

STATES OF JERSEY

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DRAFT GOODS AND SERVICES TAX (JERSEY) LAW 200- (P.37/2007): AMENDMENTS

**Lodged au Greffe on 3rd April 2007
by the Corporate Services Scrutiny Panel**

STATES GREFFE

DRAFT GOODS AND SERVICES TAX (JERSEY) LAW 200- (P.37/2007): AMENDMENTS

PAGE 26, ARTICLE 8 –

In paragraph (4), for the words “the third anniversary of the day on which paragraph (1) comes into force” substitute the words “31st December 2010”.

PAGE 43, ARTICLE 41 –

- (a) *in paragraph (1), delete subparagraph (d) and renumber the remaining subparagraphs accordingly;*
- (b) *in paragraph (2), for the words “as specified by general direction under this Article” substitute the words “as prescribed by Regulations”;*
- (c) *in paragraph (3), for the words “as the Comptroller specifies by direction to the person or by general direction” substitute the words “as are prescribed by Regulations”.*

PAGE 47, ARTICLE 51 –

- (a) *in paragraph (1), for subparagraph (a) substitute the following subparagraph –*
 - “(a) the person –
 - (i) is constructing, or has constructed, a dwelling, or
 - (ii) is converting, or has converted, a building to a dwelling,
lawfully and otherwise than in the course of or furtherance of any business;”;
- (b) *in paragraph (2)(a), delete the word “conversion,”.*

PAGE 67, ARTICLE 88 –

In paragraph (4) for the words “15 years” substitute the words “5 years”.

PAGE 68, ARTICLE 89 –

In paragraph (3), for the words “imprisonment for a term of 5 years and to a fine” substitute the words “a fine not exceeding an amount equal to 40% of the GST that would have been evaded had the offence not been discovered.”

PAGE 68, ARTICLE 92 –

In paragraph (1), for the word “neglect” substitute the words “gross negligence”.

PAGE 110, SCHEDULE 8, PARAGRAPH 7 –

Renumber the existing text in paragraph 7 as subparagraph (1) and add the following subparagraph –

- “(2) The right of entry conferred by sub-paragraph (1) may only be exercised where the authorized officer has reasonable grounds –
 - (a) for suspecting that an offence under this Law or the Regulations has been, is being, or is about to be, committed on the premises; and

- (b) for believing that there is evidence of such an offence on the premises that would be removed or destroyed before a warrant may be obtained under paragraph 8.”.

CORPORATE SERVICES SCRUTINY PANEL

REPORT

The Corporate Services Panel proposes amendments to the following Articles of the draft Law.

The power to vary the general rate of GST – Article 8(4):

1. Article 8(1) provides that GST shall be charged at 3%. Article 8(4) provides that the rate shall not be amended for a period of three years from the anniversary of the day on which Article 8(1) comes into force. As a result of the delay to the introduction of GST as discussed above, we believe that the first occasion on which the Minister might propose any change in the rate of GST could be in the Budget debate in December 2011.
2. We are conscious that the States is in the midst of a period of budget restraint with considerable uncertainty surrounding the island's financial position over the next few years due to the 'Black Hole' created by the move to zero/ten taxation.
3. The Corporate Services Panel drew attention in 2006 to the problem of future revenue shortfalls in its report on the Financial Framework of the States Strategic Plan^[1]. The Panel asked the Treasury then to provide indicative figures for the period beyond the five year Strategic Plan. Forecasts for the years 2012 – 2015 showed a growing gap between income and expenditure with ongoing annual deficits of between £33 and £40 million^[2]. Far from balanced budgets over the five year period 2006 – 2011, which was the stated aim of the Minister, we feared that a structural deficit was developing in States finances.
4. In our Interim report^[3] we examined the implications of covering a potential shortfall of £35 million through increased GST revenues. We calculated that a rate of 6.3% would be required to achieve the revenue.
5. We asked the Minister, therefore, whether it would not be better in the long run to introduce GST at a higher rate immediately in order to address the deficit at an earlier stage, and to avoid the prospect of even more serious remedial action being required at a later date. Alternatively, we asked whether it would not be better for him to have the flexibility to vary the rate without waiting for three years to pass.
6. The Minister was unyielding in his response –

I made a decision to propose the question of GST as a part-solution to a fiscal deficit of £80 to £100 million and the task given to the Crown Agents 2 years ago was to advise me on GST indications of raising that sort of level of money. The advice which I received, and which the States accepted, was that with a broad-based tax, GST, to raise that sum of money was a reasonable option. That was the advice at the time. That remains the advice and that remains the solution to that particular problem. So, yes, I think the 3 per cent is the correct rate and, yes, the problem is not going to change. That particular problem has not changed and the 3 per cent rate could be fixed for 3 years as far as I am concerned without compromising that problem at all. I think it is also a commitment that I have given, which the States have endorsed, and which I see no reason to vary or move away from.

