Supplementary comments on the Zero/Ten Design Proposal subsequent to a meeting with the Scrutiny Panel on Friday 4th August

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A Preamble

1. The 0/10 Design Proposal is inevitably complicated and the one hour available to discuss the proposals with the Scrutiny Panel imposed a time constraint on the discussion. I have had an opportunity to consider all that was said at the meeting and I hope that the comments that follow clarify some of the things that I said and probably change the emphasis on some of the comments that I made.

Jersey Limited Liability Companies

2.1 With the exception of the three Jersey utility companies (the JEC, Jersey Water and Jersey Gas) and with the exception of financial services companies which will pay income tax on its profits at the rate of 10%, all other companies resident in Jersey will not suffer income tax.

The underlying principle is that Jersey resident shareholders will pay income tax in Jersey on their deemed share of the profit of the company in which they hold shares.

There are two types of companies which can be distinguished by the basis of assessment under which they are assessed to income tax at the present time. These two types of companies can be further sub divided as suggested in the comments that follow.

Investment Companies

2.2 In layman's terms these are companies other than companies which trade. They earn their income by investing in stocks and shares, bank interest and property. They are at present assessed under the rules of Schedule A or Schedule D with the

exception of the rules of Schedule D Case I which are applied to companies which trade

The First Sub Division of an Investment Company

2.3 The majority of investment companies incorporated in Jersey in which the Jersey resident holds shares are "family companies". The limited liability company exists to provide an artificial barrier between the shareholders and the underlying assets whereas in a trading company the principal object of the company is to provide protection to the shareholders by limiting their liability.

The 100% Look Through Provisions

2.4 Under the rules of Schedule A and Schedule D an investment company is assessed on the actual income of the company. At present the company suffers income tax at the rate of 20% on its income less relief for management expenses and the shareholder suffers no further tax. The shareholder who has investment income in his own right is also assessed to income tax on the basis of the actual income arising in the year to assessment. It makes no difference therefore if the individual is assessed rather than the company if the company is a "family company".

The Family Company

2.5 It is probably easier to define a "family company" by the number of shareholders rather than the relationship between the shareholders. A family company, for example, could be defined as a company in which there are not more than ten shareholders but shareholders related by blood or marriage should count as one shareholder.

An Investment Company which is not a Family Company – the Second Sub Division

2.6 These are generally large investment companies or unit trusts in which Jersey residents hold shares. I suggest that these companies (whether resident in Jersey or elsewhere) should be granted a distribution status if they distribute say 95% of

their income. Otherwise the Look Through Provisions would apply to shares held by Jersey residents in investment companies resident in Jersey or elsewhere. It would also mean that tax which is at present being avoided by Jersey residents who invest in companies which accumulate their income would become vulnerable to income tax in Jersey.

Management Expenses

2.7 Investment companies are assessed on the gross amount of their investment income but are allowed a deduction for management expenses. This basis of assessment differs from a trading company which is assessed on its net income. I would like to vary and amplify what I said at the hearing on 4th August.

The management expenses incurred by family companies which are allowed for income tax generally consist of the annual registration fee of £150, directors' fees paid to the family and professional fees paid to accountants.

In establishing the income tax liability payable by the shareholders I see no reason for allowing relief for the management expenses in a family company. An individual who holds investments in his own name does not get relief for the fees paid to his professional advisers in dealing with the preparation of his income tax return and I see no reason why relief should be given for the fees paid by a limited liability company. The directors' fees are provided in a family company in order that the shareholder can obtain earned income relief and a married woman an additional personal allowance. These reliefs are not available to the individual who holds his investments in his own name.

Trading Companies

3.1 I believe that the 0/10 proposals for trading companies are at fault because trading companies will always retain profit to increase their reserves and fund expansion.

I suggest that as in the case of investment companies trading companies can be sub divided into family companies defined for example as a company in which there are not more than ten shareholders but shareholders related by blood or marriage should be counted as one shareholder and other trading companies.

The small family trading company would, for example, be a Jersey builder who traded as a limited liability company in order to avoid bankruptcy if the business did not prosper while he was trading in his own name. ~For income tax purposes the barrier is artificial.

The position is different for public or large trading companies which are probably best described as companies in which the majority of shareholders take no part in the day to day management of the company's business. They will generally be companies to which individuals, who are not necessarily directors, have subscribed and who hold their shares as an investment.

The Assessment of Family Trading Companies

3.2 I suggest that justice would be served if a family trading company was permitted to retain say 10% of its profits before the look through provisions are applied.

Public or Large Trading Companies

3.3 I suggest that justice would be served if the public or large trading company was permitted to retain say 33-1/3% of its profits before the look through provisions are applied. A public company will inevitably endeavour to distribute as large a dividend as prudence permits in order to maintain the value of the shares and to meet pressure from shareholders. This basis of assessment would apply to shareholders holding shares in any trading company which was not defined as a family company.

