

States of Jersey  
States Assembly



États de Jersey  
Assemblée des États

# Corporate Services Scrutiny Panel

## Deemed Rent (P.161/2008)

Presented to the States on 23rd March 2009

S.R.2/2009



## Contents

1. Chairman’s Foreword.....	4
2. Executive Summary with key findings and recommendations .....	7
3. Panel Membership .....	11
4. Independent Expert Advice .....	12
5. Terms of Reference .....	12
6. Documentation.....	13
7. Hearings .....	13
8. Background:.....	14
9. Deemed Rent.....	16
10. Article 115(g).....	22
11. Costs.....	26
12. Submissions to Panel .....	27
13. Conclusions .....	28
14. Recommendations .....	30



# 1. Chairman's Foreword.

The Corporate Services Scrutiny Panel submitted a series of reports to the States on the Zero/Ten Design proposal:

- Interim Report (S.R. 4/2006), presented to the States on 28th September 2006. This report was based on the initial consultation document, dated 5th May 2006.
- Second report (S.R.3/2007), presented to the States on 23rd January 2007. This report examined the Treasury and Resources Minister's revised proposals contained in R.80/2006 and the first part of the draft Zero/Ten legislation.
- Further Interim Report S.R.14/2007; Review of the Zero/Ten Tax Design Proposals – Taxing Foreign Owned Trading Companies.
- Fourth Report SR20/2007 Review of the Zero/Ten Tax Design Proposals - Draft Shareholder Legislation 07/11/2007.

In S.R. 14/2007, the Corporate Services Scrutiny Sub-Panel followed up one of the major concerns identified in its earlier reports, namely the fact that non-Jersey owned businesses would escape tax liability in Jersey. The report showed that this could give non-resident owners a competitive advantage over local firms, particularly if they are also avoiding or postponing tax in their own jurisdictions, and could encourage them to seek to buy out locally owned businesses.

S.R. 14/2007 adapted a proposal originally submitted by Jurat Peter Blampied (the 'Blampied proposal') for a tax on owner-occupied business property (in effect a re-introduction of Schedule A) as a workable solution to the problem of collecting a tax contribution from foreign-owned trading companies. The Treasury and Resources Minister acknowledged that this proposal had some merit and agreed to investigate the economic impact and the potential yield.

The result was the Draft Income Tax (amendment No. 32) (Jersey) Law 200- which was Lodged *au Greffe* on 21<sup>st</sup> October 2008 by Senator T. A. Le Sueur, the Minister for Treasury and Resources.

As a result of Ministerial and Scrutiny elections following the completion of the States Administration, an agreement was reached between the Minister and Scrutiny Panel that, after the legislation had been reviewed by the new Panel, it would then be debated. The debate was scheduled for 24<sup>th</sup> March 2009. The new Minister and Scrutiny Panel have adhered to that agreement and therefore the current Corporate Services Scrutiny Panel presents this report to the States.

The Panel is greatly disappointed that no substantive work has been done by the Treasury concerning the implications of the comments made by the Corporate Services Panel on P161 in 2008. It appears that the onus has been put on Scrutiny to justify the progression, or lack thereof, of this piece of legislation.

The task of Scrutiny is to review the quality of the Ministerial Decision related to a Policy rather than to formulate policy. Scrutiny should also highlight areas requiring further investigation by the Executive.

Certainly we have received no evidence of further consultation and, apart from some indicative work done by the Income Tax Department, there is no detailed evidence to support the Minister's reluctance to introduce the "deemed rental" amendment. We understand he is in favour of the repeal of Article 115(g) but, again, we have received no evidence to support this stance.

Our conclusion is that there are two main issues inherent in this proposal. The first is that all businesses profiting from their activities in Jersey should contribute to the Island. This is eminently fair. The second issue is that of equity between non-finance local and foreign owned trading companies. This question of equity for local businesses is extremely important and must be addressed with some urgency.

Despite the apparent negativity of this report, the Panel feels that there has been no clear evidence to suggest that the "Deemed Rental" legislation would be ineffective in achieving these aims and indeed the Panel is still of the

opinion that the concept has much to commend it. It is said “the devil is in the detail”. It is for the Minister to research the detail.

A handwritten signature in black ink, appearing to read "S. C. Ferguson". The signature is fluid and cursive, with a prominent initial "S" and a long, sweeping underline.

Senator S. C. Ferguson,  
Chairman of the Corporate Services Scrutiny Panel.

## **2. Executive Summary with key findings and recommendations**

2.1 The Panel inherited this review from the previous Corporate Services Panel and the previous Treasury and Resources Minister. In starting with a tentative agreement with the premise of equity behind the legislation contained in P161/2008 Draft Income Tax (Amendment No 32)(Jersey) Law 200- (referred to in this report as 'Deemed Rent'), the Panel concentrated on whether the legislation was fit for purpose and if the consultation undertaken by the Treasury was robust. The Panel's advisor examined the evidence and submitted a report which reflects the Panel's findings exactly. The report is contained in Appendix A.

2.2 The Panel looked at this proposition in two parts, the 'Deemed Rent' and the repealing of Article 115(g) of the Income Tax (Jersey) Law 1961. The full findings will be found in the main report.

### 2.3 'Deemed Rent'

The lack of an offset against UK tax caused the Panel some concern as it felt that this might be a disincentive to companies trading in Jersey. Although the offset could be arranged by reorganising the group, the costs of this have not been quantified.

### **KEY FINDINGS**

- 1. Proposal increases administrative burden on some companies.**
- 2. The Department appears not to have a robust record of companies to apply the 'Deemed Rent'.**
- 3. Parish Rates are unsuitable to obtain ownership information.**

2.4 The evidence presented to the Panel showed that that the work that has been done to establish the yield from the proposed tax was from outdated records, was based on an earlier, different version of the legislation, and was insufficient to estimate the likely yield.

2.5 One of the main drivers for the introduction of this law is the equity that was lost on the introduction of Zero/Ten between locally owned companies paying 20% tax on profits and non-local, non-finance companies paying nothing. This tax would be a step in the right direction but it does not fully achieve equity between Jersey-owned and foreign-owned companies. The lower the yield for the deemed rent tax, the wider that “equity gap” will be. In addition, the deemed rent tax will create new inequities between the foreign-owned companies themselves.

