Fiscal Support for Cottage and Small Industries

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Fiscal Incentives

Bhutan, like all developing countries, offers fiscal incentive packages that reduce direct as well as indirect taxes in various forms of tax incentives and exemptions, like general exemptions and sector-specific exemptions, with the intention of attracting investors and fostering economic growth. Fiscal incentive means slashing taxes legally as opposed to tax evasion, which means paying lower taxes by infringing the law.

The Fiscal Incentives Act of Bhutan 2017 and the Rules on the Fiscal Incentive Act of Bhutan 2017 stem from the Economic Development Policy 2016 (EDP) which sets the outline and the broad course for the expansion and growth of sectors that have the highest latent potential. EDP was prepared after consulting all the stakeholders in the government as well as the private sector to boost economic growth with a comprehensive, steady and clear policy framework. The goal for Bhutan was to achieve at least 10 percent economic growth and to be placed in the category of middle-income country by 2021.

Based on the Economic Development Policy 2016, the fiscal incentives were announced as part of the government's efforts to stimulate economic growth, foster private sector development and generate employment (Kuensel, June 3, 2017). The fiscal incentives include tax holiday, reinvestment allowance, income tax exemptions, tax rebate, Tax Deduction at Source (TDS) exemptions, Customs Duty exemptions and Sales Tax exemptions.

The General Incentives are applicable to all the sectors of the economy and Sector Specific Incentives are applicable to the priority sectors identified under Economic Development Policy of December 2016, including the five jewels.

- Direct Tax Incentives
- Direct Tax-General

Income tax exemption on convertible currency earnings from export, excluding INR earnings: The manufacturing and IT service industries can avail themselves of income tax exemption for 10 years on convertible currency earnings from the export of Bhutanese origin goods, based on a minimum value addition of 40 percent as set by the Ministry of Economic Affairs.

Reinvestment Allowance

Reinvestment Allowance (RA) of 25 percent is given to manufacturing and service industries for reinvestment undertaken in the form of capital expenditure between 8 May 2017 and 31 December 2020. This is for capital expenditure incurred for expansion of production capacity, modernisation, automation, product diversification and upgrading of production facilities, with corresponding quantifiable increase in the output or reduction in cost of production, including increase in efficiency.

RA is allowed as deductible expenditure in the income year following the completion of the project. It is allowed as deduction over and above the normal depreciation, provided that the reinvestment expense is capitalised in the books in accordance with the Bhutanese Accounting Standards. The company can either claim full deduction of RA in the same income year, or split the claim in phases, up to three subsequent years following the income year, subject to a maximum of 25 percent.

However, reinvestment should actually be undertaken in the business from general reserves and not through loans, and is supported by necessary development plans and other relevant documents. If reinvestment is undertaken from general reserves as well as through loans, 25 percent RA shall be allowed proportionate to the amount of reinvestment undertaken from general reserves. Reinvestment expenditure excludes expenditure on purchase of land, furniture and fixtures.

Tax Rebate to Industries Adopting Modern Technologies

Tax rebate of up to 15 percent of upgrading expenses for adopting modern environmentally-friendly technologies is applicable for industries adopting such technologies between 8 May 2017 and 31 December, 2020. The rebate is allowed only to the extent covered by the BIT/CIT amount payable for the income year and if the rebate amount is not covered, it is allowed to be carried forward to three subsequent income years following the income year. The condition for this is that the technological upgrade has to meet the criteria, specification, and standard prescribed by the law and recommended by NECS.

Tax Rebate for Employing 100 Percent Bhutanese Nationals

A tax rebate of 10 percent is allowed from the total tax liability to businesses employing 100 percent Bhutanese nationals throughout the year, with a minimum of 20 employees. This is applicable between 8 May 2017 and 31 December 2020.

Direct Tax-Sector Specific for Cottage and Small Industries (CSI) and Co-operative Sector

Income Tax Holiday for 10 years to CSIs and Co-operatives: This is applicable to newly established CSIs and Co-operatives. CSIs should be involved in the production and manufacturing of goods, excluding sawmills, non-integrated furniture units, mining, quarrying, and logging activities. In addition, priority service industries not included under the "sector specific incentives" shall be eligible for tax holidays based on the recommendation of the Ministry of Economic Affairs.

Waiver of income tax on interest income earned by financial institutions through preferential lending to CSI and Co-operatives: This is to encourage financial institutions to support the CSIs and Co-operatives financially through lending at preferential rates below commercial borrowing rates for the purpose of commercial expediencies. There is an additional 10 percent deductible expenditure for use of locally produced products to all CSIs sourcing locally produced raw materials for manufacturing.

- Indirect Tax Incentive
- Indirect Tax-General

Sales Tax (ST) and Customs Duty (CD) exemption on plant and machinery: Sales Tax & Customs Duty exemption on plants and machinery for manufacturing and service industry is granted until the date of commercial operation or 31 December 2020, whichever is earlier, for a new industry and plant and machinery required for the expansion, upgrading, and augmentation of an existing industry. Plant and machinery mean such plant and machinery that are peculiar to and directly related to the manufacture of the unit's product.

