Report to The Corporate Services Scrutiny Panel

The implications of the Proposal to move Prior Year Basis Jersey Taxpayers on to a Current Year Basis of Taxation

The Tax, Public Finance and Tax Administration aspects of the Proposal

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1. The Proposal

1.1 The proposal, set out in the Draft Income Tax (Amendment No 46) (Jersey) Law provides the following:

- The suspension of 2019 tax liabilities for Prior Year Basis (PYB) taxpayers
- The reallocation of payments made by PYB taxpayers in 2020 against their 2019 liability, instead to their 2020 liability
- For those subject to the Payment on Account (PoA) tax payment rules, the suspension of the payment due by 30 November 2020 which would normally be the final payment of the 2019 liability
- The commencement from 1 January 2021 of a full Current Year Basis (CYB) basis for all taxpayers. The tax liability for a year will be based on income for that year. Interim payments (payments on account and Income Tax Instalment System (ITIS) rates for employees) will be calculated based on the preceding year's income.
- The payment of the suspended liability will be the subject of Regulations, which are yet to be published.

The reasons for the proposal

Fiscal stimulus

1.2 The Report on the draft legislation[1] which is to be found as part of the draft legislation online (and will now be referred to as "the Report") states in its Introduction that the plan for the CYB implementation has been accelerated

> *"In the light of the coronavirus (COVID-19) pandemic, in order to provide a short-term cash boost to those most financially affected by the Government's lockdown measures"*

1.3 At para 8 the Report expands on this statement:

> *"As part of the Government's post-pandemic fiscal-stimulus measures (to repair Jersey's economy and restore Islanders' livelihoods) … This would keep money in the pockets of many current PYB taxpayers in the short term, helping them individually and also serving to help boost the economy"*

1.4 In Para 20 the report refers to

> *"… main stimulus benefits of this proposal… "*

It is clear that the acceleration of the proposal that at some point Jersey would implement a move to the CYB is being presented as a fiscal stimulus, and specifically in the light of income reduction due to COVID-19.

[1] The Draft Income Tax (Amendment No. 46) (Jersey) Law 202-

1.5 The Comptroller for Taxes is quoted[2] as stating that the value of the stimulus in the current year is between £18 million and £20 million. However, the responses to the survey indicate that 56.9% of PYB taxpayers stated that they have not suffered a fall in income in 2020. It is therefore likely that around £10 - £11million of that benefit will be bestowed on taxpayers who do not need additional support. This is discussed in more detail at paras 1.14 to 1.16 below. In addition, taxpayers currently taxed on a current year basis will not receive any support from this measure.

1.6 In contrast, when repayments start, the anticipated sum drawn back from affected taxpayers will be of the order of £330 million, which if spread over ten years will cost those taxpayers £33 million a year, significantly more than the amount of relief given in the current year. It is fair to say that taxpayers' personal finances might be in a better state by the time repayments start, but this would depend on how the Jersey economy recovers from COVID-19. It is difficult to see how, taken as a package the proposal can be seen as either a fiscal stimulus or relief for taxpayers.

1.7 Looking solely at the proposal to cancel the November tax payments due for Payment on Account (PoA) PYB taxpayers (that is, those not in employment who pay their tax in lump sums twice a year), this is undoubtedly a fiscal stimulus. However it is impossible to consider that aspect of the proposals alone. The proposals involve 'freezing' the 2019 tax liability for PYB taxpayers and collecting this by a method yet to be specified, but likely to involve payments over a five to ten year period. The impact of the repayment proposals in considered below at Section 3 of this report, but taken together, it is impossible to regard the proposal as a fiscal stimulus. The Report does seem to accept that, also at para 8:

> *"It would, in the longer term, provide a temporary and significant increase in cash flow for Government"*

And at para 16, under the heading 'Effect on cash flow' The Report acknowledges:

> *"It is acknowledged that the proposal, while reducing Treasury cash flow in the shorter term, would effectively accelerate tax payments into the Treasury that might otherwise take longer to collect. PYB taxpayers would experience a shorter-term benefit from the deferral of 2019 taxes but a longer-term cash flow cost from having to pay the 2019 tax bill over a fixed period of time, earlier than they might otherwise pay it."*

1.8 It is also worth noting that taxpayers paying under the Income Tax Instalment System (ITIS), that is those who pay tax monthly as it is deducted by their employer from their wages, will not see a marked benefit, or fiscal stimulus of the change as they will continue to pay tax each month. They cannot benefit from their ITIS rate being reduced to reflect their (possibly) reduced 2020 income unless and until Revenue Jersey is aware of the level of that income.

[2] https://www.bailiwickexpress.com/jsy/news/plans-scrap-prior-year-tax-paying-system/#.X4v9atBKjD4

So any perceived benefit is not automatic as the rates will only be adjusted when information (or a tax return) is delivered to the tax authority. There is a suggestion of this in para 9 of the Report:

> *"All taxpayers' 2020 tax liabilities would be finalised in 2021 following receipt of the 2020 tax return. It will be advantageous to taxpayers to file online where they can to accelerate this process."*

Key finding 1 : The proposal's aim for the change to act as a fiscal stimulus to support taxpayers affected by the pandemic does not stand up to detailed analysis.

Benefits of moving Islanders to a CYB – perceived problems with PYB

1.9 The Report also states in the Introduction that

> *"The longer-term benefits … of moving all Islanders to CYB would also be realised"*

1.10 Before setting out the perceived benefits of a CYB tax system, the Report outlines the perceived problems with PYB. I shall now comment on these in turn, using my 30+ years of experience in tax and tax administration.

1.11 Under Part 1: Prior year basis (PYB) report proposals at para 5 the Report states:

> *"The problem with paying on a PYB are well known. Where taxpayers' circumstances change and their incomes reduce, it can be difficult to pay a prior years' tax bill on a current year's income."*

The examples provided include the following:

> *"When a PYB taxpayer loses their job or faces a significant drop in income. In 2020, many Jersey household incomes have been badly affected by the coronavirus pandemic"*

1.12 My experience of UK taxation is that significant reductions in income are more challenging on a PYB than on a CYB, and that unless a tax reserve (savings account) is carried related to income as it arises then tax liabilities can be difficult to meet following a drop in income. There is no reason to think that the issues in Jersey would be any different.

1.13 However, the advantage for taxpayers in being taxed on a PYB is that as income rises, tax is paid on a lower amount of income each year. The effect of this is that taxpayers experience a lower effective rate of tax when income is rising. Income will generally rise from a taxpayer taking up their first job, as the effects of inflation and progress through promotion etc increase their income.

> <u>Example</u>
>
> A taxpayer with income rising by 5% a year bearing a rate of tax of 20% flat on that income will experience an actual tax rate of 19.05% in paying tax in the year based on the PYB.
>
> However, when income reduces the experience of the taxpayer is the reverse. With a 5% annual drop in income the taxpayer above experiences a 21.05% actual tax rate.

Current actual experience of income reduction in Jersey

1.14 In fact, the evidence available to date suggests that the PYB taxpayers who have suffered a reduction in income are in the minority. Respondents to the Government survey[3] associated with the proposed changes (albeit only a small sample of taxpayers) indicated that only 32.66% overall had experienced a reduction in their income, and when replies only by confirmed PYB taxpayers are taken into account, only 34.4% said that their income had reduced. Some caution is needed: the response rate was very low indeed – only 3.6% of all Island taxpayers responded to the survey, and only 4.4% of PYB taxpayers – those directly affected by the proposals.

1.15 In addition, reviewing the most recent Index of Average Earnings Report[4] the overall position in Jersey in June 2020 was that average earnings were up by 1.1% against June 2019. By June 2020 most businesses were again operational following the Covid measures introduced in March 2020. Looking in more detail at the data in the report, it is clear that the headline figure masks some wide variations in average earnings.

1.16 Average earnings in the public sector during the period June 2019 to June 2020 increased by 3.3%. In the private sectors all sectors reported increases in excess of inflation with the exception of electricity gas and water (0% increase against inflation of 0.5%), Hotels, restaurants and bars (decrease of 10.2%) and agriculture (decrease of 11.5%). The hospitality sector will mainly employ younger workers, who are therefore likely to be taxed on a CYB and for whom this change does not offer any additional support.

1.17 A further issue described by the report as a problem with PYB is

> *"When people retire and have to pay a full year's PYB liability for (usually significantly lower) pension income."*

1.18 The proposition that this is a problem is not borne out by the evidence from submissions to the Panel.

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[3] Prior Year Basis (PYB) Tax Reform Public Survey Report dated September 2020 and published by the Government of Jersey at https://www.gov.je/SiteCollectionDocuments/Tax%20and%20your%20money/R%20PYB%20Tax%20Reform%20Survey%20Findings%20Report%20-%20FINAL.pdf

[4] Index of Average Earnings June 2020 published by Statistics Jersey

> *"I manage my household finances and plan for the future as do many others. My mortgage ends 4 years before my official retirement age. I had planned that this 4 year period is where I would start to overpay my income tax to clear the difference between tax payable on my salary and my pension."*[5]

> *"As it stands, I will pay income tax until death (if pensions warrant it) with my estate paying the additional year"*[6]

> *"We are aware of the "bump" in liability that is generated by one's last year of working, whilst in one's first year of retirement. Personally, we are preparing to save a little in our last 20 years of working to flatten this "bump" out."*[7]

1.19 It is difficult, without further evidence, to support the suggestion that this is a real issue for Jersey taxpayers. However, the Report does accept in para 6 that:

> *"As they approach retirement, some PYB taxpayers do make arrangements to pay more tax each year to pay off (or reduce) their PYB tax liability – so that they do not face a large bill in their first year of retirement. Others' final tax bills are only settled after they have died."*

1.20 One further issue proposed by the Report is:

> *"When an individual leaves Jersey for a jurisdiction where people immediately start paying taxes on a current year basis (such as the UK). They may often be asked to pay 2 year's taxes in one year and may default on the payments due to Jersey."*

1.21 Pursuing taxpayers who have left the island and have outstanding tax liabilities under PYB represents an administrative cost, and it is possible that the eventual tax liability will be difficult to collect. However, with the current proposals for CYB tax payments, there would still be a residual tax liability when a person leaves Jersey permanently, albeit a smaller one than experienced under PYB.

Example

John, who is self employed, leaves Jersey in August 2022 and does not intend to return. His annual tax liability has been £6,000 for many years. His income in 2022 to his date of departure produces a liability of £4,000.

Under the PYB, at the point of departure, John would owe tax for the balance of 2021 (due in November 2022) of £3,000 and for 2022 of £4,000. Revenue Jersey would then be left trying to collect £7,000 after John has left the Island.

Under the CYB, John would have paid all of his 2021 tax by May 2021, and thus would only owe his tax for 2022, an amount of £4,000.