## **KEY FINDINGS**

- 4. There have been insufficiently robust investigations to establish yield.**
- 5. Without a robust estimate of the likely yield, we do not know how far the legislation goes to satisfy equity objectives between local companies and foreign companies. The legislation will also create new inequities between foreign companies themselves but without evidence as to what proportion own their own premises we do not know how widespread those inequities will be.**
- 6. The difficulty in obtaining an offset against UK tax could be a significant disincentive to trading in Jersey. The Treasury has not obtained evidence of how many companies would have to reorganise their groups to obtain an offset, or what the cost of doing so would be.**
- 7. Anti-avoidance measures are contained within the draft law but several commentators still believe that it will be possible to avoid the tax.**
- 8. Evasion of tax is a criminal activity dealt with by the Income Tax (Jersey) Law.**

## 2.6 Article 115(g)

During the hearings, it was revealed to the Panel that the level of activity inspired by 115(g) in Jersey is unknown. As it stands, 115(g) would allow companies to avoid the ‘Deemed Rent’ tax easily by placing property into a UK pension vehicle. The further arguments for its repeal are that other

jurisdictions have dispensed with it, therefore Jersey can do the same and that it is inequitable to give a tax exemption to one class of investors but not others.

2.7 The consequences of the repeal of this article are unquantified. Submissions to the Panel indicate that they could be significant but the evidence presented by opponents of the proposal does not support this. The Panel notes the evidence for the repeal is weak because of the unknown consequences. Further, the Ministerial support for the repeal at this time is limited due to the current world financial situation. Therefore, the Panel only considers the case made on the basis of the anti-avoidance provision. It considers there is insufficient analysis of the collateral effects and therefore can neither condemn nor support the repeal of 115(g).

#### **KEY FINDINGS**

- 9. The level of activity in the Island inspired by 115(g) is unknown.**
- 10. The consequences of the repeal are unquantified.**
- 11. The evidence for repealing 115(g) is not sufficient.**
- 12. In the light of the paucity of evidence produced by the Treasury Department, the Panel can neither support nor condemn the repeal of 115(g).**

2.8 Whilst the Panel accepts that the administration of this proposal requires no new staff, due to the release of staff from the introduction of Zero/Ten, it notes the requirement of administration staff and attendant costs. Were the 'Deemed Rent' tax not introduced, those staff could be made available for other duties. It finds, therefore, that there would be costs involved in the application of this proposal, which have not been quantified by the Treasury.

#### **KEY FINDING**

- 13. There are manpower and cost implications to this proposal.**

2.9 In the hearing, the Panel clearly established that there appears to be little Ministerial confidence in this proposition. This is understandable in the light of differing views resulting from a Ministerial changeover.

## **KEY FINDING**

**14. There is no Ministerial confidence in this proposition.**

### **2.10 PANEL CONCERNS**

- a) The Panel is concerned that there are many unquantified assumptions made, which must be resolved before there is support for the legislation.**
- b) The Panel is concerned that there is no Ministerial support for the proposition.**
- c) The Panel is concerned that the effects of repealing 115(g) have not been evidenced.**
- d) The Panel remains concerned about the underlying issues that this tax was meant to resolve. If the ‘Deemed Rent’ tax is the “only runner” then it needs to be examined properly, not in this half-hearted manner.**

**In examining the evidence contained in this report, the Panel formed its key findings, based on which, it makes the following recommendations:**

- 1. P161/2008 Draft Income Tax ( Amendment No 32) (Jersey) Law 200- is NOT appropriate and fit for purpose as it is currently presented.**
- 2. The consultation process was incomplete, with too many assumptions and unquantifiables supporting the proposal.**
- 3. The Minister must resolve the unanswered issues and resubmit this Proposition before it can be supported.**

### **3. Panel Membership**

The Corporate Services Scrutiny Panel is constituted as follows:-

Senator S. C. Ferguson, Chairman.

Deputy C. H. Egré, Vice Chairman.

Connétable D.J. Murphy,

Deputy T. A. Vallois.

Officer support Mr M. Robbins and Mr W. Millow.

The Panel acknowledges the work done by the previous Corporate Services Scrutiny Panel:-

Deputy P. J. D. Ryan, Chairman

Senator J. L. Perchard, Vice Chairman

Connétable J. Le Sueur Gallichan

Connétable D. J. Murphy

Deputy C. H. Egré

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

For the purposes of S.R. 14/2007 the Panel formed a Sub Panel:-

Senator J. L. Perchard, Sub Panel Chairman

Senator B. Shenton

Deputy P. J. D. Ryan

## **4. Independent Expert Advice**

The Panel engaged the following advisor to assist with the review:-

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.

On 2<sup>nd</sup> March 2009, Mr Teather submitted a report, which concurred with the evidence established by the Panel.<sup>1</sup>

## **5. Terms of Reference**

The Corporate Services Scrutiny Panel approved the following Terms of Reference for the 'Deemed Rent' Review:-

1. To establish that P161/2008 Draft Income Tax (Amendment No 32)(Jersey) Law 200- is appropriate and fit for purpose.
2. To confirm that the consultation process was robust and complete.
3. To examine any further issues relating to the topic that may arise in the course of the Scrutiny review that the Panel considers relevant.
4. To present a report to the States on 24<sup>th</sup> March 2009.

---

<sup>1</sup> Appendix A and transcripts of hearings on Scrutiny website

## **6. Documentation**

The following documents are available on the Scrutiny website  
<http://www.scrutiny.gov.je/research.asp?reviewid=56>

- Further Interim Report S.R.14/2007; Review of the Zero/Ten Tax Design Proposals – Taxing Foreign Owned Trading Companies.
- P161/2008, Draft Income Tax (Amendment No32) (Jersey) Law 200-
- Draft Income Tax (Amendment No32) (Jersey) Law 200- (P161/2006): Comments
- Article 115(g) Income Tax (Jersey) Law 1961

## **7. Hearings**

The following witnesses attended a hearing with the Panel on Tuesday 17<sup>th</sup> February 2009.

