

CORPORATE SERVICES SCRUTINY PANEL

ZERO/TEN DESIGN SUB PANEL HEARING

Review of Zero/Ten Design Proposals

Friday, 4th August 2006

Panel

Senator J.L. Perchard (Chairman)
Senator B.E. Shenton
Deputy P.J.D. Ryan of St. Helier
Deputy G.P. Southern of St. Helier
Mr. B. Curtis (Advisor to the Panel)
Mr. R. Teather (Advisor to the Panel)
Miss. S. Power (Scrutiny Officer)

Witnesses

Mr. D. Stuart (Le Rossignol, Scott Warren & Co)
Mr. P. Frith

Senator J.L. Perchard:

Welcome, gentlemen. Thank you for coming to the Zero/Ten sub-panel that are scrutinising the design proposal. Firstly, as you are witnesses I have a statement to read to you, if you will just bear with me. It is important that you fully understand the conditions under which you are appearing at this hearing. You will find a printed copy of the statement I am about to read in front of you on the table. The proceedings of the panel are covered by parliamentary privilege through Article 34 of the States of Jersey Law 2005 and the States of Jersey Powers, Privileges and Immunities Scrutiny Panels, PAC and PPC Jersey Regulations 2006. Witnesses are protected from being sued or prosecuted for anything said during hearings unless they say something that they know to be untrue. This protection is given to witnesses to ensure that they can speak freely and openly to the panel when giving evidence without fear of legal action, although the immunity should obviously not be abused by making unsubstantiated statements about third parties who have no right of reply. The panel would like you to bear this in mind when answering questions. The proceedings are being recorded and transcriptions will be made available on the scrutiny website. As I said earlier, welcome. We are running a scrutiny review on the Zero/Ten Design proposals and we have had many submissions and none better than yours from Le Rossignol and Paul gave one from his home address. We note that they have a lot in common and the author has had involvement in both documents. Thank you for coming and whilst we have read and consumed the information in the documents I would like to kick off if I may by asking you to just give us a broad outline of the concerns you have with the Zero/Ten document and perhaps we could highlight the issues that we want to touch on during our session.

Mr. P. Frith:

I will kick off, shall I? I think we look at where we are at the moment with the Jersey tax system, and compared with many sophisticated systems operating throughout the world I think it can be said without a shadow of a doubt that Jersey's is a simple, well-understood system. The question, therefore, is begged as to whether we should aim to keep it that way or whether we should go for more complexity. In order to, in effect, retain the status quo (by that I mean what we would aim to do is preserve the tax base as far as we can) we do not want to raise the rate of tax. We maintain the rate at 20 per cent as far as I can tell. Therefore, our aim really ought to be maintain the simplicity, maintain equity, and keep the costs of compliance down for business in general and the general body of the taxpaying public. Now, one of the problems that has arisen out of the paper is the deemed distribution charge for trading profits and the look through for investment companies. Straight away we have 2 different systems for the same corporate entities, in effect. That to my mind is not the right direction to go in. We should aim as far as possible for symmetry. Secondly, we have the position of the shareholder. For controlling shareholders, whichever basis is adopted, whether it is deemed distribution or look through, it is not a problem because the controlling shareholder is in a position to dictate affairs. For the minority shareholder, it is a problem. It is a very serious problem. I think one has to express some surprise that the position of minority shareholders has not been covered in any great detail in the document except insofar as there is a deferred distribution. In other words, it is giving the shareholder some time to collect his funds together in order to pay the tax. But, in essence, that deferral will only apply for the first 3 or 4 years. Thereafter, a minority shareholder will have to find the tax each and every year on something which he may never receive. That to my mind cannot be right. There are a number of subsidiary issues which will further complicate the tax system. One example would be, for example, in a group situation where we have trading and investment companies. Under the proposal we will have 2 systems applying to the same group. We will have look through and we will have deemed distributions. It may be in the mind of the author that in the ultimate holding company everything would come together and in the holding company the distribution will be on one or the other basis, but it is not explicitly stated so we do not know what the position will be in the group. We're not clear - although the position at the moment with losses is that group relief is given on a concessional basis, under the proposals group relief would be put on a statutory basis. But we are not clear because it is not stated how group relief will be dealt with as between investment and trading companies within the same group. That is an example of the complexity that we will find ourselves in, which is difficult enough for accountants and lawyers to deal with but we are moving from a system that is relatively well understood currently to a system which will become, never mind for the accountants and lawyers, but for the layman impossible to run with. I think that that is wrong. We may be forced ultimately into doing it because we have no alternatives, but we should really examine the alternatives before we take this drastic step, to my mind.

Senator J.L. Perchard:

Doing what? To zero? When you say --

Mr. P. Frith:

The system that we are looking at under the proposal is the deemed distribution and the look through. The question is whether there is an alternative. Because if there is a viable alternative, then a lot of the other problems (for example, minority shareholder issues, group relief, et cetera) may well disappear. There is no perfect solution to this, I am sure, but in the Le Rossignol, Scott Warren paper there is a proposal put forward there whereby the --

Senator J.L. Perchard:

Can you just remind us of that?

Mr. P. Frith:

It is on page 7 of the Le Rossignol paper, midway down that page: "The paper does not tell us to what extent a shareholder tax is being considered whereby all companies and their Jersey resident shareholders would be under the deemed distribution system. Under such a system we envisage that profits would be taxed currently rather than on a deferred basis with the crucial difference that the shareholder should he so elect would have the 20 per cent tax due paid by the company on account of his final liability. The shareholder would receive a certificate of tax paid from the company and file this with his personal tax return. In the books of the company the tax payment would be booked as a loan to the shareholder. The loan would be cleared by a declaration of dividend or loan waiver."

Senator J.L. Perchard:

That is the company acting as an agent, then, similar to the Isle of Man proposal?

