2024

BERMUDA FISCAL
RESPONSIBILITY PANEL

ANNUAL ASSESSMENT

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GOVERNMENT OF BERMUDA
Ministry of Finance

Bermuda Fiscal Responsibility Panel

Annual Assessment 2024

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List of Acronyms

BCE: Bermuda Constituent Entity
BHB: Bermuda Hospital Board
CIT: Corporate Income Tax
CITA: Corporate Income Tax Agency
CPF: Contributory Pension Fund
CPI: Consumer Price Index
GDP: Gross Domestic Product
GEHI: Government Employees' Health Insurance
GILTI: Global Intangible Low-Taxed Income
GMT: Global Minimum Tax
GloBE: G20/Inclusive Framework Global Minimum Tax
IMF: International Monetary Fund
MNE: Multinational Enterprise
MRF: Mutual Reinsurance Fund
OECD: Organisation for Economic Cooperation and Development
PSSF: Public Service Superannuation Fund
QRTC: Qualified Refundable Tax Credit
TRC: Tax Reform Commission

Executive Summary

This is the Panel's tenth annual report. We visited the Island from November 24 to November 29, and we had productive discussions with Ministers, officials, and many others. We are grateful for their contributions, but all the judgements and recommendations are our own.

Bermuda's economy has strengthened further over the past year, driven by international business and related services, but growth has been broad-based with accommodation and food services growing particularly rapidly and some progress made on diversifying the economy.

We expect the Government to remain within its fiscal guardrails, for the ratios of gross and net debt and debt service to GDP, for the forecast period. The Government's budget plans are consistent with its objectives of a balanced budget in 2024-25 and a surplus of $50 million in 2026-27. However, there has been a small but material amount of off-budget health expenditure. This is regrettable and should not be repeated.

The most pressing issues facing Bermuda relate to the introduction of a Corporate Income Tax (CIT) for companies in scope of the Global Minimum Tax. The Government has worked closely and effectively with stakeholders in developing the CIT; it now needs to accelerate the establishment of the new Corporate Income Tax Agency to administer the tax and put the necessary people and systems in place to implement it.

The potential additional revenues from the CIT mean Bermuda's existing fiscal framework requires substantial modifications. We recommend the following:

- In Budget documents, CIT revenues should be reported clearly and transparently, and clearly delineated from other government revenue sources, as is the case in Ireland.

- the government should balance the current budget without resort to the CIT revenues. That is, revenues, excluding CIT revenues, should meet or exceed current spending, including net interest[1], but excluding capital spending; this rule should be enshrined in statute.

We note that under the non-CIT revenue and spending projections tabled in the 2024/25 budget this rule would not preclude either significant reductions in existing taxes or spending increases aimed at reducing costs to business so as to ensure the Island remains a competitive jurisdiction, as well as alleviating cost of living pressures. As gross debt is paid down in future, the amount available to the current budget would increase. Depending on the economic conditions at the

[1] Marian Bell disagrees with the inclusion of debt interest. See paragraph 61.

time, such a large fiscal stimulus might not be prudent, in which case the constraint implied by this fiscal rule would not be binding.

Meanwhile, CIT revenues should be allocated to the following:

- Repaying Bermuda's outstanding long-term debt obligations. This should be the first priority, in particular the debt repayment of $605 million due in January 2027.

- Capital spending, subject to an assessment of capital needs and prevailing macroeconomic conditions to avoid inflationary overheating associated with large increases in capital spending.

- Building up a liquidity reserve or stabilisation fund with a target balance in the region of $1 billion, to cover lean years and shocks.

- Reducing the very large unfunded liabilities in the social insurance system

- Establishing a Sovereign Wealth Fund that invests in longer-term, less liquid assets, for the benefit of future Bermudians.

The Fiscal Responsibility Panel would evaluate and report on compliance with the fiscal rule and would make recommendations on the path of revenue and expenditure, as it does under the existing fiscal guidelines. It would also advise on the allocation of CIT revenues between debt repayments, stabilisation, capital expenditures, and other uses, although of course decisions are always a matter for the Government, subject to appropriate Parliamentary scrutiny and control.

Finally, it is vital that the fiscal space provided by the CIT does not distract from the urgency of addressing Bermuda's long-term structural challenges, especially demographic pressures and climate change.

Role of the Panel

The Panel is established to provide Bermuda's Parliament, Minister of Finance and the Financial Policy Council with an annual published assessment of the territory's fiscal strategy, focusing on progress in meeting the territory's medium term objectives for public spending, taxation, borrowing and debt reduction.

In its reports the Panel will therefore review:

1. Progress towards the Bermuda Government achieving a balanced budget by fiscal year 2024/25.
2. Compliance with the fiscal guardrails that Government has established — ratio of gross debt to GDP not to exceed 55%; ratio of net debt to GDP not to exceed 50%; and debt service to GDP not to exceed 3%.
3. Prospects for further progress towards meeting the longer-term aims of reducing debt and debt service to less than 80% and 10% of revenues, and for implementing the rule that net borrowing can only be considered to finance capital spending.
4. Advise on ways to refine these goals, and on adjustments to fiscal strategy and tax and spending policies needed to achieve them. If there are dissident views within the Panel, these will be included in its report.

Introduction

1. This is the Panel's tenth annual report. Our remit, shown in Box 1 above, is set out by the Minister of Finance in our letters of appointment; it reflects the government's fiscal targets as reiterated in the 2024 Budget Statement.

2. The Panel is comprised of Jonathan Portes (Chair), Marian Bell, and Victoria Perry. We greatly value the face-to-face interaction with Bermuda's key stakeholders, inside and outside government, that we gain from our annual visits, and we were therefore pleased that we were again able to visit Bermuda this year, between November 24 and November 29.[2] We had a full schedule of meetings and helpful discussions with Ministers and their officials, and thank particularly Chidozie Ofoego, Cheryl Lister, Tina Tucker, Deborah Harris, Carol Martin, and the other staff of the Ministry of Finance for their support. We would also like to thank the many others on the Island who have offered us information and advice (a complete list of our meetings is in Annex A). However, the report's judgements and recommendations reflect our own independent views.