The Complications of the 0/10 Design Proposal and its lack of equity

3.4 Both the Jersey Chamber of Commerce and the Jersey Hospitality Association have referred to the proposals being complex. The Jersey Chamber of Commerce has also expressed concern about the look through procedures with particular relevance to the deemed distributions. The proposals are inevitably complicated and I share the concern about the deemed distribution proposals. I spoke about my concern about the deemed distribution proposals at the hearing on 4th August and I refer the Scrutiny Panel to paragraph 26.3.7 of the proposals. The table in that paragraph deals with a profit of £400 over four years and an actual distribution of £340. This is a distribution of 85% of a company's accumulated profit over four years or a retention of 15% of the profit each year. I cannot recall having seen the accounts of a bona fide trading company (other than a family trading company) resident in Jersey which retains only 15% of its profit. I believe that the suggestions that I have made reduce the complications of the 0/10 proposals and reduce the lack of equity in the proposals for trading companies.

Regulation of Undertakings & Development (RUDL Charge)

4.1 There are a large number of large companies which trade in Jersey which are subsidiaries of English companies or which are owned by shareholders who do not reside in Jersey. Prior to the introduction of a zero/ten provision these companies will have paid a substantial amount of tax.

4.2. There are also a large number of companies incorporated outside Jersey which trade in Jersey in a permanent establishment in Jersey as defined by the Double Taxation Agreement between the United Kingdom and Jersey.

4.3 These companies will not pay tax in Jersey under the 0/10 proposals and their shareholders will avoid paying tax in Jersey on dividends or profits distributed to them.

4.4 These companies will therefore enjoy a fiscal advantage when compared with their Jersey competitors. It has been suggested that those companies which trade in Jersey and which will avoid paying Jersey tax will suffer tax in the territory in which the parent company or its shareholders are resident. I think that this is to some extent a naïve suggestion as it depends upon the territory in which the parent company or shareholders are resident and the anti avoidance legislation in that territory in order to tax the profits arising in Jersey.

A Lack of Equity

4.5 There has been considerable critical comment on the proposed RUDL charge and this is principally because it will impose an undue burden on the small Jersey trading company which will incur additional costs and enhanced administrative problems if it has to convert to a Limited Trading Partnership. I do not therefore propose to add to the critical comments that have already been made and which are generally well known.

I recognise however that the proposed introduction of the RUDL charge is an attempt to reduce the lack of equity in the treatment of a company resident in Jersey whose shareholders will be liable to income tax at the rate of 20% on its profit when compared with those companies whose parent company or shareholders are resident elsewhere.

The paragraphs that follow dealing with Schedule A suggest an alternative to the introduction of the RUDL charge.

5.1 Schedule A

My original comments on the 0/10 proposal suggest that the benefit in kind enjoyed by the owner/occupier of land and buildings in Jersey should be taxed and I do not propose to repeat those comments.

5.2 I recognise that the suggestion is controversial particularly because it introduces the assessment of a benefit in kind albeit that this benefit in kind was assessed to income tax until the Law was changed.

I recognise also that it can bear heavily on the resident whose financial resources outside the ownership of the house are limited.

I recognise also that the owner/occupier is involved in costs which are not suffered by the individual who rents the property which he or she occupies.

5.3 I suggest that the difficulties referred to in paragraph 5.2 above would be overcome or diminished if a threshold be introduced below which no Schedule A tax would be payable and if a reduced rate were applied before income tax at the rate of 20% is imposed.

5.4 I enclose the 2005 Rate List for St. Clement. I suggest that no Schedule A tax be paid for the foncier quarters, which represent the assessed rental value, up to an amount of £15,000 and that the next portion of £10,000 or part thereof be assessed at 10% and the excess of £15,000 be assessed at 20%. The quarters shown in the rate list are for owner/occupiers where the foncier and occupiers quarters are identical. In some instance the occupiers quarters are less than the foncier quarters because part of the property is occupied by another individual. This is illustrated by my own assessment as my housekeeper lives in a flat on the property but I should nevertheless be assessed on the amount of the foncier rate.

5.5 A principal benefit of the reintroduction of Schedule A assessments being raised on the owner/occupier would be that it would provide an alternative to the RUDL charge for companies trading in Jersey which are not owned by Jersey residents. There should be no threshold and no reduced rate for trading companies wherever the shareholders are resident. This is because of two reasons. Firstly, the gross annual value which would be the equivalent of the foncier rate quarters would be

allowed as a deduction from the profits assessed to income tax under the provisions of Case I of Schedule D. This is the position which prevailed before Schedule A for owner occupiers was abolished. On the look through provisions the assessable profit would be reduced by the gross annual value.

Secondly, the trading company would be allowed as an expense to the costs incurred in maintaining, insuring and the payment of parish rates in assessing the profit liable to tax under the provisions of Case I Schedule D.