QUESTIONS TO BE ASKED OF THE PRESIDENT OF THE FINANCE AND ECONOMICS COMMITTEE ON TUESDAY 20th APRIL 2004, BY SENATOR R.J. SHENTON

Question 1

Would the President inform the Assembly whether the Committee considered the following alternatives to Sales Tax and, if so, state why they were rejected?

(a) Wealth/Net worth tax as, for example, in France and part of the United States of America;

(b) Capital Gains Tax as in most countries;

(c) Inheritance/Estate Tax as, for example, in the United Kingdom and the United States of America;

(d) Payroll Tax;

(e) Gift Tax as, for example, in the United Kingdom and United States of America;

(f) Permanent Establishment Tax as, for example, in the United Kingdom;

(g) Second property tax;

(h) Development Tax as, for example, in Canada;

(i) Increased registration charges for previously exempt companies;

(j) Registration charges for foreign incorporated but locally administered companies;

(k) Trust registration charges;

(l) Work permit registration;

(m) Graduated rates of tax.

Answer

The Committee considered a number of alternatives to some form of a goods and services tax, and reviewed alternatives against a
number of tests –

Firstly, any measures had to be capable of generating significant revenues to help contribute to the expected States deficit of up to £80-£100 million. In short, the Committee preferred a limited number of measures as opposed to a plethora of relatively low yielding measures.

Secondly, any new taxes must not harm Jersey's competitive position as a major offshore financial centre.

Thirdly, the Committee sought taxation options which minimise complexity and are appropriate for a small island economy like Jersey. It must be recognised that simply duplicating the range of taxes used in larger jurisdictions could create an excessive legislative and bureaucratic burden.

Fourthly, any changes to the Island's fiscal structure must be acceptable to the international community and unlikely to provoke retaliatory action that could harm Jersey's economy.

Finally, any new tax should not incur administrative costs disproportionate to their yield.

Unfortunately, many of the taxes outlined in the question, including those in (a), (b), (c), (e), (g), (h), (l) and (m) do not meet one or more of the tests.

The Committee will publish, in the very near future, comprehensive responses to the feedback received throughout the consultation exercise, including in more detail, the reason for rejecting many of the alternative taxes.

Furthermore, as announced yesterday, the Committee has commissioned an independent review by pre-eminent tax expert, Mr. John Whiting of PricewaterhouseCoopers London. This review will cover the issues raised in Senator Syvret's Proposition P.41/2004 and give an independent opinion of the Committee's assessment of alternatives. This will provide States members with further evaluation of the Committee's proposals and the alternatives rejected.

Nevertheless, I would like to address here certain of the more substantive alternatives raised by Senator Shenton, starting with Capital Gains Tax (CGT) -

Firstly, the Comptroller of Income Tax has estimated that if implemented in a similar manner to the UK, CGT would only raise £5 million a year. It cannot therefore significantly reduce the projected deficit.

Secondly, whilst the Senator's question notes that many jurisdictions have adopted CGT, neither of Jersey's principal financial services competitors, Guernsey and the Isle of Man, tax capital gains. The imposition of this tax would therefore risk making our financial services industry less competitive.

Thirdly, CGT has a relatively high cost of collection and needs complex legislation, which can become progressively detailed as avoidance takes place. The imposition of CGT would therefore be contrary to our tradition of seeking clear, straightforward taxation legislation in Jersey. The Committee feels that this policy has served us well for many years and should be continued.

The Finance and Economics Committee has carefully considered Payroll Tax as an option in its current fiscal proposals. As members know, the Committee has retained it as a last resort should the proposed goods and services tax, however finally defined, fail to realise the necessary revenue to close the projected fiscal deficit.

However, as is made clear on Page 10 of our published document - 'Facing Up To The Future' - we have identified several drawbacks to the introduction of a Payroll Tax which make it an inherently unattractive option.

Where the tax liability falls on the Employer, this tax –

Raises the cost of doing business in Jersey.

Is counter-productive in terms of encouraging economic growth.

Makes it more difficult to ensure that Jersey remains internationally competitive for financial services businesses.

Acts as a severe deterrent to job creation and retention. This has been the experience in the United Kingdom in recent months with the announcement of the outsourcing of a significant number of jobs, which has been partly attributable to the recent rise in Employer National Insurance contributions.

