



# Corporate Services Scrutiny Panel Report

## Review of the Zero/Ten Tax Design Proposals



Presented to the States on 23<sup>rd</sup> January 2007

S.R.3/2007

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# 1. Executive Summary

## 1.1 General points

### **General approach**

The Sub Panel's Interim Report accepted the broad approach of Zero/Ten.

*This acceptance is still valid.*

### **Areas of opposition**

There were some specific aspects of the Initial Design Proposal which the Sub Panel opposed, in particular:

The RUDL charge **[See Section 6a]**;

The deferred distribution charge **[See Section 6d]**.

*These aspects have been removed from the Revised Design Proposal, which the Sub Panel welcomed.*

However, the Sub Panel believes that it is still vital to pursue an alternative to the RUDL charge, to mitigate the well-founded "concerns of Jersey-owned Jersey-trading businesses, that Zero/Ten would leave them at an unfair disadvantage against foreign-owned competitors". **[See Section 9]**

In addition, the Sub Panel's Interim Report raised doubts about the deemed distribution charge.

*This has now been amended to a partial deemed distribution model at 60% of annual qualifying profits.*

However, there has been little justification for the revised proposal, which seems to be suggested on a "try it and see" basis. **[See Sections 6c and 7.4]**

### **Areas of concern**

In its Interim Report, the Sub Panel was "alarmed ... by the total lack of data available from the Treasury and Resources Department with regard to the expected tax losses

and yields from the Zero/Ten proposals”<sup>[1]</sup> Following the presentation of the Sub Panel’s Interim Report, the Treasury provided the Sub Panel with confidential information outlining the estimated deficit from moving to Zero/Ten. However, *the Sub Panel’s initial concerns remain*, indeed the Treasury appears to have removed various provisions that it initially put forward as essential to preserve tax revenues. **[See Section 7.2]**

The Sub Panel is concerned that the complexity of the proposals may be an additional cost burden to businesses and encourage aggressive tax planning. **[See Section 7.3]**

Under the current system, the assessment of business profits is based on the accounts ending in the previous year. The Revised Design Proposal includes the move to a current year basis of assessment, and given the one year transitional period to this system, self-employed individuals will have two half-years worth of income tax-free, which is a benefit that will not be enjoyed by employees. **[See Section 7.7]**

## **1.2 Revised design proposal**

The Treasury and Resources Department released the “Zero/Ten Design Proposal” consultation document on the 5<sup>th</sup> May 2006. Following the consultation period, and the Sub Panel’s Interim Report, the Revised Design Proposal “Zero/Ten Tax Design Proposals” (R.80/2006) was issued on the 10<sup>th</sup> October 2006.

The principal differences between the Initial (May) Design Proposal and the Revised (October) Design Proposal are summarised below, and can also be found at **Section 12 (Appendix, page 50)**:

### **Overall**

The Revised Design Proposal is much less comprehensive, and lacks a lot of the detail and background that were included in the Initial Design Proposal. Witnesses commented that it was unclear whether the revised proposal was a new *stand-alone* document or a *revision* of the original; if the revised version did not mention a provision, was it abandoned or was it to be introduced as per the original proposal? **[See Section 5.1]**

### **Deemed distribution**

The original proposal was for a 100% deemed distribution for trading companies (so that Jersey-resident individual shareholders would be taxed on their full share of a company’s profits). Instead, under the revised proposal the deemed distribution would be 60% of profits (less any actual dividends). No rationale has been given for setting the level at 60%.

### **Deferred distribution**

The original deferred distribution provisions are also abandoned. Originally the 100% deemed distribution was only to be applied if profits had not actually been paid out as dividends after 3 years. Now the 60% deemed distribution will be applied the year after profits are made. As a result, the “deferred distribution charge” initially proposed (effectively to charge interest over the three years for which tax is postponed) is abandoned.

### ***RUDL charge***

The proposed RUDL charge has been abandoned. Currently no alternative mechanism to collect taxes from foreign-owned businesses trading in Jersey has been proposed. The Sub Panel has investigated the two alternatives raised in its Interim Report, and believes that one of those is workable as a partial solution.

### ***Investment companies***

The proposal that investment companies be taxed on a “look-through” basis (so that Jersey-resident individual shareholders are taxed on their share of the company’s income, with no delay) is retained unchanged.

### ***Foreign superannuation funds***

These are currently exempt from tax on rental income from Jersey property. Under the Initial Design Proposal, this exemption was to be removed (under 0/10 Jersey property income will still be taxed at 20%). Under the Revised Design Proposal this measure has been dropped, leaving the funds still exempt.

### ***Anti-avoidance measures***

“Further work” is said to be needed on these in the Revised Design Proposal. The Sub Panel agrees, as these are extremely difficult and contentious points. ***[See Section 5.3]***

## ***1.3 Lodged draft law***

The lodged draft law only enacts half of the Revised Design Proposal and therefore omits many of its provisions. The Treasury’s stated intention is that these will be introduced later in 2007, before Zero/Ten is implemented.

The lodged draft law includes the company tax reforms; the general corporate tax rate of 0%, and the special rates of 10% and 20%. The main provisions that are excluded from the draft law are the corresponding shareholder taxation measures to ensure that Jersey-resident shareholders are taxed on their income from these newly tax-free companies, in particular:

Deemed distribution for trading companies;  
Look-through for investment companies;  
Anti-avoidance measures (including shareholder loans and other benefits in kind).

This means that the States are being asked to pass a law reducing the tax on most Jersey companies to 0%, but without any provision to tax Jersey-resident shareholders unless the company actually pays them a dividend. This would make it relatively simple for shareholders to avoid all tax on their companies' income; as most sole traders and partnerships<sup>[2]</sup> could incorporate, Jersey could lose virtually all tax on business income.

It is perhaps not surprising that the areas of shareholder taxation are the most difficult; both conceptually and technically. There must be a danger that the Treasury will be unable to resolve these issues in time.

## **2. Panel Membership**

The Corporate Services Scrutiny Panel is constituted as follows –

Deputy P. J. D. Ryan, Chairman  
Senator J. L. Perchard, Vice Chairman  
Connétable J. Le Sueur Gallichan  
Connétable D. J. Murphy  
Deputy J. Gallichan

Officer support: Mr M. Haden and Miss S. Power

For the purposes of this review the Panel formed a Sub Panel, which was constituted as follows –

Senator J. L. Perchard, Sub Panel Chairman  
Senator B. Shenton  
Deputy P. J. D. Ryan  
Deputy G. Southern



## **2.1 *Independent Expert Advice***

The Panel engaged the following advisers to assist it with the review –

Mr. Brian Curtis, FCIB, MSI (dip.), PFS, FInstD, has worked in Jersey's Finance Industry for some 35 years and is currently involved with a number of activities within the industry and the voluntary sector.

Mr. Richard Teather, BA, ICAEW, a senior lecturer in Tax Law at Bournemouth University; a Freelance Tax Consultant and a writer on Tax Law and Policy.

## **2.2 Terms of Reference**

The Sub Panel continued its review based on its original terms of reference, in addition to reviewing the “Zero/Ten Tax Design Proposals” (R.80/2006) presented by the Minister for Treasury and Resources on the 10<sup>th</sup> October 2006, and the first part of the Zero/Ten draft legislation<sup>[3]</sup>, with a particular focus on the following issues -

1. Compliance with the EU Code of Conduct on business taxation; OECD’s Harmful Tax Competition initiative; and the European Convention on Human Rights.
2. The effect on Jersey’s tax revenues and the resource implications of the legislation.
3. The effect on the Financial Services Industry and the wider effect on Jersey’s economy.
4. The distributional effects and the equity of the proposed Zero/Ten Design Proposal and the potential for avoidance.

