

# JERSEY'S GOODS AND SERVICES TAX (GST)

## Financial Services Discussion Paper

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GST



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# 1 Executive summary

This discussion document sets out the proposed treatment of financial services under Goods and Services Tax (“GST”). These proposals have been framed in the context of the overarching requirement that the GST treatment must not place the Island at a competitive disadvantage<sup>1</sup>. In particular it is not intended that the proposals presented here will either bring about the relocation of existing business to other jurisdictions or lead to the loss of future business to competing jurisdictions. Subject to this requirement the Fiscal Strategy P44/2005 envisages that the GST treatment of the financial services sector will yield revenues of between £5 million and £10 million per annum. These proposals have been put forward with this yield in mind.

## 1.1 Place of Taxation

The international consensus is that consumption taxes should tax final consumption by individuals at the location where the consumption takes place. However, the place of consumption of a service is open to interpretation. Cross-border transactions can give rise to difficulties because of inconsistent rules from jurisdiction to jurisdiction. Where the EU model is followed the place of taxation is taken to be the location of the customer in respect of most financial services. This approach will be followed in Jersey. In keeping with conventional GST regimes banking and insurance services consumed by Jersey customers will be exempt. In effect this means that the GST cost will fall on the financial service firm in the form of GST on expenditure that cannot be recovered.

## 1.2 Simplified Schemes

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Many firms conducting banking business, trust company business, investment business and fund services business primarily service international clients. In these circumstances a standard treatment would create inordinate compliance and administrative burdens and where appropriate a simplified scheme will therefore be available. Under these schemes a straightforward procedure will determine a *fair and reasonable* estimate of GST on expenditure that cannot be recovered.

Companies, trusts and partnerships that do not operate as links in a value chain ending in final domestic consumption will be entitled to remission of GST on expenditure. Furthermore, where these criteria are satisfied there will be no requirement to register and therefore any supplies will be outside scope for GST purposes. It is expected that most investment funds will be encompassed by this treatment.

## 1.3 Consultation Process

This document presents the first version of the proposals. In preparing the document every effort has been made to take into account the full range of activities within the sector. However it may be that, as presently framed, the proposals will present problems for particular current or potential future services. It is therefore envisaged that these proposals may be modified in the light of specific industry feedback and further iterations of this document may be issued incorporating this feedback. It is envisaged that the proposals will be implemented by means of regulations rather than within primary GST law. However, if it becomes apparent that some aspects are more appropriately addressed in the primary legislation the timetable can accommodate this.

<sup>1</sup> For further information on the design criteria for the GST see States of Jersey Fiscal Strategy P44/2005

# 2 A Non-technical guide

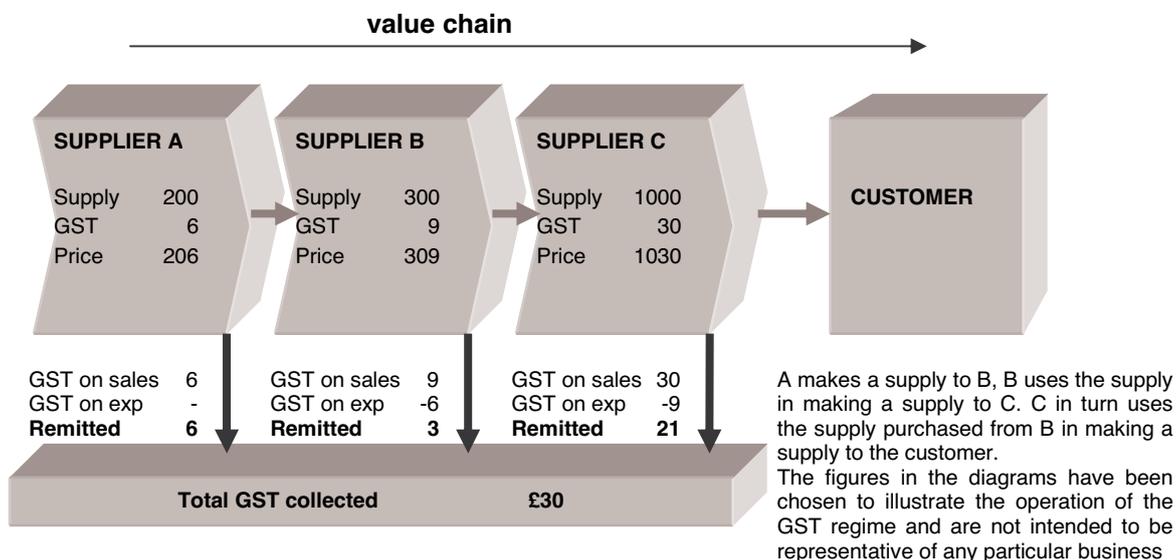
This discussion document is primarily addressed to practitioners and, of necessity, is somewhat technical in places. However these proposals will also be of interest to a wider audience. This section provides a non technical explanation for readers who wish to evaluate the proposals but who do not have the technical background that may be assumed for practitioners.

## 2.1 Context

Goods and Services Tax (“GST”) is being introduced as one element of a tax reform package that also includes the introduction of 0% income tax rate for most companies other than some financial services providers that will bear income tax at a rate of 10%. These reforms are designed to secure Jersey’s future in the face of increasing international competition and to phase out business tax measures identified by the EU as having harmful features. This change is taking place in parallel with similar steps being taken by EU Member States to phase out those tax measures with harmful features identified in their respective regimes. The States Fiscal Strategy envisages that GST will yield tax revenue of £45 million of which £5 to £10 million will be borne by the financial services sector.

## 2.2 Principles and Practice

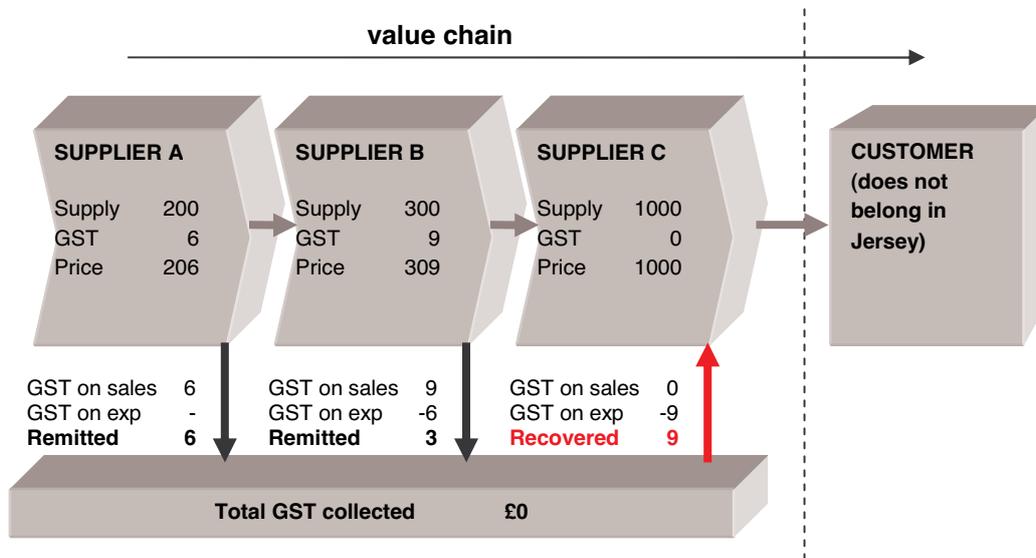
In recent decades consumption taxes (known as Value Added Tax or Goods and Services Tax) have been implemented in many countries around the world<sup>2</sup>. These taxes are designed to target domestic consumption in a way that will not distort economic production decisions. In practice the tax can be cost effectively collected because businesses account for the tax at each stage in the value chain. Businesses add GST to their taxable supplies and remit this net of any GST incurred on related expenditure:



**Figure 1: GST is collected at each step in the value chain**

The broad international consensus, with few exceptions, is that the tax should be collected at the place and time of consumption. Thus, where consumption does not take place within the GST territory the supply will fall outside of the scope of the GST regime and the supplier will be able to recover any GST incurred on expenditure that related to the supply:

<sup>2</sup> For a readable overview see The Value Added Tax - Experiences and Issues, Background Paper Prepared for the International Tax Dialogue Conference on the VAT Rome, March 15–16, 2005. Available from International Tax Dialog ([www.itdweb.org](http://www.itdweb.org))