Where the tax liability falls on the Employee, the defects are that -

A payroll tax imposed in this way only impacts on wage earners rather than on total earnings. It is therefore somewhat inequitable.

Such a tax would be inconsistent with the Committee's longer term strategy of reserving Social Security contributions increases for addressing the problems generated by the Island's ageing population.

For these reasons the Committee remains of the view that Payroll Tax as an alternative to some form of a goods and services tax is not the best way to proceed.

The concept of any Permanent Establishment Tax (e.g. corporate profits tax, withholding tax) is one whereby the Group or organisation charged is recognised as having an identified place of business - involving property, locally employed persons and other signs of local establishment - within the jurisdiction which is seeking to raise the tax.

The UK (and indeed Jersey) does recognise Permanent Establishment as a determinant to liability to tax in certain specialist situations, such as property owned by non-residents. However, these are not comparable to the general system that Jersey would require to make a success of such a proposal.

A Permanent Establishment tax for all companies in Jersey - which is essentially a territorial basis of taxation found in few international tax systems - has nevertheless been carefully considered by a specialist Group set up by the Finance and Economics Committee. This Group includes individuals with considerable private sector tax expertise.

It remains a possibility that this system could provide a partial answer to the fiscal shortfall we face if - and it is a big if - the home country of incorporation of the company or Group concerned - which in our situation primarily means the United Kingdom - is prepared to accept that corporate taxes paid in Jersey under such a system can be offset against home country tax liabilities of the company or Group.

If that home country treatment cannot be obtained, then the corporate tax paid in Jersey will be an additional cost to the company or Group arising from operating in Jersey. As our aim is to make business more, rather than less competitive, this outcome holds few attractions.

Nevertheless, we are currently engaged in sensitive negotiations with the UK Treasury on this issue. It should be noted though that even if the UK is prepared to grant the recognition of Permanent Establishment tax to which I have just referred as a unilateral matter, significant problems will still be faced with convincing EU partners that such an agreement complies with the EU Code of Conduct on Business Taxation rules. The UK has already indicated that in its view it does not and has not hitherto been prepared to discuss the matter further with other EU member states. It takes the view that such a system is simply another form of discrimination in favour of non-resident shareholders of companies. It was the elimination of the discrimination which was at the core of the EU Code of Conduct initiative in the first place.

This proposal therefore faces a significant uphill battle if it is to be successfully pursued but the Committee assures members that it will endeavour to keep them informed of progress as negotiations continue.

It is clearly unacceptable to lose the current ‘fees’ received from Jersey’s Exempt Companies sources as these amount to approximately £12 million per annum at present. However, some recovery of these monies has already been assumed in arriving at the figure of the £80-100 million shortfall we are seeking to address.

The modifications required to Jersey’s fiscal structure mean that it will not be possible in the future to have different fee levels for exempt and income tax paying companies. The recovery of this £12 million will therefore depend on setting a one size fits all, single rate for all Jersey companies.

By way of an example, if the core annual return fee proposal for Jersey companies was to be raised from the current £150 per annum to around £400-£450, then this could recoup most of the £12 million I have just referred to as this rate would also include companies currently exempt. It would however represent an increased cost of around £250-£300 on those local companies.

Members will notice that this does not raise any additional monies. To achieve that, the harmonised fee level would need to rise significantly above £600 per annum for ALL companies. There are competitive limits on how high this fee can go before the Jersey financial services sector becomes internationally disadvantaged.

Essentially then, finding a solution to recoup lost revenues as a consequence of the abolition of exempt companies will be something of a balancing act. For competitive reasons the Committee feels it is not possible to raise any significant additional sums from this source. The best we can do is get back most of what the Island stands to lose from the loss of exempt company status and that Committee has already assumed that recovery in its estimation of the £80-100 million shortfall.

Senator Shenton raises the issue of charging registration fees for companies incorporated by foreign investors from foreign jurisdictions, such as for example the British Virgin Islands, but which are administered on behalf of those investors by Jersey based institutions.