Mr. P. Frith:

It may well be. My understanding of the situation is that there are concerns (and I know that the word "agent" is referred to in the paper itself) that we might be in breach of the code if the company is seen to be an agent. However, I have not seen anything in writing to this effect. I have not seen anything from the Code of Conduct Committee that says that it would be. Our difficulty, I think, all through this process has been trying to conform to a set of rules and we do not know what they are. With hindsight, one might say that we should have established the rules before we sat down and attempted to draft a new system, but we are where we are and we have to deal with the matter as we see it currently. But I think that because of the minority shareholder situation, if we are going to ride roughshod over the minority shareholders, well, fine. Whether that passes human rights tests, et cetera, is another matter. It seems to me that it is a very powerful argument for being able to say that the shareholders' liability ought to be funded in some way or other by the company because otherwise the minority shareholder is at a financial loss.

Senator J.L. Perchard:

Does this only apply, in your opinion, to minority shareholders' vulnerable position in local companies or all companies and businesses?

Mr. P. Frith:

I think the thrust of the provisions is to maintain the tax base in Jersey. The tax base in Jersey as far as businesses is concerned is Jersey-located businesses. So I think that we should be concentrating our minds on Jersey businesses and not foreign businesses. Because the comptroller has currently the power under Article 134A to tax a local resident shareholder on the profits of a foreign business if he thinks that the foreign business has been established in the way it has for the avoidance of Jersey taxation. What we are trying to do, in effect, is retain the status quo. I think to try and extend the principle to foreign businesses is a step too far. We should be aiming to collect tax from local businesses as we do at present.

Senator J.L. Perchard:

Can I suggest that a way of protecting the rights with regard to the point you made specifically over the rights of the minority shareholder could be addressed by an amendment to the memorandum and articles of that company saying that the company will pay a dividend to its shareholders at least equivalent to the estimated tax liability. Would that be a possibility?

Mr. P. Frith:

It may. There may be wider implications. I am not a corporate lawyer but it may be a possibility.

Senator J.L. Perchard:

The position of a minority shareholder is also not only in his possible inability to pay tax on a dividend he may not have received, but the majority shareholder being able to bully, in a sense, for a sale, possibly, and certainly prescribe an unrealistic value for the shares of the minority shareholder. It is not only with regard to dividend, is it? It is the very vulnerable position they are in.

Mr. P. Frith:

Very, very vulnerable, yes. There are lots of shareholders, from what I can tell in Jersey, particularly through long-established companies, where several generations ago it was established by one individual and then as it has moved down through the generations the shareholdings have been split and they are now widely held. It might be possible to amend a company's articles to force a dividend, but I would think that you would meet quite significant objections to that from the legal fraternity.

Mr. D. Stuart (Le Rossignol, Scott Warren & Co):

It seems strange that the majority shareholders would be prepared to change the memorandum and articles to protect the minority shareholders if they are not prepared to pay a dividend.

Mr. P. Frith:

There would have to be a government edict or legislation brought in forcing the company to do it despite its opposition.

Senator J.L. Perchard:

I understand, yes. The vulnerable position of the minority shareholder in your opinion is only and directly as a result of the deemed distribution charge? There is no other part of the proposals other than that?

Mr. P. Frith:

The deemed distribution and the look through on investment companies, that is all, yes.

Senator J.L. Perchard:

Yes. Is there anything you want to add about minority shareholders? It is a very, very important point.

Deputy G.P. Southern:

I am just picking up strands that refer back to the European Code on Business Taxation. You suggested that maybe it would have been better if we had known the colour of the horse we are dealing with before we went down this road. The reality is that because it is a political decision and not a strictly legal decision, you are judging the mind of a politician so it is a difficult one to do. Their interpretation of what you think is straightforward and not company tax may not necessarily be their interpretation, if you are asking for interpretations. That is the danger there. Certainly as you were talking about the scheme as you laid it out, immediately my thought was the Germans will look at that with one eye and the Italians will look at that with another eye and say: "Oh, it is just another way of getting round it if the intention is this is company tax under another guise." Interestingly, you raised this balancing point about what is the position of the minority shareholder if this deemed distribution goes through in terms of human rights. What do you see as the situation with fundamental human rights there? I am interested in that area.

Mr. P. Frith:

Again, I am not a lawyer and I am certainly no expert in the field of human rights, but to me it seems that if one is required to pay a tax on something that one has not received, then that could be an issue. One accepts that other jurisdictions (and obviously we always refer to the UK) have similar legislation. Certainly in relation to UK residents owning foreign companies the income of the foreign company is deemed to belong to the UK resident. But typically that legislation applies to majority shareholders because in the UK's legislation it talks about having the power to enjoy. That definition is quite wide: the power to enjoy. Well, clearly, if I own the majority of shares I have the power to enjoy because I can insist that the dividend is declared. So whilst you have that situation, it is not a novel situation. I would suggest that it is novel in relation to minority shareholders in expecting them to pay tax on

something that they have not received and may never receive. As I say, I am not an expert in human rights, but to me that would seem a basic infringement, being expected to pay something. Of course, the answer is not: "Oh, well, you could sell your shares." Yes, I might be able to sell my shares, but I probably will not be able to sell them to an unconnected party because they would then be in exactly the same position as myself. I could sell them to the majority shareholder, but at what price? Am I going to get market value?

Senator J.L. Perchard:

We are seeking advice from the Attorney General about the human rights compliance of this and it's currently on his desk.

Deputy G.P. Southern:

Can I go on to the question I was going to ask there? You talked about simplicity of the Jersey tax system is something of a virtue, as does the Treasury Minister himself. He prides himself on the simplicity of the tax system. Is it true to say that in going to a multi-tier system, 0, 10 and 20, because you build in an incentive or motivation to avoid tax, to tax plan if you are 20 or if you are 10, that automatically you are going to make the system somewhat more complicated and complex?