To include a review of –

- Look through arrangements
- Other measures for maintaining the tax base
- Effectiveness, fairness and efficiency of anti-avoidance measures

### **3. Introduction**

The Corporate Services Scrutiny Panel presented its Initial Report to the States on the 28<sup>th</sup> September 2006, which was based on the “Zero/Ten Design Proposal” document that was released for consultation by the Treasury and Resources Department on the 5<sup>th</sup> May 2006.

Following the presentation of the Sub Panel’s Interim Report, the Minister for Treasury and Resources issued a Revised Design Proposal on the 10<sup>th</sup> October 2006, the “Zero/Ten Tax Design Proposals” (R.80/2006). In view of the comments it had made in its Interim Report, and the substantial changes between the Initial Design Proposal and the Revised Design Proposals (R.80/2006), the Sub Panel agreed that it was vital to continue its work into the Zero/Ten proposals and subsequently resumed its review to include these documents.

On the 19<sup>th</sup> December 2006, during the course of this further work, the Minister for Treasury and Resources lodged the first part of the draft Zero/Ten legislation<sup>[4]</sup>, and the Sub Panel subsequently extended the scope of its review to include a review of this document.

There are several aspects of the Revised Design Proposals (R.80/2006) that are not included in the lodged draft law, and the Sub Panel has been informed that the Minister for Treasury and Resources will be bringing further draft legislation to the States during April or May of 2007. At that point the Sub Panel will then consider whether it wishes to extend its review to include that document.

## **4. Chronology of documents**

The following terms will be used in this report to describe each of the relevant documents:

### **“Initial Design Proposal”**

The “Zero/Ten Design Proposal” consultation document that was released for consultation by the Treasury and Resources Department on the 5<sup>th</sup> May 2006.

### **“Interim Report”**

The initial report of the Corporate Services Scrutiny Panel on the Initial Design Proposal, presented to the States on the 28<sup>th</sup> September 2006.

### **“Revised Design Proposal”**

The Treasury’s revised proposal the “Zero/Ten Tax Design Proposals” (R.80/2006), presented to the States on the 10<sup>th</sup> October 2006.

### **“Draft Law”**

The draft Zero/Ten legislation lodged by the Minister for Treasury and Resources on the 19<sup>th</sup> December 2006; the Minister has stated that a subsequent ‘Part II’ draft law will be lodged to implement the remaining aspects of the Revised Design Proposal.

## **5. Methodology**

### **a. Call for evidence**

The Sub Panel continued its review by contacting each of the individuals who had contributed to the initial review into the Zero/Ten Design Proposals, offering them the opportunity to comment on the Treasury's updated Zero/Ten proposals. The Sub Panel requested for all submissions to be received by the 20<sup>th</sup> November 2006.

### **b. Written Submissions**

The Sub Panel received the following written submissions for this review (to view the submissions in full please refer to the Scrutiny website (<http://www.scrutiny.gov.je/>):

Jurat P G Blampied, OBE  
Mr J P Frith

Mr P Hobbs (*this submission contained confidential information and was therefore not uploaded to the Scrutiny website*)

### **c. Public Hearings**

The following witnesses attended public hearings with the Sub Panel.

#### **15<sup>th</sup> November 2006**

Jurat P G Blampied, OBE  
Jersey Finance Fiscal Strategy Group (FSG) Representatives:  
Mr G Drinkwater;  
Mr J Riva;  
Mr J Shenton

#### **15<sup>th</sup> December 2006**

Senator T A Le Sueur, Treasury and Resources Minister,  
accompanied by:

Deputy J A N Le Fondre, Assistant Treasury Minister;  
Mr M Campbell, Comptroller of Income Tax;  
Mr J Harris, Director, International Finance; and  
Mr J Morris, Treasury Scrutiny Liaison Officer

Full verbatim transcripts of the public hearings are available on the Scrutiny website.

## 6. Changes to the Design Proposal R.80/2006

The Sub Panel's initial review and subsequent report highlighted a number of contentious areas in the "Zero/Ten Design Proposals" consultation document. The following section summarises the proposals which were included in the consultation document but have since been removed from the updated proposals.

### ***a. Regulation of undertakings & development ('RUDL') charge***

The Initial Design Proposal proposed the introduction of a 'RUDL' charge, to be levied annually in January each year on all businesses registered under the Regulation of Undertakings and Development Law<sup>[5]</sup>. The charge would be a fixed amount for each RUDL-licensed employee, the amount varying by industry sector.

The Sub Panel had strong concerns with this proposal, and felt that it would be excessively complex, administratively expensive for both businesses and government, discourage new investment into the Island, and increase prices for consumers.<sup>[6]</sup>

The Sub Panel was therefore pleased to note that the Treasury removed the RUDL charge from the Revised Design Proposal as a result of the opposition which had been voiced during the consultation period.

However the Sub Panel recognised the real problems that the RUDL charge was intended to solve, and therefore its report proposed two alternatives to the RUDL charge, and urged the Treasury to urgently investigate them and their viability. The Sub Panel has subsequently spent some time investigating one of these proposals (further details of which can be found in **Section 9** of this report), and still believes that it is a viable option that should be studied further by the Treasury with a view to implementing it alongside Zero/Ten.

### ***b. 'Limited trading partnership' ('LTP')***

The Initial Design Proposal proposed the LTP as an adjunct to the RUDL charge, as a structure to allow Jersey-resident shareholders to offset the company's RUDL charge against their tax on its profits. Although some witnesses believed the LTP could be a useful vehicle, the Sub Panel felt that it failed to meet the concerns surrounding the RUDL; was an unnecessary complication to the proposal; and did not belong in proposals to reform the Island's taxation system.<sup>[7]</sup>

The Sub Panel was therefore pleased to note that the LTP proposal had been dropped from the Revised Design Proposal, as with the removal of the RUDL proposal there was no longer an immediate need for this vehicle to be introduced.

However, in view of the comments from some witnesses that the LTP could be a valid business structure in its own right, the Sub Panel would support further independent consideration of this matter by the Economic Development Department.

### ***c. Deemed Distribution Charge***

The Sub Panel felt that the proposal to introduce a full deemed distribution charge for Jersey-resident individuals with shares in a trading company was unnecessarily complex and potentially damaging to minority shareholders, who could face a tax bill without being able to obtain any corresponding cash income.<sup>[8]</sup> The Sub Panel's report therefore requested the Treasury to investigate the effectiveness of both a 'minimum distribution exemption' (similar to the Isle of Man proposals) and an 'actual only' basis for distribution (as Guernsey has proposed). The Sub Panel was therefore pleased to note that the Treasury had modified its original proposals and put forward a partial deemed distribution model at 60% of annual qualifying profits.

However during the course of its review the Sub Panel heard further problems with this proposal, a summary of which can be found at **Section 7.4** of this report.

### ***d. Deferred Distribution Charge***

Although the Initial Design Proposal contained a 100% deemed distribution charge, this was deferred by up to 3 years to give the company time to pay an actual dividend instead. This effectively would have allowed the tax on the company's profits to be delayed for up to 3 years compared to the current system.

To counteract the resultant cash flow shortfall for the Treasury, delayed payments would have been subject to a deferred distribution surcharge of 20% of the shareholders' income tax liability on the distribution, which would have been equivalent to an interest charge of 4%.<sup>[9]</sup>

The Sub Panel felt that this was an unnecessary and complex burden which would have been disproportionate to its benefit, and was therefore pleased to note that the Treasury had



removed this charge from the Revised Design Proposal as a result of its complexity, and other issues which outweighed the relatively small revenue yield it would have generated.