[5] Email to the Scrutiny Panel dated 11 September 2020
[6] Email to Scrutiny Panel dated 18 September 2020
[7] Email to the Scrutiny Panel dated 28 August 2020

1.22 There is therefore no doubt that moving to the CYB would reduce tax owed by those who leave the island, but the administrative effort in collecting this tax would still be an issue, as the same time would need to be spent tracing and contacting the taxpayer.

***Key finding 2**: There is limited evidence that the income reduction that the change is seeking to ameliorate is widespread amount the population of PYB taxpayers. Undoubtedly some have been affected, but this would appear to be the minority.*

***Key finding 3:** There is evidence from those have made submissions to the panel that their financial planning accepts a final liability on retirement and in general taxpayers have made arrangements to cover this.*

***Key finding 4:** The suggested benefits of a CYB in relation to taxpayers who leave Jersey are minor. There is likely to be a residual tax liability even under CYB*

Benefits of moving Islanders to a CYB - Anticipated immediate benefits of a CYB

1.23 The UK moved from a preceding year basis to a current year basis of taxation for over the period 1994 to 1997. The precise timing of how this was achieved is explained in Section 4 of this report starting at para 4.12. However, the proposal for the move was put forward on grounds of simplification and fairness. My practical experience of the change was exactly that. I would not disagree with the premise that the change will be for the better in the long term, but the immediate consequences are much less palatable than they were with the change in the UK. This is dealt with in Section 3 later in this report (starting at para 3.18).

1.24 The Report offers a number of short-term benefits of moving to CYB at paragraphs 10 and 11. In essence para 10 identifies particular types of taxpayer who will benefit from the proposals. I will comment on these in turn. They are listed as:

> *"Self-employed people who have faced a down-turn in business during 2020 and who may still be in a recovering position through 2021. Without this proposal, many of these people could be faced with a potentially large 2019 balancing payment in November 2020."*

1.25 It is absolutely certain that those PYB taxpayers paying tax by Payments on Account (PoA) in May and November will benefit from the cancellation of their payment due on 30 November. But as observed above, the proportion of PYB taxpayers who have experienced a drop in income would, on the available evidence, seem to be in the minority, so this benefit may not be well directed at those who most need help. Indeed some of the benefit will quite clearly be directed at taxpayers who have seen their income increase during the pandemic.

1.26 Another group of taxpayers benefitting from the change to CYB is described as follows:

> *"Employed people whose income has reduced during 2020 and who may still be in a recovering position through 2021. Their ITIS deductions may now not be paying off their 2019 tax bill so they are accumulating debt to pay off later. A larger tax bill and higher ITIS effective rate in 2021 can be avoided if PYB taxpayers are switched to CYB for the 2020 year of assessment."*

1.27 However, what this comment fails to recognise is that the proposed changes will accrue a much larger debt in respect of 2019 than the benefit due to diminished income (if indeed it has reduced – see paras 1.14 to 1.16 above). Those people will be faced with a debt equal to their full 2019 liability, rather than part of it as is the case now. For this group of taxpayers it is difficult to see the benefit of the change.

1.28 The final group of taxpayers which the Report describes as benefitting in the short term are:

> *"Pensioners whose pensions are dependent upon returns from the stock market."*

1.29 It is not clear what the Report is meaning by this statement. I take it to mean that the removal of the November 2020 PoA will provide them with some financial relief. However, the resulting crystallisation of the 2019 tax liability as a consequence of the changes imposes additional tax liabilities for many years on those on largely fixed incomes. No suggestion as to how these taxpayers will meet those liabilities has been put forward, and it is likely that taxpayers in this position will be forced to sell assets (including income bearing assets intended to support them during their retirement) to meet the liability.

Benefits of moving Islanders to a CYB - Longer term benefits

1.30 The Report goes on in para 17 to set out the longer-term benefits on moving to a CYB. It describes these as

> *"the longer-term benefits that would arise from everyone in Jersey paying income tax as they earn income"*

This statement is questionable as without a fully implemented PAYE system, or the ability to file tax returns and receive an immediate assessment (or make a self assessment) the notion that Jersey taxpayers will be paying tax on their income as they earn it is difficult to argue. I have demonstrated why, and the issues that prevent this being so in Section 2 below at para 2.11 and Illustration 3.

1.31 The specific advantages listed form a series of bullet points. I do not intend to comment on every advantage listed, but some are worthy of comment. The first of these is the following:

> *"Most commonly, people who leave Jersey for the UK would no longer have to settle a PYB tax bill in Jersey while immediately paying as they earn in the UK. This would also help Government reduce the costs associated with managing offshore tax debts."*

1.32 As I have set out in para 1.21 above and the related example, there are no real changes to the administrative cost of pursuing such debts. Most taxpayers leaving Jersey will still have a residual liability, unless by chance their ITIS rate has correctly reflected their actual liability for the year. The problems associated with this are described in para 2.11 below. The only fiscal effect would be in relation to tax debts that end up be uncollectable and are written off. There could be a fiscal advantage in this case, as the residual debt is likely to be lower.

1.33 Another benefit is described as:

> *"It would prevent CYB employees effectively becoming PYB pensioners when they retire, as they do now. This can mean people pay no tax in their first year of retirement but then can end up with a tax bill to be paid out of their testamentary estate if they do not make arrangements to pay it earlier."*

1.34 It is true to say that the move from CYB to PYB would present some issues, both in understanding their tax position, and in cash flow. However, the resulting one year without tax due occasioned by the move to PYB would help somewhat with any residual liability to tax under CYB before retirement.

1.35 The responses we received indicated that taxpayers understand the need to prepare for this change. Additionally, the demographic suggests that this is not a major problem at the moment in need of urgent resolution – most CYB taxpayers have either arrived on Island since 2006 or joined the ranks of taxpayers since that date. It is therefore unlikely that this issue affects taxpayers on a widespread basis at the current time. This is, however, a general issue that supports the move to CYB at some point.

1.36 Other longer-term benefits include:

> *"It simplifies the tax system, making it easier to understand and for Government to administer."*
>
> *"It is fair and more equitable, because everyone is paying off the same year at the same time, and is affected simultaneously by changes to tax legislation (e.g. increases in allowances)."*
>
> *"It is more responsive, because adjustments to effective rates can be made more quickly in response to fluctuations in income and to life events (e.g. birth of a child)."*

1.37 It would be difficult to argue with those statements. The experience in the UK of the move from PYB to CYB for self employed taxpayers is most certainly of simplification and perceived fairness. The moving of the tax base to a current year basis in Jersey would also allow changes in circumstances to be reflected in current period ITIS deduction, provided of course the taxpayer notifies the Revenue authority which responds quickly

1.38 The final proposition worthy of comment is:

> *"Everyone pays their Long-Term Care (LTC) contribution on a current year basis. The current discrepancy between PYB income tax and LTC (paid on a current year basis) is often difficult to explain and can be confusing for taxpayers."*

1.39 The Panel was not presented with any evidence to support this assertion, nor did any submission refer to this point.

Impact on Government Finances

1.40 The Report on the proposal made little mention of the direct impact on Government finances, apart from a reference in para 8:

> *"It would, in the longer term, provide a temporary and significant increase in cash flow for Government"*

And in paragraph 16, under the heading "Effect on cash flow" the following statement:

> *"It is acknowledged that the proposal, while reducing Treasury cash flow in the shorter term, would effectively accelerate tax payments into the Treasury that might otherwise take longer to collect."*

1.41 A prior year basis will obviously bring tax in based on actual economic activity one year later than under a current year basis. When an economy is growing, this delays the tax receipts by a year, but the growth inherent in an expanding economy makes this largely neutral on Government revenue from taxes, provided forecasting of tax receipts is accurate.

1.42 One might argue that the prior year basis makes forecasting revenues from tax easier, as more data is available. However, it is not absolutely clear how the income tax projections cope with the mix of CYB and PYB taxpayers, and in particular what the recurring adjustment of £8m[8] a year represents.[9] This adjustment was adversely commented[9] on in an independent report produced by the Chartered Institute of Public Finance and Accountancy (CIPFA).

1.43 The type of change proposed in Jersey is commonly used to provide a one-off boost to Government finances without raising the headline rate of tax. This technique has been used repeatedly by UK Governments over the last decade due to the political concern over apparent tax increases. In order to hold all major tax rates steady but increase Government income the payment period for various taxes has been reduced.

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[8] Corporate Services Scrutiny Panel report on Budget 2018 prepared by CIPFA published in November 2017 para 3.6 and Figure 58

[9] Corporate Services Scrutiny Panel report on Budget 2018 prepared by CIPFA published November 2017 para 7.6

- Acceleration of payment of Capital Gains Tax on the disposal of residential property from between 10 months and 22 months after the disposal to 30 days after the disposal (implemented April 2020) : projected yield £1.2 bn[10] on a tax which yields annually £9.5 bn[11], an effective increase over two years of 12.6%.
- Acceleration of payment of corporation tax by very large companies implemented in April 2019: projected yield £9.85 bn on a tax which yields £54.6bn[12], an effective increase over two years of 18%.

1.44 The exact impact on the Jersey Government finances will depend on the repayment term for the 2019 tax liability. If the liability was to be collected in a single year it would produce one off additional income yield of £330 million on a base of income tax receipts for 2019 of £586 million[13], a 56% uplift in terms of income tax alone. Seen related to total Government income in 2019 (£845m) it would be an extra yield of 38.5%. Spreading over five years would increase Government revenues from all sources by 7.7% a year over the period of collection, or approximately 4% if collected over a ten year period.

Key finding 5: *The proposed changes, and in particular, the freezing and subsequent collection of the 2019 tax liability for PYB taxpayers will result in a very significant increase in Government funds.*

[10] UK Budget Autumn 2017 Red Book page 29 Published by HM Treasury 22 Nov 2017
[11] UK Capital Gains Tax Statistics 2018-19 published by National Statistics 13 Aug 2020
[12] UK Corporation tax statistics 2018-19 published by National Statistics 24 September 2020
[13] Treasury and Exchequer data published on Gov.je

2. The practical impact of the change

2.1 The following illustrations are intended to aid understanding of the practical effect of the change on taxpayers and their tax payments. In most cases I have illustrated the impact of the change on a particular set of circumstances by bar charts showing the tax payments under PYB and CYB in different colours.

2.2 In all cases I have ignored the impact of the repayment of the 2019 liability, as this will be dealt with separately.

Illustration 1 – self employed taxpayer making payments on account (POA)

2.3 The following diagrams illustrate the impact for PYB taxpayers of the transition to the CYB. With income that is broadly level, there is no real change in the tax payments, apart from the omission of the November 2020 payment.