Mr. P. Frith:

I think you are right, yes. As soon as you have different rates of taxation, inevitably taxpayers are going to look at those rates and say: "How can I get the benefit of the lowest rate?" That in itself brings in complexity because the State is going to try and counter those benefits or advantages wherever possible. When you look at the proposals, one of the issues which reading between the lines seems to be there in order to deal with the deemed distribution is the suggestion that the distribution be based on profits measured by the accounting basis GAAP (Generally Accepted Accounting Principles). Reading the paper, it appears that it would only be corporate profits that would be required to draw up their accounts under GAAP. So a partnership or a sole trader or whatever would continue to prepare his accounts on the current basis and submit a tax computation. Immediately you have an arbitrage there because if I am sole trader I am probably going to sit down with my accountant and say: "Well, should I be a sole trader and should I also have a company? Because if I am on the corporate basis I am going to get some deductions that I would not get as an individual." For example, in a company if they are prepared on the GAAP basis - and Duncan will correct me if I am wrong - I could make provision for bad debts just on a percentage basis without specifying them; whereas if I am a sole trader, my bad debts have to be specific. In other words, I cannot make a general provision. That is one example where I am better off in a corporate situation than I would be as a sole trader. So if this proposal goes ahead, we are going to have this situation.

Senator J.L. Perchard:

Under the current proposals as drafted, you are likely to be an LTP?

Mr. P. Frith:

If you want to come overcome the RUDL charge.

Senator J.L. Perchard:

What are the implications there with regard to the point you made?

Mr. P. Frith:

I think in the main this is going to be a judgement call on the part of those who at present operate through a company. They are going to have to decide for themselves if the RUDL charge comes to pass whether they are prepared to accept that as a cost. Because if they are not a designated financial services company they are not going to get a credit for that cost against their tax liabilities. Or whether they feel that on balance in order to avoid the RUDL charge it is better to go to the limited trading partnership. Obviously everybody is going to have a different idea. We do not know how much the RUDL charge is going to be. The median rate is stated to be £500 but I imagine that in the agricultural industry it could be somewhat lower and possibly for the hotel industry as well, who knows?

Senator J.L. Perchard:

It says variable by sector, I think, in the design proposal.

Mr. P. Frith:

Indeed, yes. So it will be a judgement call on a case-by-case basis. Of course, it is not simply a question of taking the credit for the RUDL charge against one's tax liability as you will in an LTP. There are other issues that have to be borne in mind if one wishes to convert from a company to an LTP. Is there going to be continuity of contract? For example, if the company has borrowed money on mortgage to finance its development or to extend its premises, et cetera. There are lots of issues, and Duncan and I were discussing the implications for his business before we came into the room. Duncan estimates that they have in their practice alone around 500 trading companies for local businesses. If one of them was to say: "We would like to change over" no problem. But if 500 of them change over his business is going to be a 24-hour-a-day business. The industry generally is already stretched for staff, so whilst from an academic point of view the idea of moving over to an LTP is tenable, from a practical point of view it is going to be difficult to achieve, I would suggest. The other thing that has to be recognised is that many clients, particularly lower down the order, the plumber, the guy who works on his own or the 2-man partnership who are operating through a company, their focus is not going to be on any of this. If you talk to the man in the street and say: "Are you all ready?", they have just managed to grapple with ITIS (Income Tax Instalment System). They are going to have to grapple with GST (Goods and Services Tax) and they have this sort of consideration as well. It is not going to be at the front of their thought processes but the accountants are going to have to deal with it. They and the lawyers are the ones that are going to have to deal with it.

Senator J.L. Perchard:

Limited trading partnerships obviously would be the vehicle used under the current proposals to reclaim your RUDL effectively or not pay your RUDL?

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

Are there any other advantages with LTPs for local businesses? It is suggested that LTPs could be a useful vehicle for international business, but local businesses, are there any other advantages? Do you see yourself advising clients to move to LTPs for any other reason?

Mr. D. Stuart:

From a sole trader point of view, they have the limited liability, which is the only other reason. Obviously you already have that if you are a company anyway, but the RUDL charge would be the only reason. And, of course, I would say the cost of preparing accounts, submitting income tax and working out the deferred taxation charges and everything else on a company is going to be much higher than they are on an LTP because there is going to be a lot more work on the computational side for the accountants.

Senator J.L. Perchard:

I will let you into a secret. RUDL is looking very vulnerable. We had the Minister in this morning and he is taking bullets from all directions, including from us, on RUDL. I think it may be pulled, so that would be a bit of a relief. If that were the case and RUDL was taken out of the design proposal package, is there a necessity to try and recover some tax monies from non-locally owned businesses trading on the Island? Because this is the point of RUDL, is it not?

Mr. P. Frith:

It is, yes.

Senator J.L. Perchard:

Is there a necessity? Secondly, if there is, how do we do it?

Mr. P. Frith:

I think it breaks down into 2 areas. One is what is the loss financially by not taxing such businesses.

Senator J.L. Perchard:

Estimated at £5 million.

Mr. P. Frith:

Yes. So that is obviously a consideration and 5 million is a worthwhile sum. The other question, which is more of a political question, I guess, is whether one should be allowed to operate within a community and not make any contribution in terms of direct taxation. I guess everyone will have a different view on that. My view, for what it is worth, is that if you operate in a community, you use its resources, et cetera, then you ought to be prepared to make a contribution to the society in general for whatever purposes because that in the end is what society is all about. So I do believe that they ought to make a contribution. How one extracts that, if we go to zero tax, is another question. I think it is probably true to say that the majority of foreign-owned businesses that are operating in the Island are public companies. If you look at the High Street, the vast majority would probably be public companies. In the paper it says that in discussions with the UK Treasury there was an indication (it is not put very strongly but there was an indication) that public companies might not be caught by the code. Now, if that is the case, it begs the question as to whether - it is at paragraph 19.1.1 --

Senator J.L. Perchard:

In the code?