**e. Foreign Charities and Superannuation Funds**

The Initial Design Proposal proposed to repeal Article 115(a), which currently exempts foreign charities and superannuation funds from Jersey income tax on any rental income received from property in the Island.<sup>[10]</sup> This was proposed in order to prevent distortions in the market and to protect the tax base, and is particularly important under Zero/Ten since rental income from Jersey property will be the only type of taxable income for most companies. However, the updated proposals have removed this proposal, and state that this matter requires further investigation and quantification with which the States Economic Adviser has been charged.

The Sub Panel has heard further views on this proposal, a summary of which can be found in **Section 7.6** of this report. The Sub Panel remains unconvinced by the arguments to preserve this exemption, and believes that further work is required with a view to proceeding with its abolition at a later date.

***As was the case with the Sub Panel's interim report, the Sub Panel accepts the move to a Zero/Ten taxation structure. The Sub Panel is pleased to note that the areas which had caused the greatest concern in the Initial Design Proposal have been removed from the Revised Design Proposal.***

## 7. Outstanding Problems with the Updated Proposals

The following section outlines remaining issues with the updated proposals, which were brought to the Sub Panel's attention through witnesses' submissions, and evidence provided to the Sub Panel during public hearings.

### 7.1 *Lack of information in the proposals*

The Jersey Finance FSG representatives expressed concerns when they attended a public hearing with the Sub Panel, in terms of the lack of information contained in the Revised Design Proposal. The following statements were made:

**Mr J. Riva:**

*"I think principally we found the proposals rather lacking in information and detail, and we were unsure as to whether we should read these proposals in conjunction with the original document because there are a number of aspects on which the revised proposals are silent."*<sup>[11]</sup>

**Mr J. Shenton:**

*"I think the second one is quite limited in its presentation and in its content. As we said, there was no real guidance as to what you read it with, and there are certain leaps of faith you have to make with it."*<sup>[12]</sup>

***The Sub Panel believes that the Revised Design Proposal lacks detail, and would benefit from containing more information on each of the proposals, and how they will be implemented. This would assist interested parties and those involved with the initial public consultation exercise.***

## **7.2 Lack of information on the size of the ‘Black Hole’**

The Sub Panel’s Interim Report expressed strong concerns over the lack of data that had been provided to the Sub Panel in terms of the expected tax losses and yields from the Zero/Ten proposals<sup>[13]</sup>. This issue was further raised by representatives from the Jersey Finance FSG during their attendance at a public hearing with the Sub Panel where they expressed concern over the tax losses and yield from each of the measures in the fiscal strategy. The following statements were made when discussing this issue:

**Mr G. Drinkwater:**

*“... When you move bits from each I worry that at some stage there is not somebody putting this all together and finishing it all off as a complete package. So, you know, it was fine when we started, and there are little bits being removed. I hope someone is not going to turn around to us, when we get it all together and say, “Oh, well, hang on a minute. We are short again.” I do not see anybody putting those numbers together.”*

**Mr J. Shenton:**

*“I must admit I am a little bit concerned that under these new proposals RUDL is not in there, superannuation is not in there, deemed distribution, deferred distribution charge is not in there. We have taken things out which we were told were necessary in order to fill the black hole, and we have just taken bits out, and I do not see what else has gone in there to replace it, and I do not know if anyone is actually looking at it...”<sup>[14]</sup>*

Since the Sub Panel’s Interim Report, the Sub Panel has been provided with further information from the Treasury in terms of the estimated deficit from moving to Zero/Ten. However, as can be seen from the following quote from the Minister for Treasury and Resources, there is still a great deal of uncertainty in this area:

**Senator T.A. Le Sueur:**

*“I think I quoted... I am working on a figure between 79 and 95.”*

The Minister subsequently went on to state:

**Senator T.A. Le Sueur:**

*“Those figures will be reviewed from time to time but to me the question is not*

*whether it is 83 or 85, it is a question of getting the law in place, whatever the yield is.”<sup>[15]</sup>*

***The Sub Panel recognises that it is difficult for the Treasury to pinpoint exactly what the deficit will be, however the Sub Panel remains concerned that there is still a lack of information on this issue given the importance of this figure. The Sub Panel is pleased that the provisions covered in Section 6 have been removed, however remains concerned by the fact that these provisions were designed to contribute to the yield, and have not been replaced by additional measures.***

### **7.3 Information powers and anti-avoidance**

In the Sub Panel's Interim Report concerns were expressed that the proposal for increased powers and information requirements for the Comptroller of Income Tax would damage relations between taxpayers and the tax office. The updated proposals still contain the proposal to extend Article 134A in order to enhance anti-avoidance and information powers.

The Sub Panel received a submission from Mr Frith in response to the Revised Design Proposal, which acknowledged that the proposed powers were essential both to act as a deterrent and to provide the Comptroller with a mechanism for countering tax avoidance, when detected. Mr Frith stated that he had no issue with the proposed amendment to Article 134A. However, Mr Frith's submission went on to use the 1979 Vestey case as an example of how if Jersey were to adopt a tick the box approach and leave it to the Comptroller to decide who shall be taxed and the quantum, then the Island would be in exactly the same position as the UK was in prior to the Vestey case, and Mr Frith stated that he felt strongly that the Island should not go there. The submission went on to state:

*“UK law on this subject is extremely complex as too is its administration. It begs the question as to whether it is right that Jersey should go down this road. I believe that we should not apply a sledgehammer to crack a nut. We are not the UK and our tax regime is famed for its relatively benign approach. We should be wary of upsetting the delicate balance that currently exists, albeit eroded somewhat for 11Ks by the changes effected in 2005, particularly if the Island wishes to continue attracting wealthy residents as part of its economic development programme.”*

This issue was also raised with representatives from the Jersey Finance FSG during a public hearing, where the following responses were received:

**Mr J. Shenton:**

*“I think all you need to do is look at other western jurisdictions. The tax planning industry in the UK is enormous, an enormous business, and the UK has the second biggest tax legislation in the world. It is only the Indians have more. So, I think there is something to be taken from that whereby if you start putting in large amounts of legislation, then we will be obliged to try and find our way around it, and I think that the simple thing is when the legislation is relatively simple...*

*... Your original question is will there be opportunities for tax planning? I think the more complex you make the law, the more opportunities we will have."*

**Mr G. Drinkwater:**

*...We have arrived from the stage over the last 4 or 5 years of simplistic to quite complicated, and you are turning potential clients away. We know that. We have seen that clients just do not feel there is consistency. They feel there is a lot of change, and they go to somewhere where it is not quite so complicated."* <sup>[16]</sup>

This issue was acknowledged by the Minister for Treasury and Resources during a public hearing:

**Senator T.A. Le Sueur:**

*"Certainly there is the danger that the more complicated you make anti-avoidance provisions two things happen. Firstly, it provides more work for accountants and lawyers to find ways of getting around them, so it makes them happy and a little richer. Secondly, it discourages people*

*from using Jersey, or living in Jersey, and encourages them to go elsewhere. So there could be a loss of yield through a different way. Against that you have got to have a system sufficiently clear to require people to disclose things which require disclosing, but Jersey taxation up to now has been based on a simple straightforward approach with, I think – I have no great research to prove this – but the general feeling is a high degree of compliance relative to many jurisdictions."* <sup>[17]</sup>