[2] Marian Bell was unable to travel this year and joined all the meetings virtually.

A. Key findings of the 2023 Report

3. Our 2023 report noted that Bermuda's economy had strengthened. We expected the Government to remain within its fiscal guardrails for the forecast period and to achieve the targets of a balanced budget in 2024/25 and a surplus of $50 million in 2026/27. However, we also observed that over the medium to long term, Bermuda faces several serious risks to its economic and fiscal position: international economic and political developments; the adverse impacts of climate changes; an ageing population, adding to large spending pressures, explicit and implicit, from the pension and health systems; and the risk that changes to international tax rules might result in an exodus of companies from Bermuda.

4. Fortunately, the introduction of a corporate income tax (CIT) for companies coming within the scope of the Global Minimum Tax (GMT), if structured appropriately and implemented efficiently, offered an opportunity to address these challenges. Our view was that it was essential that the Government put in place a framework that ensures that any additional revenues are allocated in a way that retains international business, maximises the sustainable benefits to the people of Bermuda and mitigates the very serious risks we identified.

5. We therefore recommended:

- Bermuda should make an early and binding commitment to use a substantial proportion of the revenues from introducing a CIT for companies coming within the scope of the Global Minimum Tax to reduce Bermuda's net debt, eventually converting it to a net asset position.

- Some revenues should be held in a "stabilisation fund"; this would help insure against the risk of having to borrow at high interest rates on the open market if volatility was such that revenues fell below base budget needs in any year.

- A mechanism should be established to ensure that decisions on the allocation of the CIT revenues are taken transparently on the basis of independent expert advice and scrutiny, and do not jeopardise macroeconomic stability.

- The above recommendations should be enshrined in legislation on a fiscal framework.

6. We also made recommendations as to the objectives and structure of Qualified Refundable Tax Credits (QRTCs), and to the approach of the Tax Reform Commission (TRC) in recommending changes to the current tax system to modernise it and make it more progressive, including the introduction of a personal income tax at a low rate.

7. Beyond tax, we made a number of further recommendations, relating in particular to diversification (both geographic and sectoral), planning for and mitigating the impact of climate

change, and immigration and housing, where both policy changes and improvements to government processes are required.

B. Recent economic developments

8. At the time of writing the Panel's last report, the release of final 2022 Gross Domestic Product (GDP) data had been delayed by the cyber attack on government computer systems. We estimated that the economy had grown in the region of 3-4% to regain its pre-pandemic level, following a sharp 5.4% post-pandemic bounce in 2021. In the event, growth in 2022 was considerably stronger than we estimated, at 6.5%.

9. Since then, Bermuda's strong economic performance has continued. The economy is estimated to have grown by 4.9% last year and accelerated into 2024. International Business, followed by other Financial and Insurance activities and the Accommodation and Food Services sector made the largest contributions to growth in 2023. But growth was widespread across most sectors, with Accommodation and Food Services growing the most rapidly.

10. In the first half of this year activity is provisionally estimated to have been around 7½% up on a year earlier. The external balance again made the largest contribution to growth in the first half as exports of, largely business, services grew strongly. However, household consumption appeared sluggish, while government expenditure picked up as wages and salaries rose after a period of stagnation. Economy wide capital spending, which had been falling for several quarters, grew modestly in the second quarter.

11. In line with the stronger economy, the employment rate in November 2023 was 80% and the unemployment rate remained consistent with the historic low observed in March, at 2.8%, 3.3% for Bermudians. However, the unemployment rate for persons aged 16-24 was much higher at 13.5% and the number of jobs in Bermuda, although growing across multiple sectors remained below pre-pandemic levels. The Minister of Labour and Economy recently noted that plans which are underway to grow the workforce by 8,400 and bring Bermuda's old age dependency ratio in line with the OECD average are not likely to be achieved in the five year timeframe outlined in the Government's 2022 position paper "Addressing the Challenge of an Ageing Population in Bermuda". This is despite the growth in jobs over the last two years and measures that are being taken to retain and repatriate Bermudian workers and retain Bermudian seniors in the workforce.

12. Nevertheless, the stronger economic data suggest that other economic growth and diversification initiatives are beginning to bear fruit. The investment by Google in trans-Atlantic sub-sea communications, noted last year, has progressed with the signing in September by its

Bermuda subsidiary, Seagrass Services Ltd, of a $4.9 million lease of onshore land from the Bermuda Land Management Corporation to build a cable landing and data station. Plans for wave power generation using the renewable energy regulatory sandbox continue to advance, while proposals for floating solar generation are being developed. The Bermuda Blue (ocean) Prosperity Plan, incorporating the strategy for growing Bermuda's ocean-related industries has been published and a Marine Development Act, incorporating the Marine Spatial Plan, is being drafted. As of April 2024 [3], an additional economic empowerment zone had been set up in South East Hamilton, the online marketplace for local businesses was up and running, and good progress was noted on constructing affordable housing, developing an electric vehicle charging infrastructure, upgrading the Tynes Bay Water and Waste Treatment Facility and developing an agricultural strategy. Investors have been found for both vertical farming and medical tourism projects, the latter awaiting due diligence. In addition, the Bermuda Economic Development Corporation has solidified partnerships with international incubator/accelerator programmes to facilitate developments in Bermuda. Progress on extending access to healthcare and reducing its cost is steady but slow.

13. In line with the Economic Development Strategy 2023-2027, which has superseded the Economic Recovery Plan, there has been welcome progress in some other areas. Financing has been agreed and building work started on the refurbishment of the Fairmount Southampton complex, which should in time provide needed beds, supporting tourism and air traffic, as well as conference facilities in Bermuda. In line with our previous recommendations, the government plans to introduce legislative amendments to allow scrutiny of and, if necessary, prevent local mergers and acquisitions that could harm competition and drive up prices.