Mr. P. Frith:

In the design document. It says: "The position discussed with HM Treasury seems to suggest that publicly owned companies operating in the Channel Islands could be considered as falling outside the scope of the code. It might, therefore, be possible for the Island to consider charging the Island's publicly owned companies which are not specified financial services companies tax at a rate other than the zero per cent rate, i.e. at the 10 per cent rate or another rate." That is certainly worthwhile considering, and again it comes back to the point made earlier that in order to design a system we ought to know the rules under which the system is going to operate, and here we are not knowing. It is not the best position to be in. As I understand it, the desire on the part of the UK and the EU is that if there are any exceptions to the general rate, which will be zero, then they ought to be in the distinct minority. When the changes come to pass, the companies that will be subject to the zero rate are those companies that are registered in Jersey (unless there is a specific exemption because they are financial services), so that would be Jersey-registered companies and all other companies that are managed and controlled in the Island. I understand there are around 35,000 Jersey-registered companies. There are probably several times more than that managed and controlled in the Island registered in other jurisdictions, so the total population of Jersey resident companies paying tax at the zero rate is likely to be 100,000 plus, 150,000, 200,000. Of the public companies that we might seek to tax at a rate greater than zero per cent, in percentage terms it is miniscule. If there are 30 or 40 of those companies, it is miniscule. It does beg the question as to whether instead of having the RUDL charge we apply a 10 per cent rate to a public company. One would have to define the term "public company" in a way that is better than we have at present.

Senator J.L. Perchard:

Many of our investment vehicles are quoted companies, are they not?

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

So it is the distinction which is going to be difficult?

Mr. P. Frith:

Yes. A public company at the moment is defined as a company with more than 30 shareholders or which has issued a prospectus. That is what it says.

Senator J.L. Perchard:

That is all of them, yes. That will be all investment company and they have to be zero. Do you suggest that we could perhaps --

Mr. P. Frith:

You redefine the definition of "public company".

Senator J.L. Perchard:

Well, a public company is a credit company, is it not?

Mr. P. Frith:

Again, I am not a lawyer in this area, but a public company is one in which the shares are listed and tradable. That is either on the Stock Exchange or over the counter. So in either way it takes out all the SPVs (Special Purpose Vehicles) for a start because at the moment SPVs are caught because they issue a prospectus. If you remove the prospectus piece of the definition of "public company" you then have to define what a public company is.

Deputy G.P. Southern:

I think you are giving us food for thought.

Senator J.L. Perchard:

We all know what we are trying to target: publicly quoted or UK trading companies involved in retail, really, is it not?

Mr. D. Stuart:

What would prevent Boots UK forming Boots Private Jersey Company Limited, which could not be then defined as a public company? The Boots Private Jersey Company Limited would then be trading in Jersey and probably would fall outside the definition you are trying to tax anyway.

Senator J.L. Perchard:

It is a bit of a minefield, is it not?

Mr. P. Frith:

Your public company, of course, would include a subsidiary of a public company or a branch; a branch or a subsidiary or the public company itself. It would have to include those, obviously.

Deputy G.P. Southern:

Feel free to correct me. You seem to be saying that almost Zero/Ten, the whole shift, is called into question, that in fact do we really want to be going there?

Mr. P. Frith:

No, I am certainly not saying that. I think that the concept of the Zero/Ten is correct and it applies wonderfully for the vast majority of companies and financial services companies. But there are the bits in between that we are grappling with, and that is where our problems lie. Deemed distribution, extracting tax from the High Street stores run by foreign parents, that is where our problems lie.

Senator J.L. Perchard:

Just before we do move away from Zero/Ten, are you satisfied that the 10 per cent companies are clearly defined or we can ably define them? There is no grey area? Is there opportunity for avoidance there in the 10 per cent? How do we define them clearly?

Mr. P. Frith:

I cannot quote verbatim the definition in the design proposal, but the definition that I read seemed to me to be an acceptable definition. I think of it in terms of a business that is registered or licensed by the Jersey Financial Services Commission.

Senator J.L. Perchard:

As a zero?

Mr. P. Frith:

They will be 10 per cent.

Senator J.L. Perchard:

Sorry, yes.

Mr. P. Frith:

Because they are licensed. In general I am happy with that definition.

Mr. D. Stuart:

Because the Jersey owners of those companies will still be paying 20 per cent tax on their share of the profits from those companies, but they would be getting, in fact, 10 per cent credit because of the tax suffered by the company. So Jersey is still getting a 20 per cent share of the profits made by those companies; it is just getting one tranche from the company and one tranche from the shareholder.

Senator J.L. Perchard:

Are there many Jersey-owned ...?

Mr. P. Frith:

There are lots of trust companies but that is the makeup of it. Clearly the banks are not owned locally, but a large number of the trust companies are, those that have not been bought out by RBC!

Deputy G.P. Southern:

The problems that you envisage around deemed distribution, are they solved by going to actual distribution?

Mr. P. Frith:

No, because if you look at the FTSE100 currently, the yield on FTSE100 companies is just over 3 per cent, so most companies will pay a dividend to reward the shareholder in some way currently. But the vast majority of their profits they would wish to retain to reinvest in the business: finance, stock, work-in-progress, et cetera. So no, they would not distribute their entire profits. That is one of the fundamental problems with the paper. There is an assumption that a company is a moneybox, simply there to roll up profits. But a business, why does a business exist? To grow and develop.