Figure 1A Tax payment dates for PYB Payment on Account (PoA) taxpayers

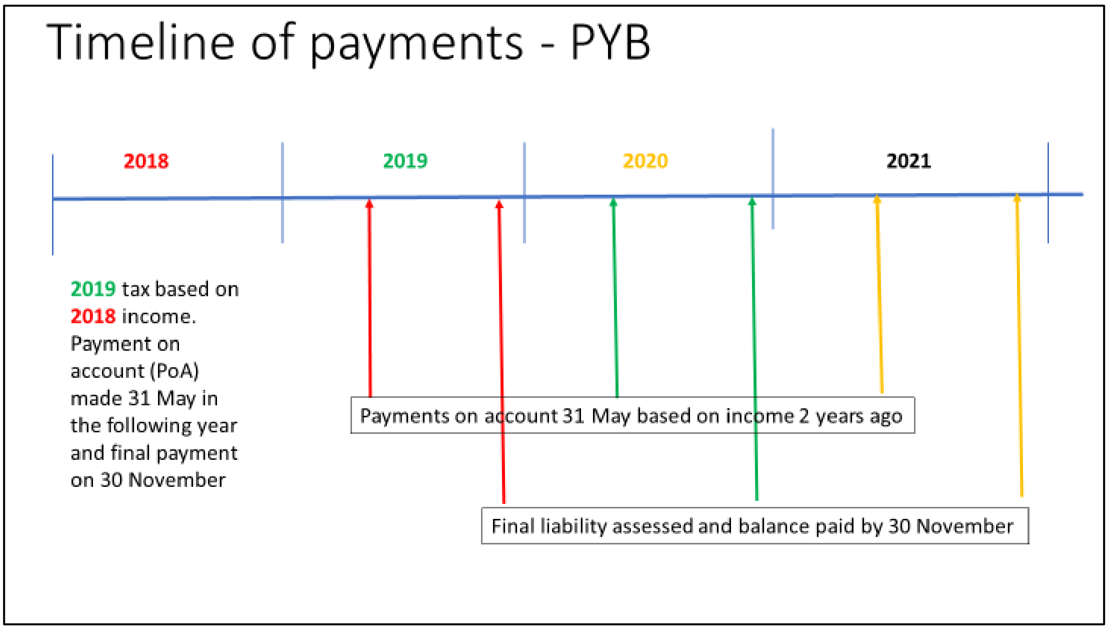

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Figure 1B Tax payment dates for PYB PoA taxpayers during transition to CYB

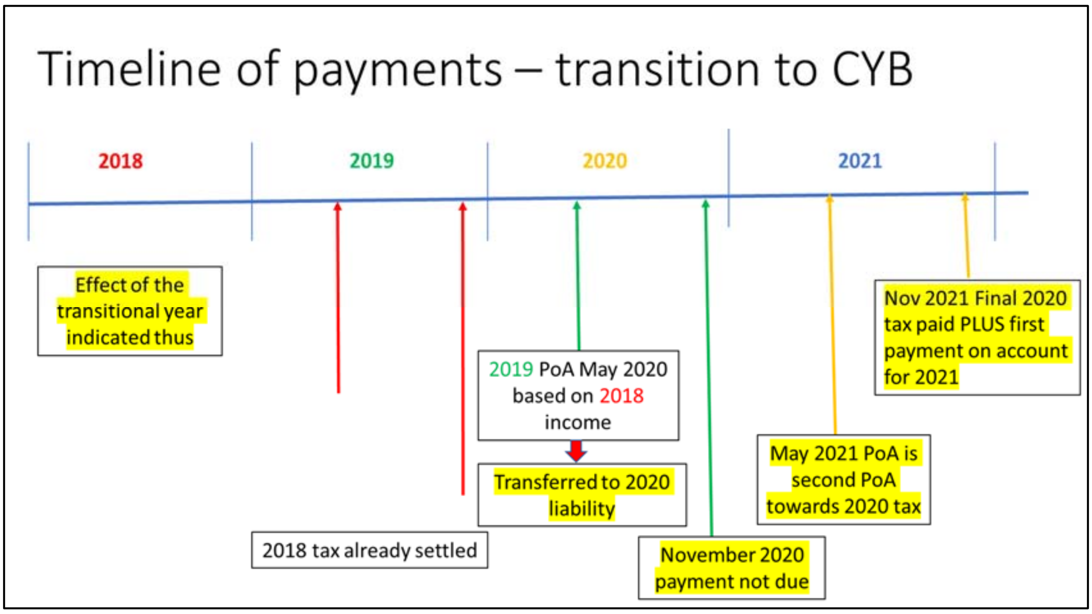


Figure 1C Tax payment dates for new CYB PoA taxpayers after the change

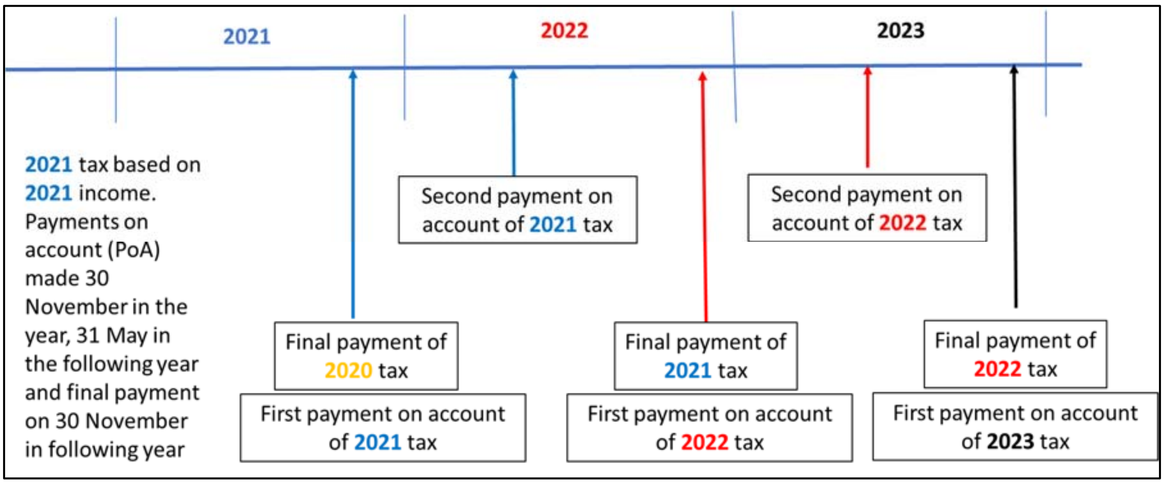


Illustration 2 – self employed taxpayer, numerical examples

2.4 There now follows an example with numerical tax payments to show the effect on a self employed individual, Peter, of the changes. I have included several scenarios to illustrate how the change will affect him and his tax payments.

Scenario 1 – Level income

Peter's income for the last few years is such that his tax payments do not vary and amount to £4,000 a year. During the transition to CYB, this will be his experience.

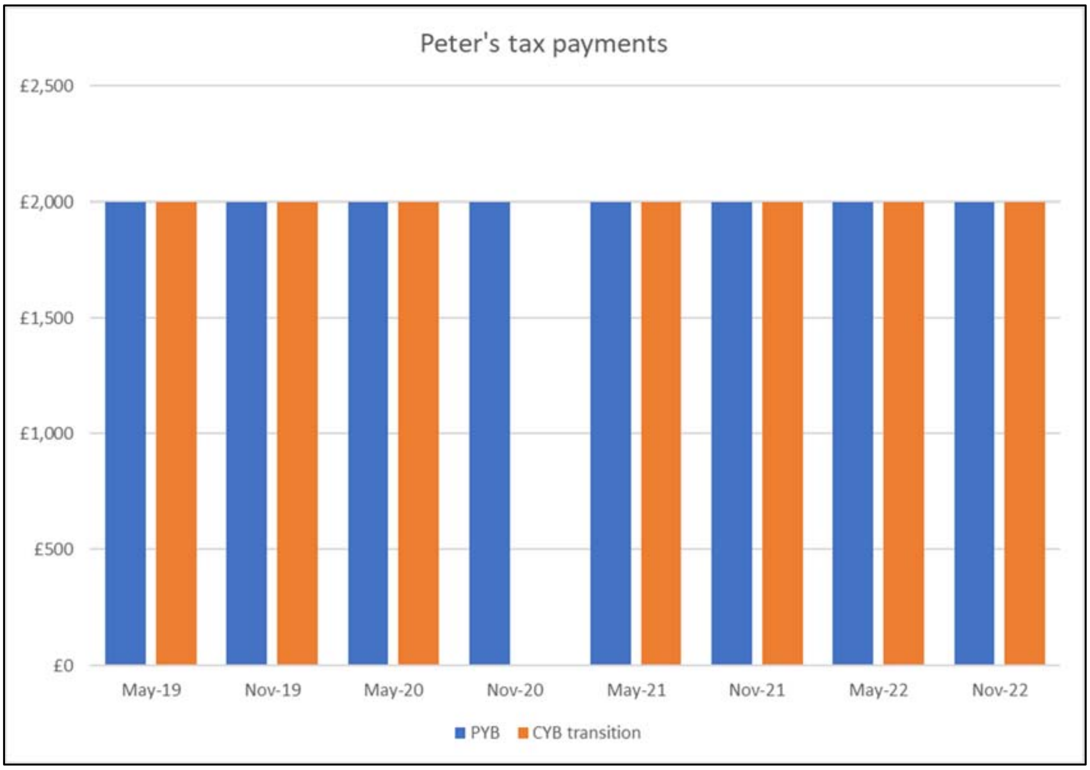
Under PYB Peter has paid:

- £2,000 in May 2019 against his 2018 liability
- £2,000 in November 2019 against his 2018 liability
- £2,000 in May 2020 against his 2019 liability – now to be reallocated to 2020

During the transition he will pay :

- £0 in November 2020
- £2,000 in May 2021 (second PoA for 2020)
- £2,000 in November 2021 – his first PoA against his 2021 liability

Figure 2A Peter's tax payments comparing PYB with transition to CYB Assuming steady income



He will continue to make PoA and final payments in May and November and will see no change to these regular payments until he starts to pay off his 2019 liability. If spread over 5 years this will increase his regular payments to £2,400 each time. If spread over 10 years the payments will be £2,200 each.