14. However, some earth stations aside, plans for a national space strategy have so far progressed slowly and, although the Banks and Deposit Companies Act 1999 was amended to allow restricted banks to provide banking services to entities licensed by the Gaming Commission, no such entities have so far been established. Plans for a fish processing facility and a cannabis ‘industry’ are subject to further review and are not currently progressing.

15. Consumer Price Inflation peaked at 5.1% in September 2022 amid higher inflation globally, but has since fallen back to hover around 2% and stood at 2.3% in August. Bermuda’s inflation rate has tended to be lower than that of its trading partners, despite high costs due to its remote island location, at least in part due to government measures to alleviate cost of living pressures. Over recent years duty on staple goods has been eliminated, the sugar tax reduced, fuel prices frozen and vehicle licensing fees reduced. This fiscal year, the standard premium rate of health insurance was frozen for the third successive year; this effectively transfers costs from individuals and households to the government budget, as discussed below.

[3] Latest Economic Recovery Plan update.

16. Bermuda's strong economic performance has been achieved despite the world economy slowing markedly in 2022 and into 2023 as policymakers responded to higher inflation. The slowdown was particularly pronounced in the advanced economies including in the US, the UK and Canada, Bermuda's major trading partners. Nevertheless, recession seems to have been avoided in most nations and global growth has stabilised at around 3% per annum, slower in the advanced economies, as inflation returns to target and policy interest rates ease. Debt burdens remain high, however, and bond yields elevated.

17. Tight fiscal policies are likely to be a drag on future world growth, as are ageing populations in the developed economies and slowing productivity growth in many countries, combined with rising regional conflicts and protectionism. In October, the IMF described the outlook for world growth as "stable yet underwhelming" with forecasts little changed from those in April when medium-term prospects for growth in world output and trade were "the lowest in decades"[4] particularly for the advanced economies, although the recent relative strength of the US economy has surprised.

18. Risks are to the downside. The global economy remains vulnerable to inflation, commodity price and financial market volatility, while the recent US election results have increased threats of protectionism, higher inflation, and slower growth in both the US and global economies. Enacting policy proposals to forcibly remove all undocumented migrants would reduce the US labour supply and disrupt business, slowing the economy, while high tariffs on imported goods will significantly increase prices in the US and slow growth in exporting countries. Together with likely higher budget deficits, this will lead to upward pressure on US dollar interest rates along the yield curve. As well as higher interest rates, of particular concern to Bermuda would be sharply higher import prices reflecting higher prices in the US, weaker demand from US tourists, and changes to US corporate tax which could result in a loss of tax competitiveness for Bermuda. Further out, risks from climate change, as well as more general political risks, are likely to be enhanced by the change in administration. Bermuda could also be vulnerable to any shift in the post-war international order and global defence alliances.

[4] IMF World Economic Outlook, October and April 2024.

C. Recent fiscal developments

19. At the time of our last report in December 2023, the deficit for the fiscal year 2022/23 (ending in March 2023) was estimated to be $48 million, compared to the budget projection of $70 million. The eventual outturn was $28 million. This better outcome was entirely due to greater than expected revenues. Meanwhile, current expenditure was kept in check at $945 million. Increased interest expenses for debt refinancing were partly offset by an underspend on capital expenditure.

20. This outperformance of revenues compared to forecasts appears to have continued for the 2023/24 fiscal year, with an increase in revenues to $1.19 billion, compared with the original projection of approximately $1.16 billion, and about 6% higher than the 2022/23 outturn. The strong underlying growth of the tax base (especially payroll tax) was only partially offset by tax cuts. Meanwhile, there was substantial unbudgeted extra spending, including an additional $16 million grant to the Bermuda Hospitals Board (reflecting historic deficits), wage rises for civil servants and teachers, and extra spending resulting from the cyber attack in late 2023. However, these were partly offset by savings elsewhere. In contrast to previous years, capital spending was slightly above forecast, although this may in part reflect extra grant allocations (for example to the Bermuda Housing Corporation) rather than actual spending. All this means that the overall deficit, at $22 million, was only half the original forecast, and slightly below that of 2022/23.

21. However, there were a number of off-budget expenditures, financed by payments from the Sinking Fund, including $33 million to finance a deficit of obligations over contributions in the Government Employee Health Insurance (GEHI) fund and "working capital" movements of about $25.5 million, largely reflecting the timing of payroll tax receipts. In addition, there was a payment of approximately $10m to repay the Bermuda Gaming Commission's outstanding credit facility under a government guarantee. As with previous calls on government guarantees (such as Caroline Bay at Morgan's Point), this does not increase the reported deficit, but does impact the net debt position. Taken together, this meant that net debt rose by approximately $80 million in 2023/24, considerably more than the reported budget deficit of $22 million.

22. The strengthening economy meant that revenues for 2024/25 were projected in the Budget in February 2024 to reach $1.23 billion, about 3% higher than the estimated 2023/24 outturn. As in previous years, this is almost entirely driven by buoyant payroll tax revenues, which are forecast to rise by more than 10%. Much of this increase is accounted for by the rebasing of the new hire relief. While this has been extended for a further two years to 2026, the baseline year has been adjusted, meaning that it will be significantly less costly in 2024/25 and beyond, with a resulting revenue increase of about $30 million.

23. Meanwhile, current expenditure, at $992 million, was expected to rise only slightly compared to estimates for the 2023/24 year, even after additional funding was allocated to establish the new Corporate Income Tax Agency (CITA). With interest payments coming down slightly to $128 million, this allowed an allocation of $112 million to capital expenditure, which would represent a significant increase on last year's spend of $98 million. Taken together, this allowed the government to present a budget for the current fiscal year that was almost exactly in balance.