Senator J.L. Perchard:

The Deputy was right that problems would be solved by a shareholder tax on any actual distributions.

Mr. P. Frith:

If we just take an example, if a company makes 100 profit, what the paper is seeking to do is tax that 100 profit on the shareholder, assuming it is a Jersey resident, whereas normally of that 100 profit maybe only 5 would be paid out as a dividend, so the other 95 is retained within the business.

Mr. D. Stuart:

The problem is solved as far as minority shareholders are concerned, but it is not solved as far as the

Revenue is concerned because it is not able to get at a large part of the profits because they are not being distributed.

Deputy G.P. Southern:

So in terms of the Treasury Minister's perspective, under that system the Revenue is taking a tax cut because he is not getting his hands on as much as he might otherwise have done. Certainly with complete look through he feels he would get to ... so there is a revenue loss?

Mr. P. Frith:

Yes.

Deputy G.P. Southern:

Thank you for saying that because the Treasury Minister never managed to get his words round that.

Senator J.L. Perchard:

Because you are aware this is what Guernsey is proposing, that the shareholders would be taxed on actual distribution, what they receive in dividend, and nothing else?

Mr. P. Frith:

Yes. I think that does present a big temptation for controlling shareholders at least to retain profits. There is a lot of reliance being placed on the goodwill of the taxpaying population.

Senator J.L. Perchard:

Indeed.

Deputy G.P. Southern:

Traditionally, that compliance level is a source of satisfaction; that trust is there. Under the new system will that trust be dissipated?

Mr. P. Frith:

As I understand it, Guernsey have presumably drawn up their budget or extrapolated on the basis that companies will distribute their profits and not retain them.

Senator J.L. Perchard:

They are not compelled to under the current proposals.

Mr. P. Frith:

They are not, no. I think for the smaller company, the companies that maybe have 2, 3 or 4 active participators, then in the main, yes, those companies do tend to distribute their profits because they are

the livelihood of the proprietors. But for the larger companies, those that are expanding and developing, those are the ones that will retain their profits. There are many companies in Jersey that are owned by people who have independent means, so there is not going to be any incentive if you have the Guernsey system for those companies to distribute their profits.

Deputy G.P. Southern:

Under that system, the Comptroller of Income Tax would be spending instead of one day in 3 chasing roll-up funds of various sorts spending all his time chasing those to see if they are appropriate and at the right level.

Mr. P. Frith:

Yes, assuming that the law was developed in that way. I do not know fully the Guernsey proposal, but if the proposal was simply that you would only be taxed on what you received from a company by way of dividend, unless the government is prepared to see profits being rolled up within the company you would have to have some way of taxing the shareholders. The UK used to have the shortfall system so if a company did not distribute its profits the shareholder was taxed as if the profits had been distributed. You would have to have some sort of system like that to get at the tax on the profits that have been retained, so you are back to a deemed distribution or look through or whatever.

Senator J.L. Perchard:

It is a tough one. Jersey Finance are saying start off with actual distribution, what is actually distributed to shareholders is taxable, and if it is becoming apparent after a couple of years that, if, as you suggest, there is avoidance -- well, not avoidance because they would not be compelled to pay the dividend, but if it was noted that dividends were not being paid and profits were being rolled up, then to revisit it at a later date. Do you think that would be a prudent way to start?

Mr. P. Frith:

From my point of view it is not very appealing because when we sit down with clients, typically clients want a certain amount of certainty in how they are going to be taxed. If we are bringing in a system, we want this system to be robust and long lasting. I do not think it is good to be saying we will do something now and then if it does not work properly we will do something else. I think we need to have a clear message what our tax system is going to be. We need to be satisfied that it is going to be robust and workable and fair and go with it.

Senator J.L. Perchard:

You have echoed the problem that has been noted by many people, including the panel here. Deemed distribution has its problems; there are opportunities for avoidance; the minority shareholder issue; actual distribution has problems. Where do we go? Where can we practically go that is compliant? I would suggest your suggestion in there is unlikely to be EU compliant. Well, we are informed it is

unlikely to be. Where does Jersey go? If you were the Minister for Treasury Resources, what is your solution?

Mr. P. Frith:

If that proposal that is in the paper is not acceptable, clearly one would have to think of something else, but the room for manoeuvre is obviously very, very limited. I still come back to how do we deal with the position of the minority shareholder. I suppose one way, which is rather cumbersome but it is another way and certainly the UK uses it from time to time, is to give the taxpayer a statutory right of recovery. The taxpayer would have statutory right of recovery. If the taxpayer is taxed on something he has not received, so he has a liability of £50, what the laws says is that if you have not had the dividend to fund that liability then the law will give you, the taxpayer, a statutory right to say to the company: "Pay me the tax."

Senator J.L. Perchard:

It is all trying to plug the holes. We have a big hole in the ship under the water line.

Mr. P. Frith:

I hear what you say about it not being acceptable under the code, but I do wonder and I question as to what extent those who have written the code, that negotiations are being handled through, appreciate the problem of the minority shareholder. They may turn round and say: "Well, it is your decision to go to zero tax and it is your problem."

Senator J.L. Perchard:

I think that is probably what they would say and they would do that with a big smile on their faces.

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

This is really the nuts and bolts of the issue now, is it not, the way that we distribute the profits of a company and the way we tax the profits of a company, whether we look through, whether we deem a distribution or we tax on an actual distribution? Because, as I say, the RUDL is probably on its last legs. I am just trying to think what other points you made in your opening remarks. You spoke about trading and investment companies.

Deputy G.P. Southern:

You talked about symmetry.

Senator J.L. Perchard:

Yes, to do with look through and deemed distribution.