Concern has been raised about the Island's ability to attract wealthy residents, particularly 1(1) (k) category individuals, given the increased complexity of Jersey's tax law surrounding the move to Zero/Ten. The Minister for Treasury and Resources was questioned on this issue, and the question of whether a "tax cap" would make Jersey more competitive, but he was dismissive:

**Senator T.A. Le Sueur:**

*"In my view the person who has got an income in excess of £1.5 million a year and does not want to pay one per cent tax on it may not be the sort of person who is necessarily uppermost in my mind"* <sup>[18]</sup>

However from the Sub Panel's discussions with the members of Jersey Finance, the issue was

clearly not the amount of tax to be paid but the complexity and the level of information demanded, or to be demanded, by the Comptroller (which would be unnecessary from a taxpayer paying the maximum amount under a tax cap). The Minister agreed that Jersey's tax system was becoming more complex:

**Senator T.A. Le Sueur:**

*"I do not think the days of simple tax -- the days of dead simple tax are over. I do not want to make it more complicated than I can possibly avoid."*

**Deputy G.P. Southern:**

*"But nonetheless it is becoming complicated."*

**Senator T.A. Le Sueur:**

*"It is becoming more difficult than it was. But I think the political direction, if you like, to the Comptroller of Income Tax would still be to try to apply a lighter touch."* <sup>[19]</sup>

***The Sub Panel remains concerned that too stringent anti-avoidance measures may have a negative effect on the relationship between taxpayers and the tax office, and also create further opportunities for tax planning. This may in time lead to the Island becoming less competitive compared to other jurisdictions.***

***The Sub Panel is also concerned that legitimate tax planning opportunities will force the Minister for Treasury and Resources to regularly bring amendments to the law to "plug holes" and that Jersey will ultimately end up with a highly complex and expensive taxation structure.***

## **7.4 Deemed distribution charge**

The Sub Panel was pleased to note that the Treasury had amended the proposal for a deemed distribution system. However, during the course of the Sub Panel's review, further concerns were expressed over the updated proposals, and the proposed 60% distribution system, particularly with regard to its lack of equity. The following section summarises each of these concerns.

### ***Lack of equity:***

Mr Riva made the following statement during a public hearing about the proposed system being discriminatory between different businesses:

#### ***Mr J. Riva:***

*"The 60 percent is an unusual figure; 50 percent seems to be a better figure, mainly because it would show some equity between financial services companies and the zero-raters. But we still have this problem... of sole traders, and it is very much a political decision as to whether there should be fairness between corporates and partnerships. My view is there ought to be..."*<sup>[20]</sup>

The equity question here is between trading companies (which will be taxed at 0%), and partnerships or sole traders.

A trading company will not be taxed on its profits, but its shareholders (if they are Jersey-resident individuals) will be taxed at 20% on 60% of the company's profits under deemed distribution, an effective 12% tax rate (unless the company pays more than 60% of its profits in dividends). In contrast sole traders and partners will be taxed at 20% on their entire profits.

This is inequitable, as two businesses will have different effective tax burdens depending on their legal structure (although the UK has long had a similar inequity, with sole traders taxed at 40% and small companies taxed at 19%). In addition, this difference makes it more likely that existing sole traders and partnerships will incorporate their businesses to take advantage of the potential for lower taxes.

Mr Shenton made a similar point in the same hearing:



**Mr J. Shenton:**

*“...We obviously discriminate, I think which all of us do not agree with, if you are looking at a trading entity, not only do you have a difference between a regulated and an unregulated company, you also have a difference between a company and a partnership or a company and a sole trader. So, my sole trader is subject to tax, and the income tax rate is 20 percent on all his income earned, not only 60 percent of his income earned.”<sup>[21]</sup>*

Mr Riva went on to raise a second area of discrimination:

**Mr J. Riva:**

*“We are still unclear as to the policy drivers for not extending the deemed distribution rules for trading companies to Jersey-owned financial services companies. It seems rather an oddity that if I were a shareholder of a Jersey trading company and that Jersey trading company is a zero-rated company, then my effective rate of tax on those profits is 12 percent, while if I were a shareholder in a company which pays tax at 10 percent, then my effective rate is 10 percent. So I find that quite unusual.”<sup>[22]</sup>*

**Lack of clarity:**

During their attendance at a public hearing, the Jersey Finance FSG explained that the revised proposals lack clarity in terms of whether the look through provisions for investment companies and trading companies would be specific to Jersey-resident companies, or whether they would apply to both resident and non-resident companies. It was felt that if the proposal was for the provisions to apply solely to Jersey-resident companies then it would give an opportunity for taxpayers to arrange their affairs in such a way that would minimise their tax liabilities, to such an extent that it could be detrimental to the Exchequer.<sup>[23]</sup>

Similar concerns were expressed over the lack of clarity in terms of whether the proposed 60% deemed distribution system would apply to finance companies. The updated proposals state:

**3.6.1 In terms of distribution policy, it is proposed that Jersey resident shareholders of 0% rate companies have special provisions applied to them to ensure that some of the undistributed profits arising in the trading company which they beneficially own are assessed on them as personal shareholder income in their**

## **own personal notice of assessment.**

This is not merely an issue for deemed distribution, but also for the other proposed anti-avoidance rules. It appeared that it would be possible for a Jersey-resident to own shares in a finance company, and receive money from the company without paying any tax (beyond the 10% already paid by the company). In contrast, a full range of anti-avoidance rules are proposed for shareholders in 0% trading companies in order to tax them at 20%. With reference to this issue, Mr Riva made the following statement during a public hearing:

### **Mr J. Riva:**

*“...So that does not apply to the 10 percent, and then shareholders could avoid paying personal tax on dividends arising in a 0 rate corporate by taking the loans. So, once again, the loans provisions do not apply to 10 per centers...”*<sup>[24]</sup>

### **Company acting as agent for the shareholder:**

The Sub Panel’s Interim Report considered the Isle of Man’s proposals for a company to pay the tax by acting as agent for the shareholder as a way of improving the proposed deemed distribution system, but voiced concerns that it may not be compliant with the EU Code of Conduct.<sup>[25]</sup> At the time of writing this report, the Sub Panel had not received confirmation that the Isle of Man’s proposals had been accepted by the EU Code of Conduct, and it appears that the Isle of Man’s proposals have not yet been considered by the Code group. However, the Minister for Treasury and Resources updated proposals state:

**3.6.1 Any shareholder who, in extremis, cannot pay the deemed distribution charge because distributions have not been received from the trading company in which he has a beneficial share, may claim not to be assessed on the deemed distribution, the notice of assessment being raised instead on the trading company itself as agent for that particular individual shareholder.**<sup>[26]</sup>

This issue was raised by Mr Riva during his attendance at a public hearing:

### **Mr J. Riva:**

*“But we seem to have accepted that a company acting as agent is permissible... So, it seems that the agent point has been accepted.”*<sup>[27]</sup>

Mr Shenton similarly commented on this proposal during his attendance at a public hearing:

**Mr J. Shenton:**

*“Where does extremis come into it? You know, for companies with multiple shareholders you do not want to distribute and do not want the hassle. They would probably be more than happy to accept paying it as agent. But then I think you fall foul of - - I do not expect Code of Conduct to agree with the Isle of Man.”* [28]

However, despite the Minister for Treasury and Resources not having received further information on the Isle of Man’s proposals, he did not share the view that the Island’s updated distribution proposals wouldn’t be compliant with the EU Code of Conduct:

**Senator J.L. Perchard:**

*“In the mark 2 Zero/Ten Design Proposals, Minister, you planned a 60 percent distribution for trading companies which is similar to the Isle of Man proposal, are you happy that is fully EU compliant?”*

**Senator T.A. Le Sueur:**

*“Yes.”* [29]

There is a difference between the Isle of Man proposals and the Treasury’s Revised Design Proposal, in that the Isle of Man proposes that tax will automatically be collected from the company as agent for the shareholder, whereas under the Jersey proposals this will be a reserve power when collecting tax from the shareholder would result in injustice.

