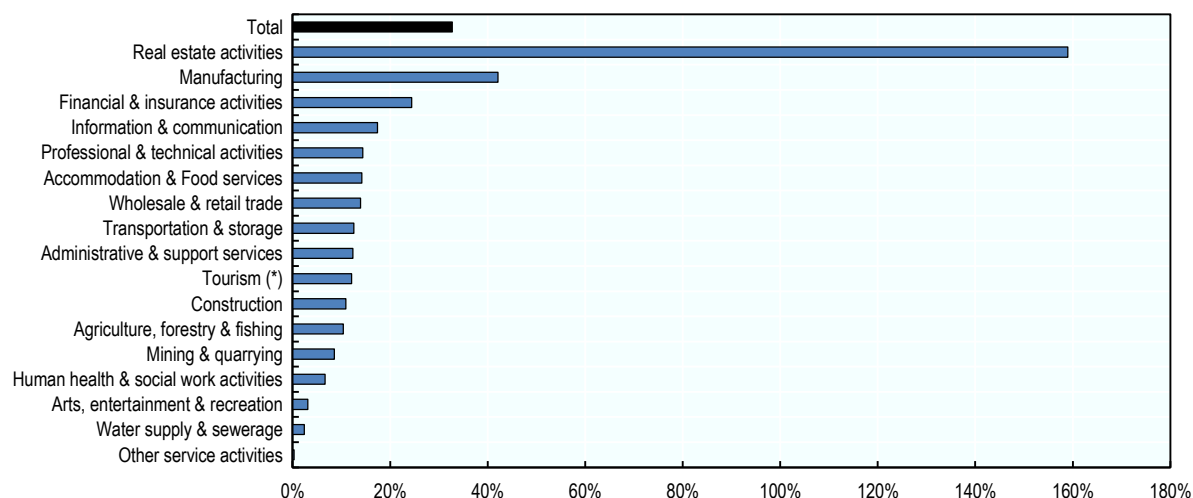


Note: Excludes Corporate Service Providers, Companies with Special Licenses, non-resident aircraft and ship owners and exempt companies. Two manufacturing companies were excluded because of extremely high ratios (TIN 1184, 1241).

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.

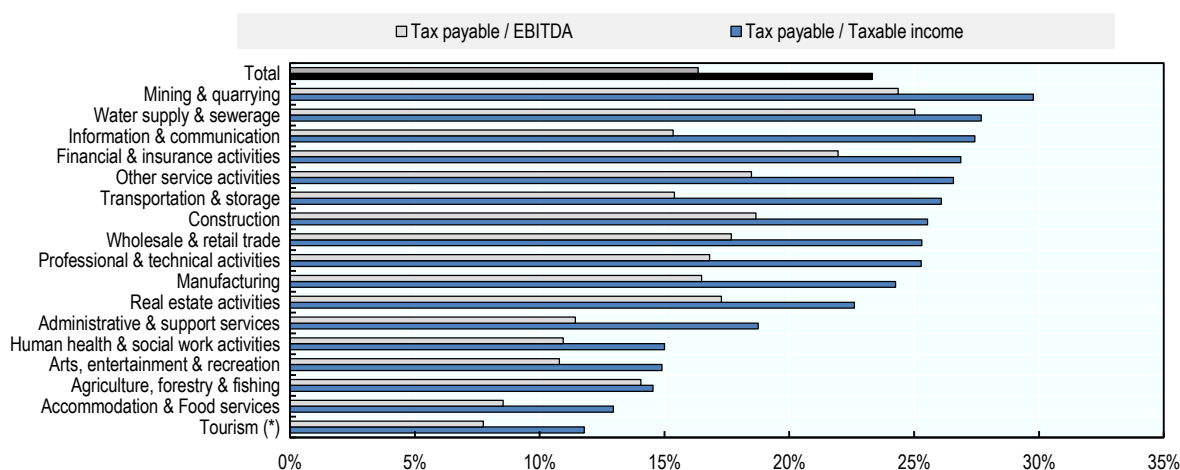
The differing statutory rates and tax base provisions across sectors explain the wide variations in businesses' backward-looking effective tax rates

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



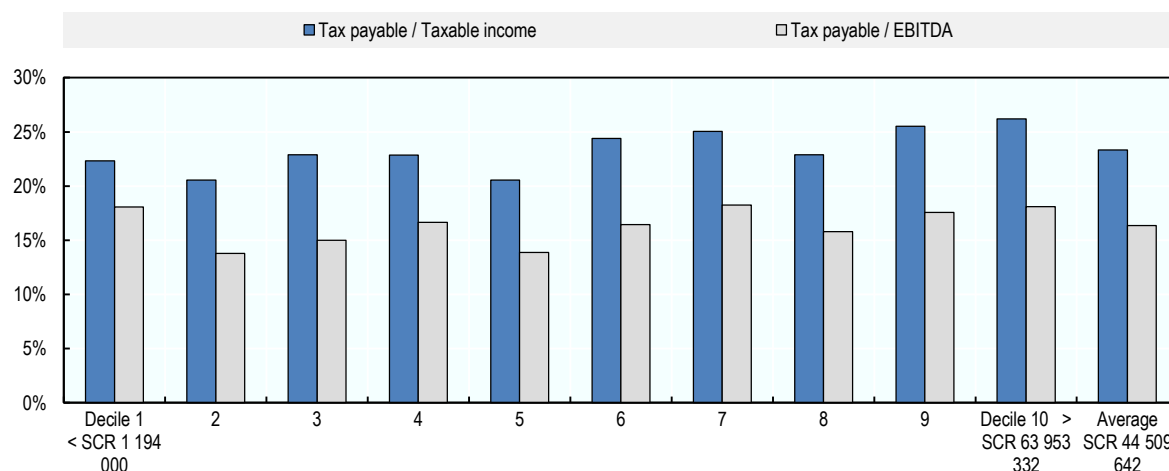
Note: The figure only includes corporations with a positive tax liability. It excludes Corporate Service Providers, Companies with Special Licences and exempt corporations. Tourism is defined in line with Business Tax Act.

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.

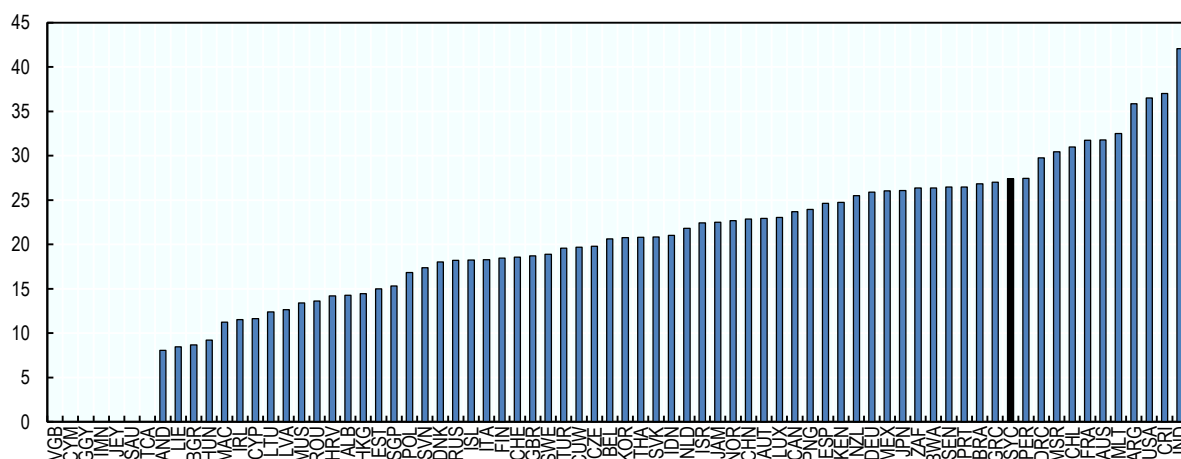
Forward-looking ETRs

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 plant 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



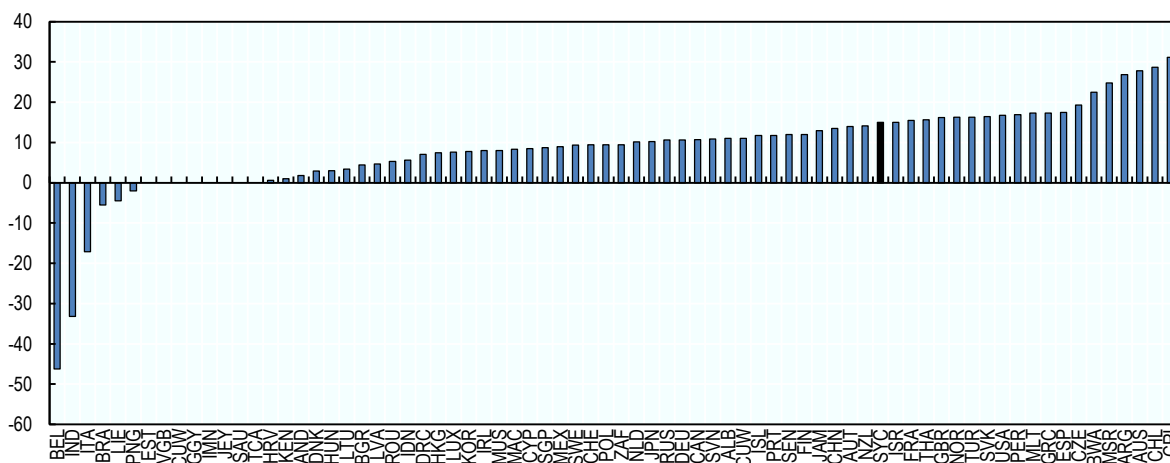
Note: Scenario assuming 5% real interest rate and 2% annual inflation rate.

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 from 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

Current regime	Current	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	
		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%
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.