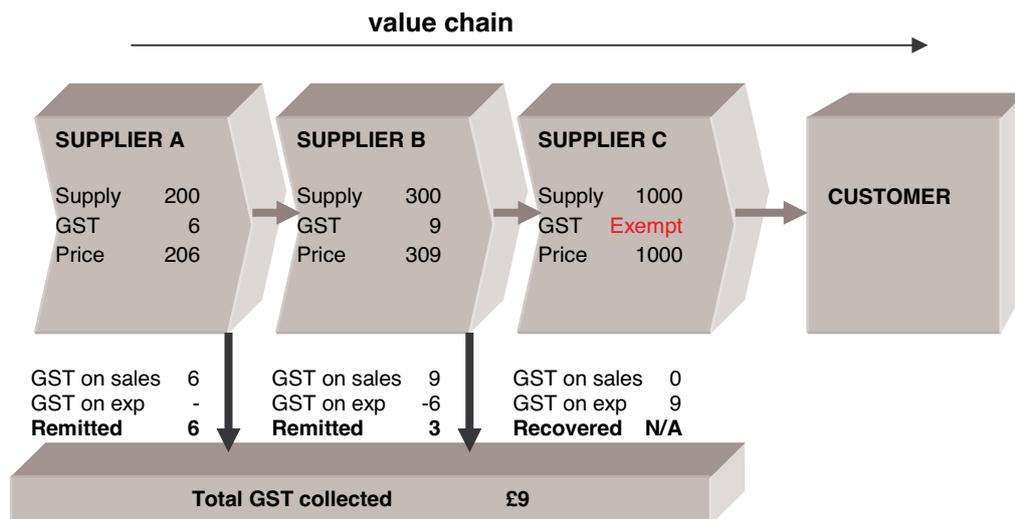


**Figure 2: GST is recovered by the supplier when the customer is outside the GST territory**

### 2.3 Financial Services

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In some situations significant problems are encountered in implementing this ideal. In particular, no wholly satisfactory way of addressing most banking and insurance services has yet been developed. In the absence of a more satisfactory approach these financial services are usually exempt. In this treatment GST is not explicitly included in the price paid by the customer. However in this situation a GST cost does fall on the supplier by virtue of tax on expenditure that the supplier is not allowed to recover.



**Figure 3: Where the supply to the customer is exempt a GST cost is borne by the supplier**

Exempt treatment provides a mechanism for generating a GST yield in relation to services that are not open to more direct treatment. However, unfortunately this approach has certain undesirable consequences:

- Although it may be possible for the financial services firm to pass on some element of the GST cost by increasing the price of its services the business customer will not be able to recover the GST element of the price (a so called *tax cascade* effect arises).
- Because the financial services firm will not be able to recover GST suffered on expenditure a disincentive to outsourcing arises.

If the EU model is followed, where financial services that would be exempt are supplied to customers outside the GST territory they are treated as outside scope and the tax on related expenditure can be recovered. Thus, in those cases where most of the firm's customers do not belong in the GST territory the tax cascade and outsourcing disincentive problems are less severe.

## 2.4 Place of Taxation

The international consensus is that the consumption taxes should be collected in the jurisdiction where consumption takes place. However, the place and time of consumption of services is open to interpretation. In practice jurisdictions have developed incompatible rules for determining the deemed place and time of supply and this leads to problems of double taxation or non-taxation that can impede cross border trade.

## 2.5 Competing Jurisdictions

The impact on Jersey's competitive position is a further factor that will influence the potential scope of the GST. While tax is an important factor it is not always the primary factor that determines the choice of location for business. For example many retail collective investment funds migrated from Jersey to Luxembourg in the 1990s even though the tax position may have been more favourable in Jersey<sup>3</sup>. In that instance an important factor was the regulatory environment (the UCITS Directive) that allowed Luxembourg funds to be marketed within the EU more readily than Jersey funds. Nonetheless, other things being equal, tax will often be a deciding factor and in such cases it would be counter productive for Jersey to introduce a tax that placed the Island at a disadvantage.

## 2.6 Trusts, Companies and Partnerships

Tens of thousands of companies, trusts and partnerships are managed or administered from Jersey. Informally these are often described as "corporate vehicles" although, strictly, this terminology is misleading. For example, whilst a limited liability company is a legal person with legal rights and legal obligations distinct from those of the people who make up its membership this is not the case in respect of a trust or a Jersey limited partnership. The term "corporate vehicle" is therefore used throughout this document in a loose sense.

<sup>3</sup> In particular Luxembourg funds can incur an annual subscription tax ("taxe d'abonnement") and both funds and investment managers may incur some irrecoverable VAT

Trusts, companies and partnerships play an indispensable role in many of the specialised services provided by the sector. For example:

- A limited liability company may be formed to provide group finance or insurance services for a company with operating subsidiaries in many countries around the world;
- Many UK listed companies as well as European and North American companies provide an equity compensation scheme for employees and these are frequently established by means of a Jersey employee benefit trust;
- A venture capital fund may take the form of limited partnership, as (unlike a limited liability company) capital raised from investors may readily be returned to them as investments are realised. The limited partnership structure permits investors to incur the same level of taxation as if they had invested directly in the underlying securities (“*tax-transparency*”).

6 In many cases the “corporate vehicles” will manifestly not form part of a value chain that ends in the supply of goods or services that are consumed by individuals belonging in Jersey. There would be little merit in subjecting such vehicles to the detailed machinery of a GST regime that is designed to tax domestic consumption. Furthermore, experience in other jurisdictions has shown uncertainties of treatment can present significant problems for “corporate vehicles”. If the introduction of GST created such uncertainties this could make Jersey unattractive in comparison to jurisdictions that do not give rise to similar concerns. To secure this certainty of treatment and to isolate “corporate vehicles” from the potential complexity of the machinery of the GST regime it is proposed that those “corporate vehicles” that, subject to appropriate safeguards, do not form part of a value chain that ends in the supply of goods or services consumed by Jersey residents will have *international services* status. Vehicles with this status will benefit from remission of GST on expenditure and will not be liable to register. Because these “corporate vehicles” are not liable to register any supplies that are made by these vehicles will be outside the scope of the GST. A £50 annual fee will be payable by “corporate vehicles” that are eligible for and wish to benefit from *international services* status.

In some cases this treatment will be more favourable than the treatment offered in other regimes. For example, where the EU approach is followed collective investment funds can incur some irrecoverable VAT. In principle rules could therefore be formulated to increase the Jersey GST yield. For example some services could be deemed to be consumed in Jersey when the client does not belong in Jersey. However this approach would be less favourable than the current position for “corporate vehicles” and has therefore not been further pursued.

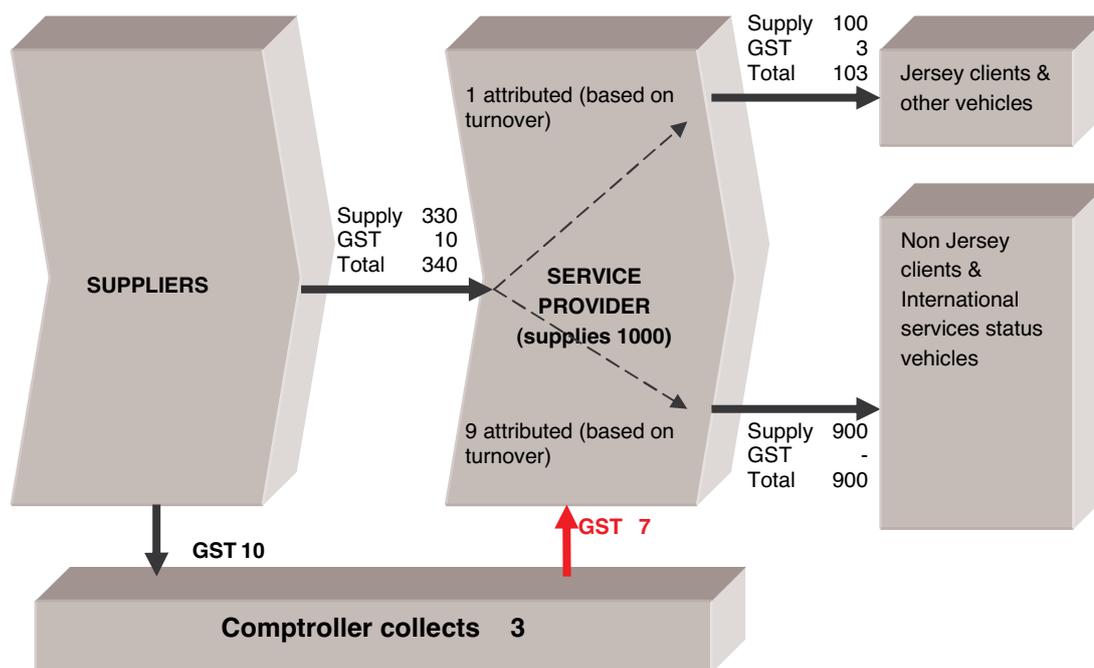
## 2.7 Banks

Although many of the services supplied by banks are exempt other services can be taxable supplies. Furthermore banks serve customers belonging in Jersey, overseas customers and “corporate vehicles” that may or may not have *international services* status. Accounting for GST presents a significant administrative challenge in these circumstances. In particular the bank must track the GST status of customers and the nature of the services provided in each case (exempt / taxable supplies / outside scope). The bank must also relate GST incurred on expenditure to supplies and apportion GST on expenditure that cannot be directly related to a particular supply.