The question of extending a registration fee at some level to such companies is also currently being considered. However, naturally here the competitive situation must also be carefully taken into account. There could be significant migration of these entities from Jersey to be administered elsewhere should we begin to impose a cost which another jurisdiction is prepared to waive. The loss of business and associated employment activity would of course be damaging to the Committee's proposition to grow the Island's economy.

Were a registration charge to be feasible then it would require a low fee level. A modest fee of around £100 per company per year might raise around £7-8 million. This is not in itself a major contribution towards reducing the overall fiscal shortfall identified, although the Committee remains open minded about all measures which could practically reduce the amount required. The Committee has not ruled out this measure entirely, however, considering the competitive risks identified it feels it would be unwise to rely on any contribution from this source.

Trust registration charges equate to a tax on the capital of foreign sourced business at the heart of the Island's finance industry.

The Committee has severe reservations about this proposition since no other major financial centre proposes to impose trust registration charges. Jersey is viewed internationally as a major, if not pre-eminent, Trust services provider; when considering this option the Committee concluded that trust registration charges would diminish the Island's share of this key market.

Losing market share in any industry inevitably translates into less business, less jobs and ultimately less taxes, which then poses a repeat cycle of questions about how to fund essential services through taxation but this time from a smaller economy.

The Committee always sought solutions to the proposed deficit based upon the premise that the more competitive Jersey's businesses can become, the more there will be benefits for the population as a whole because taxation can be kept to a minimum.

This answer I hope shows that alternatives have been and continue to be considered by the Committee. The Committee welcomes alternative ideas but remains of the view that the arguments in favour of some form of goods and services tax are persuasive when compared to the relative merits of most of the alternatives. As most jurisdictions already have some form of a goods and services tax this is perhaps not an unsurprising conclusion.

Question 2

Would the President explain why the Committee considers that the preservation of the 20 per cent rate of income tax is so important if it now only applies to local residents, with wealthy persons able to negotiate alternative rates?

Answer

20 per cent has been the standard rate of income tax in Jersey for over 60 years, contributing to what is internationally recognised as a very stable fiscal regime. This recognition contributes to Jersey's appeal as a finance centre. The rate has therefore served the Island well in the past and there is no reason to suppose that it will not serve us well in the future as far as personal taxpayers are concerned.

The Committee's proposal to phase out allowances for high earners is a very effective way of increasing the amount of tax paid by those taxpayers, whilst maintaining that 20 per cent rate.

The answer the President gave on Tuesday 30th March 2004 to a question asked by Deputy Southern illustrates how this will work. In the example used then, the married couple on an income of £150,000 would see their effective rate of tax rise from a current average of 13.9 per cent to an effective rate of tax of 19 per cent.

It is the Committee's view that increasing the tax paid by high earners using this method is much more preferable than raising the standard rate of tax above 20 per cent, particularly when some of our main competitors, such as the Isle of Man, have already announced a reduction in direct rates of tax on their residents.

The only wealthy persons who are able to negotiate how much tax they pay are non-residents who wish to become resident in Jersey by virtue of Regulation 1(1)(k) of the Housing Law. That Regulation was approved by the States in 1970 and still exists. As long as it does, any wealthy non-resident who wishes to take up residence in Jersey is able to make a specific application to the Housing Committee who will consider whether consent can be justified on social or economic grounds. It is a condition that a 1(1)(k) resident who takes up residence on economic grounds must pay an agreed amount of tax every year.

This does not equate to an alternative rate of tax applicable to 1(1)(k) residents as supposed in the question. The Notice of Assessment issued by the Comptroller of Income Tax, either to the individual personally, or to the company they beneficially own, or the trust in which they have an interest and which makes the tax contribution on his behalf, is still charged at the standard rate of 20 per cent to collect the amount of tax contribution agreed for each year.

Those 1(1)(k) residents already in Jersey paid a total of £10.7 million in tax in 2002. It may well be that we should be encouraging more 1(1)(k) residents to Jersey as a means of contributing to the deficit we face and thereby keeping down the tax increases for other islanders.

Question 3

Would the President inform members whether the Committee has considered retaining personal tax allowances at their present rate and introducing a higher rate of 35 per cent for those with a net income over £80,000 as a fairer alternative to the Committee's proposals and, if not, why not?