Scenario 2 – Rising income

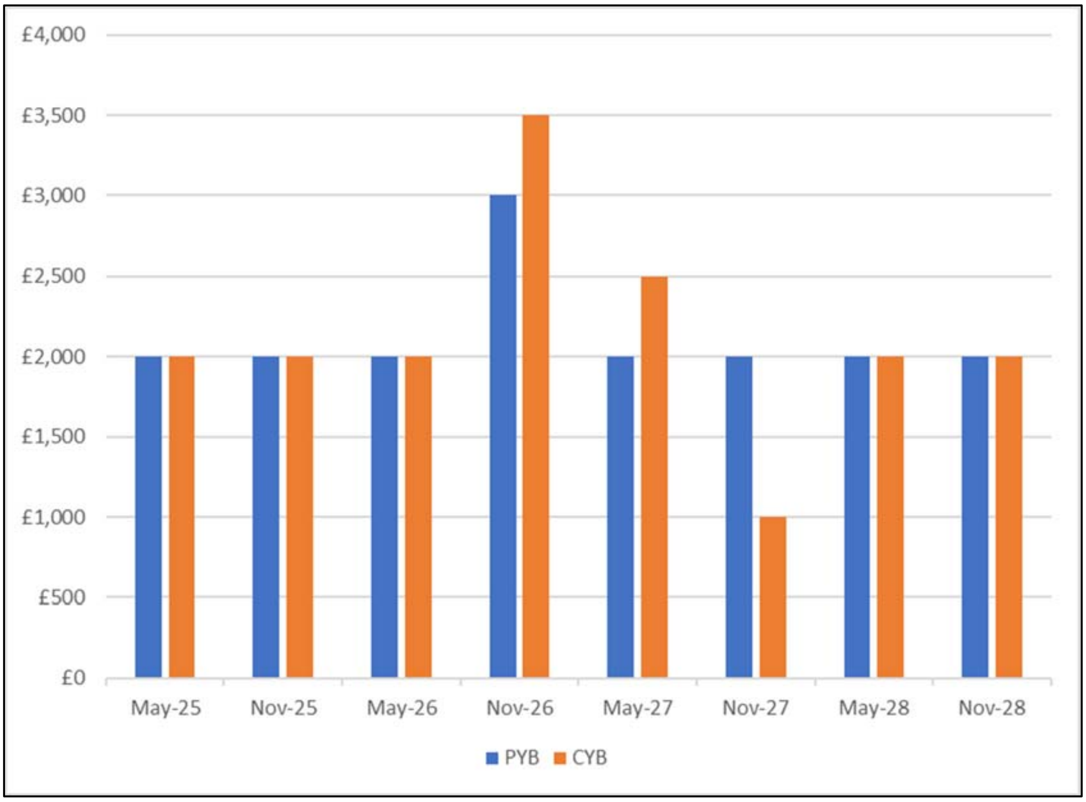
2.5 Because the Payments on Account (PoA) are based on the previous year's income, when income rises this pushed a disproportionate rise into the November payments, partly to make up the shortfall for the current year, but also due to a higher payment on account for the following tax year.

Peter's income rises, such that his tax liability in 2025 increases to £5,000. Assume that his income in the surrounding years produces a £4,000 tax liability.

Under PYB he would have paid £2,000 in May 2026 as his first payment on account, followed by £3,000 in November 2026 to finalise his liability.

Under CYB he will have paid £2,000 in November 2025, a further £2,000 in May 2026 and then be due to pay £1,000 final payment the following November, plus a payment on account of £2,500, bringing the payment due in November 2026 to £3,500.

Figure 2B Peter's tax payments comparing PYB with CYB assuming increased income



2.6 This is a particular issue in the UK, where self employed taxpayer pay tax on a CYB. Their experience of the tax increases when their income rises can prove very challenging to meet, and they need plenty of advance notice to plan for these tax payments.

2.7 In my own client base, if I know that a client has had a better year than the previous year I prioritise their tax return so that we can get a final tax figure as soon as possible – ideally in April or May (the first two months of the following tax year) so that they have maximum time to plan for the payment due the following January.

2.8 The pattern of tax payment in relation to the tax year is similar in Jersey to that in the UK, so this does emphasise that assessments need to be completed as quickly as possible when returns have been filed in order for the system to work as intended. Assessments completed in November leave less than a month for self employed taxpayers to assemble the necessary payment. A consequence of the move to the CYB (which can be identified above) is that the November payment can be significantly higher than under PYB when income increases.

Scenario 3 - When income reduces

2.9 Under the CYB the impact of a reduction in income shows earlier in the tax payments. However, the early recognition of the reduction depends on the taxpayer or his agent filing the tax return early to obtain the benefit more quickly, or applying for a reduction in payments on account as provided for by the Draft Amendment[14].

2.10 This is also the experience in the UK where fluctuating income (a marked feature of self employment) makes it very difficult for those with low incomes to plan for their tax payments unless their self assessments are completed well in advance. A year with very little income followed by a return to success will require payment of 1½ years tax on one date (November after the year of return to normal) which taxpayers are unlikely to be able to fund in a short time frame.

Peter (above) has very low income in 2025, so owes no tax for that year. In both the preceding and the following tax year his liability is £4,000.

Under the PYB Peter will pay tax in 2025 of £2,000 in May followed by £2,000 in November in respect of his Year 2024 liability. This characterises the difficulty with the PYB in that taxpayers who see a drop in income but do not benefit from the drop in tax payments until later. If he manages to file his return for year 2025 early in 2026 he will pay no tax in year 2026. If filed after the May payment is due he will make a payment and then potentially receive a refund when his assessment for year 2025 is complete (although refunds are not automatic). In 2027 he will pay zero in May (if he has filed his 2026 return, otherwise possibly £2,000) and either £2,000 or £4,000 in November depending on his May payment.

Under CYB rules Peter will pay £2,000 of tax in November of 2025 towards his 2025 tax bill, a further £2,000 in May of year 2026 unless he has filed his return early in which case he will be refunded £2,000. By November of year 2026 he will have had any amounts paid for 2026 refunded (assuming that refund are

[14] Draft Income Tax (Amendment No. 46) (Jersey) Law 202- Article 3 inserting new Article 41AA into Income Tax (Jersey) Law 1961

automatic). He will make no payment in May 2027, but then will have to find £6,000 in November 2027 being a final payment for 2026 of £4,000 and a payment on account for year 2027 of £2,000.

Figure 2C Peter's tax payments comparing PYB with CYB assuming decreased income and tax return filed late in permitted period

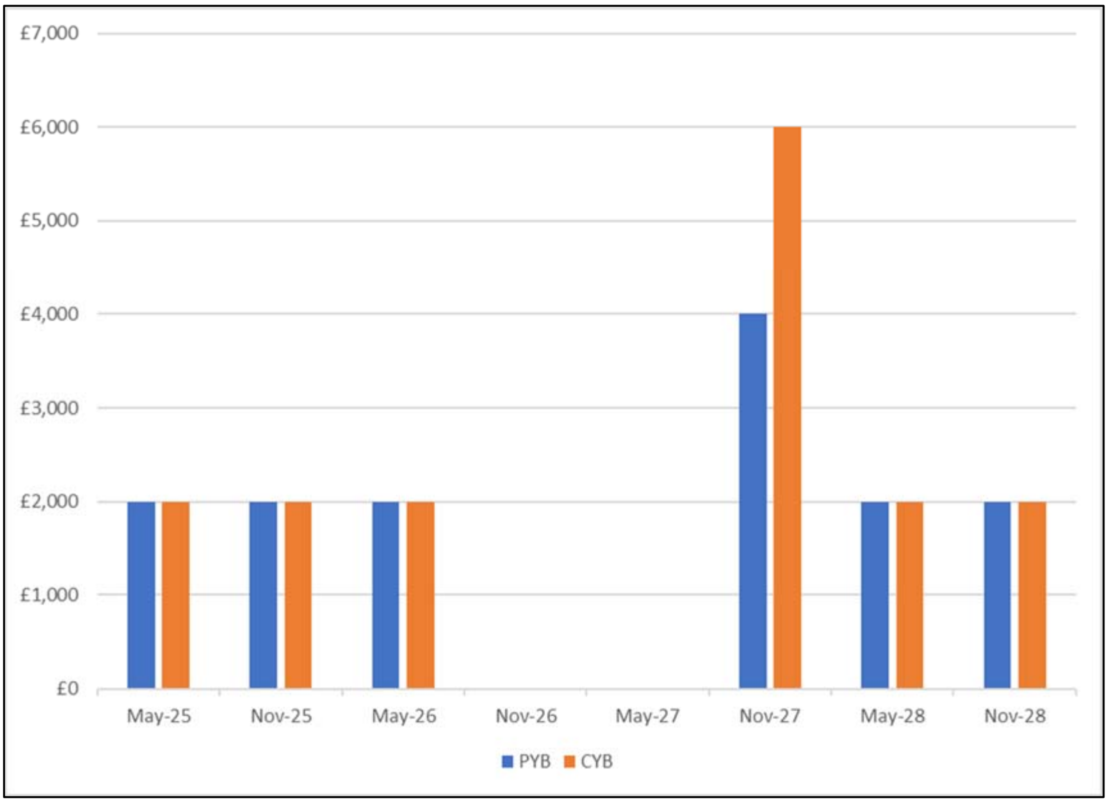


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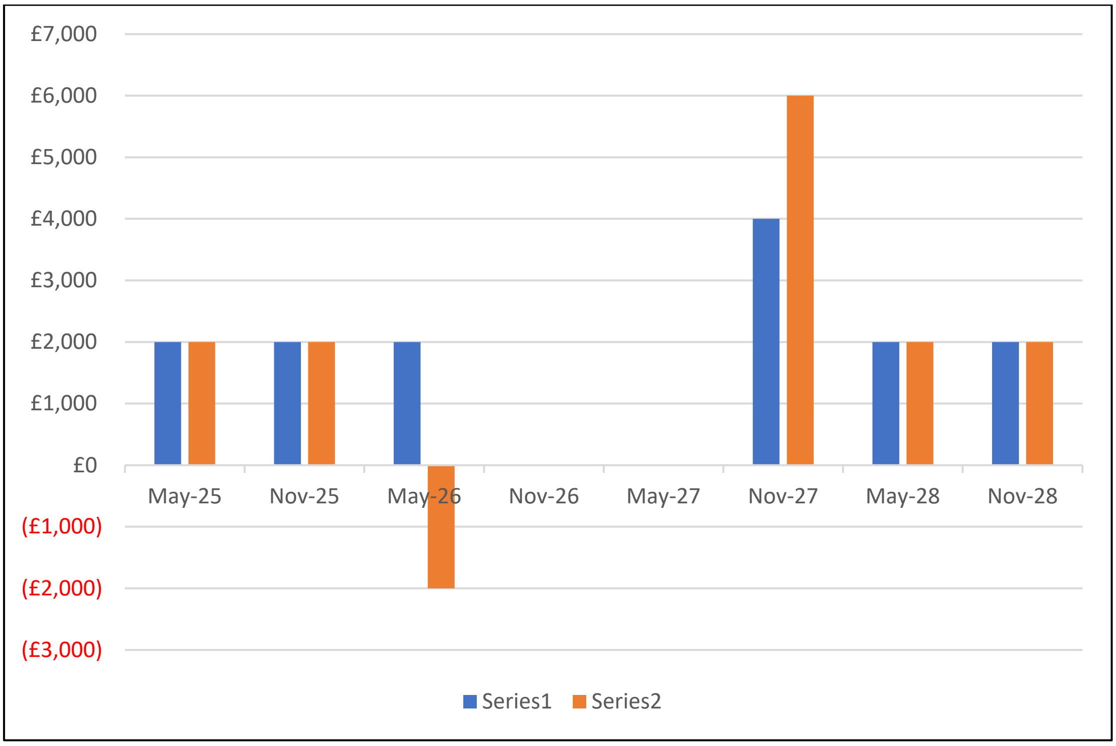
Figure 2D Peter's tax payments comparing PYB with CYB assuming decreased income and tax return filed early in permitted period



***Key finding 6**: It is unarguable that taxing PoA taxpayers on a CYB is simpler and generally easier to cope with for these taxpayers than a PYB. However, the key to success of the CYB system is planning and up to date knowledge of tax liabilities as early as possible, to allow taxpayers time to plan their payments. This is a more pronounced need under CYB.*

Illustration 3 – Impact on an ITIS taxpayer (Paying tax monthly from their employment income)

2.11 The following illustration shows the difference between the PYB and the CYB for an ITIS taxpayer. Note that there is no difference in the timing of payments as the tax is deducted each month by the employer, but the commentary on the diagrams provides an illustration of how the revised system might work. Much depends on the provision of information about changes in circumstances to Revenue Jersey and how quickly these are acted upon.