In practice a large part of the banking activity taking place in Jersey serves customers that do not belong in Jersey and “corporate vehicles” that may have *international services* status. Under these conditions the full apparatus of the GST regime may present an inordinate administrative and compliance burden in comparison to the likely GST yield. Therefore, subject to appropriate safeguards, a simpler presumptive scheme will be available to banks. Under this scheme an appropriate fixed percentage (e.g. 75%) of GST incurred on expenditure will be presumed to be recoverable. A scheme of this type has operated successfully in Singapore for some years.

## 2.8 Other Service Providers

Many firms engaged in trust company business, fund services business and to a variable extent investment business and insurance business predominately serve clients that do not belong in Jersey and trusts, companies and partnerships that will have *international services* status. Where this is the case standard treatment may present an inordinate administrative and compliance burden. A simplified scheme will therefore be available, where this yields a *fair and reasonable* result. For example the proportion of turnover relating to clients belonging in Jersey may provide an appropriate basis for estimating the GST on expenditure that can be attributed to those supplies:



**Figure 4: GST recovery for service provider with both international and Jersey clients**

The service provider in the above example incurs GST of 10 on taxable expenditure of 340. Supplies to clients belonging in Jersey have a value of 100 and the value of supplies subject to the *international services* status provisions and other international clients is 900. GST incurred on expenditure is attributed in this ratio. Thus, assuming for simplicity that all supplies to clients belonging in Jersey are taxable supplies the service provider will calculate the GST recoverable from the Comptroller as follows.

GST charged on supplies to clients belonging in Jersey and trusts, companies and partnerships **not** having *international services* status (3)

Less: GST on expenditure attributed to clients belonging in Jersey and trusts, companies and partnerships **not** having *international services* status (100/1000 x 10) 1

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(2)

GST incurred on expenditure attributed to clients not belonging in Jersey and trusts, companies and partnerships having *international services* status (900/1000 x 10) 9

GST recoverable from Comptroller 7

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Where some supplies to clients belonging in Jersey etc. are exempt the calculation will be more complicated but similar in principle.

# 3 Introduction

This paper has been prepared to facilitate discussion with businesses operating in Jersey's financial services sector. It is a supplement to the main GST discussion document and should be read in conjunction with it.

Proactive participation of firms operating in this sector is essential to the framing of GST legislation (and the interpretation and administration of the legislation) that is appropriate to the particular challenges and opportunities that occur in the sector. In particular individual firms are best placed to foresee specific issues that might arise in the context of their businesses. Where potential issues can be identified and resolved in advance the legislation can be framed accordingly. Those issues that only come to light at a later date may be more difficult to address. Firms are therefore urged to give detailed and systematic attention to the consultation material now. The consultation document identifies particular issues where several approaches may be feasible and views on the merits and drawbacks of these alternatives or further suggestions will be taken into account. In view of the central importance of feedback from firms the consultation process may encompass further iterations of this document, with each building on feedback received.

## 3.1 Intended Audience

Jersey is a leading offshore financial services centre and for the purpose of the GST consultation this paper addresses the full spectrum of activities that this is generally understood to encompass. Specifically the discussion paper is addressed to those firms conducting banking business, investment business, trust company business, fund services business (together with the investment funds), insurance business and to those firms providing legal and accounting services in this context.

## 3.2 Design Criteria

### 3.2.1 Fiscal Strategy

The design criteria for the GST were initially set out in P.106/2004 and updated (in the light of the Crown Agents report) in the Fiscal Strategy (P.44/2005):

- raise circa £45 million, net of collection costs, with an initial rate of 3% fixed for three years;
- meet recognised best practice for such taxes;
- not breach the Island's obligations with the EU;
- minimise the cost of collection;
- not create an inordinate administrative burden for business;
- minimise economic distortions, for example, cascade problems;
- not create an uncompetitive environment for the Island's critical industries, in particular it must not harm the competitive position of the Island's finance industry;
- support the objective of the total fiscal strategy package being progressive.

The proposals described in this consultation document have been made with the above criteria in view together with the further Fiscal Strategy expectation that the financial services sector can be expected to contribute between £5 million and £10 million of the target yield of £45 million.

### **3.2.2 Competitive Position**

The Island's competitive position is determined by a constellation of factors that can change rapidly. Practitioners with detailed current knowledge of competing jurisdictions will be well placed to assess the impact of these proposals on the Island's competitive position. It has been assumed that feedback will be provided drawing on that expertise and that this will play an important part in finalising these proposals.

# 4 Concepts & practice

## 4.1 Consumption

In principle consumption taxes target *final* consumption of goods and services within the jurisdiction where that consumption takes place. It is important to note that consumption taxes are not intended to tax savings/investment. Neither are consumption taxes designed to operate as a tax on business - the economic cost is intended to fall to the final consumer<sup>4</sup>.

Although this conceptual foundation may appear intuitive significant practical implementation difficulties are encountered in defining the place and time of final consumption for some goods and more frequently for services / intangibles. Detailed rules must therefore be framed and precedents established to address particular situations<sup>5</sup>.

Alternative rules can be framed to determine where and when final consumption is deemed to take place. In many cases some form of proxy is expedient in framing the rules<sup>6</sup>. These alternative rules may be reasonable but nonetheless lead to different outcomes. In practice different jurisdictions have formulated incompatible rules<sup>7</sup>. This presents significant problems for international trade where inconsistencies lead to problems of double taxation / unintended non-taxation and increased administrative and compliance burdens. These effects present barriers that inhibit economic efficiency<sup>8</sup>. Work is in progress on the formulation of a set of principles that may eventually provide the basis for agreeing more consistent rules across all jurisdictions that apply consumption taxes<sup>9</sup>. However this work is at an early stage and progress towards this goal is likely to take some years<sup>10</sup>.

## 4.2 Financial Services

In addition to the practical problems that are common to all services, particular difficulties are encountered in respect of financial services. These difficulties are both theoretical and practical. At a theoretical level there is continuing debate as to whether financial services should be treated as taxable consumption<sup>11</sup>. At a practical level the treatments adopted by various countries depend in large measure

<sup>4</sup> In practice the extent to which the economic cost does fall on the customer rather than the supplier will depend on how far market forces permit the supplier to pass the cost on to the customer.

<sup>5</sup> For a lucid overview of these issues see *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, Centre for Tax Policy and Administration, OECD, June 2004.

<sup>6</sup> For example, following the EU approach the location of the supplier and invoice date are generally used as proxies although other rules are used in specific circumstances.

<sup>7</sup> See *QuoVATis: Where are we going with VAT/GST globally?*, PriceWaterhouseCoopers, October 2005 for an overview.

<sup>8</sup> For more details see *The Application of Consumption Taxes to the Trade in International Services and Intangibles*, Centre for Tax Policy and Administration, OECD, June 2004.

<sup>9</sup> See *The Application of Consumption Taxes to the Trade in International Services and Intangibles, Progress Report and Draft Principles*, Centre for Tax Policy and Administration, OECD, February 2005.

<sup>10</sup> Notably the USA has not implemented a GST. Some US interests have argued that the GST applied on imports within the EU amount to a non-tariff barrier, although this view is not accepted by the WTO.

<sup>11</sup> *GST and financial services; a government discussion document*, Policy Advice Division, New Zealand Inland Revenue Department, October 2002. See chapter 3 for a readable survey of studies on the GST treatment of Financial Services.

on exemption. Under this treatment the financial services firm becomes the proxy for final consumption. This approach presents significant drawbacks<sup>12</sup> that may cause economic distortions. A number of possible solutions have been put forward, and in some cases, implemented but “*no convincing conceptually correct and practical solution for capturing the bulk of financial services under the VAT has yet been developed*”<sup>13</sup>. *None of the alternatives offered to date clearly amounts to a feasible improvement on the status quo*<sup>14</sup>.

The financial services sector in Jersey predominantly serves an international client base<sup>15</sup> and identifying workable solutions to the design challenges described is therefore central to the successful implementation of GST.