Answer

The Committee considered a large number of variations of introducing higher rates of income tax for those with higher incomes. We sought to achieve a level of greater tax contribution from wealthy residents, which would not ultimately be counter-productive by causing this highly mobile segment of the population to move to jurisdictions with a lower tax burden.

If a higher rate of income tax was levied on taxable household income over £80,000 it would be likely to raise slightly more than £1 million per annum per 1 per cent point increase above 20 per cent. So a rate of 35 per cent might potentially yield somewhere in the order of £16 million to £17 million.

However, at this rate of 35 per cent, the highest income households in the Island could save a considerable amount of tax by moving to a lower tax rate jurisdiction like the Isle of Man. Excluding 1(1)(k) residents, the households in Jersey with incomes above £500,000 per annum will see their total tax bills rise in total by over £6.5 million per annum, varying from a rise of around £60,000 to more than £150,000 each. If only one in five of taxpayers whose increase was over £120,000 decided to move, the total reduction in income tax paid would be in the order of more than £2 million, rather than any increase.

If all of the top 10 tax paying households moved, the reduction in income tax would be in the order of £4 million per annum. Even on these assumptions as to how an increase in tax rates from 20 per cent to 35 per cent might influence behaviour, there is a significant reduction in the net tax increase and the proposal could become counter-productive.

In addition to the reduction in tax revenues, emigration of this sort would be likely to cause a reduction in on-Island expenditure and other economic activities, so there would be additional knock-on effects in the economy.

The Committee takes the view that at a top rate of even 30 per cent, let alone 35 per cent, there is a real risk that a significant amount of taxable income would leave the Island. It is almost impossible to accurately estimate such a risk, but nonetheless the judgement of the Committee is that the risk is real and should be taken into account. The Committee believes that under its proposals the risk of income leaving the Island is minimal as the headline top rate of income tax remains at 20 per cent.

In addition, this 35 per cent top rate above £80,000 would not by itself be anywhere near sufficient to meet the challenge of moving to 0 per cent/10 per cent, so additional significant tax increases would still be necessary. If these were also aimed at those with incomes above £80,000 this would further increase the risk of ‘income flight’.

Question 4

Would the President confirm that the current proposals of his Committee concerning taxation changes relate particularly to persons who are employed and do not affect those wealthy people who have planned their affairs to turn income into capital?

Answer

I cannot confirm that the current proposals of the Committee concerning taxation changes relate particularly to persons who are employed. The ‘20 per cent means 20 per cent’ proposal, for example, will affect all Jersey resident taxpayers, not just employed persons, although 1(1)(k) residents who have agreed a specific tax contribution by virtue of Regulation 1(1)(k) of the Housing Law will not be directly affected. The proposed indirect tax on consumption will also affect all Jersey residents, including 1(1)(k) residents, so, once again, it is not just employed persons who are affected. Even the Income Tax Instalment Scheme being proposed is not targeted exclusively at employed persons, because subcontractors, who are self employed, will also be affected.

As for those people, including incidentally employed persons as well as those who may loosely be termed as wealthy, who attempt to plan their affairs to turn income into capital, the Comptroller of Income Tax has a general anti-avoidance provision in the Income Tax Law, Article 134A, which he has used to good effect when ruling in over 150 cases in the last six months.

Many of those cases related to taxpayers attempting to transfer income-producing assets into those producing a capital return. The Comptroller has invoked Article 134A to counteract such transactions, either wholly or partly. He has also formally invoked that Article in other cases, for example, in a property development case where the taxpayer is arguing that no taxable profits arise in Jersey.

As the Senator will have noted from the President’s reply to a question asked by Deputy Southern on Tuesday 30th March 2004, it may well be that the Committee will propose amendments to Article 134A or, alternatively, introduce new legislation, to strengthen the powers of the Comptroller to combat tax avoidance.

Question 5

Has the Committee considered how much tax would be raised by the introduction of higher rates of tax together with a wealth/gift/inheritance/capital gains tax, together with a proposal to plug the gap for foreign owned trades, possibly with a permanent establishment tax or a payroll tax with credit, and if so, could he confirm whether these measures would be sufficient to reduce the projected deficit without doing undue harm to the majority of the population or significantly increasing the administrative burden?