***With the revised proposals, under certain circumstances (as outlined above) the company could still be perceived as acting as agent for the shareholder. The Sub Panel notes that there is a distinct difference between Jersey and the Isle of Man’s proposals, however it considers that this matter may still create problems with the EU Code of Conduct.***

***Deemed distribution (trading companies) versus look-through (investment companies)***

It is still proposed to tax the shareholders of an investment company on a “look through” basis, i.e. all the profits of the company will be attributed to the shareholders who will be taxed

thereon. The changes to the deemed distribution provisions make this distinction more important, since shareholders in a trading company will only be taxed on 60% of the company's profits, but shareholders in an investment company will be taxed on 100% of its income.

There was some concern from witnesses that the distinction between trading and investment companies would leave some trading companies subject to look through.

This issue was discussed with representatives from the Jersey Finance FSG during a public hearing:

**Mr J. Shenton:**

*“Say you have got a start-up business... and you have got fairly ambitious growth plans, so you let 5,000 square foot of office space, and you then have to sublet off 3,000 square foot. Now, it is a trading - - you have not bought an asset, but then rent you would get in, even though you would have a corresponding deduction going back out to the head landlord, would technically be investment income. If that, therefore, is greater than 5 percent, then my new start-up business turns into an investment company, and I am into a different tax regime because of economic forces.*

*...As soon as you put a big, thick, black line into where you want the definition to be, then you are always going to end up with exceptions either side of the line, and you either accept it or you make the line not quite so thick and quite so black and you allow people to interpret it depending on the circumstances of their individual business.”*

**Senator J.L. Perchard:**

*“Reasonable enough. Not an insurmountable problem, then, you would suggest?”*

**Mr J. Riva:**

*“I do not think so.”*<sup>[30]</sup>

***The Sub Panel is aware of the fact that any definition will always have exceptions. However, the Sub Panel has strong concerns that problems with the distinction between trading and investment companies could create significant opportunities for tax planning and avoidance in the Island and could damage start-up businesses.***

## ***Draft Law***

This question of shareholder taxation has not been included in the lodged Draft Law. This is clearly going to be very difficult, both conceptually and technically, to put into law. Further consideration will have to be given to this area later in the year once the second part of the draft law is available, so that the relevant definitions and the interactions between the different parts of the provisions can be examined in detail.

## 7.5 Defining the 10% rate

The Sub Panel's Interim Report investigated witnesses' views on the proposed definition of a company that would be taxed at 10%, as the Sub Panel was concerned that uncertainty in this area could lead to increased avoidance or unfairly categorising a company in terms of being taxed at the 10% rate.<sup>[31]</sup>

However the witnesses believed that this definition would be relatively easy to set:

**Senator J.L. Perchard:**

*"... One of them is about the definition of the 10 per cent specified financial services companies. Is it going to be easy to define a financial services company that is eligible to be taxed at the 10 per cent?"*

**Senator B.E. Shenton:**

*"I think originally we said it was regulated by the JFSC (Jersey Financial Services Commission), which I think is what they will take on board."*

**Mr. J. Shenton:**

*"I think what you will end up with is you will have it regulated by the JFSC under categories A, B, C, D, E and F, and I would expect the JFSC to work in conjunction with the rest of the civil servants to ensure that the companies which they want to pay tax at 10 per cent will fall in subcategories A to F."*

**Senator J.L. Perchard:**

*"So you are not worried that the definition can be clear and the JFSC can come up with a definition that is watertight?"*

**Senator B.E. Shenton:**

*"I think they can. I think it is investment companies where the problem lies."<sup>[32]</sup>*

***The Sub Panel considers that the definition of the 10% rate needs to be strong enough to ensure that there is not further scope for avoidance, or companies being unfairly categorised and that the definition should be formally reviewed after three years of operation.***



## **7.6 Foreign Charities and Superannuation Funds**

As mentioned previously, the original proposal to repeal Article 115(a) has been removed from the Revised Design Proposal in order for the States Economic Adviser to look further at the effects the proposal would have. This therefore means that foreign charities and superannuation funds are currently exempt from Jersey income tax on any rental income received from property in the Island.

The Minister for Treasury and Resources indicates that this proposal will be brought forward again once further work has been undertaken:

**Senator T.A. Le Sueur:**

*"I do not know. I am trying to solve this taxation problem first. As I said, it is something which we need to bring in the next year or two. So I suppose sometime during 2007."*<sup>[33]</sup>

This issue was raised with representatives from the Jersey Finance FSG during their attendance at a public hearing, where they unanimously agreed that there was no reason for not repealing this article. The following statements were made:

**Mr J. Shenton:**

*"You have to remember that most of these commercial properties, if you take the hotel on the waterfront, no one is actually going to be contributing a single penny to the tax under Zero-Ten. So, what you will have down the waterfront is you have a very large area owned by a pension fund which will not pay any tax, run by an international group of hotels which will not pay any tax."*<sup>[34]</sup>

**Mr J. Riva:**

*"I do feel that it goes back to this issue of equity. I struggle to see why one certain person would not pay tax while another will, and I feel that by removing that discrimination it would bring some equity into it. But we do need to look at other repercussions of that, and I think a proper study is the right way for it."*<sup>[35]</sup>

The Sub Panel's Interim Report made reference to a number of submissions it had received which supported the retention of Article 115(a).<sup>[36]</sup> This view was similarly supported by Jurat Blampied in his submission to the Sub Panel:



*“For reasons that have been canvassed elsewhere I recommend that Superannuation Funds and Charities should continue to be exempt from income tax in Jersey on income which would otherwise be assessed to income tax under the provisions of Schedule A.”*<sup>[37]</sup>

The proposed repeal of this article was further raised at a public hearing with Jurat Blampied, where he stated:

***Jurat P.G. Blampied:***

*“I think it would be a bad thing because a lot of development is taking place, I think, for the benefit of the Island, in buildings. And also, I mean, charities are exempt in Jersey and pension funds are exempt in Jersey, and I think it would be consistent to exempt them.”*<sup>[38]</sup> <sup>[39]</sup>

***The Sub Panel believes that there is a need to address the current inequity in the tax system regarding foreign charities and superannuation funds, and therefore calls on the Minister for Treasury and Resources to bring forward his proposals on this issue as a matter of priority.***

## **7.7 Current year basis of assessment**

Under the current system, the assessment on business profits is based on the accounts ending in the previous year. The Revised Design Proposal includes the move to a current year basis of assessment, and states:

**3.5.2 It is proposed that the taxable profits shown in the accounts ending during a year should be used in the tax assessment for the same year. For example, accounts for the year ended 30<sup>th</sup> June 2009 would form the basis of the assessment for the year of assessment 2009 (rather than Year of Assessment 2010, as at present). The change in the basis of assessment of business profits will apply to companies, sole traders and partnerships.**

This proposal was raised during a public hearing with representatives from Jersey Finance, and Mr Riva stated:

***Mr. J. Riva:***

*“I think it is an unusual situation, and it is a win-win situation for both taxpayer and the Exchequer. For the taxpayer, who looks mainly at accounting profits,*

*there will be effectively one year's worth of tax released as provision within the accounts. It is an advantage to Exchequer, who looks at cash flow and money in and would be paying tax on -- well, assuming that profits are rising, on a high amount of taxable income at an earlier date. It is a one-off, never to be repeated again, but very much a win-win situation.*<sup>[40]</sup>

The Sub Panel is concerned that with the introduction of this system, some taxpayers will be given a year's income tax-free. The Draft Law states:

*"Notwithstanding Article 64A but subject to sub-paragraph (3), tax shall be charged in the case of the trade, profession or vocation for the year of assessment 2008 on one half of the aggregate of the full amount of the profits or gains of the trade, profession or vocation for the financial periods ending in 2007 and 2008."*<sup>[41]</sup>

Given the one year's transitional period, this proposal will mean that self-employed individuals will have two half-years worth of income tax-free. However, since tax will be paid in every year the benefit for the taxpayer will not be obtained until the business ceases. Currently when the business ends there is still one year's worth of profit to be taxed; this will no longer be the case.