7. He assured the Sub Panel that despite difficulties being experienced in resolving shareholder provisions, Zero/ten would deliver the anticipated revenue –

What we are saying is there is a need to have shareholder provisions in Zero/Ten which are watertight which generate the levels of revenue that we are expecting to generate and those projections are still on target. How the Zero/Ten regulations are finally drafted in the law in respect of those shareholder provisions will cause us some concern. We have got to get them right but as soon as we get them right the level of revenue we are talking about is still within my estimate.

8. The Minister told the Corporate Services Panel^[4] that there were a number of reasons why he preferred

to maintain the proposed rate for the full three years. In his view, the moratorium would encourage the States to be disciplined in its spending plans. He feared that higher States spending would have the effect of making businesses uncompetitive and would undermine economic growth. He said that the States faced constant pressures to increase spending on improved social provision; however, it was essential to curb spending to what the States could reasonably afford. Therefore he preferred to keep the door closed for the time being on any rate rise.

9. He went on to say that attempting to remove the three year moratorium on changing the rate of GST and vary the rate at an earlier stage would create complications in determining the correct levels of assistance to the Income Support scheme. It was likely also to re-open the debate on further exclusions. He felt that the priority should be to ensure that the scheme worked properly whatever the rate. The possibility of a higher rate of GST now would make this job harder.
10. Despite the confident assertions by the Chief Minister in announcing the provisional outturn figures for 2006 and the revised financial forecasts for the next few years^[5], we believe that there is every reason to remain cautious about the Island's financial position. We are aware of the urgent spending pressures already faced by the States – the funding of the Early Years Strategy is a case in point and we have already drawn attention to the need to address this problem as a matter of priority (See paragraph 28 of the Panel's main report). By 2010 there may be further reasons why the Minister might consider a rise in the general rate of GST would be appropriate, even necessary.
11. We understand that the States will be in a much better position in 2009 to take stock of the effects of the Fiscal Strategy changes and the impact on States income. Nevertheless, we continue to have concerns about waiting for a full three years from the anniversary of the introduction of the tax before the Minister is permitted to make any proposal to the States to vary the general rate of GST.
12. Also, as stated in our main report, we are aware of the significant loss in future revenue in the first year of GST caused by the delay in debating the draft legislation. The four month delay in lodging the draft legislation may have further postponed in practical terms the date on which the Minister might deem it necessary to vary the general rate (to the Budget debate in December 2011). We recognise that this delay was caused by factors which required attention but we believe it may be unwise to similarly postpone the Minister's ability to vary the general rate.
13. **Unlike GST the effects of Zero/ten and the creation of the 'Black Hole' will not be postponed. We believe that it would be in the best longer term interest of the Island not to delay the Minister's ability to respond to the fiscal circumstances which will arise following the introduction of zero/ten. We therefore propose an amendment to Article 8(4) which will allow the Minister to propose an amendment to the GST rate at any time after 31st December 2010.**

The power of the Comptroller to determine the evidence required to claim input tax credit – Article 41(2) –

14. We believe that this is a matter of sufficient importance to be prescribed by the States. This Article deals with a principle, rather than a procedural matter, under which the Comptroller could potentially turn what is meant to be a Goods and Services Tax into a pure sales tax with the consequent disadvantageous cascading effect. To the extent that a business holds market power and therefore the ability to pass on such a cascaded tax to its customers it could in addition have the effect in practice of turning a consumer tax into a business tax.

Conversion of a non-residential property – Article 51(2)

15. For the Interim report we commissioned a study of the potential impact of GST on domestic housing. We accepted the Treasury's position that new build domestic properties should be zero-rated but questioned the proposal to zero-rate extensions, improvements, maintenance and repair, as we felt that zero rating

these items would have been inconsistent and unfair when the line was held so firmly against zero rating in general. **We welcome the fact that the Minister has accepted our recommendation.**

16. Article 51(2) specifies that refunds of GST will not be allowed on ‘the alteration, conversion, enlargement, improvement, reconstruction or repair of an existing building’ and ‘the making of an extension’.
17. We estimated that the potential revenue gain from applying GST to repairs and maintenance alone would be £0.6 million^[6]. The Minister said that this additional revenue will compensate for the revenue foregone through the exemption for charities.
18. We question one element of Article 51(2). We believe that conversion of a non-residential building (such as a barn) to residential use is the equivalent of new build and should have the same GST treatment. If GST is payable on the supply of goods relating to the conversion of an existing property we foresee the possibility that developers would find it more economical to demolish rather than take the trouble to convert the existing structure. **We therefore propose an amendment to the draft law to delete the word ‘conversion’ from Article 51(2)(a).**