24. However, as of the end of September, revenues are once again projected to exceed the Budget forecast in the current fiscal year, by about $30 million—again primarily due to higher than forecast payroll taxes—even after taking account of an in-year cut in energy taxes of about $10 million. This is partially offset by the government's announcement of a $25 million mid-year package of extra spending (of which about two-thirds is current spending and one third capital) on primarily social measures, including extra resources for mental health services and crime prevention. The overall impact is that the budget is now forecast to be in surplus by $4 million; if, as in previous years, departments do not spend up to their expenditure limits, and payroll tax revenues increase even further relative to current projections, this may prove to be a conservative estimate.

25. At first sight, then, the government will meet its target of budget balance in 2024/25 with room to spare, and the experience of the last two years suggests that, absent any other major shock, the projected surplus may if anything be exceeded, since revenue has consistently exceeded forecasts and there may be a return to capital underspends, while current spending appears to be reasonably well controlled. The projections for 2025/26 and 2026/27 also now appear pessimistic, since they imply revenue growth, excluding the CIT, of only 1% in 2025/26.

26. However, as with last year's reduced deficit, the apparent "balance" this year is at least in part illusory. The Budget also announced an extra off-budget allocation of $30 million to the Mutual Reinsurance Fund (MRF), which in turn partly funds the Bermuda Hospital Board, as well as some other health-related expenses. This largely compensates for the continued freezing of the Standard Premium Rate of health insurance premiums payable to MRF for the Standard Health Benefit by employees (and their spouses). It also seems likely that additional financing will be required, as in 2023/24, to compensate for deficits in the GEHI. The Budget also announced that the government would invest an additional $10m into the Bermuda Housing Corporation for affordable housing, although this represents the provision of notional collateral rather than actual expenditure and the funds remain technically within the Sinking Fund.

27. While these health-related expenditures are not funded by additional gross borrowing, they are nonetheless – in either economic or government accounting terms –government spending, according to internationally accepted definitions. Importantly, they result in an increase in the government's net debt, which indeed is forecast to rise from $3.12 billion at the end of 2022/23, to $3.20 billion at the end of 2023/24, and $3.23 billion at the end of 2024/25, with the differences between the change in net debt and the reported budget balances being broadly accounted for by these off-budget allocations. This can be seen in the net debt figures in the table below.

Table 1: Key Bermuda Fiscal Aggregates ($1000)

	2022/23 Budget Estimate	2022/23 Actual	2023/24 Budget Estimate	2023/24 Actual	2024/25 Budget Estimate	2024/25 Projected	2025/26 Budget	2026/27 Budget
Revenue	1078000	1127000	1155525	1186910	1232341	1261344	1275473	1320114
Current Spending (exc debt interest	945100	932100	972632	963606	992017	992017	1006897	1022001
BHB Subsidy		15000		16323				
Economic relief package						17638		
Current Balance (exc debt interest)	132900	179900	182893	206981	240324	251689	268576	298113
Debt Interest	129700	140600	130400	130554	127777	127777	127777	127777
Current balance	3200	39300	52493	76427	112547	123912	140799	170336
Capital expenditure	73000	67400	96007	98217	112337	119679	116000	120000
Budget surplus (deficit)	-69800	-28100	-43514	-21790	210	4233	24799	50336
Off-budget spending				57799		30000		
Change in net debt	69800	28100	43514	79589	-210	25767	-24799	-50336
Net debt (end of year)		3120338		3199927		3225694	3200895	3150559
Sinking Fund		223554		93965		68198	92997	143333
Gross debt (end of year)		3343892		3293892		3293892	3293892	3293892

28. Beyond that, the Budget marked out a path to the target of a $50 million surplus in 2026/27, based on the assumptions of 3.5% revenue growth, 1.5% growth in current spending, and some further modest growth in capital spending, again excluding any additional revenues from the CIT.

D. Panel assessment

29. Bermuda's finances are generally well-managed by international standards. The fact that estimated outturns for overall revenue and expenditure – and hence the deficit – for 2023/24 are

similar to those in our last report, despite some in-year pressures, shows the government's commitment to meeting its targets.

30. We welcome the Government's continued commitment to a balanced budget in 2024/25, and to achieving the $50 million surplus target for 2026/27. However, the fact that both the 2023/24 outturn, and the 2024/25 target have only been met by shifting some expenditures off-budget is regrettable, and means that the overall fiscal position is somewhat less favourable than presented by the government. Bermuda's net debt is still rising.

31. Of particular concern is the use of off-budget financing to effectively plug deficits, first in the GEHI (in 2023-24) and then in the Mutual Reinsurance Fund (in 2024-25). Essentially, unless corrective actions are taken, this represents an ongoing government commitment to extra spending, so as to reduce the financial pressure on individuals from health insurance premiums. This is an entirely legitimate policy objective, but it is also clearly a government spending commitment and one that adds to the government's deficit. As a result, the Sinking Fund is projected to fall below $70 million in the current financial year.

32. It also calls into question the spending projections for 2025/26 and 2026/27, which assume continued revenue growth and tight control over current spending; but if, as in the past three years, there is a substantial financing gap in the health sector, experience suggests that the government will again increase spending – on or off budget - to fill the gap.

33. The Ministry of Finance has assured us that actions are underway to address both the GEHI shortfall (the GEHI Board has agreed to a change in policy to address excess payments made for prescriptions) and the financial imbalances in the MRF ahead of next year's budget. We emphasise the need for such corrective actions to be implemented as a matter of urgency.

34. The Government's gross debt position has not changed materially since our last report; after successive refinancings, discussed in detail in previous reports, no repayment is required until 2027 (the local issue of $50 million due at the end of 2023 was repaid from the Sinking Fund). However, the practice of funding off-budget expenditure from the Sinking Fund, means the net debt position has deteriorated further.