Sales Tax & Customs Duty exemption on permissible raw materials and primary packaging materials: ST exemption on permissible raw materials and primary packaging materials for manufacturing industry is granted until 31 December 2020. Raw materials are those items that are used as direct inputs in the manufacturing process and forming part of the finished product. Primary packaging materials are those materials that are required for packing, bottling and labelling, without which the product cannot assume its final identity with its brand name, or without which the product cannot be sold. Besides, the raw materials and packaging materials should be directly related to the manufacture of units' products specified in the licence issued by the authorised agency. The other important criterion is that the final product has to meet the value addition measures prescribed by Ministry of Economic Affairs.

For the import of raw materials and primary packaging materials for manufacturing industry from third countries, this is also granted until 31 December 2020, and manufacturing industries must earn their own convertible currency through the export of their finished products manufactured from the imported raw materials.

CD exemption is provided to the extent of the value of the import of raw materials and packaging materials covered by convertible currency earned. Only exports and its corresponding convertible currency earned between 8 May 2017 and 31 December 2020 is considered for CD exemption.

Payment of concessional customs duty rate of 3 percent on permissible raw materials and primary packaging materials: This is applicable to manufacturing industries that do not earn their own convertible currency to avail themselves of full or 100 percent CD exemption, and is granted until 31 December 2020. Manufacturing units must employ at least 80 percent Bhutanese nationals throughout the income year, to be eligible for CD exemption on industrial raw materials and primary packaging materials.

Indirect Tax - Sector Specific for Cottage and Small Industries (CSI) and Co-operatives Sector

Sales Tax & Customs Duty exemption on plant and machinery, permissible raw materials and primary packaging materials: This is granted until 31 December, 2020. The Customs Duty exemption is provided to the CSIs for purchase of raw materials/primary packaging materials, without having to comply with the convertible currency earnings requirements for import value up to USD 50,000 per annum per CSI.

Sales Tax & Customs Duty exemption on raw materials, equipment, and tools for artisans and craftsmen in rural areas. This facility is granted until 31 December 2020, applicable to those raw materials, equipment and tools that promote indigenous skills.

Conclusion

The exemption of sales tax and customs duty provided as per the Fiscal Incentives Policy is expected to result in the following sectorial benefits:

- Hydropower sector is encouraged to use high quality products in construction without bringing about cost escalation.

- Agriculture sector is expected to increase domestic agricultural products as seeds and tools are exempted.

- Mining sector is encouraged to bring about value addition to the domestically sourced minerals, as indirect tax is exempted on mining equipment and machinery. Tax holiday is also provided.

- Tourism sector enjoys tax benefits for hotel industry as well as for tour operators. Indirect tax exemptions are provided on interior furnishings of hotels to develop hotel infrastructure. Tour operators are also exempted from paying CD and ST on tourist buses, vans, and hiking equipment. Tax holiday is also provided.

- The CSIs & Co-operatives enjoy tax holidays, especially during their initial stage of set-up. Further, incentives in the form of CD and ST exemption on machinery, raw materials, and packaging materials are being provided to ensure that the products of the CSIs are competitive.

Fiscal incentives aim to create conducive environments for businesses by providing a transparent and suitable tax regime. The objective is to stimulate economic growth, private sector development, and generate employment. As quoted in a local newspaper, Business Bhutan (15 April 2017): "The scope of the new fiscal incentives is broader than the Fiscal Incentives 2010, as the incentives cover businesses apart from the sectors identified under the EDP."

Fiscal incentives are also intended to cut down the cost of production and increase the competitiveness of products, both within the country and also in the international markets. The incentive is expected to act as a stimulant to attract investments, which would also create jobs for youths and skills development.

The 2017 EDP has learnt from the experiences of 2010 EDP and has come up with game changers, and focuses mainly on the five jewels -- hydropower, mining, tourism, agriculture and CSIs. Likewise, the Fiscal Incentives 2017 has been geared towards supporting these five jewels broadly.

However, fiscal incentives come with a revenue cost. Table 1 below shows the summary of total taxes forgone under Fiscal Incentives by "major sectors and tax type" for the period January 2008 to February 2018.

Table 1: Summary of total taxes forgone under Fiscal Incentives by "major sectors and tax type" for the period Jan 2008 to Feb 2018 (Amount in Nu. million)						
Sl No	**Major Sectors**	**No of beneficiaries**	**Income Tax (IT)**	**Sales Tax (ST)**	**Customs Duty (CD)**	**Total**
1	Service	87	7.86	1316.28	3720.79	5044.93
2	Manufacturing	203	145.75	1121.01	3009.65	4276.41
3	Tourism (Hotel)	171	123.81	81.08	242.80	447.69
4	Health	17	0.00	25.36	184.27	209.63
5	Education	40	48.04	5.13	3.83	57.00
6	Tourism (Travel Agent)	79	0.00	6.33	22.55	28.88
7	ICT	7	9.27	7.99	0.95	18.21
8	Transport	46	0.00	9.25		9.25
9	Film and Media	20	3.05	0.82	1.52	5.39
	Grand Total	**670**	**337.78**	**2573.26**	**7186.36**	**10097.39**

Source: Ministry of Finance, Thimphu website.

The details of tax forgone can be viewed as per the link http://www.mof.gov.bt/news/fiscal-incentive-and-tax-forgone-from-2008-to-2018-04-apr-2018/

Revenue forgone from fiscal incentives should be quantified against expected benefits and reported. Where the benefits cannot be quantified, qualitative factors could be considered. The objective of the fiscal incentives is to satisfactorily meet our goals of attracting investors, fostering economic growth and creating much needed employment within the country, rather than serving a few individuals.