Figure 3A ITIS taxpayer's tax payments under PYB

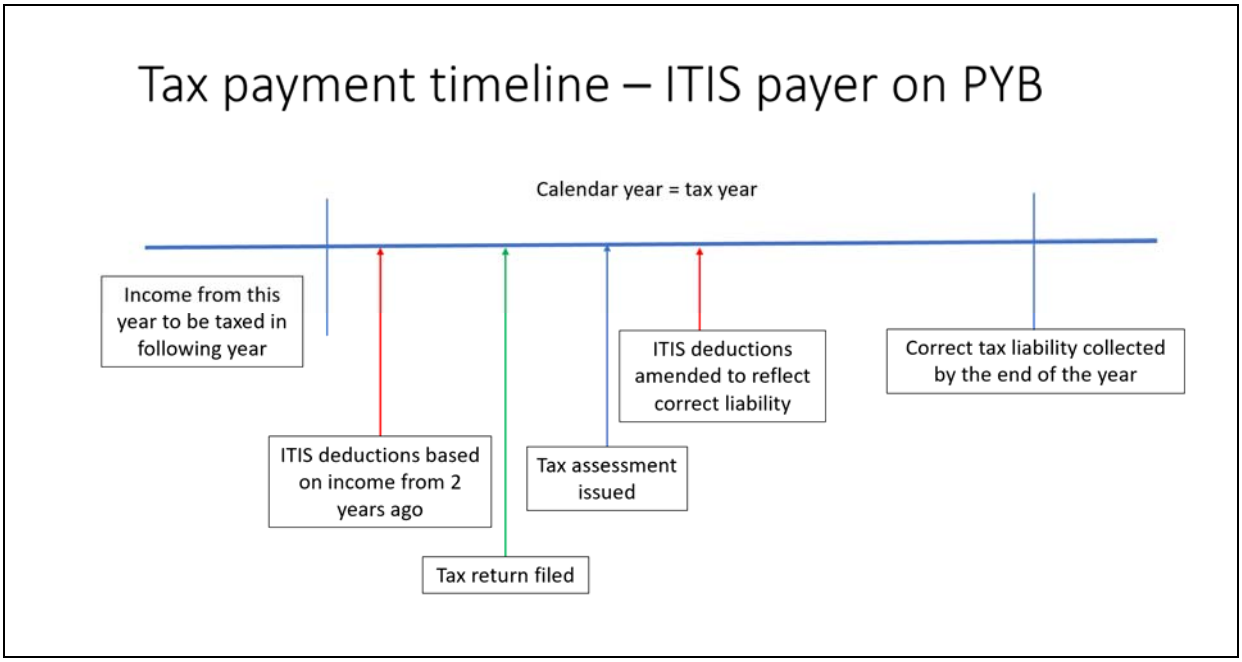
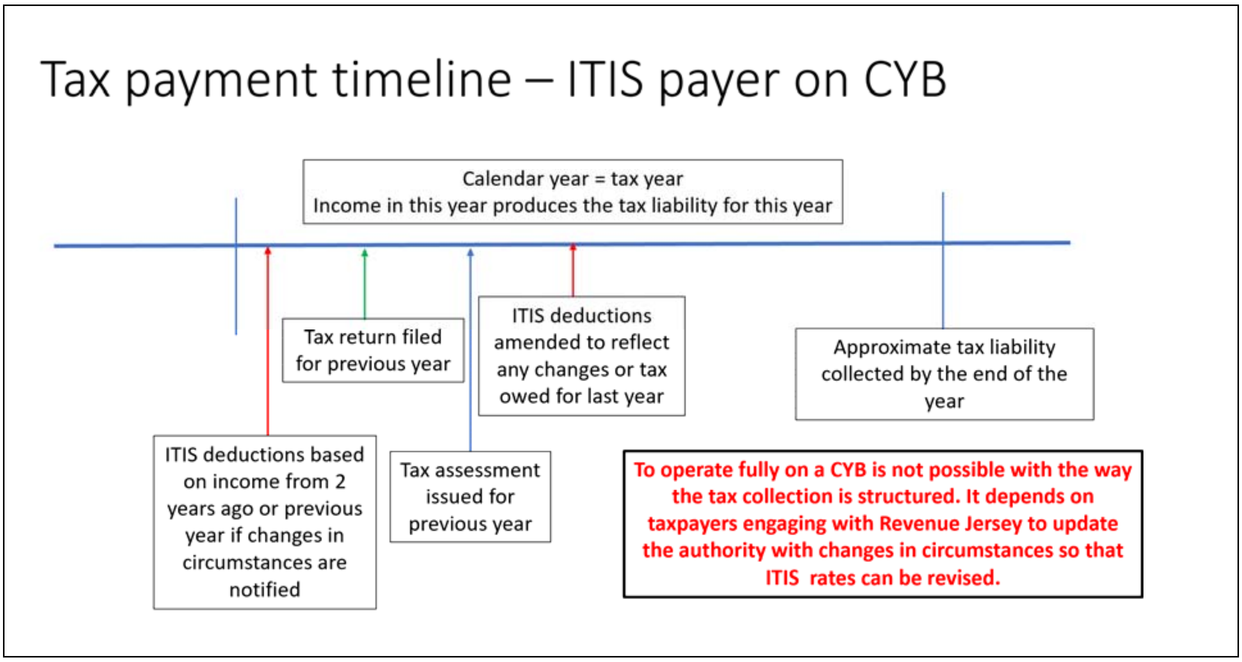


Figure 3B ITIS taxpayer's tax payments under CYB



3. Repayment of the 2019 liability

The proposal

3.1 The proposal and draft legislation are largely silent on the plans for repayment of the 2019 tax liability by PYB taxpayers.

Arrangements for the repayment terms to be included in Regulations

3.2 The current draft legislation[15] at Article 8, inserting into Schedule 5 of the Income Tax (Jersey) Law 1961 new para 23, states that the 2019 liability will become due and payable as specified in Regulations made under this paragraph (New para 23(1)(b)). Further, new para 23(3) requires that Regulations must be made by 31 March 2021 at the latest.

3.3 Regulations made under delegated authority as a result of the proposed legislation form a critical part of the acceptability of the new regime to those taxpayers affected by it. By allowing for the Regulations on repayment to made separately the proposal as it stands leaves a empty space where the most crucial element of the reform should sit – how and when taxpayers will be required to make good the additional liability placed on them.

3.4 The principle that the proposal for the change could be considered without the key aspect of the proposals that will impact taxpayers is difficult to reconcile. The actual move from PYB to CYB is largely uncontroversial. It is the freezing and subsequent collection of the 2019 liability that poses an issue for PYB taxpayers.

***Key finding 7**: The presentation of the proposals for the change to CYB without the associated Regulations on how the frozen 2019 liabilities will be collected makes it difficult for those called upon to evaluate these proposals to carry out their oversight effectively.*

***Recommendation**: That the terms of repayment of 2019 liabilities are considered and approved by the States Assembly at the same time that this legislation is considered.*

Background – where the tax system is now

3.2 Until 2006 all taxpayers paid tax on the income of the preceding year. Tax assessments were issued in the second half of each calendar year, based on income tax returns submitted and the tax was paid in a lump sum before the end of the year.

[15] Draft Income Tax (Amendment No. 46) (Jersey) Law 202-

Reform of the tax system in 2016 meant that:

- All taxpayers registering with Revenue Jersey were to pay tax on the Current Year Basis
- Income tax would be deducted from payments made to employees towards their eventual tax bill using an estimated rate (ITIS); the ITIS system of .collecting tax is broadly similar to PAYE in the UK, except the rate is arrived at using a formula. It applies to all employed taxpayers, whether they are taxed under PYB or CYB.

3.3 The reforms at that time also required taxpayers not subject to ITIS to make payments of 50% their estimated tax liability on 30 April (now 31 May) each year with the balance being settled by the end of November, rather than a single payment towards the end of the year.

3.4 Reforming a prior year basis system to move to a current year basis is not a technically difficult move, but the upheaval on the administration of the tax system could be considerable, and place the Revenue authorities under considerable pressure. This is discussed in more detail at Section 4 of this report.

Moving from a prior year to a current year basis – experience in the UK

3.5 One of the issues in switching from a prior year to a current year basis of taxation will always be how to deal with the "missing" year if such a proposal is to be implemented.

3.6 In the UK this was much easier because of the way the prior (or preceding) year basis operated. On commencement of self employment (only self employed taxpayers were taxed on a preceding year basis) the taxpayer effectively paid tax on the same self employed income twice – once in the first year of tax as self employed, and again in the second year.

3.7 Under the prior year basis, on cessation of self employment some profits escaped tax completely as the final year was taxed on an actual (i.e. current year) basis. This effectively compensated the taxpayer for the double taxation at the start of self employment. Although the amounts taxed twice and the amount escaping tax could be significantly different sums, this was regarded as the simplest way to operate the system.

3.8 In a similar way to the changes in Jersey in 2006, the UK started the task by setting a date from which all new self employed individuals would be taxed on a current year basis (1994). Then in 1996/97 the remaining self employed individuals were taxed on the average of the 1996 and 1997 net income, with part of the 1998 income being regarded as "overlap relief". This enabled the system to skip a year, but minimised the risk of manipulation of income. The "overlap relief" crystallised the deduction for taxpayers moving to current year basis and will be deducted on cessation, effectively replicating the deduction obtained on cessation under PYB. Obviously over time, the value of this deduction has diminished, but that is not perceived to be unfair by those who have been self employed for a long time.

3.9 Most taxpayers in the UK, it must be said, do not understand which profits are taxed in which year in any event, as the tax charge is also distorted by using "basis period rules" to allocate profits of an accounting period to the relevant tax year. Self employed people are allowed a free choice of accounting period.

3.10 So moving from the PYB to the CYB in the UK did not cause any public outcry, as the move was perceived to be fair.

A related change in the UK - Self assessment

3.11 At the same time as implementing the change from the prior year basis to the current year basis, the UK implemented the "Self assessment" system to remove the requirement for assessments to be raised, radically improving administration of the tax system. The tax return submitted acts as a self assessment of the income. Taxpayers are not required to calculate their own tax liability. Generally speaking employed taxpayers in the UK with no other income do not need to submit a tax return as the PAYE system calculates the correct tax in real time.