- Deputy E. J. Noel, Assistant Minister for Treasury and Resources.
- Mr Malcolm Campbell, Comptroller of Income tax.

Verbatim transcripts are available on the Scrutiny website.

## 8. Background:

### 8.1. The Panel

8.1.1. Following the 2008 elections, a new Minister and Assistant Minister for Treasury and Resources were instated and the Corporate Services Scrutiny Panel ('the Panel') Chairman and Members were differently constituted. Following the legacy of the previous Minister and Panel, the Panel undertook a review into the Draft Income Tax (amendment No. 32) (Jersey) Law 200- which was Lodged *au Greffe* on 21<sup>st</sup> October 2008 by Senator T. A. Le Sueur, the (previous) Minister for Treasury and Resources.

8.1.2. The Panel had no wish to undertake the work previously completed in public consultation.<sup>2</sup> Therefore, the Terms of Reference were set to establish if the draft legislation as set out in P161/2008 was fit for purpose and that the consultation process undertaken by the Treasury was robust. The Panel intended to submit a report in time for the date of the debate in the States on 24<sup>th</sup> March 2009.

8.1.3. The new Members of the Panel were coming to this issue from outside with impartial views on the proposal. The Members of the Panel who had been previously involved held no strong views on the benefits or otherwise of the legislation. The views of the new Minister were not known, however, as the proposition had not been withdrawn, it was presumed that there was Ministerial support.

### 8.2. Equity

Under Zero/Ten, the profits of Jersey-owned businesses are taxed (as deemed distributions to the shareholders), but non-Jersey owned, non-finance businesses escape any tax liability in Jersey. The Panel accepted the premise that this could give non-resident owners a competitive advantage over local firms and that equity needed restoring. The Panel accepts, in principle, that

---

<sup>2</sup> See T&R Web Page- <http://www.gov.je/NR/rdonlyres/C099F9D7-2560-47AD-A9E9-03CBD444F570/0/Deemedrentalchargeconsultationresponsefinal.pdf>

the proposed legislation may work towards equity, although there was concern that it would only move partially along that road.

### 8.3. Tax Contribution.

As a second issue, although arguably just as important, it would be useful if the foreign-owned businesses contributed to the Island by some form of tax, which they do not under Zero/Ten as it stands today. The Treasury estimated that Zero/Ten proposals are to cost the Island £10-12 million in lost tax revenue from foreign-owned, non-finance companies. The Department estimates that the 'Deemed Rent' tax would recover about half of that sum, £4-6 million.

### 8.4. Tax Exemption

The Minister also proposed repealing the exemption from Jersey tax currently enjoyed by UK superannuation funds and charities.

Article 115(g) Income Tax (Jersey) Law 1961,

#### *115 Miscellaneous exemptions*

*Exemption from income tax shall be granted in respect of –*

- (g) any income derived by a superannuation fund from investments or deposits of that fund, where the fund is a superannuation fund within the meaning of section 379 of the Income Tax Act 1952 of the United Kingdom;*

This exemption in the law would allow avoidance of the 'Deemed Rent' tax, which is the reason why the proposal to repeal it is included with the 'Deemed Rent' tax. However, in the public hearing it was revealed that the Treasury Minister would consider putting this matter forward on its own if the 'Deemed Rent' tax is shelved. This is discussed later in the report.

## 9. Deemed Rent

### 9.1. Intention of the Law

On Tuesday 17<sup>th</sup> February 2009, the Panel held a hearing to establish some baseline facts from the Minister for Treasury and Resources, Senator P. Ozouf. In consultation with the Panel, it was agreed that the Assistant Minister for Treasury and Resources, Deputy E. Noel would represent the Ministry on this matter. During the hearing with Deputy Noel and Mr M. Campbell, Comptroller of Income Tax, the Panel attempted to establish the exact intention of the law as drafted. The Assistant Minister stated that the main intention was to raise tax revenue from the non-local, non-finance companies operating in Jersey. The Comptroller of Income Tax added that the restoration of equity the tax paid on the profits made by such companies and local firms was also an aim. Towards the end of the hearing, the Assistant Minister confirmed this secondary objective.

### 9.2. Tax payable / profit and loss connection

The Panel considered the issues of a company making limited or no profit and how the 'Deemed Rent' tax would account for that and established that this is catered for by 123H(8+9) of p161/2009:

#### *123H Non-Jersey companies*

*(8) If a non-Jersey company has no annual profits or gains for a year of assessment that are chargeable to tax under Schedule D (notwithstanding that the rate is 0% under that Schedule) the company shall not be charged to tax in respect of its deemed rental income for that year.*

*(9) A non-Jersey company shall not be charged to tax in respect of the amount of its deemed rental income for a year of assessment that exceeds the amount of annual profits or gains that are chargeable to tax under Schedule D for that year (notwithstanding that the rate under that Schedule is 0%).*

The intention here is to avoid companies paying more than they would previously have done on their profits, regardless of whether the company is heavy on property and low on profit (such as the Hotel Industry) or low on property and higher on profit (such as the Construction Industry). However, this then places an additional burden on many companies to prepare two sets of documentation:

1. Details of 'Deemed Rent' property;
2. Profit returns.

This will be required in order to satisfy:

- a) a claim that their profit is sufficiently low to nullify or reduce the 'Deemed Rent' tax;
- b) or to appeal against a 'Deemed Rent' tax after the demand;
- c) or to establish if such a claim is necessary.

## **KEY FINDING 1**

**Proposal increases fairness but also increases the administrative burden on some companies and the Tax Office.**

### 9.3. Shareholdings and Ownership.

9.3.1 The matter of who owns what company was a concern. How would the Tax Department know who owned which companies? This has been addressed within the new income tax returns, in that the document asks for a list of shareholdings. This provides information on the connection local residents have with local companies but left the Panel wondering how the Department identifies non-local, non-finance companies without local shareholders.