The transition to a current year basis appears to be a welcome simplification of the tax system, but the Sub Panel is concerned that it seems to give an advantage to the self-employed that will not be enjoyed by employees (who are now paying by ITIS). When the UK moved to a current year basis, their transitional provisions ensured that no profits escaped tax.

This aspect of the reform was not apparent until the Draft Law was presented, at which stage it was too late to question the Treasury and Resources Minister publicly on this point.

***The Sub Panel is concerned about what appears to be inequitable treatment, with the self-employed escaping tax on part of their profit, and recommends that the States press the Treasury and Resources Minister for an explanation.***



## **8. Draft Legislation**

During the course of its review, the Sub Panel was informed that the Minister for Treasury and Resources would now be bringing the draft Zero/Ten legislation to the States for debate in two sections. The first part of the draft legislation was lodged 'au Greffe' on the 19<sup>th</sup> December 2006, and would be debated by the States on the 30<sup>th</sup> January 2007. The Sub Panel was informed that the Minister for Treasury and Resources would be bringing the second part of the legislation to the States during April or May 2007.

The initial draft includes only the basics of Zero/Ten; that is the removal of the Exempt Company and IBC regimes (no longer permitted under the EU Code of Conduct), the general 0% tax rate for companies and the 10% and 20% rates for specific companies.<sup>[42]</sup> The secondary provisions, to ensure that Jersey-resident shareholders continue to be taxed on their share of the company's profits, are not included.

By comparing the Draft Law with the Sub Panel's Interim Report, it is clear that the provisions included in the Draft Law are relatively simple and uncontroversial but the provisions delayed until the promised second part of the legislation are difficult, conceptually as well as in terms of the legal drafting.

### **8.1 Items to follow in the second part of the legislation**

As the Draft Law only contains the basics of Zero/Ten, the States are effectively being asked to pass a general 0% tax rate for companies with no corresponding provision to collect tax from Jersey-resident shareholders:

- The Initial Design Proposal was for a 100% deemed distribution (i.e. companies would pay tax at 0%, but any Jersey-resident shareholders would be taxed on their full share of the company's profits, whether or not it paid a dividend);
- The Revised Design Proposal (R.80/2006) was for a 60% deemed distribution for trading companies (i.e. Jersey-resident shareholders would pay tax on 60% of their share of the company's profits, or the actual dividends they receive if higher), and a look-through for

investment companies (i.e. Jersey-resident shareholders would be taxed on their full share of the company's profits);

- The Draft Law has no provisions for shareholder taxation, either for trading or investment companies, so companies' profits will not be taxed unless and until they pay a dividend to a Jersey-resident shareholder. This is basically the "distribution only" system proposed by Guernsey.

It is understood that some form of deemed distribution system, and a look-through provision for investment companies, will be introduced at a later date, before Zero/Ten becomes operational. The Sub Panel questioned the Minister for Treasury and Resources on this point:

**Senator J.L. Perchard:**

*"...Is the States going to be asked to pass Zero/Ten without any shareholder legislation in place?"*

**Senator T.A. Le Sueur:**

*"Yes."*

**Senator J.L. Perchard:**

*"Are you happy with that?"*

**Senator T.A. Le Sueur:**

*"Yes. Because this is effectively dealing with taxation at the corporate level and the subsequent one will deal with taxation at the shareholder level. There are 2 separate – there is a clear distinction you can make between corporate taxation and shareholder taxation."<sup>[43]</sup>*

And...

**Deputy P.J.D. Ryan:**

*"If the States pass this law which you are going to lodge next week and did not pass- "*

**Senator T.A. Le Sueur:**

*"Did not do anything else."*

**Deputy P.J.D. Ryan:**

*“Did not do anything else then you are on actual distribution?”*

**Senator T.A. Le Sueur:**

*“I think you are probably right, yes. But that was not the intention.”*<sup>[44]</sup>

***The Sub Panel is concerned about the complexities that may arise under the shareholder legislation. The Sub Panel will examine the Minister’s proposals carefully when the next stage of the draft legislation is brought to the States.***

## 9. The Deemed Rent Proposal

Although the Sub Panel's Interim Report found against the proposed RUDL charge, it strongly supported the view that an alternative to RUDL needed to be found so that non-Jersey owned companies trading in the Island would continue to pay taxes in Jersey.

This was seen as vital not only to ensure that non-locally owned non-finance companies continue to contribute to States revenues, but also for there to be equity between locally owned and non-locally owned non-finance businesses operating in the Island. Under Zero/Ten the profits of Jersey-owned businesses would be taxed (as deemed distributions to the shareholders), but non-Jersey owned businesses (including many High Street operations) would pay no Jersey tax and might, through tax planning, be able to avoid paying any tax in their home country either. The Sub Panel is also concerned that without an alternative to the RUDL charge, local trading companies would be more likely to be sold to non-resident entities, which could have devastating consequences to the economic future of the Island.

The Sub Panel's Interim Report therefore proposed two alternatives to the now removed RUDL charge. The Sub Panel urged the Treasury to investigate these proposals, in order to find a solution that would meet the objectives of the RUDL charge without its disadvantages.

The crucial factor in terms of whether any alternative to the originally proposed RUDL charge would be viable is whether it could be structured so that the UK would regard it as an income tax, and UK-owned businesses would therefore be able to recover it against their UK tax.<sup>[45]</sup> This element of the proposal is key, as without this the tax would be an absolute cost of doing business in Jersey, and therefore (like RUDL) would risk reducing investment in the Island.

The Sub Panel's Interim Report suggested the following alternatives to the RUDL charge:

- a. Goods and Services Tax (GST) Restriction
- b. Taxing Deemed Rents

Since the Sub Panel presented its report, it has become apparent that the proposal to tax the deemed rents of commercial properties would be the most suitable of the above two proposals.

This proposal was initially put to the Sub Panel by Jurat Blampied, and the Sub Panel received a further submission from this witness explaining how this proposal could work in the Island.

Jurat Blampied's proposal was to return to the original Income Tax Law previously used (in both Jersey and the UK), so that all occupation of property would be assessed under Schedule A :

- when property is let, the *landlord* (whether or not resident in Jersey) would be taxed on the actual rent received (or the proper market rent, if higher); and
- for owner-occupied property, the owner would be taxed on the property's rental value.

[46]

In either case, the tax would be at the standard income tax rate of 20%. For businesses taxable in Jersey the deemed rent would also be a tax-deductible expense, ensuring that they were not taxed twice.