Table 2: Bermuda Government Debt Outstanding			
	Amount ($M)	Coupon Rate	Maturity Date
	604.6	3.72%	01/25/2027
	449.3	4.75%	01/11/2029
	675	2.38%	08/20/2030
	890	5%	7/15/2032
	675	3.38%	8/20/2050
Total	3293.3		

35. As we have noted in all of our previous reports, simply looking at Bermuda's public debt significantly understates the country's potential liabilities given the size of the contingent liabilities and guarantees, implicit or explicit, that might ultimately have to be financed by Bermuda's taxpayers, directly or indirectly. The most recently reported actuarial deficits of the Contributory Pension Fund (CPF) and Public Service Superannuation Fund (PSSF) sum to approximately $1.8 billion. This means that the sum of the Government's official debt and unfunded implicit pension liabilities remains around $5 billion, or about 4 times annual revenues. On top of this are the potential liabilities presented by Government guarantees, in particular that to the BHB and recently issued guarantees for the refurbishment of the Fairmount Southampton and the Bermudiana Beach development.

Table 3: Bermuda Government outstanding debt and approximate implicit/potential liabilities ($m)	
Existing net debt	3,200
CPF	800
PSSF	1000
Bermuda Hospital Board	270
Other miscellaneous guarantees	300
Total (approximate)	5,570

[1] As noted above, this will be very substantially reduced if proposed measures to address the actuarial deficit are implemented.

[2] The value of the guarantee of the BHB's debt is shown in the Government's accounts as approximately $800 million, but this also includes future interest payments

[3] Where these are guarantees for commercial projects, they are contingent liabilities, which will not necessarily, but may, have to be financed by taxpayers.

36. The Panel's formal assessment of compliance with the government's targets and guardrails is set out in the box below. Briefly, while the overall picture is relatively positive, we are disappointed by the use of off-budget accounting to meet the balanced budget target this year; this should not be repeated. Going forward, it is essential that the government set out a coherent long-term strategy for the allocation of CIT revenues that puts Bermuda on a sustainable long-term fiscal trajectory. We discuss this in section F below.

Compliance with the Government's fiscal rules: The Panel's Assessment

1. Progress towards the Bermuda Government achieving a balanced budget by fiscal year 2024/25 and a surplus of $50 million in 2026/27.

The Government appears on course to achieve a balanced budget in 2024/25 and a surplus of $50 million in 2026/27. However, this has only been achieved by significant off-budget financing of about $30 million in 2024/25.

2. Compliance with the fiscal guardrails that Government has established — ratio of gross debt to GDP not to exceed 55%; ratio of net debt to GDP not to exceed 50%; and debt service to GDP not to exceed 3%.

Bermuda's current level of GDP (in 2023) is approximately $8.1 billion, implying limits of approximately $4.45 billion, $4 billion, and $250 million, for gross debt, net debt, and debt service respectively, in the current year.

With net debt peaking at about $3.2 billion, while gross debt has reduced to $3.3 billion, debt service costs of approximately $130 million, and strong nominal GDP growth, we expect all the guardrails to be observed throughout the forecast period.

3. Prospects for further progress towards meeting the longer-term aims of reducing debt and debt service to less than 80% and 10% of revenues, and for implementing the rule that net borrowing can only be considered to finance capital spending.

Net debt to revenue is forecast to fall below 240% over the forecast period, from a peak of more than 300%, which is welcome but still much too high. The debt service ratio is about 10% and falling, but may rise again when debt has to be refinanced, likely at higher interest rates in 2027. Progress towards meeting these longer-term objectives depend crucially on Government's decisions on the allocation of revenues from the Corporate Income Tax, as described below.

E. Corporate Income Tax (CIT)

37. Since the time of our last report, finalised in the last weeks of 2023, good progress has continued in the adoption and—shortly—the implementation of the CIT. The Corporate Income Tax Act 2023 was enacted in December 2023, with an effective date for corporate fiscal years beginning on or after January 1, 2025. The CIT will apply to Bermuda Constituent Entities (BCEs) of In Scope MNE Groups (those multinationals with turnover of €750 million or more).

38. In July 2024, the Corporate Income Tax Agency Act 2024 was passed, to establish the Bermuda Corporate Income Tax Agency (CITA). A consultation paper was promulgated with a comment period running from August 8 to September 5, 2024, to provide a preliminary high-level summary of the proposed taxpayer compliance framework for the CIT, and to obtain public feedback. It is contemplated that after draft legislation incorporating results of this consultation is published later in the year, a second consultation and comment period will follow before adoption of final legislation and regulations under the CIT legislation.

39. Several provisions of the current draft consultation document should be noted with approval as they accord—at least at this outline level—with international best practices in the tax administration field:

(i) primary interactions of all types between taxpayers and CITA will take place electronically through an on-line portal, including registration, filing, processing of payments, communications regarding compliance and enforcement, and access to compliance aids including technical guidance;

(ii) instalment payments will be required in-year, in the 8th and 12th months of the taxpayer's taxable year, with final reconciliation and payment due at the time of final filing in the 10th month after the close of the taxpayer's fiscal year—with this provision due to commence in August of 2025 for the 2025 fiscal year, the first year of the CIT's implementation;

(iii) the statute of limitations for questioning returns will be three years, unless extended by mutual agreement; and

(iv) overpayments of tax will accrue interest at a published reference rate, while underpayments will accrue interest owed to the government at a slightly higher rate.

40. As of the time of drafting of this report, some progress has been made in setting up the agency, in particular hiring a CEO who will take up the position as of January 1, 2025. Given that initial payments are at this point expected to be due from in-scope BCEs just nine months from now, it will be critically important that the pace be accelerated in finalising the implementation rules—currently expected in early 2025—, in hiring and preparing the staff for the CIT Agency, and in putting in place the relevant IT framework.

41. In part as a result of the effectiveness of the communication between the government and key stakeholders, including the Bermudian international business sector—the locus of most of

the in-scope companies for the CIT—the potential mentioned in our last report for a possible negative reaction by in scope companies to the overriding of the tax assurance certificate program by the adoption of the CIT has not come to pass. To date, business remains on-side, and on-island. The government should be congratulated for the way it has handled the exceptionally difficult, and complex, issues arising in designing the CIT to date. But it is important that this progress is maintained and indeed accelerated given that the first stages of implementation are now imminent.