Answer

Because of the inherent uncertainties surrounding many of these proposals, including their feasibility and international acceptability, it is impossible to quantify precisely the additional tax revenues they would generate, however, it is clearly the case that they would not generate the £80-100 million needed, and some, likely to damage the economy, would actually lead to a reduction in tax revenues.

As I have indicated, Permanent Establishment tax of the sort postulated here is theoretically possible but unlikely to be achievable in agreement with foreign governments, particularly the UK, for the reasons I have given. The Committee has not given up but it would be irresponsible to put that solution forward as a definite proposal when the Committee’s proposition is debated.

Were it to be achieved, it is possible that some or most of the £25 million identified as ‘leakage’ to foreign governments as a consequence of foreign owned businesses moving to a zero tax platform could be recouped. This would nevertheless still leave a significant amount of the total shortfall to be addressed.

I have already given an answer on the viability or otherwise of a Payroll Tax and its inherent defects. I should re-iterate that despite these drawbacks it has not been ruled out completely but remains a solution of last resort in the event that a sales tax does not raise the sums we need.

In this specific context, a Payroll Tax paid by companies with credit for any corporation taxes paid seems to be being proposed. This would mean that the finance industry would receive a reduction in corporate tax equivalent to any Payroll tax paid and the measure would thus only raise additional revenue and be relevant in the non-finance sector where significant employee numbers are a feature.

Where such companies are foreign owned, the Payroll Tax would attract no credit as the zero corporation tax proposal means no corporate tax paid in Jersey is available to use as an offset to Payroll Tax paid. Once again, in that situation, any taxes paid by way of Payroll in Jersey would raise the cost of doing business here to such companies since they would not be recoverable against home country taxes.

Another drawback of a Payroll Tax with credit system would be its administrative complexity when we have tried so hard to maintain, as far as possible, the simplicity of Jersey’s tax system which undoubtedly enhances the competitiveness of the Island for international businesses of all sorts.

Finally, with Jersey-based companies making small or minimum profits but employing significant numbers of people, a profile which most agricultural, tourist or fulfilment businesses in the Island would presently fit, the proposal would mean again that no significant profits taxes would be available to set off against the Payroll tax expense incurred and once again the latter would have resulted in a net new cost to vulnerable businesses.

On the face of it, the proffered solutions seem attractive but in their detailed application would do all of the things which the Senator suggests we avoid. They would increase the administrative burden, raise the cost of doing business and would not raise sums of money sufficient to address anything like the full fiscal shortfall that we have to face. In short, the Committee has considered these measures carefully and has rejected them.

In conclusion I thank the Senator for the opportunity to illustrate that the Committee has considered a number of alternatives to the measures proposed. We have not stopped seeking credible additional sources of income, so long as they meet the criteria I outlined earlier.

However, recent statements from the business community have made acutely clear the need for this Assembly to dispel uncertainty about the preferred measures for meeting the projected £80-£100 million deficit by July. Unlike some of the taxation options I have discussed today, the measures currently proposed by the Finance and Economics Committee are an achievable and co-ordinated means to do this. If the Assembly approves these measures in principle when a proposition is brought to the States then the Committee will be able to create more detailed individual proposals for consideration at a later stage.

Question 6

Would the Committee agree to stop the draconian cuts in essential services which have been proposed as part of the Fundamental Spending Review process and that are causing hurt and anxiety amongst the most vulnerable in our community?

Answer

I would argue that emotive phrases like draconian are extremely unhelpful in describing what is a painful, but extremely necessary process for the Island imposed upon this Assembly by the poor financial management of past States Assemblies.

The Finance and Economics Committee would also like to remind members that the over whelming response to the Committee's extensive consultation on the Fiscal Strategy to date is that the public expects the States to demonstrate that they can control public expenditure before the public are willing to pay any more in taxes.

The Fundamental Spending Review has carefully been designed to ensure that scarce resources are targeted at areas of greatest need and all States members have had the opportunity to contribute to the setting of priorities. Committees were all asked to look at those areas of their budgets which they considered the least essential. Despite this, public expenditure will still increase by 2.5 per cent in 2005 if the States agree to the Finance and Economics Committee's spending plans and the States deficit, which ultimately will have to be funded by increases in taxes, will grow to £13 million. This is higher than the Committee would have liked but recognises the need to maintain those essential services.