This submission proposed that this tax under Schedule A be imposed on both domestic and commercial properties, however a potential threshold of a rental value of £10,000 was proposed for domestic properties.<sup>[47]</sup> In contrast, there was no proposed threshold for commercial properties, and the submission stated that the company trading in a property should suffer income tax under Schedule A on the rental value established by the Parish, under the Island's current Parish rates system.

Jurat Blampied felt that the occupation of a property which a person owns is the principal benefit in kind for Islanders, and unlike other benefits in kind, this benefit is not taxed. In addition, the Parish Rates payable in the Island are currently significantly less than the Council Tax levied on occupiers of property in England, and Jurat Blampied felt that owners of property in Jersey were therefore extremely fortunate when compared to an equivalent person in England.

Despite the fact that Jurat Blampied was proposing to tax both domestic and non-domestic property under Schedule A, the Sub Panel focused its investigations on non-domestic property as this was the area that needed to be targeted in order to ensure that non-locally owned non-finance companies trading in Jersey contribute to the Island's economy.

As discussed above, the crucial issue for commercial operations is the ability for UK-owned businesses to offset the Jersey tax against their UK tax, so that it does not become an additional cost of doing business in the Island. On this point Jurat Blampied felt that a UK resident, whether a body corporate or an individual, would be entitled to double taxation relief in respect of the income tax deducted from the rent received or assessed under the provisions of the proposed Schedule A.

The Sub Panel commissioned BDO Stoy Hayward LLP ("BDP") in London to provide the Sub Panel with definitive advice in terms of whether UK-owned operations trading in Jersey



(whether a Jersey branch or subsidiary of a UK company, or a Jersey company with UK individual shareholders) would be able to obtain UK double tax relief for a Schedule A corporation tax on deemed rents.

The advice from BDO concluded that it was not felt that a tax on deemed rents for non-residential Jersey property would be an admissible tax in the United Kingdom for either United Kingdom companies with a Jersey permanent establishment or in relation to dividends paid by Jersey companies to a UK parent company. The basis for this advice was primarily that the Jersey tax would be on deemed rents whereas the UK tax would be on trading profits; the two taxes would therefore not be on the same income (which is one of the conditions which must be met before the UK will give credit for an overseas tax).

An alternative route was suggested by the Sub Panel, that a UK-owned operation which currently owns and occupies its own premises in Jersey could instead transfer the property to another group company, so that the property holding company would charge rent (at full value) to the trading company. This would transfer part of the profits from the trading company to the rental company. Instead of the trading company paying Jersey tax on a *deemed* rent (which it appears would not be recoverable against UK tax) the property company would pay Jersey tax on its *actual* rental income.

The advice from BDO stated clearly that in this case the Jersey tax would be creditable against UK tax. However, BDO stressed that the wider implications of such a move were beyond the scope of their advice.<sup>[48]</sup> The Sub Panel therefore recommends that this proposal requires further investigation.

The Minister for Treasury and Resources has agreed that this might be a viable alternative to the RUDL proposal; however there is further work which needs to be undertaken:

**Senator T.A. Le Sueur:**

*"I think two things we need to look at, and we will do in more detail once we have got this out of the way, is the -- whether that allowability would be at the 100 per cent or tax-rated at the 20 per cent rate which clearly makes significant difference to the UK residents. If it was at 100 per cent rate then they would be quite content that it was just moving money back from Gordon Brown to Malcolm and there is no economic disadvantage. At simply the 20 per cent rate then that would give them still basically an economic disadvantage. The other question we need to look at is the economic impact on the Island as a whole because we have to see just what the effect that would be on Jersey businesses and on business generally."<sup>[49]</sup>*

The Minister then went on to say:

**Senator T.A. Le Sueur:**

*“... My only potential solution at the moment as to dealing with the non-resident shareholder issue is something along the Blampied proposal... I do not know yet as to whether they work fully or not but I cannot think of anything that works better than that so it is, from my point of view, at the moment that or nothing. I am not looking at any other alternatives.”*<sup>[50]</sup>

***Although the advice the Sub Panel received from BDO was that a Jersey tax on deemed rents for owner-occupiers would not of itself be admissible as a credit in the UK, that advice also agreed that it could effectively be made admissible through the “parallel company” scheme discussed above. Such a scheme would need further consultation, and the Sub Panel believes that this means that the proposal to tax deemed rents for owner-occupiers can be made a viable alternative to the now-abandoned RUDL levy. This would reduce the revenue loss from Zero/Ten, ensure that all businesses operating in the Island contribute to its costs, and reduce any inequities between on- and off-Island owned businesses under Zero/Ten.***

***The Sub Panel therefore recommends the Minister for Treasury and Resources investigates this proposal further.***

## **10. Conclusions**

### **General (Section 6)**

As was the case with the Sub Panel's interim report, the Sub Panel accepts the move to a Zero/Ten taxation structure. The Sub Panel is pleased to note that the areas which had caused the greatest concern in the Initial Design Proposal have been removed from the Revised Design Proposal.

### **Lack of information in the proposals (Section 7.1)**

The Sub Panel believes that the Revised Design Proposal lacks detail, and would benefit from containing more information on each of the proposals, and how they will be implemented. This would assist interested parties and those involved with the initial public consultation exercise.

### **Lack of information on the size of the 'Black Hole' (Section 7.2)**

The Sub Panel recognises that it is difficult for the Treasury to pinpoint exactly what the deficit will be, however the Sub Panel remains concerned that there is still a lack of information on this issue given the importance of this figure. The Sub Panel is pleased that the provisions covered in Section 6 have been removed, however remains concerned by the fact that these provisions were designed to contribute to the yield, and have not been replaced by additional measures.

### **Information powers and anti-avoidance (Section 7.3)**

The Sub Panel remains concerned that too stringent anti-avoidance measures may have a negative effect on the relationship between taxpayers and the tax office, and also create further opportunities for tax planning. This may in time lead to the Island becoming less competitive compared to other jurisdictions.

The Sub Panel is also concerned that legitimate tax planning opportunities will force the Minister for Treasury and Resources to regularly bring amendments to the law to "plug holes" and that Jersey will ultimately end up with a highly complex and expensive taxation structure.

### **Deemed distribution charge (Section 7.4)**

#### ***Company acting as agent for the shareholder***

With the revised proposals, under certain circumstances (as outlined previously) the company could still be perceived as acting as agent for the shareholder. The Sub Panel notes that there is a distinct difference between Jersey and the Isle of Man's proposals, however it considers

that this matter may still create problems with the EU Code of Conduct.

***Deemed distribution (trading companies) versus look-through (investment companies)***

The Sub Panel is aware of the fact that any definition will always have exceptions. However, the Sub Panel has strong concerns that problems with the distinction between trading and investment companies could create significant opportunities for tax planning and avoidance in the Island and could damage start-up businesses.

**Defining the 10% rate (Section 7.5)**

The Sub Panel considers that the definition of the 10% rate needs to be strong enough to ensure that there is not further scope for avoidance, or companies being unfairly categorised and that the definition should be formally reviewed after three years of operation.

**Foreign Charities and Superannuation funds (Section 7.6)**

The Sub Panel believes that there is a need to address the current inequity in the tax system regarding foreign charities and superannuation funds, and therefore calls on the Minister for Treasury and Resources to bring forward his proposals on this issue as a matter of priority.

**Current year basis of assessment (Section 7.7)**

The Sub Panel is concerned about what appears to be inequitable treatment, with the self-employed escaping tax on part of their profit, and recommends that the States press the Treasury and Resources Minister for an explanation.