## **KEY FINDING 2**

**The Department appears not to have a robust record of companies to apply the 'Deemed Rent'.**

9.3.2 A suggestion that the Parish Rates could be used to establish property or possibly company ownership has been examined. The Comité des Connétables sent a response to the Treasury during the consultation process. This explained that rateable value ceased to be based on the rental value of

property after 2003. The Comité maintained that there would be concern were there to be a tie between property tax and the rating system and that the systems must be kept separate. Elected Officers for the Parish assess the rateable value of property for parochial purposes. The information was not readily transferable to tax purposes.

### **KEY FINDING 3**

**Parish Rates are unsuitable to obtain ownership information.**

#### 9.4. Revenue Raised

The Panel noted that the estimated revenue gain from the 'Deemed Rent' tax was £4-6 million. During the hearing with the Comptroller of Income Tax, it was established that this figure was reached following a brief visit to the Town Hall where records from 2003 were examined. This had offered a 'broad brush' estimate of the yield from such a tax. The Panel were concerned by the low level of investigation that had taken place to base the estimated yield from the proposal.

### **KEY FINDING 4**

**There have been insufficiently robust investigations to establish yield.**

#### 9.5 Equity.

9.5.1 The proposal imposes a tax on non-local, non-financial companies operating in Jersey. One of the objectives of the imposition of the tax would be to 'level the playing field' between local companies and those owned by outside holders. Jersey-based shareholders are taxed at 20% on 60% of their company's profits under the deemed dividend rules. In contrast, the foreign companies are not taxed on their profits but would be taxed on their deemed rent where they are owner-occupiers. Whilst in some cases this would reduce the inequity, in some cases the 'Deemed Rent' tax could be little or nothing – which will create new inequities between those companies with significant deemed rent and those without. Different starting points on different aspects of the businesses make comparison difficult or impossible and suggests the proposal is intended to act as an argument that, 'we are doing the best we

can to make this equal'. In a hearing with the previous Panel the Minister for Treasury and Resources, T.A.Le Sueur stated;

*....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.*

9.5.2 This will apply to a percentage of foreign companies as many will rent properties at commercial rents which are taxed through the landlord already. Does this mean that the companies pay not tax at all? Unless they are paying tax in their home jurisdiction, it would seem so. This appears unfair when matched against local companies.

9.5.3 During the hearing, the Assistant Minister advised the Panel about Royal Court Leases. These are long leases where the lessee is treated as the owner of the property. The Panel has not examined this particular issue and does not intend to delve into the legal issues surrounding leases, however it seems that Rates data does not distinguish between long leases and outright ownership, which raises further concerns about the accuracy of the Treasury's yield estimate. The amount of taxable deemed rent of these companies would be reduced by the rent they are actually paying under these leases; if they are "market rent" leases then there will be no 'Deemed Rent' tax, but if they are "peppercorn rent" leases then the full 'Deemed Rent' tax would be due. The Treasury has not performed any analysis of these leases to answer this, and only it would have access to the data to do so.

9.5.4. The terms of each individual lease and rent agreement sets the commercial value of each individual premises. Two identical properties with differing leases may have differing rents paid. Which agreement will the assessors be required to work from or is there to be one lease for assessors to use as a template? This would lead to some companies paying the deemed rent tax even though they rent their premises on a "market rate" lease, because of differences between the actual and the "template" lease.

## **KEY FINDING 5**

**Without a robust estimate of the likely yield, we do not know how far the legislation goes to satisfy equity objectives between local companies and foreign companies. The legislation will also create new inequities between foreign companies themselves, but without evidence as to what proportion own their own premises we do not know how widespread those inequities will be.**

### 9.6 Tax Implications

#### 9.6.1 Offset against UK Tax

Prior to the initiation of any new tax, the people of Jersey need to be very sure of the effect it will have on the Island as a whole. It is clear that there is no point in raising £4 million in a new tax if it makes the Island uncompetitive for outside companies to trade. The revenue source would soon dry up and leave the Island less well off in terms of direct finance and choice for the population.

9.6.2 The 'Deemed Rent' tax could not be directly offset against UK tax because it is a 'Deemed Tax' which is not covered by tax agreements with the UK. However UK-owned businesses could obtain an offset by reorganising so that their property was owned by a separate group company and rented to the trading company. One of the main advantages of the deemed rent proposal was that an offset could be obtained in this way. It seems that some companies already operate this structure, but the Treasury has not presented any evidence as to:

- what proportion of relevant companies already operate this structure;
- or what it would cost for other companies to reorganise in this way.

9.6.3 In its previous report<sup>3</sup>, the Panel referred to methods of avoiding tax. The Panel notes that certain non-Jersey, non-finance trading companies have intermediate holding companies in other "offshore tax jurisdictions" indicating forward tax planning. Would the ability for offset against UK tax still be important for such companies?

---

<sup>3</sup> Corporate Services Scrutiny Panel Report. Review of the Zero/Ten Tax Design Proposals (SR14/2007)

## **KEY FINDING 6**

**The difficulty in obtaining an offset against UK tax could be a significant disincentive to trading in Jersey. The Treasury has not obtained evidence of how many companies would have to reorganise their groups to obtain an offset, or what the cost of doing so would be.**

### 9.7 Avoidance

The Panel noted that within the submissions to the Treasury during the public consultation process there was a suggestion that the proposed tax would be easy to avoid. Following a question to the Assistant Minister, the Panel understands that tax avoidance measures drafted into the legislation will deter avoidance of this tax. The Assistant Minister has directly confirmed that understanding<sup>4</sup>.

## **KEY FINDING 7**

**Anti-avoidance measures are contained within the draft law, but several commentators still believe that it will be possible to avoid the tax.**

### 9.8 Evasion

In considering the issue of evasion, the Panel heard from the Comptroller of Income Tax:

*“So, if they want to evade tax they take a major risk because we have, in the last 12 years, prosecuted, I think, 9 people for tax fraud in the Royal Court. They have all been found guilty and given a very substantial monetary fine.”<sup>5</sup>*

The Income Tax (Jersey) Law 1961 deals with evasion making it criminal activity.