Deputy G.P. Southern:

Can I take you on to a different issue around possible avoidance mechanisms? As soon as you have several levels of tax you have an incentive to avoid tax or to manage your tax. Jersey Finance believe that it is likely that Jersey shareholders may superimpose non-Jersey structures between themselves and their companies, especially of a new business or investment. Do you see that as a threat or as a problem?

Mr. P. Frith:

No. At present with a tax rate of 20 per cent one does not see that happening, so there is no reason to suppose that if the rate was reduced -- which it will not be, in effect, for Jersey residents; they will still pay 20 per cent. I cannot see that there is any great incentive for them to want to do that. In my experience, the desire on the part of local residents to avoid tax is pretty limited, certainly in relation to trading profits, business profits. Where the problems arise with local residents is on investment income. That is where the issues arise typically under the anti-avoidance legislation, et cetera.

Senator B.E. Shenton:

Although we are moving away from being a low tax Island with 20 means 20 and so forth. Do you not think that people will be more encouraged to tax plan in the future? If you look at university funding as a tax because you do not pay it elsewhere, you are looking at people paying sort of 35 per cent tax rate.

Mr. P. Frith:

Under the marginal rate or do you mean with the added costs?

Senator B.E. Shenton:

I am just saying tax planning perhaps has not been quite top priority for local residents because the tax has been low in the past, but taxation is increasing over here.

Mr. P. Frith:

The proposal as I understand it is that if the income of a household is in excess of £80,000 then there will be no personal allowances. So to that extent there is an increase in taxation. There has been an increase in taxation as a result of restriction on mortgage interest relief. There has been an increase due to tax on benefits in kind. All these different things, of course, conspire to increase the tax burden on the general taxpaying population. I suppose it is inevitable that some (I would think a distinct minority) would look to see if they could avoid tax in some way or other.

Senator B.E. Shenton:

No, I am talking about legitimate tax planning to bring your tax bill down. So people would use

loopholes and so on?

Mr. P. Frith:

If it is legitimate tax planning then what you are saying is that it is provided for under the law.

Senator B.E. Shenton:

But they will be looking for loopholes in the Zero/Ten?

Mr. P. Frith:

Such as?

Senator B.E. Shenton:

I do not know. I will let you know. **[Interruption] [Laughter]**

Mr. P. Frith:

It may well happen. The UK have spent years trying to prevent tax avoidance and they have had a degree of success but at a significant cost because the relationship now between the UK Revenue and professional advisers is at a pretty low point. In Jersey we have had an excellent relationship, I would say, with the comptroller; a fair relationship. I think the vast majority of tax practitioners in the Island know where the line is to be drawn. What I would say is that the issues, if you are talking about tax avoidance, really lie with those who are promoting investment products. Because clearly, where you have got a distinction between the taxation of income and the zero taxation of capital, that is where the planning opportunities arise. If you can shift something out of the income category into the capital category --

Senator B.E. Shenton:

Well, that is the case at the moment anyway.

Mr. P. Frith:

But yes, I think that is going to continue. But I do not think the Zero/Ten system in itself is going to encourage it; simply because local residents, if they control the company, are going to be taxed at 20 per cent anyway. Interposing foreign structures in order to pay no tax at all -- well, there may be some that are tempted to do it but even under the existing anti-avoidance legislation - I know that amendments are proposed - that probably would not stand up to attack by the comptroller.

Deputy G.P. Southern:

Yes, it is not that we are not interested in what you say but we have gone over much of this ground this morning as well. You are reinforcing what people have said.

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

Yes but I would like to divert away from that. There are some parts of your submission that are specific to you and have not been repeated elsewhere. You say, Paul that the proposed £150 charge for non-Jersey incorporated investment companies managed from Jersey would be damaging.

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

Why? £150?

Mr. P. Frith:

Yes, it does not sound like a lot of money but a business that I know of has got about 80 companies. So, that is quite a significant cost; you are talking about £12,000. The companies that are registered in foreign jurisdictions that are administered here, they are already paying their administration fees and why should a foreign registered company bear an extra cost compared with a Jersey company? It does not seem right to me. Although it is not expressed as a tax-raising measure, of course, that is what it is. It is just another mechanism for raising additional funds.

Senator B.E. Shenton:

I think also Jersey is quite expensive anyway is it not to do business here - I know I should not be making comments but (...several inaudible words).

Mr. P. Frith:

What we are talking about here of course is the cost of administering a company and clients will consider the cost on a jurisdiction by jurisdiction basis. If they have got, in that example, 80 companies, it is an extra £12,000 a year on top of what they are already paying. You do not need much in a client relationship to tip the balance. There might be a change in personnel who are dealing with the client, one or 2 other things that he is a bit unhappy about and: "Oh, on top of that I have got this extra £12,000. I may as well go to Guernsey and have it done just across the water; save myself all that money and get a ..." you know? It does not take very much to change a relationship and I would, in imposing any extra costs compared with other jurisdictions, always be very wary. It may well be that the vast majority will just accept it. But I do not know how much this will be worth to the Island; probably quite a lot.

Senator J.L. Perchard:

Yes, any idea of how many non-Jersey incorporated investment companies there would be?

Mr. P. Frith:

Oh, 100,000 possibly.

Senator J.L. Perchard:

Would there really?

Mr. P. Frith:

Yes, at least 100,000.

Senator J.L. Perchard:

So, we are talking £15 million?

Mr. P. Frith:

Yes. It could be a lot of money.

Mr. D. Stuart:

Some of our trust companies within the Island have a vast number of these companies and it could be quite attractive to them to shift their whole operation if costs in Jersey are seen to be that much higher than costs somewhere else. That would be very significant.

Senator J.L. Perchard:

A non-Jersey incorporated investment company would pay what currently for a licence?

Mr. P. Frith:

If it is registered overseas?

Senator J.L. Perchard:

Yes. It pays nothing?