**Shareholder legislation (Section 8)**

The Sub Panel is concerned about the complexities that may arise under the shareholder legislation. The Sub Panel will examine the Minister's proposals carefully when the next stage of the draft legislation is brought to the States.

**The deemed rent proposal (Section 9)**

Although the advice the Sub Panel received from BDO was that a Jersey tax on deemed rents for owner-occupiers would not of itself be admissible as a credit in the UK, that advice also agreed that it could effectively be made admissible through the "parallel company" scheme discussed above. Such a scheme would need further consultation, and the Sub Panel believes that this means that the proposal to tax deemed rents for owner-occupiers can be made a viable alternative to the now-abandoned RUDL levy. This would reduce the revenue loss from Zero/Ten, ensure that all businesses operating in the Island contribute to its costs, and reduce any inequities between on- and off-Island owned businesses under Zero/Ten.

The Sub Panel therefore recommends the Minister for Treasury and Resources investigate this proposal further.

## 11. Recommendations

### The Sub Panel recommends that:

- The Economic Development Department investigates the potential benefits of introducing the LTP as a business structure in the Island. (Section 6b)
- The Minister for Treasury and Resources ensures that the proposal to enhance the information powers and anti-avoidance legislation does not negatively affect the Island's ability to attract investment. (Section 7.3)
- The Treasury and Resources Minister brings forward the proposal to repeal Article 115 (a) and remove the inequity in the current tax system. (Section 7.6)
- Before the second part of the legislation is brought to the States, the issues surrounding shareholder legislation are resolved. (Sections 7.3; 7.4; and 8)
- The Treasury investigates the proposal to tax the actual rent of property companies set up for that purpose at an early date, so as to be able to implement it alongside Zero/Ten, and publishes its findings. The Sub Panel is particularly keen for the Treasury to investigate the economic impact of the proposal, and the estimated yield. (Section 9)
- The Treasury and Resources Department works in conjunction with the Economic Development Department to initiate a number of "Workshops for Business" in order to explain the new law to shareholders and employers. This will ease the implementation process and provide initial feedback that can be utilised to iron-out any initial teething problems.

## 12. Appendix - Changes in the Treasury's proposals

Issue	Initial Design Proposal	Panel's Interim Report	Revised Design Proposal	Draft Law (as lodged)
<b>Tax Rates</b>	0 / 10	0 / 10	0 / 10	0 / 10
<b>Shareholder tax</b>				
<b>Trading Co</b>	100% deemed distribution 3-year delay deferred distribution charge	Found the proposals "unnecessarily complex and potentially damaging"	60% deemed distribution no delay (next year) no deferred dist'n	None (effectively "distribution only")
<b>Investment Co</b>	100% look-through	Accepted	100% look-through	None (effectively "distribution only")
<b>Taxing off-Island owned businesses</b>	RUDL charge	Opposed RUDL charge Suggested tax on deemed rents	RUDL charge abandoned No alternative	RUDL charge abandoned No alternative
<b>Limited Trading Partnerships</b>	Proposed as mechanism to allow recovery of RUDL by Jersey-owned businesses	May be a beneficial business structure, but not part of Zero/Ten	Abandoned	Abandoned
<b>Foreign pension funds</b>	To be taxed	Further research needed	Remain exempt	Remain exempt

**Lodged draft law:** It is the Treasury's stated intention to introduce a second law later in 2007, to bring in the remaining provisions proposed in the revised design proposal.

[1] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), p. 3

[2] Except a few professions, such as lawyers, whose professional bodies do not currently allow them to practice through a company.

[3] Draft Income Tax (Amendment 20.28) (Jersey) Law 200-

[4] Draft Income Tax (Amendment No.28) (Jersey) Law 200-

- [5] Regulation of Undertakings and Development (Jersey) Law, 1973, as amended
- [6] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.5
- [7] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.9
- [8] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.7
- [9] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.8
- [10] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.11
- [11] Transcript of public hearing, 15<sup>th</sup> November 2006, p.2
- [12] Transcript of public hearing, 15<sup>th</sup> November 2006, p.4
- [13] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.2
- [14] Transcript of public hearing, 15<sup>th</sup> November 2006, p.35
- [15] Transcript from public hearing, 15<sup>th</sup> December 2006, p.26
- [16] Transcript of Public Hearing, 15<sup>th</sup> November 2006, p. 23
- [17] Transcript from public hearing, 15<sup>th</sup> December 2006, p.10
- [18] Transcript from public hearing, 15<sup>th</sup> December 2006, p.13
- [19] Transcript of public hearing, 15<sup>th</sup> December 2006, p.20
- [20] Transcript of public hearing, 15<sup>th</sup> November 2006, p.12
- [21] Transcript of public hearing, 15<sup>th</sup> November 2006, p. 3
- [22] Transcript of public hearing, 15<sup>th</sup> November 2006, p.2
- [23] Transcript of public hearing, 15<sup>th</sup> November 2006, p.2
- [24] Transcript from public hearing, 15<sup>th</sup> November 2006, p. 7.
- [25] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), p. 54
- [26] Zero/Ten Tax Design Proposals (R.80/2006), p.5
- [27] Transcript from public hearing, 15<sup>th</sup> November 2006, p. 13
- [28] Transcript of public hearing, 15<sup>th</sup> November 2006, p. 14
- [29] Transcript of public hearing, 15<sup>th</sup> December 2006, p.5
- [30] Transcript of public hearing, 15<sup>th</sup> November 2006, p. 21
- [31] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), p. 29
- [32] Transcript from public hearing, 15<sup>th</sup> November 2006, p. 18
- [33] Transcript of public hearing, 15<sup>th</sup> December 2006, p.17
- [34] Transcript of public hearing, 15<sup>th</sup> November 2006, p. 26
- [35] Transcript of public hearing, 15<sup>th</sup> November 2006, p.27
- [36] Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.11
- [37] Jurat P G Blampied, Schedule A, The Taxation of Immovable Property – submission to the Sub Panel, section 9.2
- [38] Transcript from public hearing, 15<sup>th</sup> November 2006, p.21.
- [39] Following this hearing, Jurat Blampied requested for the meaning of his statement to be clarified, and provided the Sub Panel with the following statement:  
*“Also charities are exempt in Jersey and pension funds are exempt in Jersey and it would be consistent for charities and pension funds resident in England to be exempt.”*
- [40] Transcript from public hearing, 15<sup>th</sup> November 2006, p. 32
- [41] Draft Income Tax (Amendment 20.28) (Jersey) Law 200-, Article 149A 1(2) p. 39
- [42] The draft law also includes the “current year basis” of taxation.



[43] Transcript from public hearing, 15<sup>th</sup> December 2006, p.23

[44] Transcript from public hearing, 15<sup>th</sup> December 2006, p.24

[45] This is on the basis that under Zero/Ten UK-owned companies will still be paying the same amount of tax but to the UK Treasury rather than to Jersey. In the Sub Panel's Interim report some doubt was cast on this assumption by some witnesses **(Corporate Services Scrutiny Panel Report, Review of the Zero/Ten Design Proposal (SR4/2006), Section 5.5)**

[46] Jurat P G Blampied, Schedule A, The Taxation of Immovable Property – submission to the Sub Panel, section 5.1

[47] The possibility was also discussed of allowing people with valuable properties but no income to defer the tax, with the States taking a charge on the property to ensure eventual payment.

[48] To view the BDO advice in full please refer to the Scrutiny website

[49] Transcript from public hearing, 15<sup>th</sup> December 2006, p.15

[50] Transcript from public hearing, 15<sup>th</sup> December 2006, p.26