## **KEY FINDING 8**

**Evasion of tax is a criminal activity dealt with by the Income Tax (Jersey) Law 1961.**

---

<sup>4</sup> Email of Thu 26/02/2009 10:07 between Assistant Minister and Chairman of Panel. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

<sup>5</sup> Hearing of 17<sup>th</sup> February 2009. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

## 10. Article 115(g)

### 10.1 Reason for repeal.

10.1.1 The Assistant Minister explained that this article would allow avoidance of the Deemed Rent tax:

*“...it is an immediate tax avoidance device if it is not repealed because it would be relatively easy for these companies to restructure their affairs to put the ownership of that property into a U.K. pension vehicle and, therefore, automatically avoid this tax. That is the driver behind that.”<sup>6</sup>*

10.1.2 However, the Assistant Minister also thought that there would be a case for repealing Article 115 on its own:

*“I personally would split out the 2 elements of this, 115 and the deemed rental. I would pursue the 115 first.”<sup>7</sup>*

### 10.2 Extent of Activity

As mentioned previously in this report, Article 115(g) Income Tax (Jersey) Law 1961, would be used as a tax avoidance device in relation to Deemed Rent if not repealed. The Panel has not established how much pension fund activity has been going on in the Island over the last few years but was concerned that the Assistant Minister and Department had no evidence of this either. Consultation by the Treasury seems to have found arguments both for and against, each as vociferous as the other<sup>8</sup>. Submissions to the Panel are

---

<sup>6</sup> Hearing of 17<sup>th</sup> February 2009. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

<sup>7</sup> Hearing of 17<sup>th</sup> February 2009. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

equally polarized<sup>9</sup>. However, the extent to which pension funds are involved in the Island remains unknown.

## **KEY FINDING 9**

**The level of activity in the Island inspired by 115(g) is unknown.**

### 10.3 Effect of repealing article

10.3.1 Going hand in hand with the unknown level of pension activity in the Island is the question of what will happen if it is repealed. There is no database to give accurate information of this nature and the Assistant Minister stated in the hearing that creating such a record was, *“Not worth the effort.”*<sup>10</sup> Therefore, the likely consequence of repealing the article is based on an unquantified field.

10.3.2 One of the submissions received raised concerns about the repeal of 115(g):

*“That the repeal of Article 115 is included in the draft Law, after my previous representations from 2006 to 2008 still leads me to have serious doubts about whether potential unintended economic consequences have been considered, understood and taken into account.*

*...The lack of the additional liquidity coming from the institutional investors, owing to their potential ability to fund large buildings with high end values, will restrict the ability of the market to create modern, high specification office buildings with large floor plates. The consequence of that will be stagnation, unless rents rise to compensate, adding to the finance industry’s costs and a loss of revenues to the States from:*

---

<sup>8</sup> See T&R Web Page- <http://www.gov.je/NR/rdonlyres/C099F9D7-2560-47AD-A9E9-03CBD444F570/0/Deemedrentalchargeconsultationresponsefinal.pdf>

<sup>9</sup> See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

<sup>10</sup> Hearing of 17<sup>th</sup> February 2009. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

- *The reduction of land values on the waterfront, in particular,*
- *Loss of stamp duty receipts from land sales and sales of completed investments,*
- *Loss of revenues and job losses throughout the property sector amongst building contractors and developers and their architects, quantity surveyors, structural engineers, letting agents and surveyors and accountants, lawyers et al,*
- *A reduction in the freight companies and the port,*
- *Potential for bad debts amongst the local banks from a reduction in capital values, leading to over-exposure to the sector and adjustment of lending portfolios to compensate for the increased risk, resulting in increased finance costs, assuming finance is available at all and a further reduction to land values.”<sup>11</sup>*

10.3.3 Clearly, land is a limited and valued resource in Jersey. There seems little or no evidence of effects on property values from the recession to date. The Panel notes that the submission above, as others, has concerns about the reduction in capital value of large commercial properties that may be caused by the repeal of 115(g). The Panel then raised the question:

“If property prices are actually reduced, is that a bad thing?”

## **KEY FINDING 10**

### **The consequences of the repeal is unquantified.**

10.3.4 The suggestion that 115(g) needs repealing because other jurisdictions have dispensed with it is insufficient reason to convince the Panel that this is the best way forward for Jersey.

---

<sup>11</sup> Submission of J. Russell. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

## **KEY FINDING 11**

### **The evidence for repealing 115(g) is not sufficient.**

10.3.5 When discussed with the Assistant Minister at the hearing, he said:

*“I do not believe that it would be that detrimental to repeal it. But in the present climate it could very well be. There could be a short term detrimental effect in doing it.”*

10.3.6 The main submission in opposition to repealing Article 115(g) also gave evidence that there were other players in the Jersey property market who would be unaffected by Article 115(g), which would mean that the effect of repeal, although negative, might be small. In a major negotiation with a UK pension fund:

*“we had three other bids from Channel Islands entities at the same sort of level”<sup>12</sup>*

## **KEY FINDING 12**

**In the light of the paucity of evidence produced by the Treasury Department, the Panel can neither support nor condemn the repeal of 115(g).**

---

<sup>12</sup> Submission. J Russell. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

## 11. Costs

11.1 Notably, the Comptroller of Income Tax informed the Panel<sup>13</sup> that this tax would not be difficult to administer and that he would have staff available due to the introduction of the Zero/Ten system. In addition to being contained in the proposal, this was put to the States in:

Section 9 of the Budget Statement 2009.

### ***Manpower Implications***

*The proposals within the Budget Statement 2009 will be implemented without any increase to current approved manpower levels. The income tax proposals for a new Deemed Rental Charge will require additional resource but this will be found from savings arising from the change to a 0/10% corporate tax structure.*

The Panel recognises that there is cost involved, as it would mean retaining staff positions, which would have gone with savings of the relevant wages.