Mr. P. Frith:

In Jersey it does not pay anything.

Senator J.L. Perchard:

Nothing to Jersey. The proposal is to manage it.

Mr. P. Frith:

Managed. Yes.

Senator J.L. Perchard:

(...several inaudible words)

Mr. P. Frith:

It does not pay any government fees in Jersey.

Senator J.L. Perchard:

Yes, it does not pay any but as a ...?

Mr. P. Frith:

It will pay registration fees in BVI or wherever it is registered.

Senator J.L. Perchard:

But it will pay zero in Jersey and the proposal is to charge them £150?

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

Yes. What do they pay in management fees in Jersey?

Mr. P. Frith:

In Jersey? I suppose it depends on the level of activity and what the fee basis is with the client. But at the moment, the Jersey trust company would charge for provision of directors which would vary from trust company to trust company. It might be £500 per director, it might be £2,000; it depends on who you go to. But the benefit for the trust company, of course, is that it is administering the assets of that company and by so doing it is generating fees in respect of its activities. Which in turn, form the tax basis in Jersey for the trust company.

Senator B.E. Shenton:

Can I just point out that Richard and Brian are not allowed speak during the Scurinty Hearing. It is just that Richard keeps whispering and I didn't want you to think he was shy. **[Laughter]**

Senator J.L. Perchard:

This is a political process, unfortunately, and on such a complicated subject as this I would have been very happy if Richard could have led because he is our professional adviser and we are very grateful to him as well. Gentlemen, are there any other areas that we need to explore? You did touch on management fees there before and I cannot remember in your submission whether you did highlight the

fact that management fees will not be deducted. Was it you that highlighted that?

Mr. P. Frith:

Yes, on investment companies.

Senator J.L. Perchard:

On investment companies?

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

Would you just like to explain on that before we break up?

Mr. P. Frith:

Well, the position presently is that if I, as a private individual, have my own private investment company and I use Duncan's firm to manage my company, he will make charges against that company for the work that he does.

Senator J.L. Perchard:

Yes. Okay.

Mr. P. Frith:

In addition to that, his firm might provide a couple of directors and charge a fee for that. So, the company itself will have management expenses which are incurred because I have got someone else managing my company for me. That happens quite a lot in Jersey, lots of people do that.

Senator J.L. Perchard:

Yes. Yes.

Mr. P. Frith:

The fees that are charged go in to Duncan's firm, they form part of his firm's taxable profits et cetera. Hitherto, those management expenses have been deductible in arriving at the income taxable in Jersey on the company. The proposal, as I understand it, is that in future those management fees would no longer be allowable.

Senator J.L. Perchard:

Yes, very good.

Mr. P. Frith:

I question whether that is the right thing to do. The end result would be that you would pay 20 per cent on that. Yes, if the company had an income of 100 and expenses of 10, it would still pay what its shareholder would pay tax on; the 100, not on the 90. At present it would only pay it on the 90.

Deputy G.P. Southern:

But the other company that was managing would pay tax on its profit?

Mr. P. Frith:

On its 10 less the expenses --

Deputy G.P. Southern:

On its 10 less its expenses?

Mr. P. Frith:

Yes.

Deputy G.P. Southern:

Unless it is paying wages too.

Senator J.L. Perchard:

Obviously, you have described management in the case here but that would also be bank fees, accountant's fees, bank charges including interest, company registration fee?

Mr. P. Frith:

Yes.

Senator J.L. Perchard:

So, your view on that as you have described it is not to resent or allow them to be used against your profits. Are you worried about that?

Mr. P. Frith:

Well, first of all, I question whether a paper such as this is the correct place to be putting forward a radical - in Jersey terms it is radical, believe me - because there are lots of private people in Jersey with their own investment companies. One might say: "Well, they can afford to pay." Well, maybe they can but hitherto they have been used to having their companies managed for them. The management expenses have been allowed and somehow it has got into this paper that that relief should be terminated. I do not understand why it has not come from a political decision rather than to be in this paper.

Senator J.L. Perchard:

To be wrapped up in this proposal. Yes, it is a bit like the RUDL charge is it not? What is RUDL, does it do a Zero/Ten?

Deputy G.P. Southern:

An idea that's been floating around in the background and we'll just squeeze it into the paper. The net effect would be, from what you have been saying to me, that the taxman gets slightly more tax basically?

Mr. P. Frith:

Yes.

Deputy G.P. Southern:

Because without .expenses that is what he is taxing profits without expenses.

Mr. P. Frith:

Yes.

Deputy G.P. Southern:

You are not allowed to deduct that. So, it is a slight increase in the tax take (...several inaudible words).

Mr. P. Frith:

There is one investment company that I am aware of that has 13 or 14 shareholders; so, each of them are in a minority. They are going to subject, under the proposal, to the look through. None of them can force a dividend. The investment company itself incurs, fees, expenses, director's fees to one particular individual who runs it on behalf of everybody else. So, he will take his director's fees and he will pay tax on those fees but the fees will not be allowable to the investment company in arriving at the look through charge. So, to that extent, there is double taxation. I just think, in the great scheme of things, it seems rather minor. But for a lot of Jersey residents, it will be another erosion, if you like, of this fine place in which we live.

Senator B.E. Shenton:

So, if a shareholder is also a director will he pay double tax?

Mr. P. Frith:

Well, the shareholder, if he is a director, he takes out his director's fees he will pay tax on those director's fees --

Senator B.E. Shenton:

Yes and he will be assessed...?

Mr. P. Frith:

But he would also be assessed on the income of the company.

Senator B.E. Shenton:

Before the director's fees?

Mr. P. Frith:

Before the director's fees.

Senator B.E. Shenton:

So it's double tax...