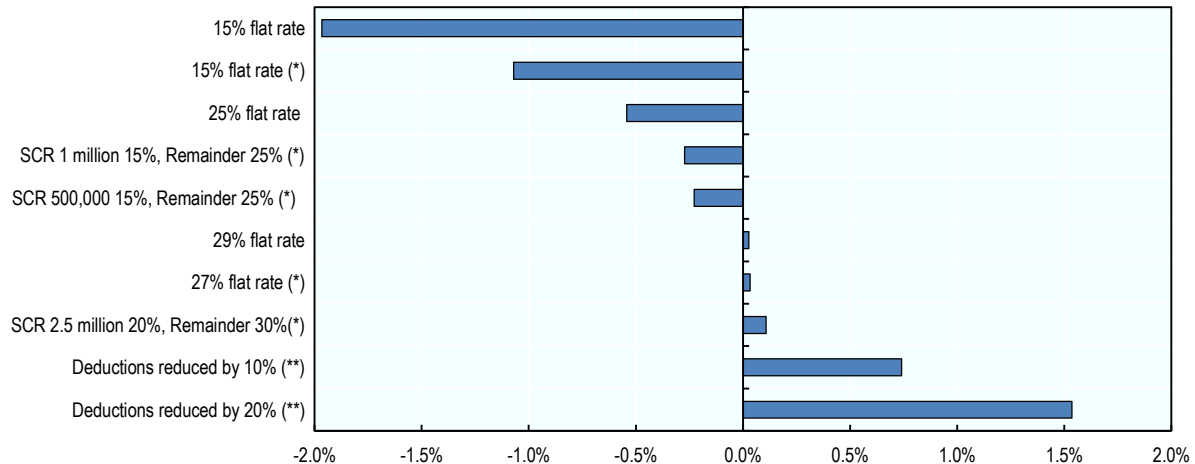
The exercises consider a total of 497 corporations in the sectors described above that in 2017 reported positive taxable income.

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.

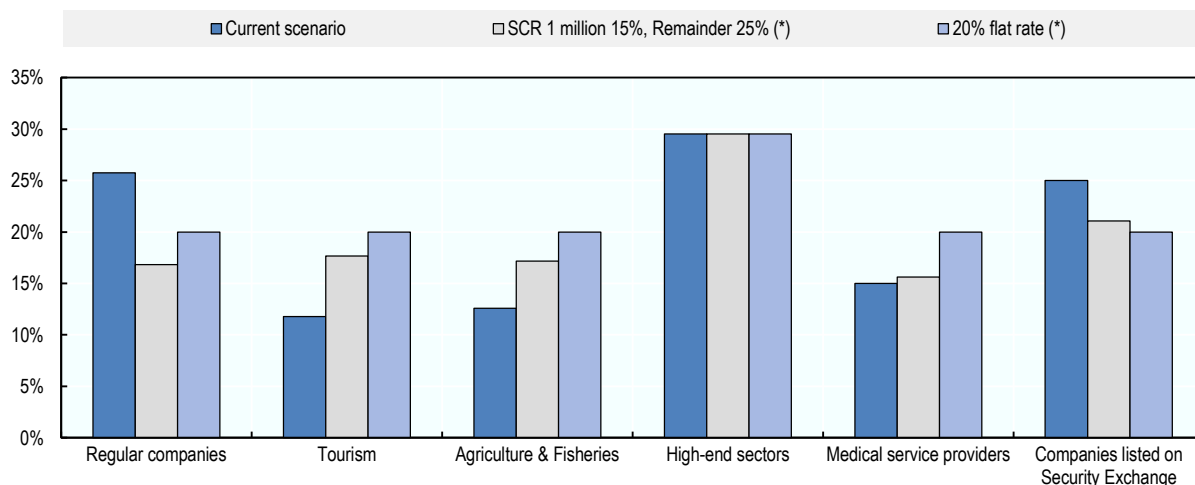
For many businesses, such a tax rate schedule would entail a significant business tax reduction, and thereby create an incentive for additional investment. This tax rate schedule would reduce tax levels in particular on businesses that have lower profits, which currently face a high tax rate when they 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 2017¹. 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.

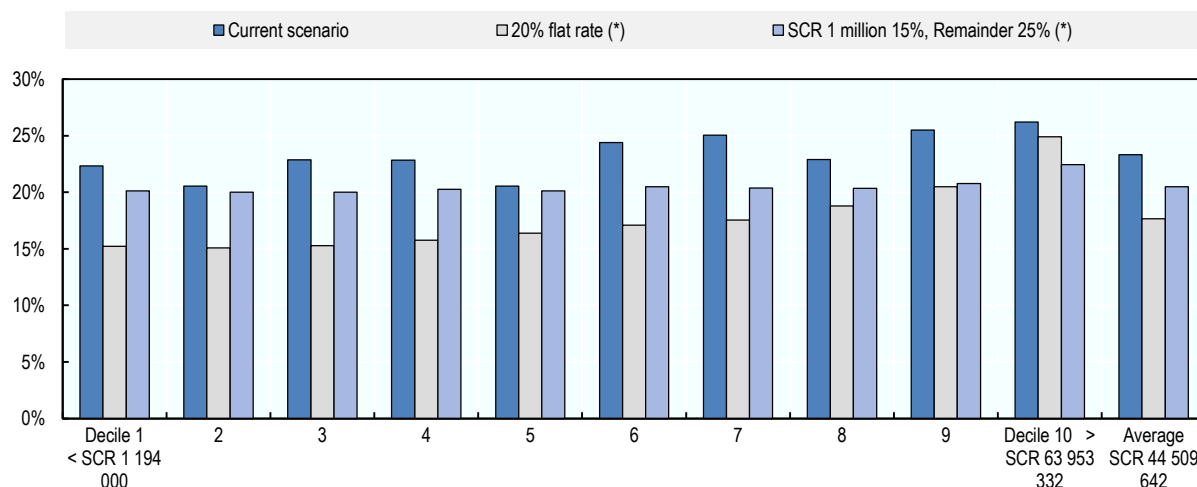
Source: Calculations based on 2017 business tax return microdata.

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 Depository (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%).

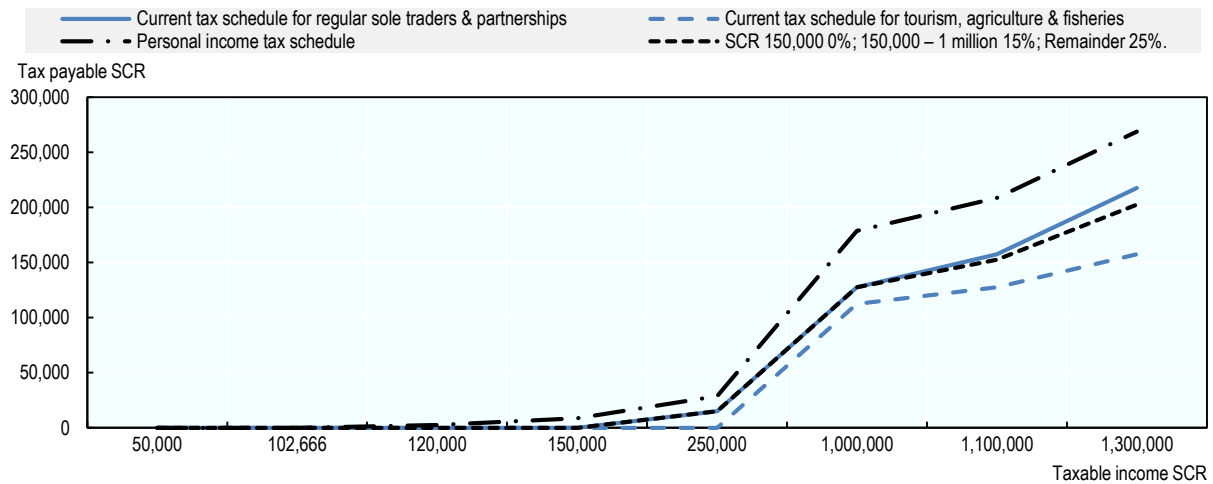
Finally, controlled foreign company (CFC) rules in line with BEPS Action 3 could also contribute to protecting Seychelles' corporate tax base. CFC rules respond to the risk that taxpayers can strip the tax base of their country of residence by shifting income into a foreign company that is controlled 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.

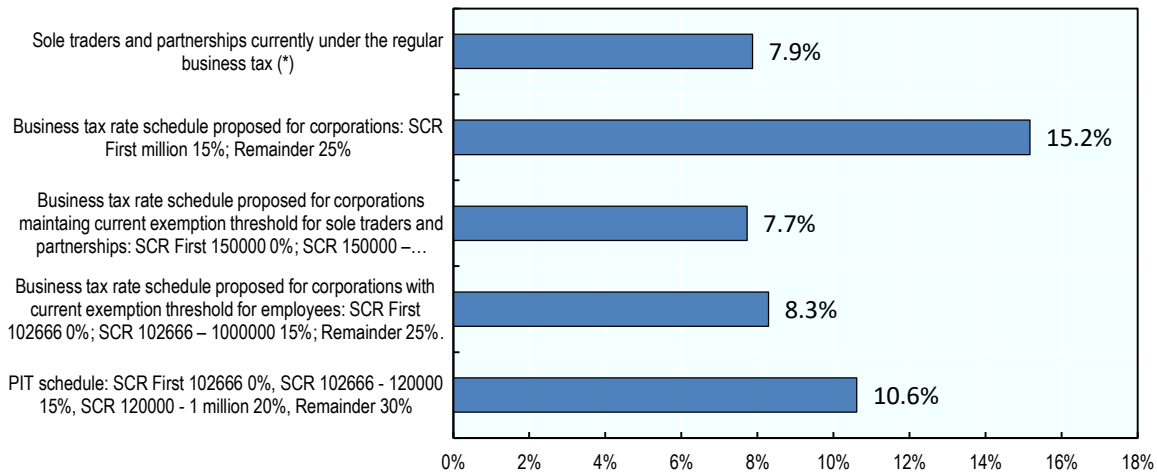
Excludes exempt companies.