### **KEY FINDING 13**

**There are manpower and cost implications to this proposal.**

---

<sup>13</sup> Public Hearing of 17<sup>th</sup> February 2009. See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

## 12. Submissions to Panel

During the course of this review, written submissions were received<sup>14</sup> which include matters relating to:

- a) Weak definition of Deemed rental;
- b) Terms of leases being central to the calculation;
- c) Costs of valuations and administration for companies;
- d) Acceptability of artificial discrimination / EU Regs;
- e) Burden on companies and States disproportionate to the yield;
- f) Insufficient analysis of expected yield;
- g) Mixed land occupation;
- h) Companies withdrawing interest in Jersey;
- i) Stagnation of commercial property market;
- j) Unquantified benefits;
- k) No UK offset;
- l) Complexities of relief definitions;
- m) Complications of beneficial ownership;
- n) Deemed minimum Tax;
- o) Alternative proposal;

In addition to the submissions, the Panel considered submissions made to the Treasury during its consultation period.

It was notable that submissions are vociferous and polarized. Of those received by the Panel during this review, most are against the introduction of the deemed rent and the repeal of 115(g). One is notably for the proposition. A further submission is a suggestion for an alternative proposal to obtain the parity and tax contribution sought. The Panel has not examined this proposal in detail but has passed it to the Assistant Minister and Comptroller of the States for examination. The author wishes anonymity and his name has been excluded.

---

<sup>14</sup> See Scrutiny Web Site [www.scrutiny.gov.je](http://www.scrutiny.gov.je)

## 13. Conclusions

### 13.1 Ministerial support

13.1.1 The proposal for this draft legislation followed consultation between the Treasury and Resources Minister and the Corporate Services Scrutiny Panel of the last administration. The Minister and Assistant Ministers, like this Panel, are now all different. When asked for his feelings towards the introduction of this amendment, the Assistant Minister told the Panel:

*“.....this is probably really the only potential way forward to attaching, bringing in some equity. Having said that, I personally do not believe that, at this moment in time, it is worth pursuing as it stands.  
.....I personally do not believe it is the right time to introduce this. It does not mean that there will not be a time in the future when it is fit for purpose.”*

13.1.2 As quoted above, the previous Minister was supporting this because he recognised the underlying problem and could not think of anything better. To its regret the Panel has found no evidence of a resolute examination of the proposal, or any serious attempt to find an alternative which would redress the inequality left by the Zero/Ten proposals with regard to local businesses.

13.1.3 On Wednesday 4<sup>th</sup> February 2009, Senator P. Ozouf requested the debate date for P161/2008 be moved back:

*“Finally, if I may, I am grateful for that and I am not asking for anybody, I am just going to do something myself on this one. There is a proposition down for debate on 24th March 2009, Income Tax (Amendment No. 32). It is likely that this proposition is going to be withdrawn subject to discussions with Corporate Affairs and with the Scrutiny Panel. I do not want to withdraw it at this stage, to forecast exactly what the Corporate Affairs Scrutiny Panel may say, but it is only fair to Members if I may push that to the latest possible date available in May. I think the date has been signalled 12th May 2009, if I may signal to move that there? That may be for Members’ consideration as to whether or not they wish to deal with 24th March 2009 in some other way.”*

## **KEY FINDING 14**

**There is no Ministerial confidence in this proposition.**

### 13.3 Reconciliation with Terms of Reference

The terms of reference had two main areas for the Panel to consider:

- 1 To establish that P161/2008 Draft Income Tax (Amendment No 32)(Jersey) Law 200- is appropriate and fit for purpose.
- 2 To confirm that the consultation process was robust and complete.

**The Panel has the following concerns:**

#### **CONCERN a)**

**The Panel is concerned that there have been many unquantified assumptions made, which must be resolved before there is support for the legislation.**

#### **CONCERN b)**

**The Panel is concerned that there is no Ministerial support for the proposition.**

#### **CONCERN c)**

**The Panel is concerned that the effects of repealing 115(g) have not been evidenced.**

#### **CONCERN d)**

**The Panel remains concerned about the underlying issues that this tax was meant to resolve. If the 'Deemed Rent' tax is the "only runner" then it needs to be examined properly not in this half-hearted manner.**

## **14. Recommendations**

The Panel commenced this review from a position of agreeing with the premise that equity should be established for all companies in Jersey and that all companies should make a contribution to the Island's tax structure. As a result of the review and the key findings established by evidence gathered,

### **THE PANEL RECOMMENDS:**

- 1. P161/2008 Draft Income Tax ( Amendment No 32) (Jersey) Law 200- is NOT appropriate and fit for purpose as it is currently presented.**
- 2. The consultation process was incomplete, with too many assumptions and unquantifiables supporting the proposal.**
- 3. The Minister must resolve the unanswered issues and resubmit this Proposition before it can be supported.**

# Appendix A

## **Adviser's Report**

### **Background**

The Deemed Rent tax was proposed as a response to the problem under 0/10 that most foreign owned non-finance companies would not be paying any tax in Jersey despite operating here and competing in the local market.

The tax therefore had two objectives:

1. Raising revenue for the Jersey Treasury from these companies; and
2. Removing the inequity (whether real or perceived) between these companies and the locally-owned companies whose profits would be subject to Jersey tax.

After having pursued various alternatives, the deemed rent tax seemed to be the only proposal that might even start to deal with these concerns:

“If this one does not run there are no other runners, in our view”

*M Campbell, Scrutiny Panel hearing 17th February 2009*

It was known from the beginning that the deemed rent tax would not be a perfect solution to these problems, but at best it was hoped that it would:

1. Raise significant amounts of revenue (although not as much as those companies were previously paying); and
2. Reduce (but not eliminate) the inequity between Jersey-owned and foreign-owned companies.

See briefing note for further background information.

### **Scrutiny activity**

The Scrutiny Panel has received copies of the responses to the Treasury consultation, and has also received some comments directly. The Panel also held a hearing with the Deputy Treasury Minister, Deputy Noel, and the Comptroller of Taxes Mr Campbell.

### **Consultation**

The Treasury's consultation on the proposed tax resulted in 7 responses broadly in favour and 11 broadly against.

However of the responses which opposed the proposal, at least 5 raised concerns that were subsequently addressed in the draft legislation.<sup>1</sup> A further two respondents wanted a return to the pre-0/10 tax system, which would not be acceptable under Jersey's commitment to abide by the EU Code of Conduct on business tax.