3.12 Prior to the introduction of self assessment it was not unusual for self employed taxpayers to have two or three years' tax unresolved, with taxpayers paying tax based on "estimated assessments" issued by the Inland Revenue.

3.13 As a result of the introduction of self assessment it is not unusual for some self employed taxpayers to obtain a refund of any overpaid tax as early as a few weeks into the new tax year, by dint of filing their returns quickly.

The problem in Jersey

3.14 In Jersey, it is fair to say, based on submissions made to the Panel that taxpayers seem better informed about how the prior year basis works, and many have clearly planned that when the high costs of maintaining a family fall away they will put money aside to meet the last tax bill on their income as income reduced in retirement. For some it is regarded by them as a debt to be settled from their estate on death.

> *"My mortgage ends 4 years before my official retirement age. I had planned that this 4 year period is where I would start to overpay my income tax to clear the difference between tax payable on my salary and my pension.*

> *"This is the best time for me to do it as I will have spare disposable cash that was previously used for mortgage payments and it will be painless for me to do it at this time"*[16]

3.15 Prior year basis taxpayers who have experienced a significant drop in income due to Covid will undoubtedly struggle to fund a tax liability on the previous year's profits. Repeating the example at 1.13 above, but using a 15% drop from one year to another to imitate the effect of Covid on some sectors, the experience of taxpayers on a preceding year basis would be a tax rate of 23.53%, in spite of the fact that the tax rate has not changed from 20%.

3.15 However, there are two major differences between the UK's changes and those proposed in Jersey.

3.16 The vast majority of UK taxpayers would not be affected by the change as they have been taxed under PAYE since 1944. This system is not just a current year basis, but an accurate deduction of an individual's tax liability either from week to week or month to month, as payments of salary are made. Introducing such a system of taxation in Jersey would not be prohibitively expensive, but would require third party software suppliers to be willing to invest in the software to develop such a process, which given the modest taxpayer base might not be a reasonable commercial proposition.

3.17 In the UK, the Prior Year Basis (or Preceding Year Basis as it was known) was implemented by taxing the initial profits of self employment twice and in some cases up to three times, depending on the accounting period. The quid pro quo was that a certain amount of income escaped tax when the self employment ceased, because in the final tax year the income was taxed on an actual basis (i.e. from 6 April to the date of cessation). The period for which income escaped tax was the same length as the period suffering multiple taxation at the beginning, and there were rules to prevent self employed people benefitting by artificially manipulation their income in the run up to cessation.

The real issue in Jersey

3.18 In Jersey the proposal is much more challenging, as in considering the points above:

- Although an Income Tax Instalment System (ITIS) operates to deduct tax from employed individuals (whether they are on a PYB or a CYB) it is not intended to be an 'accurate' deduction, but more a contribution to the estimated liability in the year. For PYB taxpayers it has the scope to accurately reflect their liability for the year provided assessments for the prior year are finished in good time.

- There is no corresponding 'start' rule in Jersey. Those taxpayers taxed on PYB simply did not start paying tax in the first year in which they came within the tax system. This means that fiscally, and in terms of fairness to CYB taxpayers,

[16] Written submission to the Panel.

there is no scope to 'skip' a year to bring them onto the CYB. In the various considerations about the fairness of the proposals, this, in my view is a key issue. The 2019 tax liability should not be written off – that would be manifestly unfair. Indeed many PYB taxpayers accept that.

"I am happy to pay my tax arrears and don't believe a year should be written off."[17]

3.16 The real issue in Jersey is that the preceding year basis starts with a year of income which is not taxed, and the tax system then has its one year time lag.

3.17 It is not possible to use the technique used in the UK to skip a year, balancing the double taxation at the start because this would not be fair to current year basis taxpayers. It would also impact significantly on Government finances in the future.

Key finding 8: *The reason that the move from PYB to CYB is so challenging in Jersey is because of the need to deal with the 'missing year'. There is no simple answer to this issue.*

3.18 One of the major issues is that freezing 2019 will provide a significant top up to Government resources as that year has not been affected by COVID-19. Delaying the implementation could lead to a smaller amount of additional revenue for the Government when the frozen liability is calculated.

3.19 For most PYB taxpayers it is fair to observe that although they will pay tax on the same amount of income throughout their lives, freezing and collecting 2019 liabilities puts them under a great deal more financial pressure than allowing the natural decline in income (and outgoings) to give rise to a much less onerous 'catch up' payment.

Example.

Julian is self employed. His income in 2019 was significant and gave rise to a tax liability of £20,000. He is 10 years from retirement, and will reduce his hours and work rate gradually over the ten years to bring his income (and his tax liability) down by 10% a year, at which point he will draw his pension.

So his tax liability on a PYB will arise as follows:

Tax year	Income for	Tax liability
2020	2019	£20,000
2021	2020	£18,000
2022	2021	£16,000
2023	2022	£14,000
2024	2023	£12,000

[17] Email to the Panel received 14 September 2020.

2025	2024	£10,000
2026	2025	£8,000
2027	2026	£6,000
2028	2027	£4,000
2029	2028	£2,000

3.20 His actual 'lump' tax payment on retirement is quite modest, as he has been reducing income over the period up to retirement. Freezing his 2019 liability and requiring him to pay it off over a period of time will be unlikely to be attractive to him, as he has already made plans to finance his final tax liability.

What are the liabilities involved?

3.21 I have been provided with a Table[18] identifying the estimated tax liability for 2019 in relation to PYB taxpayers. From the data provided in columns 1 to 4 of the Table below, I have made the calculation in column 5 'Average additional tax to pay' based on the total estimated 2019 liability shown in column 4 and the number of PYB taxpayers in column 2.

Age range	**Number of PYB taxpayers**	**Proportion of taxpayers in that age range**	**Estimated 2019 liability £'000**		**Average additional tax to pay £**
20-29	109	9.7%	429		3,935.78
30-39	3,094	55.0%	23,430		7,572.72
40-49	6,574	77.0%	75,240		11,445.09
50-59	8,439	86.0%	106,920		12,669.75
60-69	6,350	96.0%	69,630		10,965.35
70-79	3,760	100.0%	33,000		8,776.60
80-89	2,059	100.0%	16,170		7,853.33
90-99	606	100.0%	4,950		8,168.32
100+	28	100.0%	99		3,535.71
unknown	81		132		1,629.63

3.22 It is fair to say that the calculated amount of additional tax to pay does not make easy reading. A little further analysis follows.

3.23 Looking at the 40 to 49 age range, if they have planned for additional tax they would probably be expecting to commence paying additional tax from age 60. So the extra £11,445 that they will have to pay under the proposals will fall ten years earlier than they had planned for. It is likely that payment of this additional liability coincides with supporting children while at school or university. Several submissions made to the Panel support this concern:

[18] Table: Estimate of Distribution by Taxpayer Age of 2019 PYB tax liability

"Our concerns on this area are those of the consequences that could occur to the disposable incomes that parents will have to cover maintenance (and depending on the U.K. fees too) shortfalls."[19]

"We would request that there be no change and that we continue on a prior year basis. Adding further tax payments at any stage over the next 10-15 years will compromise our quality of life and support of our children."[20]

"Without doubt, the proposed changes will negatively impact our future lifestyle and enjoyment of retirement. Our financial planning is based on PYB tax. Spending on what we term luxuries, meals out, golf, yoga etc. will have to change. The extra tax burden during the catchup period will have to come from our non essential spend. After paying PYB for 45 years, I am naturally angry with the proposed change and its likely impact on our retirement."[21]

And finally, an impassioned plea from a single parent:

"I have been working full time since 1998 and have always paid my tax demand in arrears and never faulted. My salary has gone up over time through changes in job and promotions.

I am 40 years old with 2 children and separated from my spouse 7 years ago. I own a home and have a mortgage of 26 years left ….

I don't have any loans and stick to a budget each month which is tight and is getting tighter. I contribute 10% of my income into a private pension.

I have always been under the impression that my tax liability will be a burden when I choose to retire. I have also factored that into my chosen retirement age and pension provisions when that time comes. When I am of retirement age I will no longer be paying a mortgage and my children would have left school and therefore my disposable income will be far higher.

At this present moment in time, as a middle earner with maximum outgoings I simply can't afford the extra £80-£160 per month for a 5-10 year period <u>AT THIS TIME</u>. I choose not to have any loans to this point.

Given the age group of earners who this will impact I suspect that I am not the only one in this financial position but the majority of this group in fact will be in the same boat."[22]

I am happy to pay my tax arrears -under the legacy terms I signed up to which was to pay the last years tax when I retire. I will then have a

[19] Email submission to the Panel dated 17 September 2020
[20] Email submission to the Panel dated 12 September 2020
[21] Email submission to the Panel dated 28 September 2020.
[22] Email submission to the Panel dated 14 September 2020

healthy pension pot or accumulated savings which I would have accounted for as part of my final years earnings tax liability."

Example – family with two children

3.24 In this example, I am considering the position of a family with teenage children and a mortgage, who earn a reasonable wage, but have very significant outgoings, in paying their mortgage and supporting their children, who are imminently to attend university. If we assume that they are typical taxpayers in the 40-49 age range but are not in the range of "top earners" so life is a day to day struggle financially. They are trying to put some money aside to support their elder child's university education, but some months this is not possible. The failure of a major domestic appliance such as a washing machine represents a real 'nightmare event'.

3.25 Using the average potential 2019 tax liability calculated above at para 3.21, but applying an adjustment factor to exclude the highest earning households who distort the average it is possible to estimate the likely tax liability falling on the household. The adjustment factor is derived from the calculation of Median Equivalised Household income last performed by Statistics Jersey in 2014/15[23]. This is published by household type. It is reasonable to assume that the spread of income between the mean (arithmetic average) and the median (mid-point on the distribution of incomes) has not altered materially.

3.26 The mean household income before housing costs in 2014/15 was £860. I am using the amount before housing costs as that is more likely to be representative of the taxable income. The median equivalised weekly household income for a couple with at least one dependent child is £720, so the liability calculated above for this age range - £11,445 – adjusted for these (i.e. divided by £860 and multiplied by £720) gives is £9,582, which is a good approximation for the liability in respect of 2019 tax. This equates over ten years to £958, or £80 per month. There is little doubt that this amount would place enormous financial pressure on a couple in this position.

Discounting the liability for early settlement

3.24 New para 23(5) in the Draft law also requires that the Regulations made under the paragraph must not waive or reduce the amount of a person's 2019 liability. However, it would be sensible to give the option of a discount at Government cost of capital rates for early settlement of the 2019 liability, recognising that early settlement could reduce Government borrowings accordingly. The amount to be settled can be calculated on a discounted cash flow basis using an appropriate rate. Otherwise PYB taxpayers have no real incentive to settle early, which would not only benefit Government revenues but potentially significantly reduce the cost of collection of the 2019 debt.