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

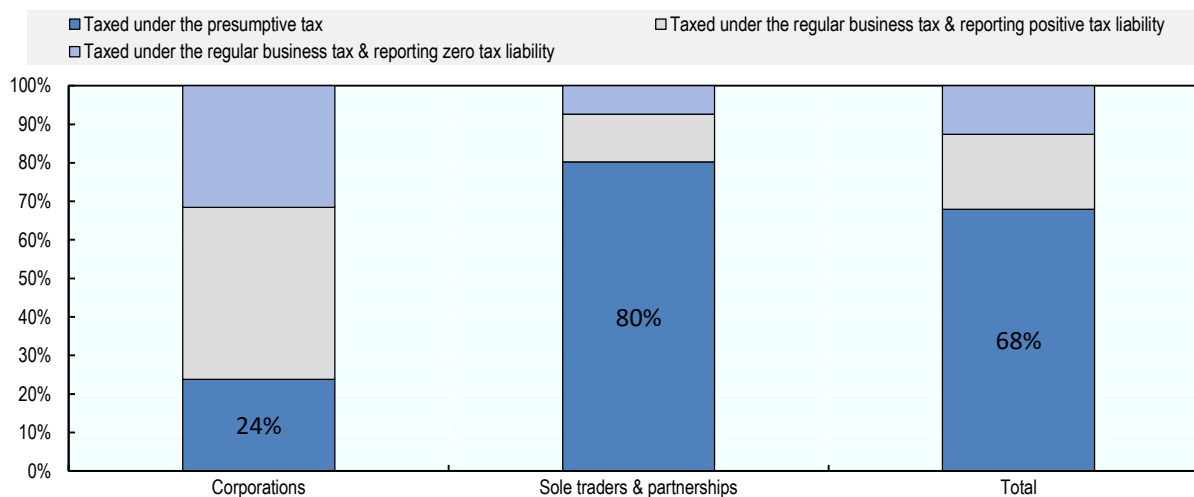
Presumptive tax regimes may be used for different reasons. A presumptive tax presumes a different tax base than income in the calculation of the firm's tax liability. Usually, the main reason for implementing such a regime is simplification, particularly in relation to the compliance burden on small 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

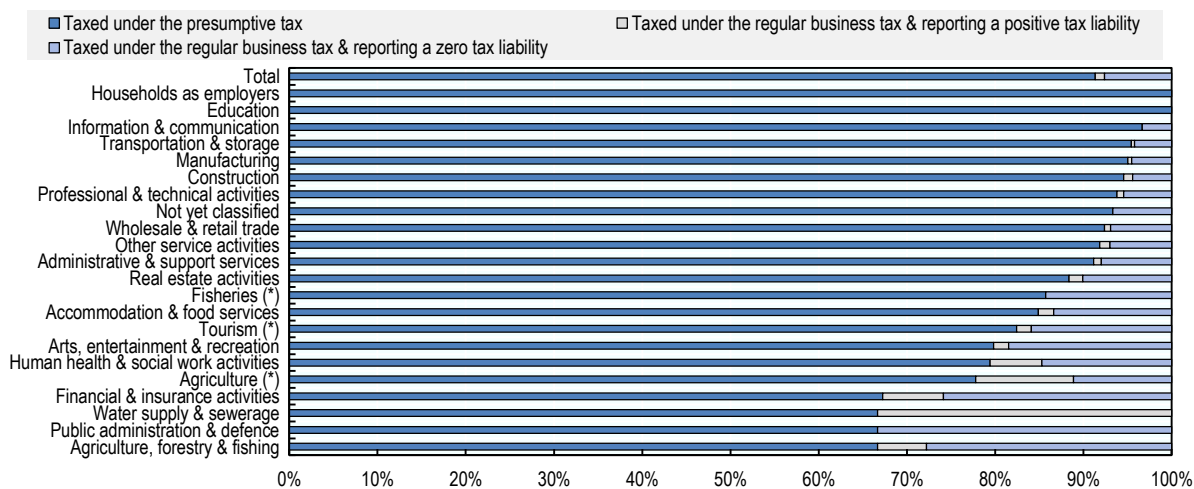


Note: Includes both corporations and sole traders and partnerships. Excludes Corporate Service Providers, Companies with Special Licenses, exempt companies and non-resident aircraft and ship owners.

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.

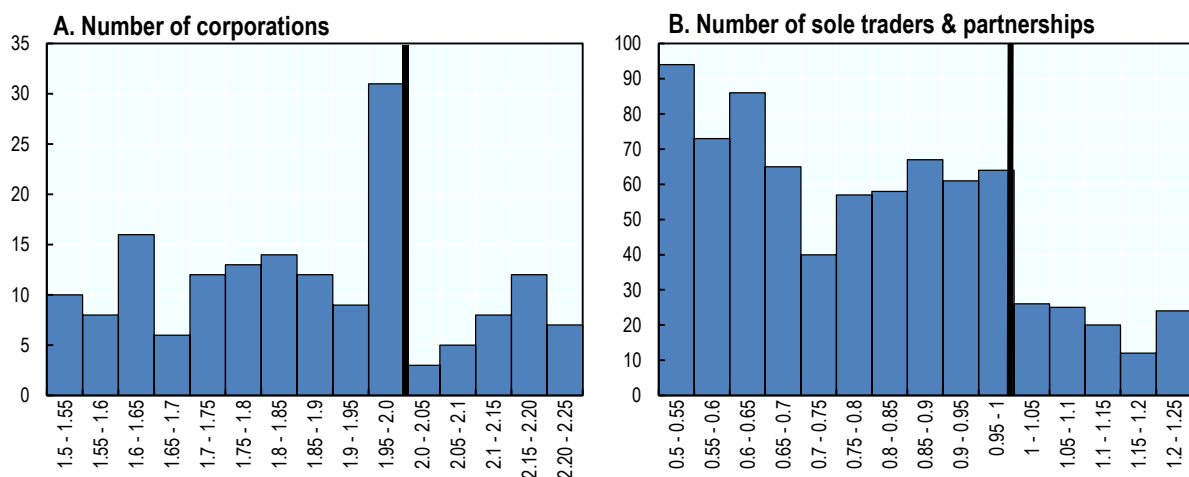
Source: Calculations based on 2017 business tax and presumptive tax microdata.

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)



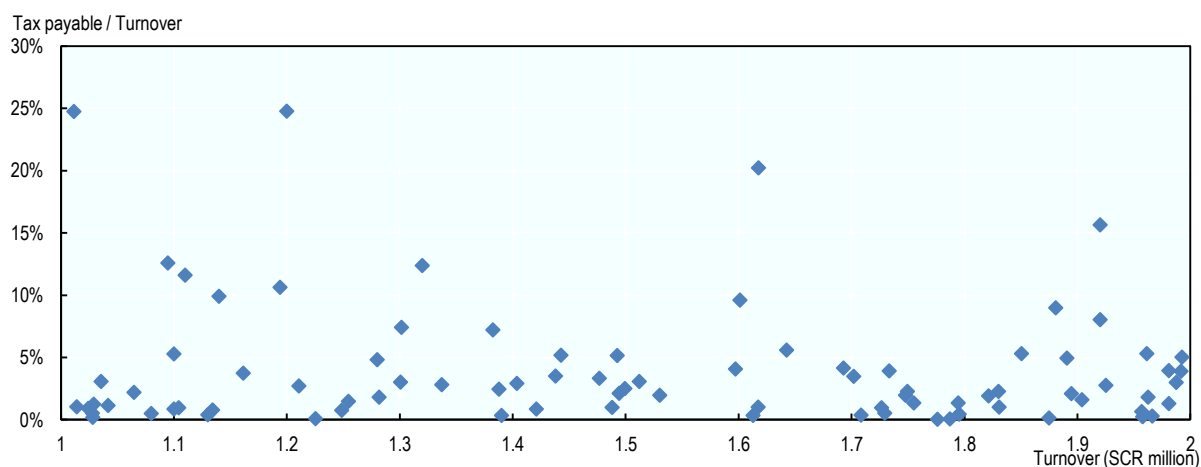
Source: Calculations based on 2017 business tax and presumptive tax microdata.

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.

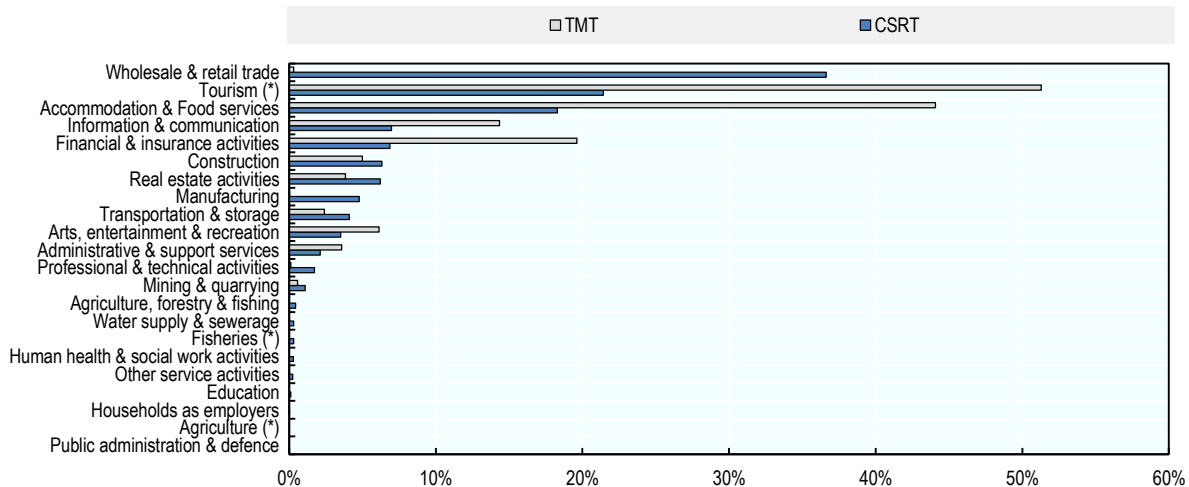
The corporate social responsibility tax and the tourism marketing tax

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.

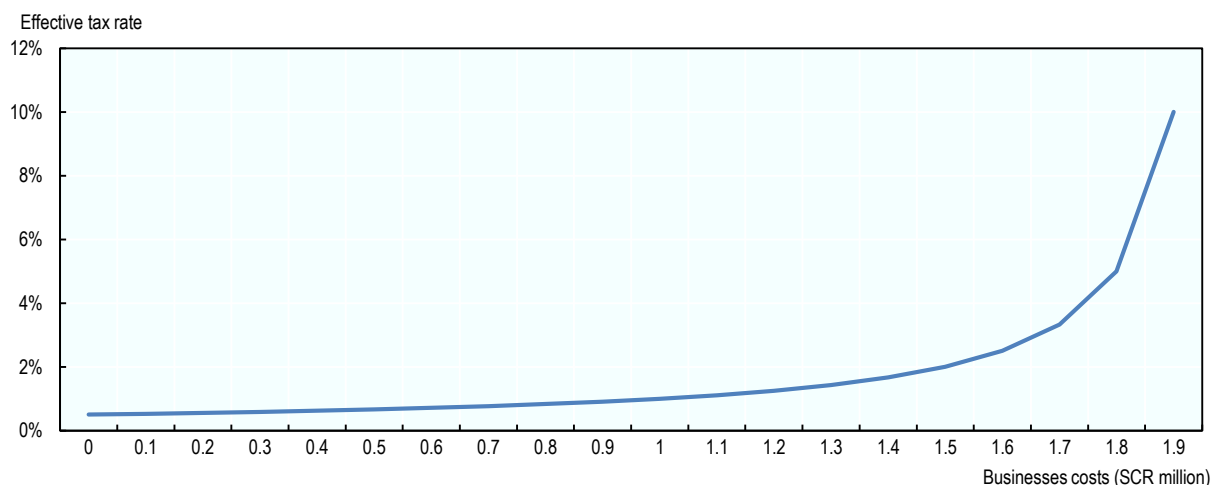
Source: Calculations based on 2017 business tax return microdata.