<sup>1</sup> The main concern raised by these respondents was that companies could have to pay more tax than they would have done under the pre-0/10 regime when they paid 20% tax on their profits (and that some would be taxed when they were making losses). However the draft law has a provision that caps the deemed rent, so that it cannot be more than the company's taxable profits would have been under the old regime. Other concerns were about whether expenses would be deductible from the deemed rent; this is permitted under the draft law.

The Treasury's consultation process is, at this stage, insufficient to support the deemed legislation because:

1. Some groups were apparently omitted from the consultation process<sup>2</sup>; and
2. The draft law has been amended in response to the consultation process, but there does not seem to have been any attempt to discuss with those respondents whether their concerns have been met.

## **Potential yield**

The Treasury originally estimated the potential yield of the tax at £4 million - £5 million<sup>3</sup>, a significant amount for the Jersey Treasury.

This estimate was arrived at by analysing the St Helier rates records, to find the rateable value of premises that were likely to be affected by the tax.

There are several problems with this process:

1. The draft law allows for various amounts to be deducted from the deemed rent (including interest payments and maintenance), which will reduce the yield.
2. The draft law caps the deemed rent so that the tax will not be more than it would have been under the pre-0/10 regime. This will again reduce the yield; for example loss-making companies will pay no tax, and some property-intensive businesses such as hotels may pay much less tax than the deemed rent would suggest.
3. It seems that the Rates system defines some leaseholders as owners ("They have ... a Royal Court lease, which means that they have a long, long lease but they are treated as the owner for rates purposes"<sup>4</sup>). If these companies are paying significant (rather than peppercorn) rents under these leases, then that again would reduce the yield of the deemed rent tax.<sup>5</sup>
4. The Parish Rates data is out of date, being based on 2003 valuations,<sup>6</sup> and no analysis has been performed as to how they relate to current valuations.

None of these points necessarily means that the law is not fit for purpose, but the analysis has not been performed to determine whether it is. A more

<sup>2</sup> "the consultation process was neither robust nor complete, when neither the Advocates nor the Chartered Surveyors were circulated in 2008". J C Russell, letter to Scrutiny Panel 4th February 2009.

<sup>3</sup> M Campbell, Scrutiny Panel hearing 17th February 2009.

<sup>4</sup> M Campbell, Scrutiny Panel hearing 17th February 2009.

<sup>5</sup> This point was also raised in Mr Levitt's letter to the Scrutiny Panel, dated 8th February 2009.

<sup>6</sup> M Campbell, Scrutiny Panel hearing 17th February 2009.

detailed estimate would have to examine the Income Tax records of these companies alongside the Parish Rates data. Only the Treasury / Tax Office would have access to this data.

If the yield is lower then the deemed rent tax will also be less effective in reducing inequity:

- Under 0/10, Jersey-resident owners of Jersey companies pay tax on 60% of the company's profits under the deemed distribution rules<sup>7</sup>, so they pay 60% of the tax that those companies would have done before 0/10.
- The yield from the deemed rent tax was initially estimated at about half the amount of tax that was previously paid by the non-Jersey owned companies – so on average they would be paying about 50% of the tax they would have done before 0/10.

That is not perfect equity, but 60% versus 50% is fairly close. However if the actual yield from the deemed rent tax is significantly lower than the estimate, the “equity gap” will be much wider.

The Treasury's yield estimated is not sufficiently accurate to determine whether the deemed rent tax is worth proceeding with.

### **Administrative costs - States**

The Tax Office claim that the deemed rent tax would not increase their administrative costs:

“There will be no additional collection costs as far as income tax is concerned because the account inspectors are currently examining the trading accounts of those non-finance non-Jersey owned businesses now and charging them tax at 20 per cent, that work will go. ... So, this work will replace it”

*M Campbell, Scrutiny Panel hearing 17th February 2009*

However the 0/10 regime is now in place (although for the moment the Tax Office may still be dealing with old pre-0/10 issues). What would those members of staff be doing if the deemed rent tax were not introduced?

The Treasury has not properly estimated these costs, on the basis of resources that could be saved or directed elsewhere were this tax not introduced.

<sup>7</sup> Scrutiny Panel report SR 20/2007, page 13. Further tax may be paid when dividends are received.

## **Administrative costs – businesses**

No estimate has been prepared of the likely cost to businesses.

Instead of using the Rates valuation, companies will have to obtain (and pay for) their own valuation from a qualified person every 5 years.

There are also questions as to what basis is to be used to calculate the rent:

“a lease of at least 100 hundred years (security of tenure) with the tenant paying all redecoration and repairs including rebuilding if required ... might justify a lower rent than would be paid by a tenant with a shorter term and more generous covenants by the landlord”

*Mr D Levitt, submission to Scrutiny Panel dated 8th February 2009*

There will have to be some agreed basis on which the valuations are to be performed.

In addition, some companies will want to perform tax calculations (as they did pre-0/10) to see whether the cap applies (since they do not have to pay more tax under deemed rent than they would have done under the pre-0/10 regime). Some companies may want to do this every year, some might only do so in years when their trading profits are low, whereas others may be confident that their deemed rent is lower than their profits without performing the calculation.

Presumably also there will be challenges from the Tax Office, to both the deemed rent valuation and the profits calculation. Dealing with these disputes will also add to companies' costs.

The Treasury has not performed any estimate of these costs for businesses.

## **UK double tax relief**

The deemed rent tax is only acceptable if UK-owned companies can offset it against their UK tax bill (as they could with Jersey income tax before 0/10). If not then it becomes an additional cost of doing business on Jersey, which could be passed on to consumers. If it also discourages businesses from operating on Jersey then it would reduce employment and competition in the local market.

The advice from UK advisers is that in a simple system double tax relief would not be available, but that double tax relief could be obtained by transferring the property into a group property company, separate from the trading company that runs the business. Clearly this would add to the administrative costs of the tax for businesses.