[23] Included in Earnings and income statistics published online at https://www.gov.je/Government/JerseyInFigures/EmploymentEarnings/Pages/EarningsIncomeStatistics.aspx#anchor-6 using data produced by Statistics Jersey

3.25 A quote from a submission received by the Panel states:

> *"..but I do believe that some sort of discount would encourage people to pay off the owed tax as quickly as possible. Maybe a sliding scale relating to how quickly the liability is cleared. Without this wealthy individuals … will simply leave their money invested and gaining interest rather than paying off their liability"*[24]

***Key finding 9**: Failing to recognise and provide for early repayment of the 2019 tax liability provides no incentive for taxpayers to settle early, which could be a significant advantage in both fiscal and administrative terms.*

***Recommendation:** That the repayment terms include the option for early settlement on discounted terms appropriate to Government cost of capital.*

Impact on married couples and civil partners

3.26 Given that the repayment terms for 2019 tax will provide for repayment over an extended period of time, and that Spouse A would primarily be liable for the payment of the debt, the likelihood that couples will separate and divorce during the repayment period is high. Leaving Spouse A with this liability after the couple have gone their separate ways could be perceived as unfair and may exacerbate the difficulties suffered by the family, including the children, in relation to the divorce.

***Key finding 10:** The current proposals for the settlement of the 2019 liability, leaving Spouse A liable for the tax debt in full pose a risk that difficulties when couples divorce that the problems will be exacerbated. This is likely to adversely affect the mental health of individuals and may also impact negatively on children of the relationship.*

***Recommendation:** That the legislation requires that before a decree absolute or the dissolution of a civil partnership is final the presiding judge / magistrate must ensure that the 2019 tax liability debts have been resolved equitably, and that any ruling made by the judge be binding on the Comptroller of Revenue.*

Anticipated impact on the Jersey economy

3.27 It is without question that withdrawing £330m from taxpayers' disposable incomes, whether over a 5 year period or a 10 year period will impact the economy. I highlight below some of the sectors on which it is most likely to have an impact.

[24] Email submission to the Panel 15 Sept 2020

Housing market

3.28 Although mortgage lenders have not given a specific answer to questions about how the repayment terms for the 2019 tax debt will affect lending decisions in the future, some lenders have confirmed that their **normal** rules will apply in future to lending decisions.[25]

3.29 Where lenders follow internationally accepted rules on affordability developed after the 2008 sub-prime mortgage collapse, this involved taking into account not only the gross income of the borrower(s) but also the regular outgoings from the household in an “affordability test”. In the UK this results in many applicants being refused a mortgage for which the repayments are lower than the rental payments they are currently making, as lenders are required to take very risk averse decisions based on the affordability test.

3.30 Assuming that broadly the same basis applies to lending decision in Jersey it is likely that lending decisions will be affected. It is possible that once the 2019 liabilities are known and the payment arrangements finalised, lenders will take these into account in their affordability tests even before repayments start. This will inevitably result in lower mortgage offers than can be made without this additional debt and may lead to families being unable to secure their first start on the housing ladder.

3.31 Whether it leads to a fall in house prices will depend on how many islanders are affected by this, but it will undoubtedly affect the ability of islanders to enter the housing market if there is no overall downward price adjustment.

Restaurants and leisure activities

3.32 With reduced disposable income it is likely that discretionary spending will be reduced, with the expenditure being diverted to repay the tax debt for 2019. Although the repayment period is proposed to be delayed until recovery from Covid is well under way, this sector has been particularly hard hit by the pandemic and will suffer a further and possibly prolonged downturn as a result of the tax debt created by the proposals.

Private education

3.33 Parents who are just about meeting the cost of private education may feel that their only option to repay the tax debt would be to take children out of private schools and return them to the state sector. This would cause hardship and disruption to the children affected, and also a contraction in the sector.

[25] Evidence given by the Minister for Treasury and Resources at the public hearing on 16 October 2020

Pension saving

3.34 Some taxpayers will regard saving for a private pension as an element of discretionary spending and therefore cease their pension savings in order to repay the tax debt. This would have financial consequences far into the future.

***Key finding 11:** It is not clear that in putting forward the proposal, due consideration has been given to the potential impact on the wider Jersey economy of the repayment proposals.*

4. Simplification of tax administration

Potential for simplification of tax administration

4.1 In essence the move from a PYB to a CYB makes the work of the tax department no different in that assessments have to be raised and issued each year, and where payments are not made according to the due date the arrears chased. This will happen each tax year, irrespective of the basis of taxation.

4.2 However, to the extent that Revenue Jersey has a backlog of assessments to raise, (Current estimates are 21,000) the transition to the current year basis will put additional pressure on the Department to get up to date, although as noted below, there will be a little 'breathing space' as a result of not needing to finalise 2019 assessments immediately. Compliance work is also unaffected, as that activity is independent of the basis on which income is taxed.

4.3 To a certain extent, deferring the 2019 liability will release pressure on the department as it allows for the outstanding returns for that year to be "shelved" pending informing taxpayers of their deferred liability, so in one sense the proposed changes takes the pressure off the Department. But it is essential that all 2018 assessments are resolved as quickly as possible so that taxpayers can get up to date.

4.4 But to look in more depth, the timing of the returns and assessment process needs to be considered in detail to establish whether the change is sustainable in the context of current output of the Revenue Department.

Current system and potential changes : Returns/ Assessments / Payments

4.5 Returns for a calendar year will remain due between January and 31 July the following year.

4.6 Assessments are then raised following the receipt of the return. Again, this process is unaffected by the changes. However, there is clear evidence that Revenue Jersey is behind with 2019 assessments.

4.7 The point of a CYB is to enable taxpayers to be up to date with their tax affairs. If assessments are delayed, then the system defaults to a PYB in the absence of assessments being raised as early in the year as possible. The ability of Revenue Jersey to raise assessments very quickly in the first half of 2021 is crucial to the success of the change.

4.8 The current backlog of assessments relating to 2019 is 21,000 (as at 18 September 2020)[26]. By the end of October 2016, 59,721 assessments had been raised, against "just under" 40,000 by 18 September 2020. It is clear that

[26] Written response to Panel by the Minister for Treasury and Resources dated 7 October 2020

the Department will have an enormous struggle to complete all of the assessments as promised by Christmas. (reference the Written response referred to above). Deferring the 2019 liability to an as yet unspecified date allows these uncompleted tax assessments to be put aside until the 2019 tax goes into collection. But of course, if resources remain limited, this is only storing up the problem for the future.

4.9 Taxpayers who are liable to make payments on account pay by 31 May and 30 November each year. Again, this is unaffected, but how those payments are to be allocated, and the amount of the payments will be changed. Under the PYB:

- The 31 May payment in any calendar year is allocated as the first payment on account for the previous tax year.
- The 30 November payment is the balance of the tax due for the preceding fiscal year.

4.10 The change to CYB will cause the payments to be re-characterised, and will amount to an acceleration of tax payment of 6 months for those with constant income, which is offset by skipping the November 2020 payments due.

- The payment on 31 May in a calendar year is regarded as the **second** payment on account for the tax of the current year.
- A further payment due on 30 November will settle any outstanding tax for the current year (as now)
- But a further payment on account will be required, on the same date, as a **first** payment on account for the following year.

4.11 So the payment schedule for tax payment will change from:

- 31 May after the tax year (50% estimate based on previous year), and
- 30 November after the tax year (balance of liability)

The new payment regime will become:

- 30 November in the tax year (50% estimate based on previous year)
- 31 May after the tax year (50% estimate based on previous year), and
- 30 November after the tax year (any balance due)

Examples of the impact of these changes on tax payment dates have been illustrated above in Illustration 1 starting at para 2.3.

Key finding 12: *The impact of the change to a CYB has minimal practical impact on the work of the tax authority. However, if the CYB is to work as intended, the speed of turning around assessments is a crucial aspect of this.*

Recommendation: *That careful consideration and evaluation is undertaken of the ability of Revenue Jersey to issue assessments within the required time* *period commensurate with all CYB taxpayers being able to settle their known liabilities at the appropriate due date*

Preparation for the switch to the CYB in the UK

4.12 The proposals for the change to the system of assessing profits on a preceding year basis in the UK were included in a consultation document in August 1991 which was at the start of the Inland Revenue's 'Change programme', which although nominally intended to last until 2002 seems to be a permanent feature of the UK tax administration system. The document was entitled 'A simpler system for taxing the self employed', carrying the theme that CYB would be simpler than PYB.

4.13 This was followed in 1992 by a second consultation which went further. It was entitled 'A simpler system for assessing personal tax' and included proposed changes to introduce self assessment for many taxpayers, making the project much larger than had originally been intended, but offering the then Inland Revenue an escape from the annual task of raising assessments (whether estimated in the absence of a return or final based on the return submitted).

4.14 Indeed, it was widely regarded at the time that the move to the CYB for the self employed could only be achieved by introducing self assessment alongside the change, so that the system effectively operated outwith the tax authority who were then charged with compliance work on returns submitted and investigating those in the hidden economy. The term still used is 'file now, check later'. The burden of entering data from self assessment returns into the computer system reduced as more taxpayers took to submitting online.

4.15 It should be noted that in the UK for income tax a self assessment is a declaration of taxable income together with claims for deductions and reliefs, and not a calculated tax figure. Those who submit online using HMRC's provided software or third party commercial software have a tax figure generated as part of preparing the return. Those who submit on paper are only guaranteed to be advised of their tax liability in time to pay if the return is submitted by 31 October. There is a penalty for submitting paper returns after this date unless it is a special case that HMRC's computer systems cannot deal with.

4.15 By 1994 the move had commenced by requiring all newly self employed individuals to pay tax on the CYB. The move for established self employed people came through (as planned) in 1996/97 when self assessment commenced. The Inland Revenue produced an audio tape and a 10 minute video to introduce the new system to the public. I personally spent around 3 years teaching accountants from all over the UK how the new system would work in advance of the commencement. 1996/97 was the transitional year for established self employed taxpayers where profits were averaged so that one year fell out of charge to tax, depending on the accounting date.

4.16 One important point to note is that during the development of the self assessment system an independent board chaired by Lord (Patrick) Carter developed the 'Carter Principle' which established that HMRC should never roll out new computer systems unless they had been tested successfully for at least 6 months. [27]

4.17 HMRC now takes a much longer view in rolling out new systems, with the Making Tax Digital project under way in the UK which started work in the summer of 2015, was publicly announced in December 2015 and for which the first phase went live in April 2019. Additional phases will commence in 2022 and 2023 with the final phase in around 2025. Time has been spent analysing 'lessons learned' from the first phase to inform the next stages of implementation. I serve as an independent adviser on the main project board, ensuring that the needs of individual taxpayers, the self employed, small businesses and small firms of accountants are properly considered in the development of systems.