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 $X = \text{business costs} / \text{turnover}$. Then, $\text{ETR} = 0.005 / (1 - X)$.

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.

3

Improving the design of non-business taxes

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

The value-added tax

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

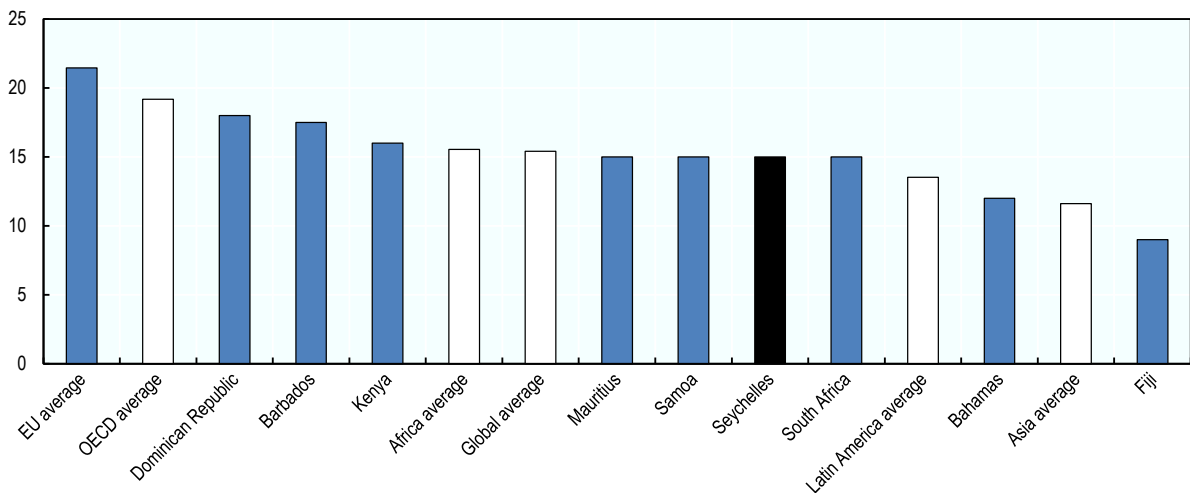
Seychelles introduced a value-added tax in 2013

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

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

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

Standard VAT rates (%) in selected countries and regions



Source: KPMG Indirect tax rate tables.

Seychelles' VAT system is relatively broad-based

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

Subjecting tourism to VAT at the standard rate is a good policy approach. Indeed, as mentioned, tourism is the sector that accounts for the greatest share of value added in the country so levying VAT at the standard rate on tourism ensures that VAT is levied on a broad base. In addition, since final consumption of tourism activities (by tourists) takes place in the country, levying the VAT on those activities is consistent with the application of the destination principle as recommended by the International VAT/GST Guidelines. There are additional arguments for taxing tourism-related services at the standard VAT rate. Reduced VAT rates on tourism-related services tend to be regressive, as OECD evidence shows that they benefit the rich vastly more than the poor both in aggregate and proportional terms (OECD/KIPF, 2014^[11]). Moreover, VAT rate cuts rarely translate into equivalent decreases in prices.

Box 3.1. The main features of a VAT

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

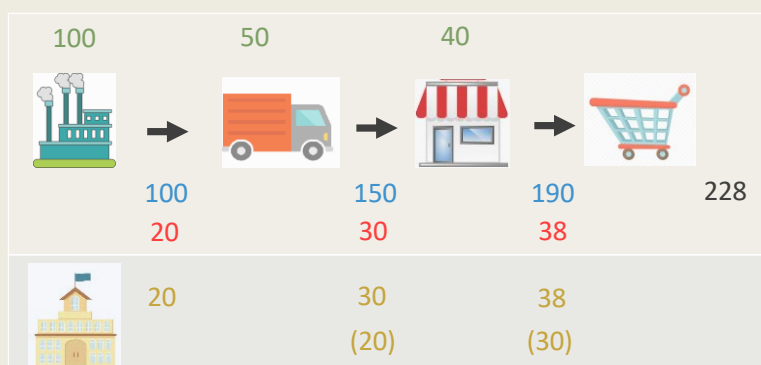
A broad-based tax on final consumption

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

The staged collection process

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

VAT’s staged collection process – domestic supplies



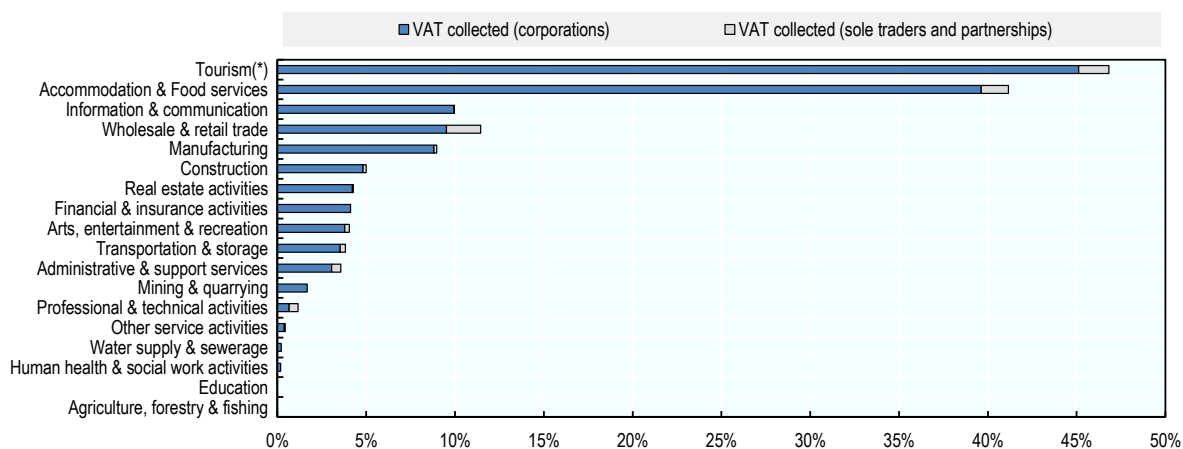
Green = Value-added
 Blue = Net price
 Red = VAT
 Black = Final consumer price
 Gold in brackets = Credit for input VAT

The destination principle in international trade

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

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

Share of total VAT collected by sector



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

Source: Business Tax microdata.

Seychelles has a number of VAT exemptions, but these are primarily targeted at basic necessities.

As mentioned above, Seychelles does not have reduced VAT rates. However, many products that are considered as “basic necessities” and typically subject to reduced VAT rates in OECD countries, are subject to VAT exemptions in Seychelles (Table 3.1). Seychelles’ VAT exemptions, primarily target agricultural and food products (fruits and vegetables, meat, dairy products, etc.) as well as other basic necessities (e.g. pharmaceutical products).

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

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

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

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

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

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

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

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

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

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

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

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

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

The VAT registration threshold is comparatively high

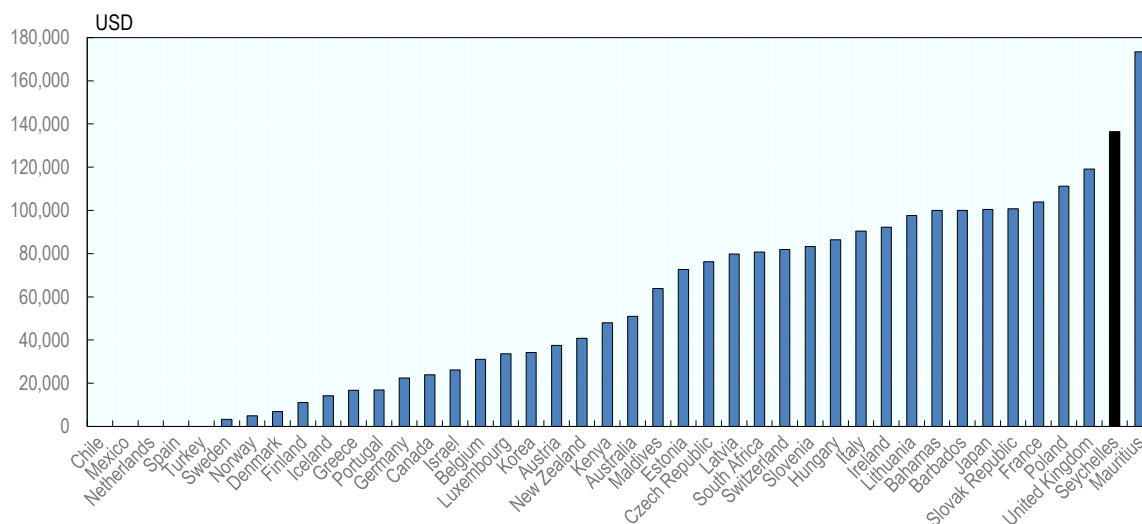
In general, setting the VAT registration threshold at an adequate level is a complex task. The main reason for excluding small businesses from the VAT system is that compliance costs for small businesses may be disproportionate compared to their turnover, and that the costs for the tax administration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

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

registered operators. Thus, to be able to face competition from non-VAT registered businesses, VAT-registered businesses end up bearing at least a part of the VAT burden themselves by charging lower pre-tax prices. Reducing the VAT registration threshold would contribute to levelling the playing field between businesses.

Figure 3.3. Seychelles has a comparatively high VAT registration threshold

Compulsory VAT registration thresholds expressed in USD



Source: OECD Tax Database and KPMG.

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

A lower VAT registration threshold could also be accompanied by VAT simplification measures. A possibility would be the introduction of a VAT flat rate scheme. A flat rate scheme allows eligible businesses (e.g. below a certain turnover threshold) to apply a fixed and lower VAT rate, typically to turnover, to determine VAT due (OECD, 2015^[41]). In principle, under such schemes, businesses give up the right to reclaim VAT on their inputs. Businesses therefore keep the difference between what they have charged their customers and what they pay to the tax administration. Variable flat rates may be applied, and are intended in most cases to reflect the average VAT rate in specific industries or sectors after taking into account the recovery of VAT on inputs. From a tax compliance perspective, a major advantage of these schemes for small businesses is that they are not required to keep detailed records of sales and invoices. However, creating a special regime that may over-compensate small businesses provides new opportunities for tax avoidance and evasion and may reduce firms' incentives to grow. Alternative measures may be preferred to simplify compliance and administration, including for instance less frequent filing of VAT returns and simplified accounting methods.