The level of penalty – Article 88(4) and Article 89(3)

19. We noted that the penalties for offences under the GST law appeared to be considerably greater than those under the Income Tax (Jersey) Law 1961. We carried out some research into a comparison with other jurisdictions (see appendix). As can be seen from this table, GST penalties vary widely across the world. However two points stand out from Jersey’s proposals –
 - The 15 year prison sentence for fraudulent evasion is far higher than the closest alternative; New Zealand has a maximum 5 year sentence, and Singapore only 2. UK VAT law does not impose prison sentences, although there is the ability to prosecute for general fraud which potentially carries a sentence of life imprisonment.
 - The offence of giving “recklessly” false information appears designed to sit halfway between an innocent mistake and fraud, and carries a corresponding sentence. However the sentence, of up to 5 years in prison, is as high as any other country’s GST system has for *deliberate* fraud. New Zealand’s GST law has a similar offence of “gross carelessness”, for which there is no prison sentence.
20. The Treasury frequently cites New Zealand as an example of a good GST system; it may be suitable to also adopt their penalty provisions
21. We sought legal advice on this issue. We understand that the penalties under the Income Tax law are considered to be too low to deal with matters of fraud. As a result, fraudulent evasion of income tax would normally be prosecuted as fraud and not under the Income Tax law. (The maximum penalty for common law fraud is life imprisonment.) The opportunity was now being taken in the new draft GST legislation to set a severe deterrent against the possibility of a really massive GST fraud. Ultimately, it is for the court to distinguish between types of fraud and to decide the appropriate level of penalty.
22. **Following our research into comparisons with other jurisdictions, we have decided to lodge an amendment to Articles 88 and 89 to reduce the level of penalties.**

The liability of a director, manager or other officer Article 92(1)

23. Under Article 92(1), if a company commits an offence, as a result of “any neglect” by a director, manager or other officer, then that individual is personally liable. This seems to us too wide a power, and casually breaches the usual principle of limited liability. We suggest it would be more appropriate for personal liability to apply in the case of “gross negligence”, not mere “neglect”.

24. We propose an amendment to Article 92(1) accordingly.

Power of Entry – Article 7 of Schedule 8 –

25. We note that under Article 7 of Schedule 8 an authorized person may enter business premises at an reasonable hour for the purposes of examining goods, services, records, devices and equipment or to take samples. We questioned whether this power introduced the impression of an adversarial or suspicious approach which was unlike the current style taken by Income Tax. Over-enthusiastic use of this power could alienate businesses whose co-operation was essential in the smooth operation of the scheme.

26. The Minister, recognising that in a small island and with a high threshold for business registration it was unlikely that there would be many occasions on which it would be necessary to call on these powers, stated –

Basically, Jersey businesses are law abiding. They are also in a small community where you can see what is going on. The likelihood of the sort of levels of VAT fraud which are occurring in the UK going on in Jersey is far more remote. So, yes, from that point of view you could say that you needed less legislation. What I would say is you need the same legislation but you would not need to apply it to the same degree because you have a far greater degree of compliance within the local community. I do not think it is a good idea not to have those powers. I think it is a good idea that we do not have to use those powers because we are a law abiding community.

27. The GST Director emphasised that the style which would be adopted was completely different from the early days of VAT in the United Kingdom –

The whole style has to be: “We are here as a service to support you, the businessman, to comply with your obligations. We will do everything that is possible to help you. If you do not then we have some measures which can be used.” But the onus, the emphasis, is on a completely different and new relationship, one which is there to support and help.

28. We have looked at this power in other jurisdictions. We noted that UK VAT is similar – “an authorised person may at any reasonable time enter premises used in connection with the carrying on of a business”. New Zealand also seems to give a similar power to make unannounced visits. However Singapore restricts the power in two sensible ways. The officer must have –

- reasonable cause to believe that an offence has been committed; and
- reasonable grounds to believe that the delay needed to obtain a search warrant would cause the evidence to be removed.

29. We accept that it is necessary for the Comptroller to have the power to enter and search premises in reserve. We believe that the Singapore restrictions are sensible and propose an amendment to the draft law accordingly.

[1] Table 1 S.R.3/2006.

[2] These forecasts were provided with an accompanying ‘health warning’. The Minister told the Sub Panel: ‘They are almost academic; they are sort of a mathematical extension to where we are now, rather than a realistic position.’ Public hearing 18th May 2006.

[3] Section 5.7 S.R.3/2006.

[4] Private meeting dated 27th February 2007.

[5] Information made public on 26th March 2007.

[6] *Based on calculations using the Household Expenditure Survey 2006. We were unable to estimate a figure for alterations and extensions on the basis of Survey data but believe that the overall estimate of revenue yield would be significantly greater.*