### 4.3 Exempt Financial Services

There is no international consensus on the conceptual basis for determining whether a particular financial service is exempt or taxable<sup>16</sup>. The EU approach treats certain fee-based services as taxable. More recently other countries have treated most fee-based services as taxable<sup>17</sup>. In the absence of a rigorous conceptual foundation the proposed approach is to broadly follow practices in competing jurisdictions.<sup>18</sup> Thus, Schedule 5 of the Draft Law, in its present form, is broadly modelled on the UK position as regards financial services.

### 4.4 Place of Taxation of Services

Traditionally, under the EU model, the basic rule for the “place of supply” of services – and therefore the place of taxation – has been where the supplier is located. Any services to be taxed anywhere else were explicitly excluded from this basic rule (e.g. banking, legal and accounting services). For these services, the place of supply is deemed to be outside the EU if the customer is not established in the EU<sup>19</sup>.

The place of supply is of particular significance for the sector and is addressed in detail below.

<sup>12</sup> *Indirect Tax Treatment of Financial Services and Instruments*, OECD, October 1998 provides a survey of the range of treatments found within OECD members.

<sup>13</sup> *VAT Revisited: A New Look at the Value Added Tax in Developing and Transitional Countries*, R M Bird & P-P Gendron, USAID, October 2005. See section 4.3 for a discussion of the conceptual and practical difficulties of applying a VAT to financial services and a survey of various treatments adopted in countries around the world

<sup>14</sup> *Exempt Treatment of Financial Intermediation Services Under a Value-Added Tax: An Assessment of Alternatives*, Tim Edgar, Canadian Tax Journal, 2001, Vol. 49, No.5

<sup>15</sup> For example statistics published by the Jersey Financial Services Commission indicate that 5.5% of bank deposits related to Jersey resident depositors at December 2005.

<sup>16</sup> For a critical assessment of the current approaches to determining whether a service is exempt see *Exempt Treatment of Financial Intermediation Services Under a Value-Added Tax: An Assessment of Alternatives*, Tim Edgar, Canadian Tax Journal, 2001, Vol. 49, No.5

<sup>17</sup> *Hong Kong SAR Policy and Administrative Issues in Introducing a Goods and Services Tax*, IMF, 2001, see Appendix 2 for a readable overview of the alternative treatments that have been implemented.

<sup>18</sup> For a comparative survey see *Indirect Tax Treatment of Financial Services and Instruments*, OECD, October 1998

<sup>19</sup> See discussion in Proposed Council Directive 2003/0329. The European Commission intends to publish further proposals specifically addressing financial services in 2006

## 4.5 International Financial Services

In the context of the international supply of financial services competing jurisdictions (to a greater or lesser extent) zero rate the “export” of financial services and allow recovery of associated input taxes<sup>20</sup>. In the EU, for example, though input tax on expenses relating to exempt supplies cannot usually be recovered such tax can be deducted when it is incurred on expenses relating to the supply of *certain* banking, financial and insurance services by a supplier within the EU to a customer belonging outside the EU<sup>21</sup>.

This treatment is, prima facie, consistent with the overarching intention of taxing final consumption. It may appear that this introduces some scope for unintentional non-taxation insofar as:

- it may be difficult for the destination jurisdiction to enforce the consumption tax. (This is less likely to present difficulties for supplies to businesses in the destination jurisdiction where a *reverse charge* mechanism can be applied. Where the supply is to a consumer other measures may be necessary. For example in the EU, non EU suppliers can be required to register in a Member State) or
- the destination jurisdiction may apply rules that deem that consumption tax has been applied at origin.

This may, for example, give the foreign firm a competitive advantage over the domestic firm. These problems are well known and jurisdictions apply a range of measures to address them (within the constraints of the WTO General Agreement on Trade in Services, where applicable).

At present there is no international consensus on how, or how far, such issues can be systematically resolved and it appears that this will remain a feature of current approaches for the foreseeable future<sup>22</sup>.

<sup>20</sup> See also *Indirect Tax Treatment of Financial Services and Instruments*, OECD, October 1998, section 5.2.

<sup>21</sup> Article 17(3)(c) of the Sixth Directive. Enacted in UK law by article 3 of the Value Added Tax (Input Tax) (Specified Supplies) Order 1999 (SI 1999/3121).

<sup>22</sup> The European Commission intends to publish a global proposal on the taxation of financial services in 2006.

# 5 Overview of a conventional GST

## 5.1 Factors Determining Treatment

Under a conventional GST regime the treatment of a transaction depends on several factors. In the most general case of a transaction between two parties (supplier A makes a supply to customer B) the following matters must be considered:

- **Whether this is a supply in the context of a business activity.** Business activity is defined in Article 2 of the Draft Law. Note particularly that where a party is not engaged in business activity it will not be able to recover any tax suffered on inputs<sup>23</sup>. Whilst at first sight this may appear straightforward it can give rise to difficulties. The potential difficulties are well illustrated by uncertainties identified in the definition of business activity in the Sixth EC VAT Directive<sup>24</sup>. This has been of particular relevance in the context of financial services. In particular, EC case law has established that pure holding company activity does not constitute economic activity for the purposes of the Sixth EC VAT Directive. Therefore a holding company is not a taxable person. However a recent ECJ ruling established that, contrary to the view taken by some EC Member States, the activities of collective investment schemes are economic activities in this context and such schemes are therefore taxable persons<sup>25</sup>. To take a second example, the mere fact that a charitable trust has charitable objects does not lead to the conclusion that it is not performing a business activity for GST purposes.
- **Where each party belongs.** For GST purposes the place where a party belongs is determined by reference to the place of establishment most directly connected with the supply or by residence<sup>26</sup>. Note particularly that this concept is distinct from direct tax concepts (“centre of management and control”, place of incorporation). Companies incorporated in other jurisdictions may have a business establishment in Jersey. Conventionally the meaning of establishment is not exhaustively defined in the law.
- **Whether the transaction is a taxable supply.** The supply may be **exempt** if the supply is explicitly specified as exempt in the law<sup>27</sup>. Exempt supplies conventionally include certain fundamental supplies associated with financial services. Alternatively the supply may be **outside the scope of GST** if (i) supplier A belongs in Jersey but is not registered (and not liable to be registered) or (ii) if consumption (“*place of supply*”) is deemed to take place outside Jersey, or (iii) if it is not supplied in the course of business). Any supply that is neither exempt nor outside scope will be a **taxable supply**.

<sup>23</sup> To illustrate the scale of the issue the UK charity sector estimate irrecoverable VAT costs in the region of £400 million per annum are incurred

<sup>24</sup> the equivalent definition (“economic activity”) is found in Article 4 of the Sixth Directive

<sup>25</sup> Case ECJ-8/03, Banque Bruxelles Lambert SA (BBL) v Belgian State. The ruling was in the context of the VAT position of a Luxembourg SICAV (an open ended collective investment vehicle).

<sup>26</sup> Details may be found in Article 4 of the Draft Law

<sup>27</sup> Exempt supplies can be found in schedule 5 of the Draft Law

- **Whether each party is registered for GST.** Any business making taxable supplies exceeding the registration threshold<sup>28</sup> is liable to register. A firm making taxable supplies below the threshold may also elect to register but there is no requirement to do so.

A business that is not registered does not charge GST on supplies and cannot recover any GST incurred on expenditure.

A registered business charges GST on taxable supplies. Credit can be claimed for GST incurred on expenditure that relates to taxable supplies. However, where a business makes both taxable and exempt supplies an acceptable method (“partial exemption method”) must be used to relate GST incurred on expenditure to both taxable and exempt supplies (known as “direct attribution”).

The interaction of these factors in a conventional GST regime gives rise to a range of possible cases illustrated in the following table<sup>29</sup>. As will be evident from the table this results in considerable complexity.

Is the supply in the course of business?	N	-	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	
Does supplier A belong in Jersey?	-	N	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	N	N	N	N	N	
Does customer B belong in Jersey?	-	N	Y	N	N	N	N	N	N	N	N	Y	N	N	Y	Y	Y	Y	Y	
Is the supply specified as exempt in the law?	-	-	Y	Y	Y	Y	Y	N	N	N	N	N	N	N	Y	N	N	N	N	
Is supplier A registered or liable to be registered?	-	-	-	Y	Y	Y	N	N	Y	Y	Y	Y	Y	Y	-	-	-	-	-	
Is the place of supply deemed to be the location of supplier A?	-	-	-	N	N	Y	-	-	N	Y	N	Y	N	-	Y	N	N	N	N	
Exempt supply treated as outside scope with recovery if customer B does not belong in the territory?	-	-	-	N	Y	-	-	-	-	-	-	-	-	-	-	-	-	-	-	
<b>Taxable Supply</b>																			• • •	
<b>Taxable Supply (B applies reverse charge)</b>																				•
<b>Exempt</b>																				• • • •
<b>Outside Scope (A may recover associated input tax)</b>																				• • • •
<b>Outside Scope</b>																				• • •

(Notes: “N” means No, “Y” means Yes, “-“ means that the factor will not be relevant)

<sup>28</sup> The threshold specified in Schedule 1 of the Draft Law is £300,000 in one year

<sup>29</sup> This table is included to illustrate the range of cases that arise in practice but it is not intended to provide a definitive or exhaustive tabulation of any particular GST regime. In practice further factors may need to be considered and uncertainties may exist in regard to which rule takes precedence in some cases. The appendices provide an example of the major factors that would be taken into consideration under the UK VAT regime.