Some businesses have reported VAT related cash-flow difficulties

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

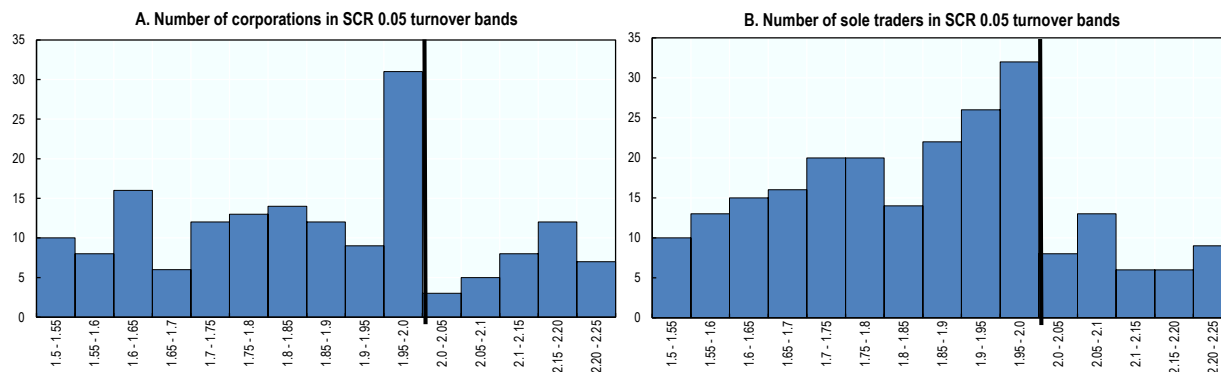
The system for VAT refunds appears well designed, but options could be considered to speed up the process for low-risk companies. An efficient VAT refund system is an essential part of a well-functioning VAT system. For businesses, delays in VAT refunds imply an opportunity cost in terms of the time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

Informality and VAT fraud remain a challenge

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

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

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



Source: Business tax and presumptive tax microdata.

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

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

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

More sophisticated tools can also be put in place to tackle fraud by VAT-registered businesses, but these might be too costly from an administrative and compliance perspective for Seychelles. For instance, data recording technology can be used to address sales suppression. At a basic level, sales

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

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

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

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

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

Digitalisation is pushing governments to revise their VAT rules on cross-border trade in low-value goods. A number of countries are now removing or considering the elimination of VAT relief regimes for imports of low-value goods. Australia was the first OECD country to implement a reform to collect VAT on imports of low-value goods, effective as of July 2018, and has already reported revenues amounting to AUD 81 million in the first quarter of operation of the regime. New Zealand has introduced a similar regime in 2019 and the European Union announced its introduction in 2021. Seychelles may wish to assess

whether the current VAT relief regime for imports of low-value goods poses issues. In particular, authorities could evaluate the extent to which the VAT relief regime puts domestic businesses at a competitive disadvantage and how much VAT revenue they forego because of that measure.

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

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

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

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

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

Environmentally related taxes

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

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

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

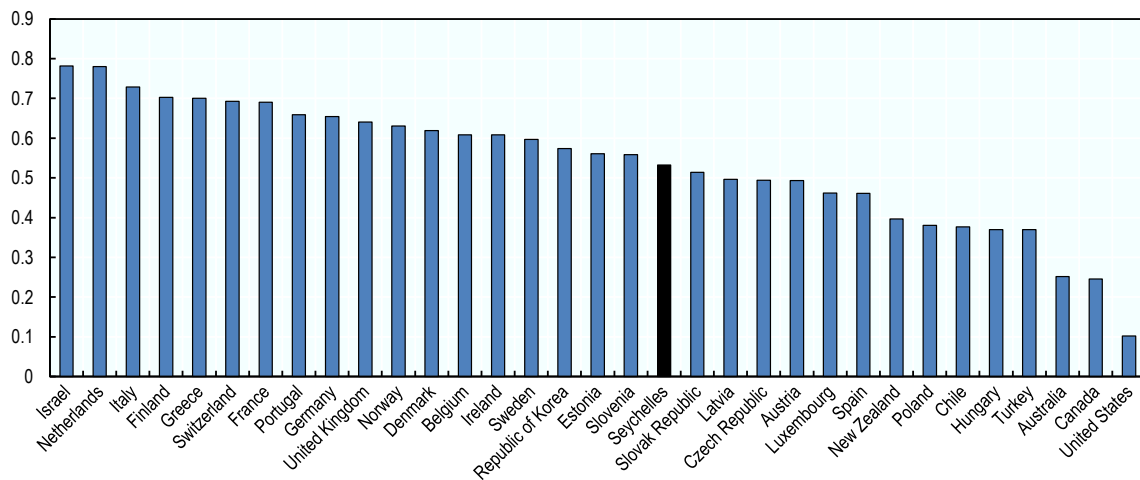
Table 3.2. Energy excise tax rates per litre of fuel

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

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

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

Gasoline excise taxes per litre in EUR ⁽¹⁾



Note: (1) Exchange rates as at 1 September 2019.

Source: International Energy Agency, *Energy Prices and Taxes Database*.

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

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

Energy category	Low-end carbon benchmark (EUR 30 per tonne of CO ₂)	
Coal and other solid fossil fuels	6.24 eurocent per kilogramme	SCR 1.01 per kilogramme
Fuel oil	8.94 eurocent per litre	SCR 1.44 per litre
Diesel	7.99 eurocent per litre	SCR 1.29 per litre
Kerosene	7.58 eurocent per litre	SCR 1.22 per litre
Gasoline	6.86 eurocent per litre	SCR 1.11 per litre
LPG	4.75 eurocent per litre	SCR 0.77 per litre
Natural gas	5.13 eurocent per cubic metre	SCR 0.83 per cubic metre

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

Source: OECD *Taxing Energy Use 2019*.

The tax rates could be low in the first phase, and increase progressively. Indeed, in most of the countries that have introduced carbon taxes, tax rates have started at low levels. Seychelles could start with relatively low tax rates as well. The tax rates could then progressively increase towards the EUR 30 per tonne of CO₂ benchmark and beyond. In the case of gasoline, this would not imply an increase in existing rates, as approximately EUR 6.9 cents (or SCR 1.11) per litre is the excise tax rate that corresponds to a tax on carbon emissions of EUR 30 per tonne of CO₂.¹ For diesel, EUR 8 cents (or SCR 1.29) per litre corresponds to a tax of EUR 30 per tonne of CO₂. For these fuels, the introduction of a carbon tax would simply mean that part of the existing excise tax would be re-characterised as the carbon tax component of fuel excise taxes. In the power sector, however, the introduction of a carbon tax would raise current tax levels (although modestly if a low rate is applied in the initial stages) and encourage diversification towards cleaner energy sources.

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

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

Box 3.4. The different approaches to designing carbon taxes

Fuel approach

The most common approach to carbon taxation has been to levy carbon taxes on specific fossil fuels, primarily oil, gas and coal, and their derivative products. Countries that follow this fuel-based approach do not tax CO₂ directly, but put a price on fossil fuels depending on the carbon content of each fuel and convert that price into regular commercial units, for instance by reference to kilogrammes for solid fuels, litres for liquid fuels, and cubic metres for gaseous fuels.

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

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

Direct emission approach

The other approach to carbon taxation consists in taxing CO₂ directly, by relying on the direct measurement of emissions from certain types of stationary installations/facilities. Given the need to measure (or calculate) emissions, these carbon taxes only apply to emitters above a certain emissions threshold or to installations that fulfil certain technological criteria. Countries that pursue such an emissions-based approach include for instance Chile, Estonia and Latvia.

One of the advantages of emissions-based approaches is that they can readily be extended to non-energy and non-CO₂ emissions, e.g. in agriculture or industry. On the other hand, administrative and compliance costs tend to be somewhat higher than with fuel-based approaches. Whether such differences in administrative and compliance costs are relevant in practice may depend on pre-existing reporting obligations for other purposes. Indeed, the additional effort of reporting carbon emissions for tax purposes may be negligible for facilities that already have reporting obligations for other reasons (e.g. requirements to measure emissions by Integrated Pollution Prevention and Control regulations or by national environmental codes). More generally, administrative and compliance costs become relatively less significant as carbon tax levels increase.

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

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

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

scaled back (in particular the 100% concession for boat owners). For the licensed accommodations not connected to the PUC grid, concessions should cease to be applicable once those are connected.

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

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

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

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

Personal income taxes

The Seychelles operates a territorial personal income tax system. Personal income tax (PIT) is payable by residents and non-residents on their Seychelles-source income. This differs from the most

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

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

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

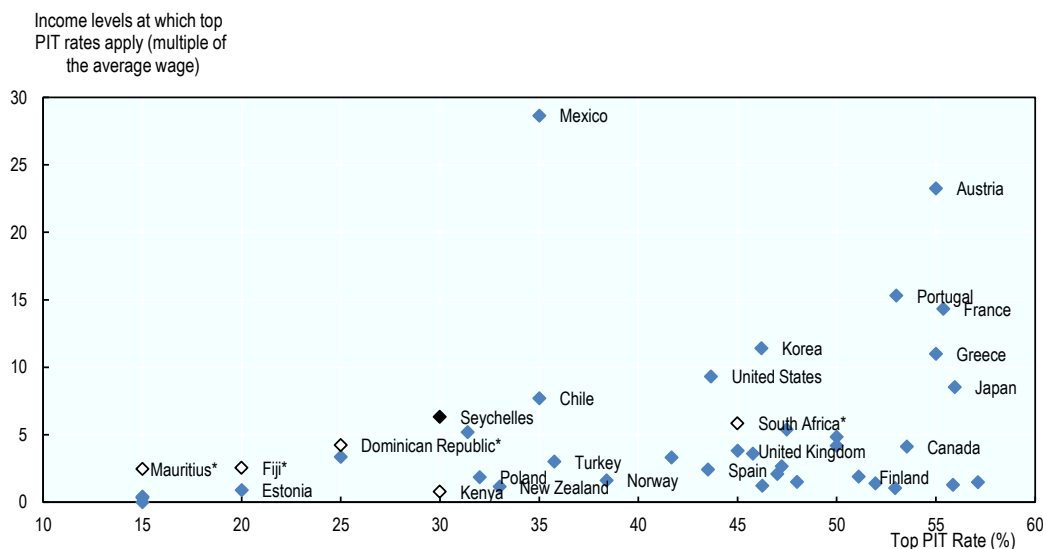
Table 3.4. Personal income tax rates on employment income for Seychelles citizens