The Tax Reform Commission

42. In parallel with the continued work to finalise elements of the CIT, the Tax Reform Commission (TRC) was reinstated and began work in 2024 to consider potential reforms to Bermuda's existing tax system in the light of the introduction of the CIT, with the aim of improving Bermuda's competitiveness, reducing the cost of living and doing business on the island, and making the tax system more equitable. The final report of the TRC, which was originally scheduled for October 2024, is now not expected until 2025, but interim advice might be available to inform the upcoming budget round.

43. The TRC is also considering what behaviours Bermuda should choose to incentivise through the tax system. Possibilities are broad, including but not limited to hiring and/or training mandates of some type(s), provision of health benefits, and physical investment. All of these could potentially benefit Bermuda. The Panel's view is that any such incentivised behaviours be developed with the longer term in mind—they should constitute real investments in Bermuda's future, and should be carefully designed not to simply add to or replace current spending.

44. Our last report noted that in the Panel's view the TRC should also explore the modernisation of Bermuda's overall tax system, particularly through the consideration of a personal income tax (PIT) at a low rate that would include in its base the salaries and wages currently taxed through the payroll tax system, but also some form of capital income taxation that would increase both the equity and efficiency of the overall tax system. This remains our view.

F. Future fiscal policy in the light of the Corporate Income Tax

Uses of CIT revenues

45. The introduction of the CIT, and the potentially very large future revenues (relative to the size of Bermuda's economy and its existing revenue base) clearly changes Bermuda's future fiscal landscape. In the 2024/25 Budget, the Premier reiterated a projection that the CIT could potentially bring in additional annual revenues of the order of $750 million. No updates to that

estimate have been made by the government. Given the complexity of the interactions of the CIT with the GloBE, the US GILTI (Global Intangible Low-Taxed Income), and the overall international tax architecture of Bermuda's partner countries, any finer estimates will require detailed analysis on a company by company basis. Nevertheless, it can be assumed that additional revenues resulting from the introduction of the CIT will be substantial, at least in the short to medium term.

46. However, as noted in last year's report, CIT revenues may well prove volatile and temporary, depending largely as they do on the profitability – and tax strategies -- of a few very large in scope MNEs. Moreover, although the government has been exemplary in its communications and interactions with international business and other stakeholders thus far, the continued residency in Bermuda of in scope companies for all time cannot be assumed and will be dependent on domestic, international, and corporate developments, many of which are beyond the government's control.

47. The Panel therefore reiterates the discussion in its last report regarding the need to regard this revenue as a volatile and potentially time-limited windfall, comparable to that stemming from an oil or gas discovery, rather than a permanent increase in revenues. Basic economic theory – the so-called "Golden Rule", which is included in Bermuda's existing fiscal rules, that current spending should be covered by ongoing current revenues, and borrowing should only be used for capital spending - as well as the guidance of the IMF, suggests that such revenues should not be used to directly fund recurrent current expenditure or permanent cuts in other taxes, at least until there is considerably greater certainty over their medium to long-term sustainability.

48. We therefore recommend that, in Budget documents, CIT revenues should be reported clearly and transparently, and clearly delineated from other government revenue sources. Ireland, which reports "windfall" corporation tax revenues separately from "structural" revenues, could be a model here.

49. There will be strong pressures to "spend" these CIT revenues on either tax reductions or spending increases. Companies, both within and out of scope, would like to see the already high costs of doing business in Bermuda reduced and there will be entirely understandable pressures to use some portion, at least, of any additional revenues to ease the considerable burdens of the current generation of Bermudians, particularly the less well off.

50. However, significant front-loaded tax cuts or spending increases might well not be sustainable, and would risk imposing considerable harm later on should revenues diminish,

requiring taxes to be raised or expenditure slashed. Moreover, as we argued previously, boosting domestic demand could be inflationary, particularly in an economy running at full capacity and with a very tight labour market. The result could be increases in both prices and nominal wages, negating the real benefits, and making domestic businesses uncompetitive (a form of what is often referred to as "Dutch disease").

51. The priority for the allocation of CIT revenues should therefore be to reduce Bermuda's very large outstanding net debts, the servicing of which imposes a considerable burden on the current generation of Bermudians. As noted in all of the Panel's previous reports over the past decade, this priority stems from the following:

- Bermuda's high debt levels relative to its relatively small secure revenue base, levels that are considerably higher now than when the Panel first began its work;

- The reliance of both Bermuda's economy and government revenues on a relatively small number of large companies in the international business sector;

- Bermuda's reliance on external, US dollar-denominated borrowing, and hence its vulnerability to either a loss of confidence in Bermuda's economic and fiscal policies, a generalised rise in global interest rates, or other developments in international debt markets;

- the very large unfunded liabilities of the pension and health system that, while not contributing to the headline debt total, are effectively long-term obligations of government;

- the myriad risks facing the island, which were the focus of last year's report, including Bermuda's long term demographic challenge, which over time will mean a large contraction in the working age population, with increased spending pressure on health and pensions.

52. The substantial majority of additional revenues from the CIT should therefore be saved to improve Bermuda's net financial liability/asset position and insure against future shocks. Although any such savings will reduce net debt – which is the primary consideration for

Bermuda's overall financial position and credit worthiness – it is likely to be useful to designate, and restrict, funds for different purposes. These could in principle include funds for the following:

- Repaying Bermuda's outstanding long-term debt obligations, rather than rolling them over or refinancing them; this should be the first priority, as a significant portion becomes due over the next few years.

- Building up a liquidity reserve or stabilisation fund: that is, a liquid credit balance that can be used both to smooth the likely volatility of CIT receipts and in the event of other unexpected economic or fiscal shocks.

- Reducing the very large unfunded liabilities in the pension system (this would not reduce measured net debt, but would reduce the government's effective long-term financial obligations), as well as addressing the issues relating to financing of the health care system. In both cases, this should not simply involve the provision of extra government financing, but would need to be accompanied by reforms designed to control costs.