Deputy P.J.D. Ryan:

It is driven, we are told, by an anomaly that exists. If you have investments without having a corporate structure to put them through, you are not allowed to claim management fees or professional advice from an individual, so therefore the company should not.

Mr. P. Frith:

Yes, I understand that.

Deputy P.J.D. Ryan:

It is the inequity between the 2 that is driving it. What do you say to that?

Mr. P. Frith:

I can see that there is an argument there. What I would say though is that the law which has existed for decades has provided relief for management expenses and it is one of the attractions, if you like. I deal with quite a number of wealthy people and I deal with quite a number of 1(1) K's, which we have not touched on at all in our discussions so far. But it is a very important part of our economy and as we go forward the wealthy people in the Island are going to become increasingly more important, in my view, if you go to zero tax and everything else. So, what we want to do, as a business community, if you like, is to preserve our tax base as far as possible and if possible, increase it. By removing what, in the great scheme of things, must be a pretty minor allowance, to me does not strike the right notes. It sends out the wrong message to wealthy people.

Deputy P.J.D. Ryan:

Do you think it should be the other way around? Do you think there is an argument which says that an individual that does not have a company but who gets taxed upon investment income, without a

company if he is being charged professional fees for whatever nature --

Mr. P. Frith:

I know what you are saying.

Deputy P.J.D. Ryan:

-- is there an argument that he should be allowed to reduce his tax? Should he be allowed to offset his management fees outside of the company? So, it might just have the effect of fewer investment companies and more people then would have -- would it go the other way, would we have less companies?

Mr. P. Frith:

The people that have investment companies are certainly at the higher end of the wealth spectrum. The ones that do not have the investment company are at the lower end, typically. That may be a bit of a generalisation but I think it is probably fairly typical. Those at the higher end are already paying their full whack anyway. When we move to 20 means 20, those people are going to be paying their 20 per cent anyway on the top slice of their income. They are not going to get any personal allowances or reliefs. So, to my mind, if they are getting some management expenses allowed through a company, it is a drop in the ocean in the great scheme of things. The guy that is lower down the wealth spectrum, he does not need to have his investment managed if he has got his money on bank deposit account there is no management that is involved in it. So, you may say: "Well, surely he should be given a relief so that he is put on a par with the wealthier person with his investment company?" I do not think that that adds up.

Mr. D. Stuart:

Generally, a smaller investor would not have any expenses of managing investments and so --

Deputy P.J.D. Ryan:

Yes but the reason for cutting it out of the company is that it is unfair on the smaller ones. But if you are saying that the smaller one generally does not have any --

Mr. P. Frith:

He would not have any normally.

Deputy P.J.D. Ryan:

-- and undermines the reason for not --

Mr. P. Frith:

Yes. People do not form investment companies and put their investments into it so that they can incur

money --

Deputy P.J.D. Ryan:

Charge for management fees.

Mr. P. Frith:

If they were capable and competent and could manage their own investments and produce an income and expenditure account and file it with the comptroller and do all the rest of it, they would not need to employ professional advisers. But it has to be accepted, like it or not, that there are thousands of people living in this Island who are wealthy individuals and they need help and assistance in order to run their financial affairs.

Deputy P.J.D. Ryan:

A widow typically?

Mr. P. Frith:

Yes. [Laughter] A widow (...several inaudible words).

Senator J.L. Perchard:

Debate on this writing up the report. It could be very --

Mr. P. Frith:

There may be many wealthy widows.

Senator J.L. Perchard:

Yes, of course. Yes and not only help but the best possible advice.

Mr. P. Frith:

There are other reasons apart from just being able to write off management expenses. If one holds investments in a number of jurisdictions in one's own name, then ultimately on death the executors of the estate have to apply for a grant of probate or whatever in the various jurisdictions. To have all the assets centralised in an investment company takes away that problem. You have got one grant of probate for the Jersey shares and that is it. That is a big bonus and it is also a tax saving measure as far as the UK is concerned because people do not want to hold assets directly in the UK. They want to hold them through their Jersey companies so they do not have UK estate exposed to inheritance tax.

Senator J.L. Perchard:

We will be writing to the Minster, it is something we should have tackled with him this morning, asking him the estimate of the yield from not writing off management fees. Once I have got that information, I

will be quite happy to forward it to you.

Deputy P.J.D. Ryan:

I asked the question of the Minister and others as to whether they felt that by doing that, there was a danger that people would move their investment companies to Guernsey. We were told: "Oh well, it will not matter because we will still look through that Guernsey company. " Do you think that is practically what will happen or do you think there is a danger that ...? Because, of course, the other side of that is that all right, you can still look through the Guernsey company but will people do that? Is there a reason to move an investment company off-shore or off the Jersey shore?

Mr. P. Frith:

Yes, typically, for a Jersey resident there is not any merit in doing that because he would be advised that by doing so the comptroller could invoke Article 134A and according to the paper, the avoidance legislation is going to be tightened up even further. So, I cannot imagine that there would be any benefit at all in a taxpayer doing that. There would be no net benefit.

Senator J.L. Perchard:

Gentlemen, anything that you feel that we have missed. As Geoff said, we have had a morning of it and a lot of the stuff is being regurgitated.

Deputy G.P. Southern:

But you have given us a couple of real meaty points that we appear to have overlooked, I think, that we need to discuss with the Minister.

Senator J.L. Perchard:

If anything springs up to mind that you wish you had mentioned, please get back to us. We certainly echo your concerns with regards to deemed distribution and RUDL, particularly. I think that is being heard loudly by the Minister. The design proposal documents, we have had a good session this morning, will be amended before it goes to the States but nobody is quite sure as to how. So, we will be working on that with the Treasury. Thank you. Unless there is anything else you would like to add? I would like to thank you very much for your submissions and your time today and declare this session closed.

Mr. P. Frith:

Thank you very much.