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

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

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

Figure 3.6. Top personal income tax income thresholds and rates



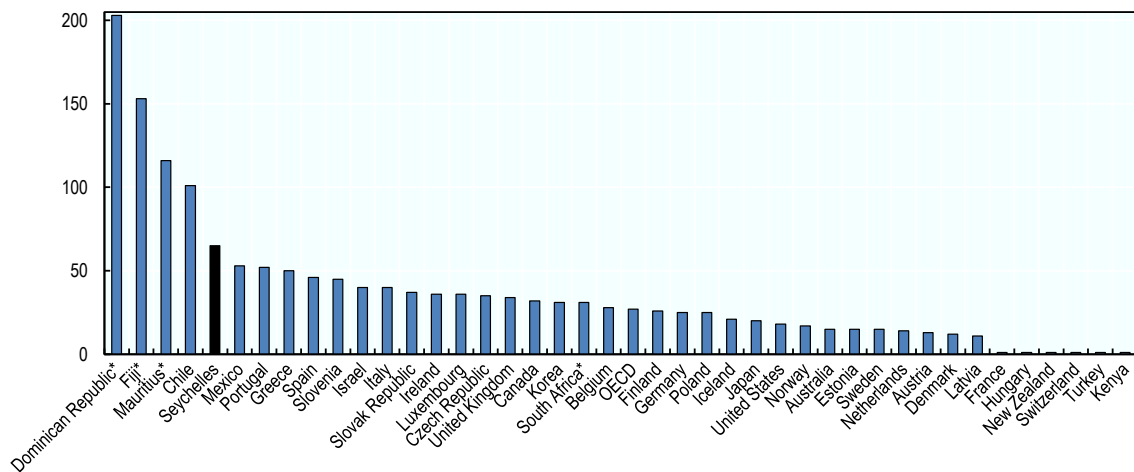
Note:*Overall average wage (including both public and private sector wages).

Source: OECD, National Statistics Offices, and International Bureau of Fiscal Documentation (IBFD).

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

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

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



Note:*Overall average wage (including both public and private sector wages).

Source: OECD, National Statistics Offices, and International Bureau of Fiscal Documentation (IBFD).

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

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

Seychelles operates a final monthly PIT withholding

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

Seychelles' final PIT withholding system worked well when the PIT rate was flat, but the introduction of the zero-rate band and the progressive rate schedule have led to difficulties. Indeed, a final PIT withholding system has the benefit of being relatively easy to administer and to comply with, as employees are not directly in contact with the tax administration. Such a system has been possible because Seychelles does not provide PIT allowances or tax credits, and worked well when everyone was taxed at the rate of 15%. However, the introduction of the zero-rate band and the progressive PIT rate schedule have led to difficulties. For instance, a taxpayer with fluctuating income might be taxed in a given month,

but not the following one, whereas smoothing that taxpayer's income over the year may have resulted in him or her paying lower taxes or not having to pay any tax. Workers who are paid late may also face issues as they may be taxed on their regular salary as well as on the part of their salary that should have been paid earlier but was paid late, which might bring them into a higher tax bracket. More generally, Seychelles' current system does not allow targeting tax provisions at specific categories of taxpayers. While this is currently not an issue, Seychelles may wish to use the PIT system in the future to target provisions at specific taxpayers.

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

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

The PIT base is narrowed by a number of exemptions

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

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

Benefits received by employees in kind are taxed under the non-monetary benefits tax and payable by employers, but many exemptions are provided as well. Benefits in kind (e.g. motor vehicle, accommodation, utilities, meals, transport, etc.) are subject to the non-monetary benefits tax. The tax is payable by the employer at a rate of 20% on the value of the non-monetary benefits provided to an

employee on a monthly basis. The tax is imposed on the fair market value of the non-monetary benefits, unless otherwise specified. However, there are many exemptions, in particular in the tourism sector (Box 3.5).

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

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

Exemptions from the Individual Income Tax

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

Exemptions from the Non-Monetary Benefits Tax

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

Personal investment income is generally not taxed in Seychelles

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

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

Seychelles has made significant progress on international tax transparency

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

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

currently ongoing. The Review will assess Seychelles' legal and regulatory framework for tax transparency and the exchange of information as well as the practical implementation of that framework.

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

Social security contributions

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

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

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

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

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

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

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

Property taxes

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

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

extreme, where taxes are directly linked to local public good provision, they effectively become a payment for services, and are therefore expected to have a smaller distortive impact on behaviour.

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

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

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

Box 3.6. Tax policy recommendations

Value-added tax

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

Environmentally related taxes

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

Personal income taxes

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

Property taxes

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

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Notes

¹ These rates only reflect the climate costs of CO₂ emissions from transport fuels, but there are other negative externalities associated with transport fuels that are not taken into account in these rates (e.g. pollution, congestion).

Annex A. Additional tables and graphs

Table A.1. Backward-looking effective tax rates and related indicators by sector

	Tax payable / Taxable income	Tax payable / EBIT	Tax payable / EBITDA	Tax payable / Turnover
Tourism (*)	12%	11%	8%	3%
Accommodation & Food services	13%	12%	9%	3%
Agriculture, forestry & fishing	15%	15%	14%	3%
Arts, entertainment & recreation	15%	14%	11%	3%
Human health & social work activities	15%	15%	11%	2%
Administrative & support services	19%	16%	11%	3%
Real estate activities	23%	21%	17%	7%
Manufacturing	24%	21%	16%	9%
Professional & technical activities	25%	24%	17%	4%
Wholesale & retail trade	25%	24%	18%	5%
Construction	26%	23%	19%	2%
Transportation & storage	26%	24%	15%	2%
Other service activities	27%	26%	18%	6%
Financial & insurance activities	27%	24%	22%	8%
Information & communication	27%	23%	15%	5%
Water supply & sewerage	28%	27%	25%	9%
Mining & quarrying	30%	30%	24%	8%
Total	23%	21%	16%	4%

Note: Only corporations with positive tax liability are included. Excludes Corporate Service Providers, Companies with Special Licences, exempt companies and non-resident aircraft and ship owners.

EBIT: Earnings before interest and taxes.

EBITDA: Earnings before interest, tax, depreciation and amortisation.

Tourism defined in line with Business Tax Act.

Source: Business Tax microdata.

Table A.2. Treaty Withholding Rates

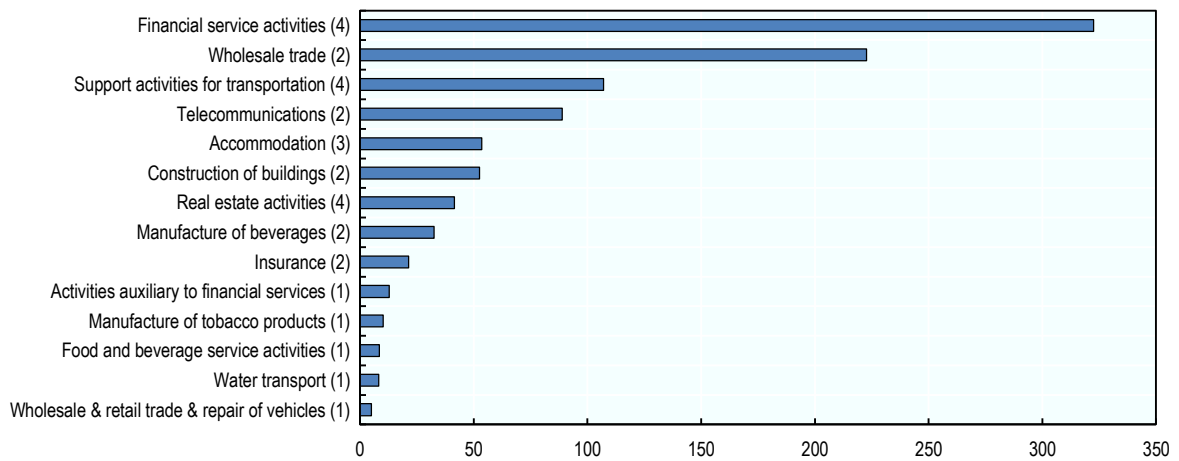
	Dividends ^[1]	Interest	Royalties
Bahrain	0	0	5
Barbados	5	5	5
Belgium	15	5/10 ^[2]	5
Bermuda	0 ^[3]	0/5 ^[4]	5
Botswana	10	7.5	10
China	5	10	10
Cyprus	0	0	5
Eswatini	10	7.5	10
Ethiopia	5	5	5
Guernsey	0	0	5
Indonesia	10	10	10
Isle of Man	0	0	5
Jersey	0	0	0
Kenya	5	10	10
Luxembourg	10	5	5
Malaysia	10	10	10
Mauritius	0	0	0
Monaco	7.5	5	10
Oman	5	5	10
Qatar	0	0	5
San Marino	0	0/5 ^[5]	0
Singapore	0	12	8
South Africa	10	0	0
Sri Lanka	10	10	10
Thailand	10	10/15 ^[6]	15
United Arab Emirates	0	0	5
Vietnam	10	10	10
Zambia	10	5	10

Note: Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the Government, including local authorities thereof, a political subdivision, the Central Bank or any financial institution controlled by the Government. Such exemptions are not considered in the interest column.

1. Cases in which the recipient company holds at least 25% of the capital or the voting power of the paying company are excluded.
2. The rate of 5% applies to commercial debt-claims resulting from deferred payments for goods, merchandise or services supplied by an enterprise and 10% otherwise.
3. If the recipient is not a company, the domestic rate applies.
4. The 0% applies to Interest received by any financial institution where the beneficial recipient is a non-resident financial institution.
5. The 0% rate applies to interest on debt-claims or loans paid to banks and financial institutions and on deposits made with banking or financial institution; the 5% rate applies in all other cases.
6. Interest paid to financial institutions (including insurance companies) is subject to a withholding at the rate of 10%.