- Establishing a Sovereign Wealth Fund that invests in longer-term, less liquid assets, for the benefit of future Bermudians. This would follow the models of, for example, Norway, which invests a large proportion of its revenues from fossil fuels in its state-owned wealth fund and, more recently, Ireland which invests proceeds from its CIT.

53. Reducing debt, and accumulating net assets, will also, over time and in a fiscally prudent way, relax the existing constraints on the current budget. As the debt and the cost of servicing it diminishes, eventually turning into an income, the underlying budgetary position will improve, enabling sustainable tax cuts and expenditure on public services for the benefit of the population. We note that this is broadly the successful model followed by Norway for the allocation of its oil and gas revenues.

54. The 2024 Throne Speech stated the following:

> "To support the implementation of Bermuda's corporate income tax regime, legislation will be introduced to update the corporate income tax framework and address matters relating to use of excess tax revenue. Based on the recommendations from the Tax Reform Commission and the International Tax Working Group, this legislation will codify how funds collected by the corporate income tax regime will be reserved for use.

> The projections state that within the next ten years, the Government should have enough in additional tax receipts to eliminate Bermuda's debt and establish a sovereign wealth fund to make strategic investments for Bermuda's future."

We welcome this commitment, which is consistent with our recommendations in our last report in which, based upon an estimated $750 million per annum of CIT revenues, we recommended that at least $350 million a year be allocated to reducing net debt with a view to eliminating it over 10 years.

55. However, the future repayment schedule in Table 2 above implies a more ambitious annual target for the next few years. We would now go further and propose that, for the medium term, all CIT revenues not needed for warranted capital projects (see below) are first allocated to reducing net debt. Repayment of some US$2.6 billion is due in the next eight years, some of which has high coupons which could merit repaying early.

56. This repayment of debt should begin as soon as the first year's CIT revenues are fully accounted for. Estimated CIT payments will begin to be paid in the latter part of calendar year 2025—that is, about the middle of fiscal year 2025/26. However, until taxpayers have submitted final returns in late 2026, such revenues are payments on account rather than certain revenues, and most or all should be held in some form of suspense account rather than treated as available government revenues. They will thus not be available to the government until fiscal year 2026/27. A US$604.6 million debt repayment is due toward the end of January 2027.

57. As in our last report, and above, we recommend the establishment of a stabilisation fund, invested in relatively liquid assets, which can be drawn down to protect the budget against fluctuations in income and economic or other shocks. The size of such fund should be related to the variability of revenues allocated to the underlying budget (and include any CIT revenues so allocated against our advice) and the possible impact of shocks. Using the recent pandemic, or the global financial crisis of the late 2000s (which resulted in an increase in Bermuda's net debt of over $1 billion) as a yardstick would suggest building a stabilisation fund in the region of $1 billion as soon as funds allow. The existing Sinking Fund currently serves this purpose: it could and should be rebuilt and redesignated. One task of this Panel (or its successors) would then be to make recommendations on the timing of withdrawals from and additions to the stabilisation fund to stabilise the economy and the public finances.

58. As well as reducing debt, non-recurring capital expenditure which adds to public sector net worth would also be warranted, particularly in projects which yield a future income or mitigate the myriad risks facing the island, which we enumerated in last year's report. Such projects might include investment in infrastructure and in the long-term resilience of the island, including energy and food security and mitigating the problems that climate change brings, as

well as investing in systems to improve government efficiency. We recommend the establishment of a body that would be charged with determining Bermuda's long-term investment needs and priorities.

59. The availability of funds notwithstanding, the pace of capital expenditure will need to be measured, carefully calibrated by the capacity constraints of a small island economy, so as not to ignite inflationary overheating nor jeopardise the balance of payments, although the latter constraint is unlikely to prove to be binding. The amount which can be allocated safely to capital projects will vary with the economic cycle.

The future fiscal framework

60. The current fiscal framework, medium term objectives and fiscal guardrails outlined in Box 1 will become redundant in the light of additional expected revenues from the introduction of the CIT and will need replacing. In addition to the guidelines and rules on using the CIT revenues outlined above, we recommend a new fiscal rule: to keep the underlying current budget, excluding CIT revenues, in balance or surplus. In other words, revenues, excluding CIT, should meet or exceed current spending. Current spending includes net interest[5], but excludes capital spending. This rule is often referred to as the "Golden Rule"; versions of it are in use in several countries.

61. However, as Bermuda will shortly be in a position to repay its debt, Marian Bell is of the view that it would be appropriate to target the primary current balance, which excludes debt interest payments as well as capital spending; that is, non-CIT revenues should exceed current spending excluding debt interest payments. Debt management and asset management decisions would then be free of current budget considerations and based on financial market conditions.

62. We note that this rule, while ensuring that CIT revenues are saved and invested for the future benefit of Bermudians rather than financing current spending (or, in the view of the majority, paying the interest resulting from past spending), would not preclude substantial reductions in tax (or increases in current spending) compared to current plans. The projections shown in Table 1 above imply a current surplus, after debt interest payments, of approximately $170 million[6] in 2026-27, which would in principle be available for reallocation, whether to reduce costs to business so as to ensure the Island remains a competitive jurisdiction, or to alleviate cost of living pressures. This amount would grow in future years as a consequence both of economic growth and reductions in debt interest as the debt is progressively repaid., The resulting overall budget deficit would, of course, need to be financed and depending on the

[5] "Net interest" here means the value of debt interest payments payable on debt, net of any interest revenues. The rule would thus mean that while CIT revenues could not be used to finance current spending, in future interest on assets accumulated from those revenues could.
[6]The primary surplus, excluding debt interest payments, is forecast at around $300 million.

economic conditions at the time, such a large fiscal stimulus might not be prudent, in which case the constraint implied by this fiscal rule would not be binding.