When asked about consultation with UK-owned companies on this point, the Comptroller of Taxes said:

“There has been some informal feedback, not written down anywhere. They will either try and avoid it or evade it or whatever, or they will try and put in place a structure so that they will make sure it is creditable in the U.K.”

*M Campbell, Scrutiny Panel hearing 17th February 2009*

The Treasury has not made any estimate of the cost of this.

Some UK-owned businesses will already operate this sort of structure, in which case there would be no additional cost. The only UK High Street chain that participated in the Treasury consultation, WH Smith, appears from its response to already have its property owned by a separate company. The Treasury has not consulted with UK chains operating in Jersey to estimate how many groups already use a separate property company.

## **Avoidance**

There are some concerns that the deemed rent tax would be too easy to avoid. This would not only reduce the yield but would also reduce the equity (see “potential yield” above).

“Although we have some sympathy with the instant reaction of the Zero/Ten tax proposals are unfair to certain local traders, one cannot ignore that the law, as drafted, would be costly, very easy to avoid, inflationary, administratively difficult and will be unlikely to yield sufficient revenue to justify its introduction.”

*John Shenton, submission to Scrutiny Panel dated 11th February 2009*

When asked about this, the Comptroller of Taxes replied:

“Well, I do not agree that it is going to be easy to avoid. If you look at the draft law there is a very strong anti-avoidance provision in that draft law. It is very strong indeed. So, I certainly do not agree that it is going to be easy to avoid. Of course, they may try and wish to avoid it and, no doubt, they will come up with schemes to try and do so and charge their clients accordingly, but there is a very strong anti-avoidance provision in there.”

*M Campbell, Scrutiny Panel hearing 17th February 2009*

Jersey Finance suggested that “it would be easy to manipulate the market value of a particular property by imposing onerous terms on the lease and thus artificially depressing the value”.<sup>8</sup>

It is also likely that the changes to the draft law, such as allowing deductions for loan interest and the “cap” on deemed rent based on the company’s profits, will increase the scope for avoidance.

There is insufficient evidence to determine which view is correct, and whether the anti-avoidance provisions will be sufficiently robust.

## **Article 115 (foreign charities & superannuation funds)**

Foreign charities and superannuation funds are not currently taxed on rents they receive from Jersey property. The proposal to remove this exemption has generated considerable opposition, primarily from the property industry.

<sup>8</sup> Jersey Finance, submission to Scrutiny Panel dated 11th February

Undoubtedly taxing these rents will make Jersey property investment less attractive to these bodies, and so will reduce demand.

It is also clearly true that any reduction in value would fall on the underlying land value (because the construction / development costs are more or less fixed).

However the property industry claims that this would be severe enough to prevent future commercial property development in Jersey. They argue:

1. If property values fall by 20% then the value of the completed property is likely to be less than the construction cost, making development uneconomic.
2. No-one else can provide the size of funding that is needed for a largescale property development.

The Treasury Minister was asked about his assessment of this risk:

“It has been hard to judge what level of impact this will have. The information just is not available to find out how many properties throughout the Island are owned by U.K. pension schemes. It is virtually impossible to identify them”

*Deputy E J Noel, Scrutiny Panel hearing 17th February 2009*

It seems that no record is kept in the Tax Office of the properties to which the Article 115 exemption applies.

However whilst the Treasury has not produced sufficient evidence to support the proposal, neither have its opponents produced sufficient evidence against it.

Whilst it is accepted that the tax exemption allows pension funds to pay more for Jersey property than other developers, and so removing the exemption will reduce the value of commercial property, we have not received any evidence that this reduction would be large enough to stop developments.

The Treasury asked the States Economic Adviser for his opinion on the risk:

“He has spoken with people from the development industry, as others, and there is little economic justification for such relief as it simply serves to inflate commercial property values by having the relief. It means that the pension funds can effectively pay more for the buildings that they buy because they are getting tax relief on it”

*Deputy E J Noel, Scrutiny Panel hearing 17th February 2009*

The main opponent of the proposal is J C Russell, who gave the example of the sale of Sir Walter Raleigh House. He explains that this was originally going to be to the (UK) Universities Superannuation Scheme, but that they pulled out of the deal once they heard about the proposal to abolish the Article 115(g) exemption.<sup>9</sup>

<sup>9</sup> Mr J C Russell, submission to the Scrutiny Panel dated 4th February 2009.

However he also says that in the initial negotiations “we had three other bids

from Channel Islands entities at the same sort of level". This suggests that although the Article 115 exemption enables pension funds to bid substantially more than other investors, in fact they are only bidding slightly more (keeping most of the value of the tax exemption for themselves), and there are other investors, unaffected by Article 115, who would be willing and able to finance Jersey property developments at a price only slightly lower.

His letter did not say how much lower the eventual sale price was than the original Universities Superannuation Scheme offer, but it does not seem that the reduction was large enough to prevent the project going ahead.

Indeed this example suggests that Jersey investors may currently be unfairly disadvantaged by Article 115, because the tax exemption allows UK-based pension funds to outbid them.

We have been told about several significant investments into Jersey commercial property by Article 115 bodies, but this is not surprising given that the exemption allows them to out-bid non-exempt competitors. We are also told that these bodies would not invest were it not for the exemption (although Guernsey does not seem to have this problem). However the evidence from Mr Russell suggests that there are other investors willing and able to finance these developments.

### **Other issues**

Given that these fundamental issues have not yet been satisfactorily resolved, we have not fully examined the detail of the legislation. Other issues remain, for example who precisely is subject to the tax and on what basis precisely is the valuation to be made. These issues will also have to be examined before the draft legislation can be said to be fit for purpose.

### **Conclusion**

At the moment there is insufficient evidence before the Panel to determine whether or not the draft legislation is fit for purpose, or whether the yield would be high enough to make it worthwhile.

The Treasury's investigations appear to be incomplete and insufficient to justify this legislation.

However the evidence presented by those opposed to the draft law is also insufficient to justify abandoning it.

Even though the evidence presented to support the deemed rent tax is insufficient, the initial problem - that a large group of businesses are operating in Jersey without paying tax here, and are competing in the local market against Jersey-owned businesses whose profits are taxed – still remains.