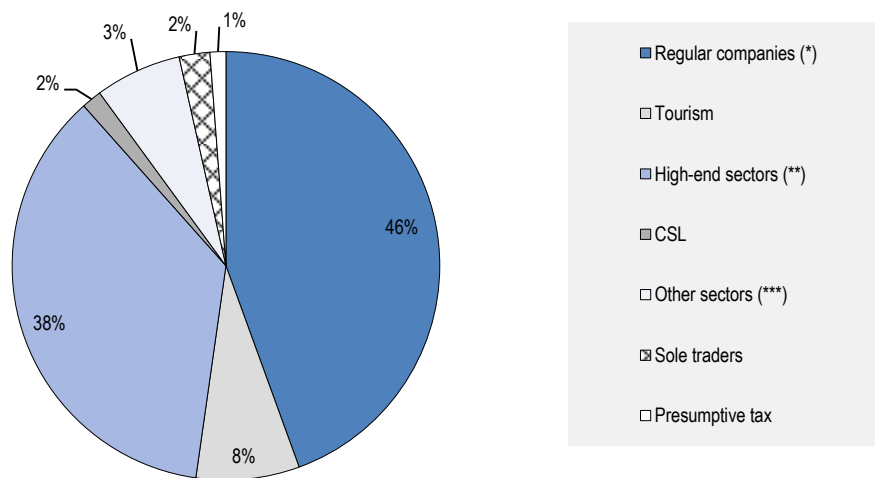
Source: IBFD.

Figure A.1. Breakdown of business tax revenue from top thirty corporations by sector (SCR million)



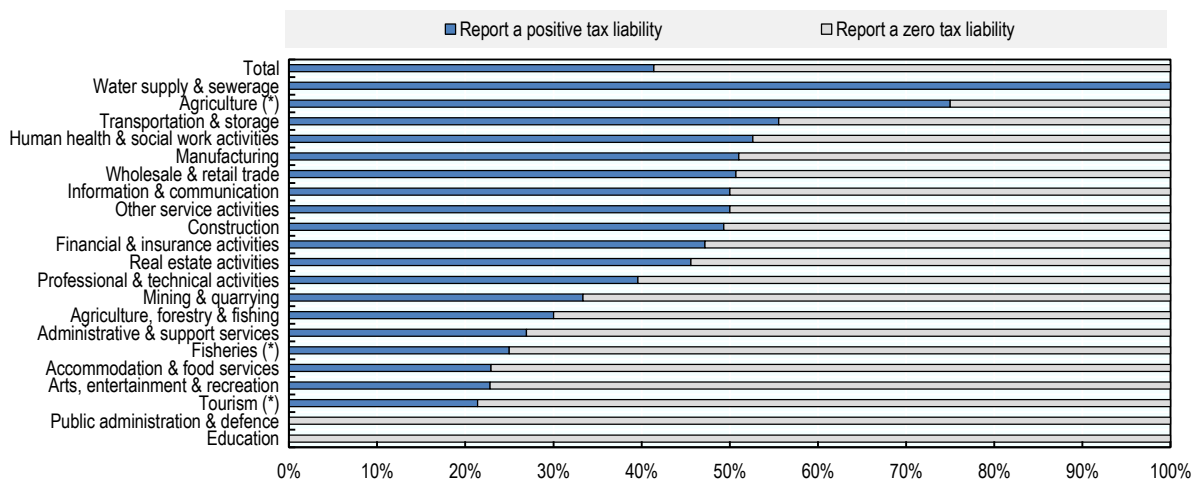
Note: Level 2: ISIC Division.
 Number of companies in brackets.
 Source: Business tax microdata.

Figure A.2. Breakdown of business tax revenue by tax regime



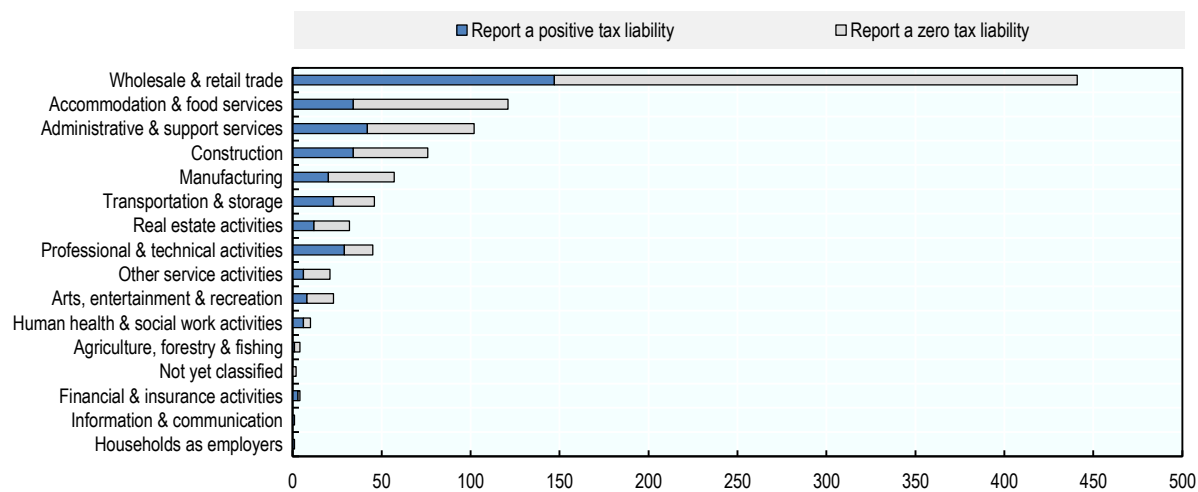
Note: (*) First SCR million taxable income taxed at 25%, remainder 30%.
 (**) Telecommunications service providers, banks, insurance companies, alcohol and tobacco manufacturers.
 (***) Includes Corporate Service Providers, non-resident aircraft and ship owners, medical service providers, agriculture and fisheries, residential and commercial rent and companies listed on the Seychelles Securities Exchange.
 Source: Business tax and presumptive tax microdata.

Figure A.3. Share of corporations under the regular business tax by tax liability status and sector



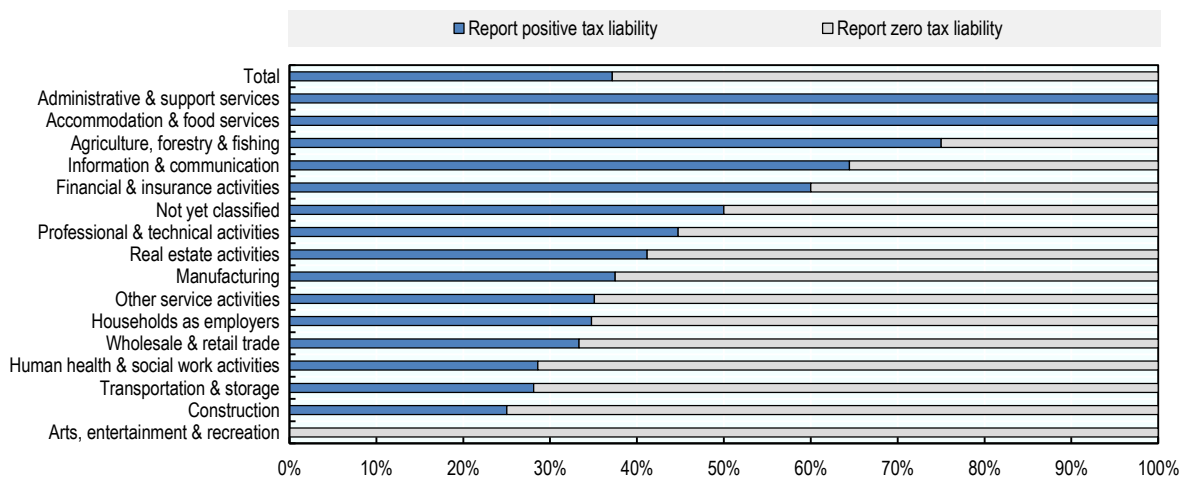
Note: Excludes Companies with Special Licenses, Corporate Service Providers, non-resident aircraft and ship owners and exempt companies.
 (*) Defined in line with the Business Tax Act.
 Source: Business tax microdata.

Figure A.4. Number of sole traders and partnerships under the regular business tax by tax liability status and sector



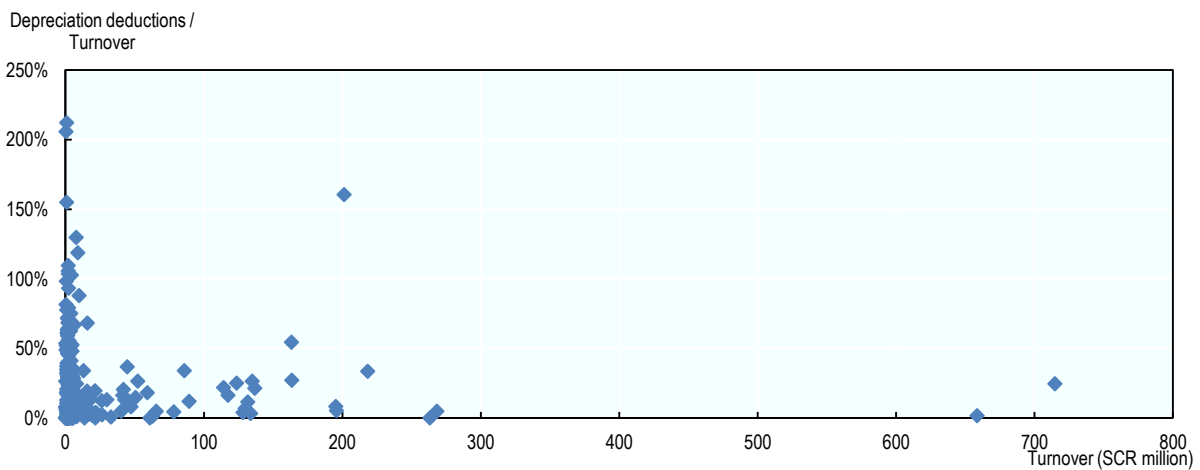
Note: Excludes exempt entities.
 Source: Business tax microdata.