63. We recommend that this rule and the guidelines on the use of CIT revenues should be enshrined in statute. The Fiscal Responsibility Panel would continue to evaluate and report on compliance with the rules, as now, and make recommendations on the path of revenue and expenditure. It could also advise on the allocation of CIT revenues between debt repayments, the establishment and use of a stabilisation fund, and capital expenditures, in the light of the prevailing fiscal and economic conditions, although of course decisions would be a matter for the Government, subject to appropriate Parliamentary scrutiny and control.

G. Other issues

64. The likely increase in revenues resulting from the CIT is a huge opportunity for Bermuda and their allocation will rightly be the focus of attention and of much debate among politicians, policymakers, business, and civil society. However, as our report last year discussed in depth, Bermuda faces several very significant challenges and risks, both in the short and longer terms, and indeed events since then suggest that some of those risks are in the process of materialising. So it is essential that Bermuda does not use the fiscal space provided by those revenues as an excuse for not addressing the long-term structural economic, social, environmental and demographic challenges the Island faces. Indeed, that fiscal space should enable real solutions. Once again, we reiterate our recommendations on a number of important topics:

(i) Large and persistent deficits remain in the PSSF and CPF. Reforms, including increased contributions and higher retirement ages, have now been agreed for the former and should be implemented as soon as possible; the Government should aim to progress similar changes to the CPF.

(ii) Progress on reforming the health care financing system has been extremely slow, and in the meantime it appears that the government has resorted to short-term measures – including the use of off-budget financing – to meet ever-increasing costs while containing the burden on households. Measures are required in the short-term to control costs and reduce the large implicit liability to the government budget, while over the medium term the Government should implement planned health care reforms along the lines of the Bermuda Health Plan to provide affordable universal health coverage to a higher standard, and more efficiently, than that now available.

(iii) Bermuda needs to continue to diversify. Rather than 'picking winners' Bermuda should continue to ensure it has the legislative and governance frameworks in place to take advantage of its well-established position in insurance, as well as its strategic ocean location. This also means reducing Bermuda's reliance on the US as far as feasible, particularly given current geopolitical uncertainties.

(iv) Bermuda is at high and increasing risk from climate change, again exacerbated by geographical risks. The current serious and welcome focus on improving the resilience of the island to rising sea levels and extreme weather events must be sustained. The Climate Task Force should be adequately resourced and supported, and recommendations for increased climate resilience should be incorporated into all Government strategies, policies and regulations.

(v) On immigration and the expansion of the workforce, the Panel repeats its endorsement of the government's analysis, contained in the report on the ageing of Bermuda's population from the Ministry of Economy and Labor, but notes the slow progress on concrete policy recommendations. Some progress has been made, but further policy development and improvements to the speed and efficiency of the immigration system are required. This is of particular importance to the international business sector, but it is also essential to the growth of other, more domestically focused businesses like tourism, retail and hospitality.

(vi) Expanding the working age population will, however, require supporting policies. In particular, to accommodate the scale of workforce (and hence population) expansion that is envisaged as needed, Bermuda will need to expand housing supply, both for current residents and new arrivals. This, and the accompanying infrastructure, should be a clear focus for government investment and could also be a focus for allowable incentives under the CIT.

H. Conclusions and key recommendations

65. Our key recommendations relate to the allocation and governance of the revenues from the CIT. We recommend:

- In Budget documents, CIT revenues should be reported clearly and transparently, and clearly delineated from other government revenue sources.

- The government should keep the underlying current budget in balance or surplus. That is, revenues, excluding CIT revenues, should meet or exceed current spending, including net interest[7], but excluding capital spending.

- All CIT revenues not needed for warranted capital projects should be saved. This would ensure progressive improvement in Bermuda's net financial liability/asset position and insure against future shocks.

66. The allocation of these saved revenues should include the following:

- Repaying Bermuda's outstanding long-term debt obligation. This should be the first priority, in particular the debt repayment of $605 million due in January 2027.

- Building up a liquidity reserve or stabilisation fund with a target balance in the region of $1 billion.

- Reducing the very large unfunded liabilities in the social insurance system.

- Establishing a Sovereign Wealth Fund that invests in longer-term, less liquid assets, for the benefit of future Bermudians.

67. As well as reducing net debt, non-recurring capital expenditure which adds to public sector net worth could also be warranted, at a measured pace to mitigate any inflationary risks associated with large increases in capital spending. We recommend the establishment of a body that would be charged with determining Bermuda's long-term investment needs and priorities. This Panel could advise on when increasing, or decreasing, capital spending would be acceptable in macroeconomic terms.

68. We recommend that a new budget rule to keep the current[8] budget in balance or surplus should be enshrined in statute. This Panel would continue to evaluate and report on compliance with the fiscal rule as now, and make recommendations on the path of revenue and expenditure, and would also advise on the allocation of CIT revenues between debt repayments, the establishment of a stabilisation fund, and capital expenditures, as fiscal and economic conditions allow, although of course decisions on this would be a matter for the Government, subject to appropriate Parliamentary scrutiny and control.

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[7] Marian Bell dissents from the majority on debt interest, see paragraph 61.
[8] Current primary budget excluding debt interest in the minority view, see paragraph 61.

69. Finally, it is vital that the fiscal space provided by the CIT does not distract from the urgency of responding to Bermuda's long-term structural challenges, especially demographic pressures and climate change.

Annex A: List of Meetings Held by the Panel

The Honourable David Burt MP, Premier and Minister of Finance

The Hon. Walter Roban, JP, MP, Deputy Premier and Minister of Home Affairs

The Hon Jason Hayward, JP, MP, Minister of Economy and Labour

Jache Adams, JP, MP, Junior Minister of Finance

Officials from the above-mentioned Departments

The Hon Jarion C. Richardson JP, MP, Leader of the Opposition, and other representatives of the Opposition

Tax Reform Commission

Association of Bermuda Insurers and Reinsurers

Bermuda International Long Term Insurers and Reinsurers

Bermuda Monetary Authority

Bermuda Trade Union Congress

Bermuda Chamber of Commerce

International Tax Working Group

GOVERNMENT OF BERMUDA

Ministry of Finance