In addition, special rules may be applied in certain circumstances. For example in the EU investment management is generally a taxable supply but is exempt when supplied to special investment funds<sup>30</sup>. The scope of special investment funds or investment management is not defined in the Sixth Directive. Under UK law exemption has been applied in the case of authorised (but not unauthorised) unit trusts and open ended investment companies but does not extend to investment trust companies<sup>31</sup>.

## 5.2 Issues for “Corporate Vehicles” Generally

As corporate vehicles are employed in diverse and changing scenarios practitioners will be best placed to assess the potential impact of generic provisions on the various structures that are administered by the financial services sector now or in future. However, in the absence of further provisions it will be apparent that supplies to these structures will in some cases be taxable and indeed some of the services rendered by vehicles may be taxable supplies.

## 5.3 Issues for Funds & Fund Managers

In the absence of specific provisions the supply of units/shares by a fund will be outside scope in a conventional GST regime<sup>32</sup>. Similarly dealing in the underlining securities by the fund will be exempt. As noted above in the case of the EU further provisions specify that in certain circumstances (e.g. UK authorised funds) the investment management services supplied to the fund will be exempt. However, other supplies to the fund that are not within the (uncertain) scope of management services would be taxable. Note particularly that where taxable supplies are received from abroad the fund would be liable to register and account for GST on those supplies. However the GST can be recovered to the extent that the fund is deemed to be supplying services (buying and selling securities) outside the GST territory.

In respect of the manager, as noted earlier, depending on the fund, management services may be exempt or taxable supplies. The question of what is included in management services is ongoing and uncertainties particularly arise in relation to outsourced elements of management services. Dealing in units/shares by the manager as principal or agent is exempt. A manager predominantly making exempt supplies may therefore incur substantial irrecoverable GST were taxable services (especially investment advice) are purchased by the manager.

<sup>30</sup> Article 13B(d)(6) of the EC 6th Directive

<sup>31</sup> In the UK the Association of Investment Trust Companies have estimated that irrecoverable VAT borne by investment trust companies is of the order of £30 million per year. Note that the sticking tax does not apply to the extent that the vehicle is invested outside the EU.

<sup>32</sup> Interestingly many EU Member States had treated this as exempt prior to Kretztechnik A.G. -v- Finanzamt Linz (Case C-465/03) which ruled that issue is outside scope (but transfer is exempt).

# 6 Proposed approach in Jersey

The treatment of financial services described in this consultation document broadly corresponds to the international practices outlined above. In summary the treatment is framed to approximate the taxation of final consumption taking place in the Island whilst treating outside scope services that do not fall into that category. In view of the substantial administration and compliance burden that can arise firms will have the opportunity to take advantage of simplified schemes where appropriate. Similarly a scheme will be available for “corporate vehicles” that meet appropriate criteria.

## 6.1 Certainty of Treatment

The existence of uncertainties in regard to GST/VAT treatment of particular transactions in other jurisdictions is a well known concern. It is expressly intended that one of the advantages that the Jersey GST regime will be able to offer is greater certainty of treatment. Feedback on any areas where uncertainty may be an issue is therefore particularly welcome.

# 7 International services status

## 7.1 “Corporate Vehicles”

In the words of the OECD “*corporate vehicles are legal entities through which a wide variety of commercial activities are conducted and assets are held. They are the basis of most commercial and entrepreneurial activities in market-based economies and have contributed immensely to the prosperity and globalisation that have occurred over the last half century. Today, the rapid flows of private capital, ideas, technology, and goods and services involve corporate vehicles at virtually every level*”<sup>33</sup>.

Trusts, companies and partnerships play an essential role in much of the activity undertaken within the financial services sector. These are sometimes loosely referred to as “corporate vehicles”. However this terminology is misleading. For example, whilst a limited liability company is a legal person with legal rights and legal obligations distinct from those of the people who make up its membership this is not the case in respect of a trust or a Jersey limited partnership. Where the term “corporate vehicle” is used in this document for brevity this caveat should therefore be borne in mind. Regulations will be framed using exact terminology.

## 7.2 International Services status

Many of the trusts, companies and partnerships discussed above manifestly do not engage in activities that form links in a value chain that leads to consumption by individuals belonging in Jersey. However conventional GST regimes do not readily accommodate these situations. Whilst this discussion document provides examples of regulations within conventional regimes that are intended to accommodate certain vehicles (e.g. funds) these are not without difficulties. Furthermore, some of the factors that have enabled the financial services sector to flourish in a competitive environment have been the certainty of treatment, simplicity and tax advantages of the jurisdiction. With this in mind it is proposed to frame regulations to allow trusts, companies and partnerships that satisfy appropriate criteria to claim *international services* status. Where this status is claimed:

- any taxable supplies made to the “corporate vehicle” by GST registered taxpayers will be eligible for remission of GST.
- the “corporate vehicle” will not be required to register as a GST taxpayer and therefore any services rendered by the “corporate vehicle” will be outside of scope for GST purposes.

## 7.3 Criteria for International Services Status

This proposal depends on framing workable criteria that will identify those “corporate vehicles” that, loosely speaking, do not form a link in a value chain that leads to consumption by individuals in Jersey. Some tentative criteria are set out below. However it is anticipated that these may require revision / refinement and feedback from practitioners is invited.

A “corporate vehicle” will have *international services* status if:

- (1) it does not make supplies to:
  - a. individuals belonging in Jersey;

<sup>33</sup> This definition is found in *Behind the Corporate Veil, Using Corporate Vehicles for Illicit Purposes*, OECD, 2001

- b. any “corporate vehicle” belonging in Jersey other than a “corporate vehicle” that itself has *international services* status;
- (2) no individual belonging in Jersey has the effective use or enjoyment of any assets owned or administered by the “corporate vehicle”;
- (3) no individual belonging in Jersey has the effective use or enjoyment of any services supplied to the “corporate vehicle” or administered by the “corporate vehicle”.

The second and third points are included to prevent the abuse of the provisions by individuals belonging in Jersey. At a minimum further refinement will be necessary to accommodate situations where there is some incidental violation of the above criteria. Here incidental means that the violation is not inconsistent with the spirit of the regulation. For example, where a trust set up in connection with a Special Purpose Vehicle distributes funds to a charity that provides support to individuals in Jersey. Specific, detailed practitioner feedback on scenarios that should be taken into account is welcome.

## 7.4 Investment Funds

Investment Funds can take a variety of forms and may or may not be open to the public. In an EU context the VAT treatment depends on the form the fund takes. In some cases investment management is exempt whereas in other cases the service is taxable. The EU treatment is also uncertain in some respects<sup>34</sup>.

The proposed treatment is intended to avoid uncertainty and inconsistency as far as possible and to maintain the status quo for funds. In particular the capacity to provide investors in other jurisdictions with the same rate of taxation as if they had invested directly in the underlying securities (“*tax-transparency*”) is an important enabling factor in the growth of this sector<sup>35</sup>. The proposed approach is to extend the *international services* status provisions to explicitly include funds. In the absence of a clause explicitly extending the provision in this way some funds may not satisfy the criteria insofar as investors belonging in Jersey may subscribe. In broad terms this treatment is more favourable than a fund subject to an EU VAT regime where investment management is exempt (for authorised funds only) but irrecoverable VAT may be incurred on other costs.

It is envisaged that the *international services* status provisions will be drafted to include a clause to the effect that:

- any fund regulated under the Collective Investment Funds (Jersey) Law will have *international services* status; and
- any investment vehicle not regulated under the Collective Investment Funds (Jersey) Law that does not satisfy the *international services* status criteria on the sole grounds that an investor belonging in Jersey may subscribe may apply to the to Comptroller for *international services* status. The

<sup>34</sup> see *VAT matters: Strategic Funds Issues*, E&Y, 2004 for an overview of EU treatment of funds and the difficulties and uncertainties this presents.

<sup>35</sup> For example, a recent empirical UK study indicated that VAT is a key factor influencing the decision to locate funds offshore, together with regulatory considerations and the availability of appropriate “corporate vehicles”, especially in regard to specialised funds (source: *The Future of UK Asset Management: Competitive Position and Location Choice*, Oxera Consulting Ltd, May 2005). This can be offset by withholding tax disadvantages.