Figure A.5. Share of sole traders and partnerships under the regular business tax by tax liability status and sector



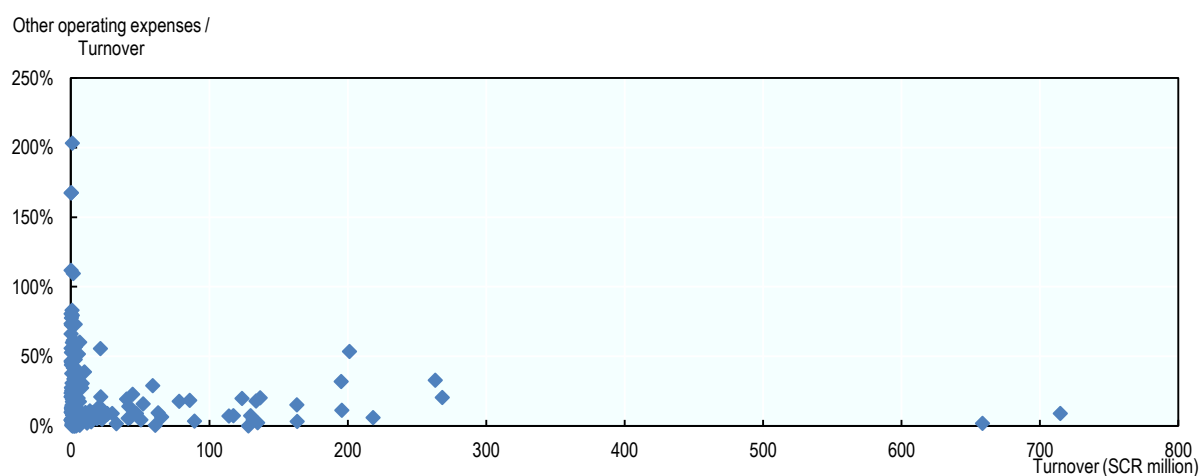
Note: Excludes exempt entities.
Source: Business tax microdata.

Figure A.6. Depreciation deductions in the tourism sector as a percentage of turnover by turnover levels



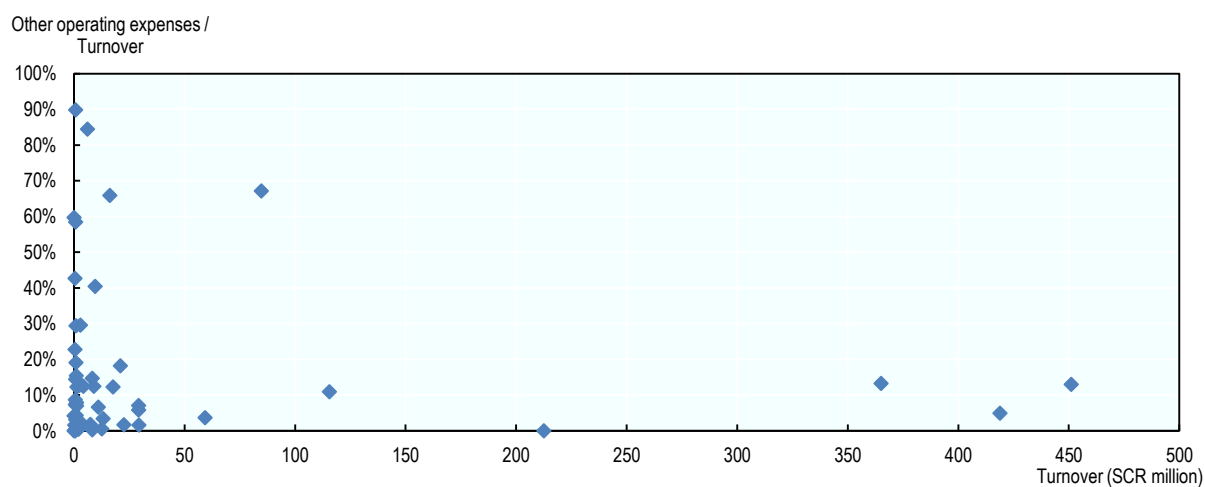
Note: Tourism is defined in line with Business Tax Act.
Source: Business tax microdata.

Figure A.7. Other operating expenses in the tourism sector as a percentage of turnover by turnover level



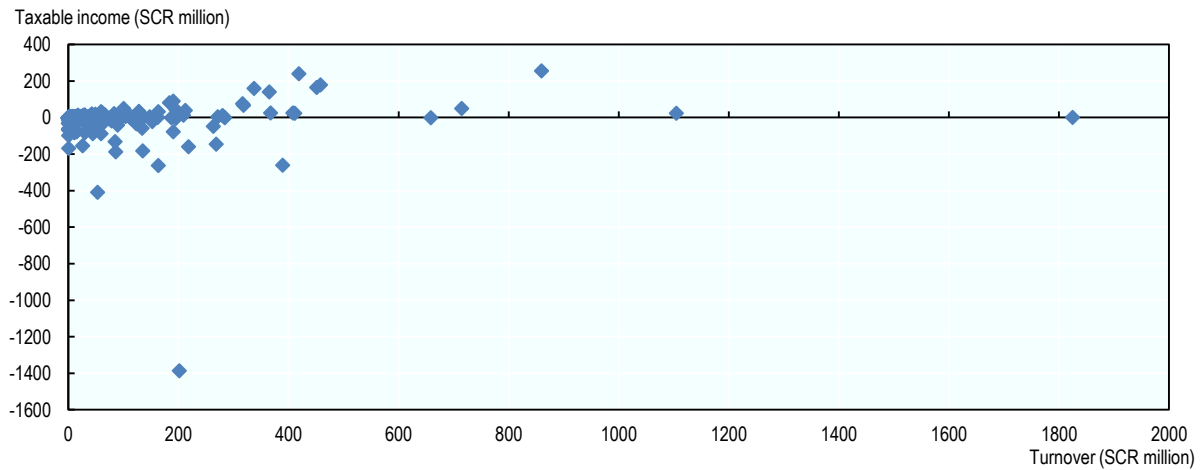
Note: Tourism is defined in line with Business Tax Act.
 Excludes TIN 89, 381, 439, 744, 1071 and 1391 because of extreme values.
 Source: Business Tax microdata.

Figure A.8. Other operating expenses in the financial sector as a percentage of turnover by turnover level



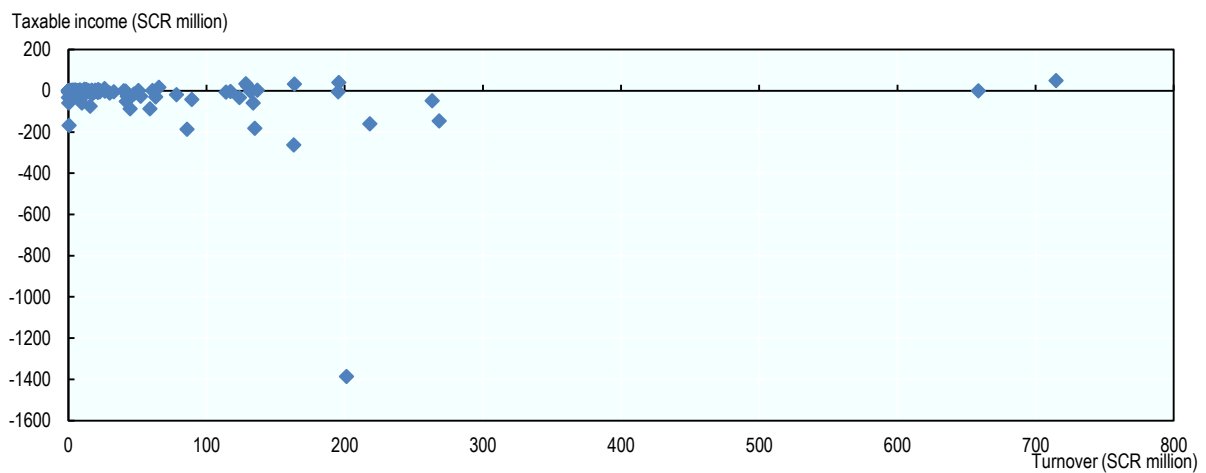
Note: Excludes Corporate Service Providers, Companies with Special Licenses and exempt companies.
 Excludes TIN 658 because of extreme values.
 Source: Business tax microdata.

Figure A.9. Corporations by taxable income and turnover levels



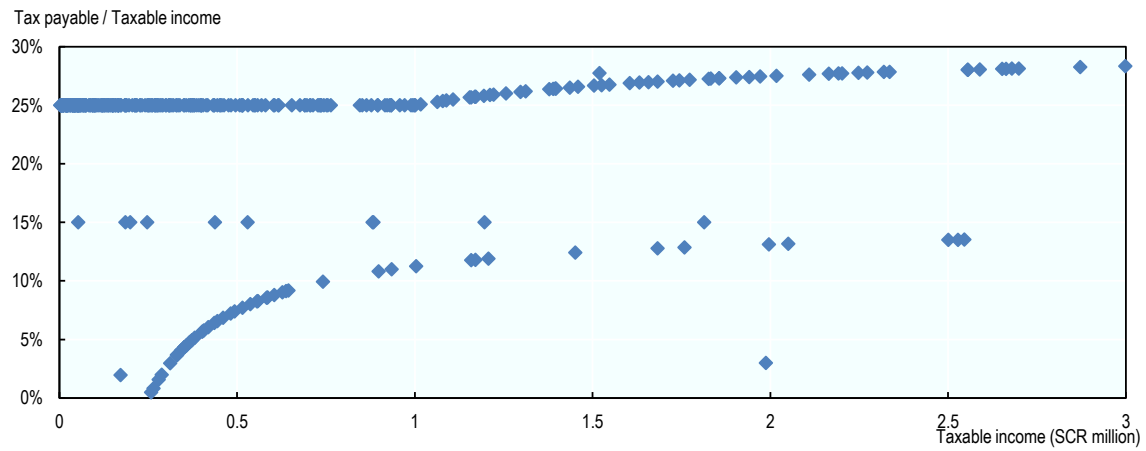
Note: Excludes Corporate Service Providers, Companies with Special Licenses, exempt companies and non-resident aircraft and ship owners. Excludes TIN 1189 to allow for a better visualization of companies with lower turnover levels.
Source: Business tax microdata.

Figure A.10. Corporations in the tourism sector by taxable income and turnover levels



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

Figure A.11. Effective tax rates by turnover levels



Note: Only corporations with positive tax liabilities. To facilitate visualisation the chart excludes a corporation with extremely high turnover (turnover SCR 5 041 million and a 30% effective tax rate).

Source: Business tax microdata.

OECD Tax Policy Reviews

SEYCHELLES

This report is part of the *OECD Tax Policy Reviews* publication series. The Reviews are intended to provide independent, comprehensive and comparative assessments of OECD member and non-member countries' tax systems as well as concrete recommendations for tax policy reform. By identifying tailored tax policy reform options, the objective of the Reviews is to enhance the design of existing tax policies and to support the adoption of new reforms. This report provides an assessment of Seychelles' tax system and recommendations for tax reform, with a focus on the business tax. Chapter 1 gives an overview of Seychelles' key economic and tax challenges. Chapter 2 provides a comprehensive assessment of Seychelles' business tax system and simulates the impact of different business tax reform scenarios, based on business taxpayer microdata. Chapter 3 focuses on improving the design of non-business taxes.

Consult this publication on line at <https://doi.org/10.1787/cba38d19-en>.

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