

Income Tax for Vanuatu??

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Key Points

- The Vanuatu government is looking at ways to introduce income tax to the island nation.
- It is unclear how an income tax regime will be formulated, however, the prospect has been extremely polarising.

Tax reform in Vanuatu

Vanuatu has no form of income tax for either businesses or individuals. Rather, the Customs and Inland Revenue Department (**CIR**) (the body responsible for the collection of duties and taxes) generates a majority of the government's income via value added tax (**VAT**), custom duties and licencing fees.¹

The Government has recently proposed introducing income tax due to a lack of funds for vital government services. An empirical analysis of revenue reform options carried out by the Revenue Review Committee (**RRC**) has highlighted the failings of VAT as an effective tax rate, compounded by the fact that a large number of enterprises operating in Vanuatu are not VAT registered.²

What is being canvassed?

The RRC released a consultation paper in September last year (**Paper**) which canvassed a range of options for reform and modernisation of taxation policy, focussing on three main areas: tax revenue, non-tax revenue and modernisation of Vanuatu's tax and customs administration.

The review by the RRC has highlighted the inefficiencies of the current revenue system where huge reliance is placed on VAT and import duties. These taxes have a direct impact on cost of goods and services, which affects lower income earners. The review also noted the bureaucratic processes of administering the fees payable at various levels to numerous agencies, which further adds to the cost of doing business in Vanuatu.

The introduction of an income tax will create a more equitable tax system – it takes into account the person's ability to pay, thus shifting the burden of providing for infrastructure, education and health services. However, revenue reforms will be futile if other fees and costs such as business license fees and rent tax are not removed or at least reduced to improve the ease and cost of doing business at other levels.

A variety of government bodies, politicians and other interest groups have proposed various tax schemes to fill this gap in government policy. For example, in September 2016 the Prime Minister Charlot Salwai proposed a new tax policy – taxing the richest 8 per cent of the population; those

¹ [https://customsinlandrevenue.gov.vu/index.php/en/inland-revenue;](https://customsinlandrevenue.gov.vu/index.php/en/inland-revenue)
<https://customsinlandrevenue.gov.vu/index.php/en/inland-revenue/rates-taxes>

² http://revenuereview.gov.vu/images/Publications/FINAL_Empirical_analysis_of_revenue_reform_options_161013_002.pdf

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making 500,000 Vatu.³ However, Finance Minister John Sala has proposed that a flat tax of 17% apply to residents making 750,000 Vatu or more, thereby only applying to the richest 3 per cent of the country.⁴ Opposition leader, Ishmael Kalsakau, has slammed the proposals, instead arguing that Vanuatu should explore more indirect forms of taxation, such as an overhaul of the VAT.⁵

What are the options?

Personal Tax Rate:

The RRC does not support a flat tax; rather it supports tax brackets similar to other countries in the Pacific. The empirical evidence supports the introduction of three tax brackets for personal tax rate:

| Tax Rate | Threshold | Tax Calculation |
|----------|--------------------------------|--|
| 0% | 1 vatu to 750,000 vatu | No tax if total taxable income is less than 750,000 vatu per year |
| 10% | 750,001 vatu to 3,500,000 vatu | 10 vatu for every 100 earned over 750,000 vatu per year |
| 17% | Above 3,500,000 vatu | 275,000 vatu plus 17 vatu for every 100 vatu earned over 3,500,000 vatu per year |

The RRC took these rates and applied them to the 6,000 employees in the public service and found that the effect would be minimal, on average creating a 4% tax on total salaries, while those in the top tax bracket would only effectively be paying 11.2% in tax. This proposed tax rate would mean 85% of the working population will not pay any income tax.

This tax rate was compared with two scenarios introducing even lower tax thresholds and lower tax rates. These proposals the committee found would be hard to enforce and affect people who could not even afford subsistence lifestyles.

Another comparison was conducted against a higher tax rate and higher threshold. However, this was found to discourage investment in Vanuatu.

Corporate Tax:

The RRC also recommended the introduction of a 17% corporate tax rate. Following an analysis of New Zealand corporate tax, the RRC extrapolated that this would only eventuate in an effective tax rate of 6.8%

Adopting a corporate tax rate would ensure that Vanuatu remained competitive within the region as a place to invest, and would ensure an effective tax rate that would genuinely benefit Vanuatu's revenue.

³ <http://www.radionz.co.nz/international/pacific-news/312769/vanuatu-income-tax-proposal-criticised>

⁴ <http://www.radionz.co.nz/international/pacific-news/312877/vanuatu-government-says-income-tax-would-help-pay-for-vital-services>

⁵ <http://www.radionz.co.nz/international/programmes/datelinepacific/audio/201815562/claim-vanuatu-pressured-to-have-income-tax>

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Risk of introducing tax to businesses:

The following assumptions were made to demonstrate the risk that introducing a corporate tax would have on the local economy:

- 1% of the manufacturing sector disappears
- there is 10% probability that 2% of the retail trade sector leaves
- there is 25% probability that 18% of the finance and insurance industry leaves
- there is a 5% probability that 35% of the professional, scientific, technical and administrative services industry leaves

Increasing VAT:

The RRC was strongly averse to the introduction of a higher VAT as this would increase the cost of living in Vanuatu. Currently, 80% of Vanuatu households spend the entirety of their income on subsistence consumption – any increase to VAT could have a devastating impact on the low income portion of the population.

What's next?

It's unclear whether Vanuatu will introduce income tax; however, the Government appears resolute in its attempts to amend the tax regime – it now looks as though change in some shape or form is inevitable.

PLN Advisory regularly advises clients on their taxation obligations. Contact **Jinita Prasad** to find out how these changes may affect your business.

Contact

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