Comptroller will confirm that the investment vehicle has *international services* status where he is satisfied that the vehicle is engaged in bona fide investment activity (excluding investment in assets in Jersey, other than bank deposits or listed companies undertaking business in Jersey).

Feedback on the framing of this clause is welcome.

## 7.5 General Implications for Vehicles

The intended effect of the proposed *international services* status provisions is indicated in the table below. Note that this treatment has several benefits:

- Sticking tax is not incurred where the supplies do not result in deemed consumption by individuals in Jersey
- Vehicles (e.g. holding companies) that are not performing economic activities would, under a conventional regime, incur irrecoverable GST whereas an *international services* status vehicle will benefit from GST remission.
- Vehicles having *international services* status that would otherwise be liable to register are not liable to register and are not required to charge GST on supplies.
- Uncertainties in regard to GST treatment can be reduced or eliminated

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## 7.6 Specific Implications for Funds

It may be that a conventional GST treatment (including exemption of investment management) would have limited impact on many funds. In particular funds will almost exclusively invest in securities outside the GST territory (Jersey) and will therefore recover any GST incurred. However the proposed approach is to include funds within the scope of the *international services* status provisions to provide a consistent and clear cut regime. The envisaged advantages of this approach are:

- the question of whether investment management is exempt in a given case (c.f. EU special investment funds) does not arise. The regulatory position has no bearing on the GST position.
- Uncertainty regarding what is within the scope of investment management does not arise
- the possible requirement to register and reverse charge does not arise
- outsourcing of services does not create uncertainties

Comments are also invited on whether the criteria, as presently framed, are workable. Amongst other matters, would these criteria give rise to uncertainties that would make it impractical to claim this status?



## **7.8 Safeguards**

It is envisaged that safeguards will be necessary to prevent misuse. It is proposed that this will take the form of penalties for falsely or recklessly declaring that a “corporate vehicle” has *international services* status. The size of the penalty will be commensurate with the risks. A reckless declaration would include a situation where this status has been claimed even though it could reasonably be foreseen that the status would not apply in future. As vehicles will generally be administered by regulated service providers it is envisaged that such penalties will provide an effective safeguard. Feedback on matters that may need to be taken into account in framing safeguards is welcome.

### **7.8.1 Special Purpose Vehicles**

Can Special Purpose Vehicles be adequately encompassed in the *international services* treatment described above? Firms are asked to submit details of particular situations that may prove problematic under the proposed approach.

# 8 Banks

In a conventional GST regime banks<sup>36</sup> typically provide a mixture of taxable and exempt supplies to business and private customers. The adjacent table gives a broad breakdown of services for an “average” Jersey bank. Consistent with international banking norms, fee based services (which are more often treated as taxable supplies), are a significant component of revenues but exempt supplies remain predominant.

Furthermore, in a conventional GST regime banking services are generally treated by reference to the location of the customer. Where customers do not belong in the GST territory supplies will be outside scope and related input tax can be recovered. Thus, in a conventional GST regime the GST compliance and administrative challenges can be daunting. In particular the bank must track the GST status of each customer and charge GST for taxable supplies made to customers belonging in the territory. The bank must then attribute the GST incurred on inputs to the taxable supplies, exempt supplies and outside scope supplies. Where the inputs cannot be directly attributed to supplies some method of determining the allocation is employed. In response to the considerable difficulties this often presents mechanisms designed to provide a *fair and reasonable* irrecoverable GST estimates, for example based on turnover data, may be agreed with the tax authority<sup>37</sup>. Often a significant element of input tax remains irrecoverable<sup>38</sup>.

In the case of Jersey a further complication arises in that, in this scenario, the bank would also need to track those customers having *international services* status.

## 8.1 Presumptive Scheme

In practice banks in Jersey generally serve an international customer base and the substantial administrative and regulatory requirements that a conventional GST regime impose do not appear to be warranted in these circumstances. It is therefore proposed to offer a presumptive scheme for eligible banks. This scheme is similar in key respects to a scheme operating in Singapore<sup>39</sup> and proposed for the

Income	%
Interest income less interest expense	70
Dividend Income	0
Fees etc Income	20
Fees etc Expense	-1
Investment Securities NET Income	1
Currency Dealing NET Income	7
Fiduciary Cash/Deposits	0
Fiduciary Securities	2
Fiduciary Other	1
Other Income	0
Total Income	100

<sup>36</sup> Banks here means those firms regulated under the Banking Business (Jersey) Law 1991.

<sup>37</sup> For a readable discussion of some methods see chapter 5 of *GST and financial services; a government discussion document*, Policy Advice Division, New Zealand Inland Revenue Department, October 2002.

<sup>38</sup> In the UK the irrecoverable VAT incurred by the banking and insurance sectors has been estimated to be 4.7% of the net receipts of the tax (source: *Consumption Tax Trends 2004*, OECD, pp70). However any comparison with Jersey would need to be flexed to reflect the domestic / “export” mix in each case.

<sup>39</sup> A brief description of the schemes used in Singapore was included *A Goods and Services Tax – The right way for Jersey? Financial Services Consultation*, States of Jersey, October 2004.

Hong Kong Special Administrative District by the IMF. The scheme will be open to any bank that predominantly serves international clients. Banks eligible for this scheme:

- will not be required to ascertain the GST status of each customer
- will not be required to charge GST on any taxable supplies to customers belonging in Jersey.
- will be required, in the same way as other businesses, to apply a reverse charge where applicable.

Under this presumptive scheme banks will be entitled to recover 75% of tax incurred on inputs.

## **8.2 Eligibility for Presumptive Scheme**

This scheme presumes that the value of supplies to customers belonging in Jersey is small in relation to the total value of supplies. As it is possible that some banks may not satisfy this assumption a test may be applied to identify those that are unlikely to satisfy the assumption. However, the purpose of the scheme is to shield banks from the full apparatus of the domestic GST regime where this is unwarranted. By default banks will therefore not be expected to have on record the GST status of every customer. Nonetheless, for the limited purpose of identifying those banks that are unlikely to satisfy the assumption, the records that are already maintained for regulatory purposes may be sufficient. For regulatory purposes banks record the geographic location of customers and in particular separately identify those that are believed to be beneficially owned by bona-fide Jersey resident individuals. Using this data the bank can estimate the percentage of exempt and taxable supplies relating to Jersey resident individuals. Where this exceeds 10% of the total supplies the bank will, prima facie, not be eligible for the presumptive scheme.

Consideration is being given to the merits of extending this presumptive scheme to include banks that have a higher proportion of Jersey resident individual customers, albeit with a correspondingly smaller percentage of recoverable GST. Specific feedback from banks having a higher proportion of Jersey resident individual customers, including the profile of exempt and taxable supplies provided to such customers, is therefore invited.

## **8.3 Disaggregating Supplies**

Some banks may also undertake other business, in particular trust company business, investment business, fund services business or insurance business within the same legal entity. Where, in aggregate, these activities satisfy the test described above this presumptive scheme will be available. Where the test is not satisfied the bank may disaggregate its activities and apply the presumptive scheme in respect of the services covered by the Banking Business (Jersey) Law 1991.

It has been assumed that banks already have systems in place that will enable them to gather the information needed to apply the presumptive test and, where applicable, to disaggregate supplies, without undue difficulty. Feedback is encouraged from any bank that envisages that the provisions described here will prove excessively difficult.

## **8.4 Potential Concerns**

Although this presumptive treatment could (depending on the status of vehicles) be less favourable than the EU position (e.g. as applicable in the Isle of Man) it is offset to an extent by the 3% GST rate. At this

level it has been assumed that the cost will not render the sector uncompetitive. However it is recognised that the position of individual banks may vary and any submissions to the contrary, with supporting evidence, will be given careful and detailed consideration.

This treatment also inhibits outsourcing inasmuch as outsourced services will incur GST which may not be fully recoverable. However, at a rate of 3% this effect is not thought to be of sufficient concern to require further provision.

Finally, to the extent that a bank supplies registered business customers belonging in Jersey it will introduce a cascade effect<sup>40</sup>. However, at a rate of 3% this effect is not thought to be of sufficient concern to require further provision.

<sup>40</sup> In this context it may be noted that Singapore taxes most financial services for which explicit fees are charged (except those exported), and exempts all others. To reduce cascading when financial services are purchased by taxable businesses as inputs, financial institutions— notwithstanding the fact that most of their outputs are exempt— are nevertheless allowed to recover a substantial proportion of the GST they paid on their purchases. (source: *Hong Kong SAR: Policy and Administrative Issues in Introducing a Goods and Services Tax*, IMF, 2001).