4.18 In summary, the move to the current year basis in the UK is widely recognised as a simplifying measure. The proposals were put forward as "simpler and fairer". I suspect that not many commentators in the UK would regard them as particularly fairer than what went before, but it would be hard to find anyone to argue with the statement that it was a major simplification.

Online filing

4.19 Encouraging online filing is a key aspect of improving tax administration; there are mentions of this in the information provided, but it is an important aspect of the CYB as it allows timely information on their liabilities to be provided to taxpayers with reduced manpower. In the UK this has taken many years. Online filing was open to individuals in 2002 for the first time. Before that, professional accountants and tax advisers were able to file their clients return online from 1998 by enrolling in a specially commissioned private network known as the Electronic Lodgement Service.

4.20 In 2002 76,287[28] individuals filed their 2000/01 returns online, out of 9 million. A further 343,009 were filed online by accountants, bringing the percentage filed online to 4.66%. There was clearly work to be done to meet the 2005 target of 50% of returns filed online. In addition, in January 2002 as the filing deadline approached, the servers struggled to cope with the number of returns being filed and rejected returns as it had reached capacity. In more modern times, HMRC has backup servers available to cover failures in IT, which is a very expensive measure, but the Department has struggled to convince taxpayers to file earlier in the year, in spite of significant advertising campaigns.

[27] Annex A to report on online filing published with Budget 2007 papers by HM Treasury https://www.legislation.gov.uk/ukia/2007/37/pdfs/ukia_20070037_en.pdf Para A22
[28] BBC News article 3 February 2003 http://news.bbc.co.uk/1/hi/business/2721743.stm

4.21 In 2003 324,710[23] individuals filed their 2001/02 return online by the due date, with a further 364,625 filed by accountants, bringing the percentage filed online to 7.66%.

4.22 By 2007, when online filing had reached around one third of returns, it was proposed that the period for filing returns on paper be reduced to seven months[29], bringing it forward to 31 October. This was intended to push taxpayers who leave returns until the last minute into filing online.

4.23 It has not been possible to obtain figures for online filing in the intervening years in the time frame, but recent online filing statistics are shown in the Table below. This has been produced using HMRC press notices for the years concerned, normally issued in the period 3 – 4 February each year.

Table – recent online filing of tax returns in the UK

Tax Year	Due date	% Filed online
2014/15	31 Jan 2016	89.00%
2015/16	31 Jan 2017	88.6%
2016/17	31 Jan 2018	92.8%
2017/18	31 Jan 2019	93.5%
2018/19	31 Jan 2020	93.95%

Online filing in Jersey

4.24 The current rate of online filing in Jersey is 31%. For the benefits of certainty regarding their tax position, and for the workload on Revenue Jersey (which is clearly under severe strain) to reduce, there will need to be a major push for online filing of returns. Setting an earlier due date for returns filed on paper was successful in the UK, and this may well be worth considering.

Anticipated changes to implement the proposals

4.25 Although I am not familiar with the exact processes applied within Revenue Jersey, I do know that there has been some new IT infrastructure introduced in the last two years. Using my experience in relation to these types of project, I would expect the following processes to be involved in the change.

(Please turn to next page)

[29] Report on online filing published with 2007 Budget papers by HM Treasury https://www.legislation.gov.uk/ukia/2007/37/pdfs/ukia_20070037_en.pdf

Change required	Comments
Freeze and isolate all 2019 liabilities and remove from taxpayer accounts on the IT system.	This may require new 'from scratch' programming as this will not have been anticipated in the building of the tax delivery architecture. It will need to automatically distinguish between CYB and PYB taxpayers.
Ensure that all 2018 assessments have been finalised and are in collection.	This is probably a manual requirement with associated resource issues.
Reallocate payments (both ITIS and PoA) from 2019 and apply to 2020 liabilities.	This will require new systems to be written and tested as it is very unlikely that moving payments in bulk would have been anticipated when the system was developed. The new system will need to distinguish between CYB and PYB taxpayers in order to treat payments separately.
Notify PoA taxpayers that there is no liability to pay in November 2020 and that their next payment will be due in May 2021.	There will be resource implications of this, including additional taxpayer contact.
Once agreed and legislated for, create the liability structure for repayment of the 2019 liabilities and notify to taxpayers (in the meantime complete all remaining assessments for 2019)	This may entail a great deal of contact time with taxpayers, whether on the telephone, in person or in writing and email. There are resource implications in 'catching up' the 2019 assessments incomplete as at 2020.
The mechanism for dealing with affordability tests will need to be developed alongside the payment plan.	Depending on how this is structured, it may require annual contact from those taxpayers likely to be affected by affordability issues. It is not expected that the award of an extended period to pay would be based on a single year's income, but rather that it would be revisited regularly to ensure fairness to all taxpayers.
From 1 January 2021 make rapid progress on 2020 assessments.	For PoA taxpayers it should be possible for all returns delivered by 31 March to be dealt with in time to revise the Payment on Account due on 31 May. Taxpayers in this position will then know what their tax payments will be on both 31 May and 30 November. This could act as an incentive to file early.

Carry out a wide publicity campaign explaining why, under the new CYB, it will be important to file tax returns as early as possible, and online wherever possible	This will need to be repeated for several years (such a campaign is still running in the UK some 23 years after the start of self assessment). If this is successful, it will place even more pressure on Revenue Jersey to deliver when taxpayers have played their part.

4.26 Assessments based on tax returns filed on time **must** be completed by 31 October at the latest, and ideally late filed tax returns (filed up to 30 September, for example) should also be targeted to be completed by 31 October. It is true that to some extent this relies on taxpayers filing their returns on time, but a fast turnaround is essential for the change to be fully effective.

4.27 In addition, some of the submissions to the Panel were very critical of the recent performance of Revenue Jersey. It would seem that staff are under pressure and struggling to cope. It is a major concern that if this is the case, the capacity of those staff to devote time to implementing system changes, and being trained on new processes while also processing a backlog of assessments and queries is seriously in doubt.

> *"Revenue Jersey are already involved in a huge change program (the new online computer system) and suffering staffing issues. To take on another major project like prior year basis whilst Covid-19 is and will be affecting operations for at least another 12-18 months looks extremely unwise."*[30]

> *" … to that end I tried to phone the department but after 15 mins on hold I decided life's too short so I would e mail them which is what they want. I duly mailed them and immediately received a computer generated message explaining what a tough time they were having due to coronavirus, after a month had elapsed I mailed them again to remind them that I hadn't had a reply ,I received another computer message, 11 weeks from my original email I still have not had a reply …"*[31]

Key finding 13: *Given my personal experience of projects of this nature, I have limited confidence that the necessary software requirements can be specified, written and tested in time for the change. I would expect a project of this nature to take several years to complete (even given the limited number of taxpayers). In addition, the evidence supplied to the Panel gives me no confidence that staff can be trained on the new systems in time for the change to be completed without disruption to tax collection.*

[30] Written response to the Panel 14 September 2020
[31] Email to the Panel on 18 August 2020

Other proposals for tax changes in the next few years

4.28 It is also important to consider the current proposal against a background of other changes to the tax system in Jersey which have been scheduled over the next 2 – 5 years. These include the following

- A proposal to increase the rate of Long Term Care (LTC) payments, which will add additional tax burdens for all taxpayers.
- A proposal to introduce independent taxation for married couples and civil partners from 2022. This represents a major change in the tax system and will result in many more taxpayers being added to the current population of taxpayers with consequent increases in tax administration costs and demand for already scarce resources.
- The proposal to remove mortgage interest relief from 2025 which will undoubtedly increase the tax burden on many homeowners.

4.29 In particular, introducing a Current Year Basis (CYB) of taxation before the introduction of independent taxation presents a technical challenge of major proportions. The current proposals are that one spouse (Spouse A – the husband or the older partner in a same-sex couple) will carry the liability for the 2019 tax debt. I have commented above at para 3.26 regarding issues on divorce, but the problems do not end there.

4.30 On the introduction of independent taxation it would be necessary to allocate the 2019 debt between the couple, but the various ways of doing so are open to challenges of unfairness by couples, Should it be based on the relative amounts of 2019 income? Which partner should benefit from the exemptions? Should it be based on the income levels when independent taxation is introduced? Is an equal split fair to both? In addition, there is a real risk that each and every couple's personal circumstances will have to be considered individually to arrive at an allocation. I do not believe that Revenue Jersey has the resources to undertake such an exercise.

Key finding 14: *Progressing the strand of modernisation of the tax system by changing the PYB basis of taxation first will make subsequent changes, and in particular the move to independent taxation of married couples and civil partners, much more difficult to implement. I also note various aspects under which the tax burden will increase, which will coincide with the planned period for recovering the 2019 tax debt from PYB taxpayers.*

5. Conclusion

5.1 The merits of the Current Year Basis (CYB) of taxation are indisputable, and it is a simpler system for taxpayers to understand. There is no doubt that as part of modernising the Jersey tax system, moving all taxpayers to a CYB will be an essential part of that modernisation.

5.2 However, the need for Prior Year Basis (PYB) taxpayers to ‘catch up’ by one years’ tax liability will always be challenging. It would not be fair to existing CYB taxpayers to write off this liability, and indeed even PYB taxpayers affected by these proposals recognise this. Finding an acceptable – or even a palatable – way of collecting the liability for the ‘frozen’ year represents the biggest design challenge of this proposal.

5.3 The proposal is offered as a fiscal stimulus but does not in my opinion meet that objective, as it is impossible to consider the proposal without the associated extra tax liability for taxpayers. Many of these taxpayers are struggling to bring in sufficient income to meet their outgoings, particularly families with children right up to University age. These taxpayers have told the panel that they just do not have any spare money to meet the extra liabilities.

5.4 The need for the CYB to operate alongside other changes in the administration of tax, such as increased use of digital systems, online filing and possibly self assessment by completion of a tax return means that attempting this change in isolation presents significant additional challenges if the benefits offered are to be realised. In particular, freezing the 2019 liability before the introduction of independent taxation of married couples will mean that when that change is brought forward there are some very difficult technical challenges to overcome in allocating the residual 2019 liability between the couple.

5.5 In any event, it is my belief that there is insufficient time and resources available within Revenue Jersey to implement these changes effectively, and in my opinion, based on extensive experience I believe that to attempt to do so is a high risk strategy.

6. Addendum 29 October 2020

6.1 The Panel was provided with a short report setting out in summary the proposals for repayment of the 2019 debt (The repayment proposals) on 28 October 2020.

6.2 The repayment proposals do address a number of the comments in this report regarding ability to repay this debt, and as a structure on which the Regulations will be based does address the most serious concerns about hardship and those who have already planned how they will repay their PYB year.

6.3 There are a few concerns that I have raised in my report that are not, at this stage, considered by the repayment proposals, namely:

- The split of the 2019 debt between married couples and civil partners on the introduction of independent taxation or on divorce.
- The impact on lending decisions by mortgage lenders and the potential impact of this debt on mortgage lending to affected taxpayers.