# 9 Trust Company business

A firm undertaking trust company business<sup>41</sup> (“service provider”) may serve both clients belonging in Jersey and international clients. However, in practice the international component of the client base is generally predominant. It is therefore expected that most companies, trusts, partnerships and any other “corporate vehicles” administered by the business will:

- be eligible for and wish to benefit from *international services* status (to avert uncertainty); or
- will otherwise be outside the scope of GST.

As explained above the service provider will usually account for *international services* status fees on behalf of the trusts, companies partnerships etc. that it serves and will maintain appropriate records of both the status in each case and fees paid.

The service provider will be liable to register if it makes taxable supplies exceeding the threshold. As services rendered to trusts, companies and partnerships having *international services* status will be included in the value of taxable supplies most service providers will be liable to register. Where the threshold is not exceeded the business may nonetheless elect to register to be in a position to recover GST suffered on inputs. In recognition of the nature of the business the Comptroller will, by concession, accept a simplified scheme that, in his judgement, presents a *fair and reasonable* GST estimate. For example the proportion of turnover relating to clients belonging in Jersey may provide an appropriate basis for estimating the GST on expenditure that can be attributed to those supplies.

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For example, the service provider in the diagram below incurs GST of 10 on taxable expenditure of 340. Supplies to clients belonging in Jersey have a value of 100 and the value of supplies subject to the *international services* status provisions and other international clients is 900. GST incurred on expenditure is attributed in this ratio.

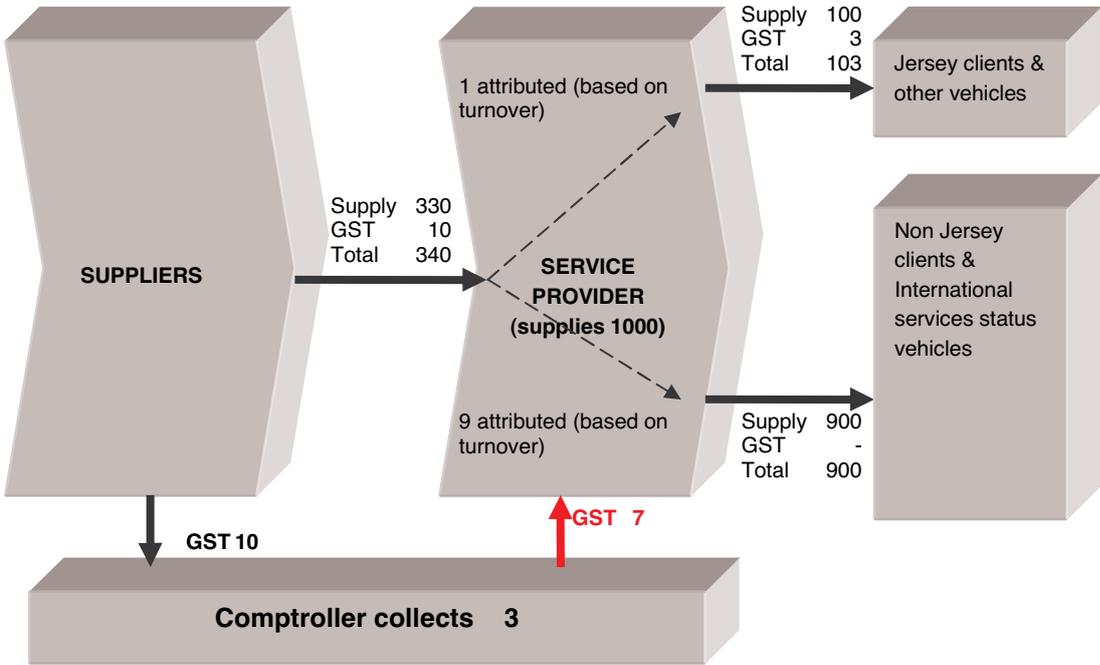


Figure 5: GST recovery for service provider with both international and Jersey clients

<sup>41</sup> Trust company business as defined in Financial Services (Jersey) Law 1998.

Assuming for simplicity that all supplies to clients belonging in Jersey are taxable supplies the service provider will calculate the GST recoverable from the Comptroller as follows.

GST charged on supplies to clients belonging in Jersey and trusts, companies and partnerships <b>not</b> having <i>international services</i> status	(3)
Less: GST on expenditure attributed to clients belonging in Jersey and trusts, companies and partnerships <b>not</b> having <i>international services</i> status (100/1000 x 10)	1
	<hr/>
	(2)
GST incurred on expenditure attributed to clients not belonging in Jersey and trusts, companies and partnerships having <i>international services</i> status (900/1000 x 10)	9
	<hr/>
GST recoverable from Comptroller	<hr/> <u>7</u>

Where some supplies to clients belonging in Jersey etc. are exempt the calculation will be more complicated but similar in principle to this example. The illustration assumes that turnover will be an appropriate basis for a *fair and reasonable* calculation. In some situations another basis may be more appropriate.

Attention is also drawn to the effect of place of supply rules discussed below.

# 10 Fund Services business

It is envisaged that a firm undertaking fund services business<sup>42</sup> or providing equivalent services in respect of investment vehicles that are not collective investment funds (e.g. private equity funds) will be in a similar position to a firm undertaking trust company business. In particular most investment vehicles:

- will be eligible for and wish to benefit from *international services* status (to avert uncertainty); or
- will otherwise be outside the scope of GST

It is therefore assumed that firms undertaking fund services business will be subject to a simplified scheme comparable to that available for firms engaged in trust company business. Comments are welcomed on any concerns that may arise.

Attention is also drawn to the effect of place of supply rules on fund services business discussed below.

# 11 Investment business

28 A firm undertaking investment business (within the meaning set out in the Financial Services (Jersey) Law 1998)<sup>43</sup> may serve both domestic and international clients. Where services are supplied to *international services* status vehicles (including funds) the position will be as discussed above. For some firms undertaking investment business clients belonging in Jersey may represent a more substantial component of the turnover and in those cases it may be more appropriate to register and account for GST in the standard way. For those firms that predominantly serve international clients and trusts, companies and partnerships having *international services* status a simplified scheme comparable to that available for firms engaged in trust company business may be more appropriate. The Comptroller will accept a simplified scheme where he is satisfied that it is *fair and reasonable* to do so. Comments are welcomed on any concerns that may arise.

Firms should note that Schedule 5 of the Draft Law, following the UK precedent, lists “*the management of an authorized unit trust scheme or of a trust-based scheme*” as an exempt supply. However, as discussed above, collective investment funds will be eligible for *international services* status and it is unlikely that this will remain in the final version of Schedule 5.

Attention is also drawn to the effect of place of supply rules on fund services business discussed below. If the basic rule is not changed as discussed below it is envisaged that the regulations will stipulate that the place of supply of investment management services will be determined by reference to the location of the customer.<sup>44</sup> Thus, where the customer does not belong in Jersey investment management services will be treated as outside scope with recovery of related input tax. Comments are invited on any other services that it may be desirable to explicitly tax by reference to the location of the customer.

<sup>42</sup> Also known as functionary within the meaning set out in the Collective Investment Funds (Jersey) Law, 1988.

<sup>43</sup> That is (1) deals in investments, either as principal or as agent; (2) undertakes discretionary investment management; (3) gives investment advice.

<sup>44</sup> C.f. Value Added Tax Act 1994 Schedule. 5.

# 12 Insurance business

It is proposed that, in keeping with international precedents, the supply of insurance will be treated as an exempt service. It is envisaged that insurance will be treated as outside scope with recovery of attributable tax on expenditure where supplied to a customer not belonging in Jersey.<sup>45</sup>

It is further envisaged that captive insurance vehicles will usually be eligible for, and will wish to benefit from, *international services* status.

# 13 Place of supply rules

The Draft Law (Article 23), following the EU model, envisages the basic rule for the “place of supply” of services – and therefore the place of taxation – will be where the supplier is located. If the EU model is followed regulations would override this rule in specific cases. For example, the EU model makes provision for the place of supply of banking and insurance to be determined by reference to the customer<sup>46</sup>. This has a particular significance for the financial services sector inasmuch as any services that are not explicitly specified as supplied where the customer belongs may be taxable where the supplier belongs in Jersey.

The basic rule adopted in the EU serves well where most supplies are made to domestic customers<sup>47</sup> but may not be an appropriate choice for an export oriented economy. Consideration is therefore being given to adopting the place the customer belongs as the basic rule. This basic rule would also be consistent with the rationale for the *international services* status proposal. Comments on the merits and drawbacks of adopting this basic rule, and any exceptions that may be necessary, are welcomed.

Note that the *international services* status provisions are intended to override place of supply rules that would otherwise apply.

<sup>45</sup> C.f. Input Tax (Specified Supplies) Order (S.I. 1999/3121).

<sup>46</sup> For example, in the UK this is determined by VAT Act 1994, Schedule 5, paragraphs 1 to 8 which is limited to banking, financial and insurance services.

<sup>47</sup> The possibility of changing the basic rule was recently considered, see *Consultation Paper VAT – The Place of Supply of Services to Non-Taxable Persons*, European Commission, 2005.

# 14 Organisational structure

The treatments outlined above have considered each area of business separately. In practice many firms engage in more than one of these business areas, as well as other business areas not covered here. For GST purposes it is envisaged that these activities can, if necessary, be readily disaggregated so that the appropriate scheme can be applied to each business area. It is envisaged that it will not be unduly difficult for firms to disaggregate business as it is likely that the organisation of the business will already reflect regulatory requirements corresponding to these business activities. Comments are invited on any practical difficulties that may arise.

# 15 How can I make my views known?

It is envisaged that most measures relating to financial services will be implemented through regulations and consultation on this paper is therefore scheduled to end at the same time as the general consultation on the forthcoming regulations (31 August 2006).

Please forward your comments, suggestions, or questions, in writing to:

The GST Consultation Team,  
Income Tax Office,  
1st Floor, Cyril Le Marquand House,  
The Parade,  
St Helier,  
JE4 8PF

E-mail: [gstconsultation@gov.je](mailto:gstconsultation@gov.je)

Please identify any response that is made in confidence. Responses that are not expressly submitted in confidence may be published in due course.

# Appendix A - VAT liability in the UK

In a UK context the VAT Blue Book recommends that the relevant factors are considered in following sequence to establish VAT treatment in respect of financial services:

- **Is it within the scope of UK VAT?** (Value Added Tax Act 1994 section 4).
- **Where does supplier or recipient belong?** (Value Added Tax Act 1994 section 9).
- **Is the place of supply covered by Value Added Tax Act 1994 section 7 paragraph 10?**  
(Place of supply of services determined by reference to where supplier belongs)
- **Is it covered by the Value Added Tax (Place of Supply of Services) Order 1992 (S.I. 1992/3121)?**  
(The place of supply for certain banking and financial services is where the customer belongs if they are outside the EU)
- **Is it Zero rated?** (Value Added Tax Act 1994 Schedule 8)
- **Is it covered by Input Tax (Specified Supplies) Order 1999 (S.I. 1999/3121)?**  
(Provides for recovery of input tax relating to the supply of certain insurance and finance services that are exempt or would be exempt when the supplies are made to persons belonging outside the Member States).
- **Is it within Exemption?** (Value Added Tax Act 1994 Schedule 9).
- **Is it supplied where received?** (Value Added Tax Act 1994 Schedule 5).
- **Is there an agreed industry treatment agreed with Customs and Excise?**

# Appendix B - Definitions

## Dealing in Money

Services provided in connection with the issue of, receipt of, dealing in, or transfer of money. Specific services include:

- transfers of money between accounts
- provision of bankers' drafts
- cable transfer charges
- clearing services
- direct debits
- issue or dealing in commercial paper / promissory notes.

## Operation of Bank Account

Services provided in connection with the operation of an account; including:

- transaction charges
- interest / service charges
- issue of standard cheque books
- overdraft charges

## Documentary Credits

An international trade finance facility, relating to credit or guarantees in respect of:

- exports of goods
- imports of goods

## Provision of loans

Includes:

- the granting of credit, secured or unsecured, to a customer
- the receipt of a commitment fee in connection with the granting of credit
- charges made by an intermediary for making arrangements for the granting of credit.

## Credit Card Services

Charges relating to credit card services, including:

- fees received from the card holder
- interest charges
- annual charges
- commission from participating outlets

## Financial Guarantees

A contract issued by a guarantor obliging him to indemnify a party for any loss arising from the failure or default of the other party to fulfil his obligation.

## **Guarantee Claims**

The settlement by the guarantor of any liability arising under a financial guarantee, described at 6 above.

## **Dealing in Financial Instruments and Shares**

The issue, sale, transfer or receipt of financial instruments including:

- bonds
- certificate of deposit
- shares and stocks
- co-operative investments
- government bills/gilts

Charges by intermediaries for the making of arrangements for transactions in the above instruments, including the underwriting of share and stock issues.

## **Stock Lending**

The lending of stock, for a fee to a counterparty (the equivalent stock to be returned at an agreed date).

## **Share Dividends**

The receipt of dividends by a company / individual.

## **Futures**

Contracts for the sale of a financial instrument or commodity at a fixed price at a fixed future date. Standard contracts are used and these are authorised by a regulated market.

### **a. Financial Futures**

The sale as principal of a financial futures contract, and the services of intermediaries in connection with the making of arrangements for the sale of a financial futures contract

- to a market member
- to a non-market member

### **b. Commodities Futures**

The sale as principal of a commodities futures contract, and the services of intermediaries in connection with the making of arrangements for the sale of a commodities futures contract:

- to a market member
- to a non-market member

### **c. Forward Agreements**

These are contracts entered into outside the regulated markets. The form of contract is not necessarily standardised. However the principle of agreeing a sale at a fixed price on a fixed future date is consistent.

## Options

Options may be entered into in respect of interest rates, exchange rates, securities stock indices, commodities and their derivatives. For example, in an interest rate option, the purchaser of the option has the right (but not the obligation) to lock into a predetermined interest rate for a given period of time. The writer of the option is exposed to a market risk in respect of interest rate movements. Options may be contract over the counter (i.e. directly between counterparties) or through recognised exchanges.

The supplies may include:

- the grant of an option
- the close-out of an option
- the exercise of an option
- making arrangements for any of the above services.

## Swaps

Swaps may be entered into in respect of interest rates or currencies. In the classic interest rate swap, two parties contract to exchange interest payments (and sometimes principal payments) on the same amount of indebtedness of the same maturity and with the same payments dates, with one providing fixed interest rate payments in return for variable rate payments from the other.

Supplies may include:

- contracting as principal to a Swap agreement
- the receipt of a periodic payment (e.g. interest) under the agreement
- the services of an intermediary in connection with the making of arrangements for a Swap contract.

## Underwriting Financial Instruments

Underwriting the issue of financial instruments, e.g. guaranteeing to find buyers for all or part of an issue, including the services of sub-underwriters. The fee will sometimes take the form of a discount (i.e. underwriter buys instruments after the issue at, say, 2% less than the estimated market value). The underwriter's income will therefore derive from the difference in buying price and selling price (i.e. the "turn").

## Dealing in Foreign Exchange

The exchange of currency between counterparties:

- spot (bought at the current exchange rate)
- forward (agreement to buy a fixed price amount at a future date and price)
- over the counter (supplied to customers at the spot rate plus a fee).

## Financial Leases

Finance provided for the acquisition of goods by way of instalment credit or a credit sale agreement. This includes:

- repayment of capital
- separately disclosed charge for credit.

## **Debt Collection**

Fees for the collection of outstanding debts.

## **Debt Factoring**

Recourse factoring: An advance is provided calculated on a discounted value of debts recoverable. The factor takes title to the debts but has the right to assign back those debts not paid by a given date. Non-recourse factoring: Factor purchases debts at a discount taking into account the risk of non-payment since the title to the debts cannot be assigned back to the original supplier.

## **Safekeeping**

The provision of safe custody facilities, including safety deposit boxes.

## **Financial Advisory Services**

Provision of advice regarding, for example, the buying and selling of securities or advice in relation to market conditions.

## **Provision of Life Insurance/Reinsurance**

Provision of insurance against death - often linked to a mortgage, investment or savings policy; traditionally, such insurance comprises:

- term cover for mortality; and
- an investment / savings plan.

## **Provision of Non-Life Insurance/Reinsurance**

Provision of insurance cover relating to a specific risk (i.e. theft, loss, damage, illness etc.) in return for a periodic premium, including the services of brokers and agents. The insurance may be provided:

- by authorised insurers; or
- by non-authorised insurers.

## **Settlement of Insurance Claims**

The settlement by the insurer of claims arising under LAS below.

## **Loss Adjusting Services**

Provision of services relating to the assessment and negotiation of an insurance claim.

## **Trustee Services**

Provision of services as Trustee for an estate, fund or special investment funds. Fees may include periodic management fees.

### **Fund Management**

Provision of management services relating to a fund, including the management of:

- pension funds
- a collective investment fund
- an investment portfolio
- a private fund

Fees may comprise

- a management fee
- a transaction-based fee for the buying and selling of securities.

### **Professional Services**

The provision of services by accountants/lawyers

- in the general course of business in relation to a specific financial transaction.



