

JERSEY HOSPITALITY ASSOCIATION RESPONSES TO THE ZERO/TEN DESIGN PROPOSAL DATED 24 JULY 2006

1. Jersey Hospitality Association (JHA)

Jersey Hospitality Association is an independent trade association that was formed nearly 50 years ago to promote the interests of its members (currently around 400 businesses) who are all involved in the hospitality, tourism and leisure industry in Jersey.

JHA believes that one of its functions is to act as spokesman for the hospitality; tourism and leisure sector in Jersey and it is in this capacity that this response is given.

2. Background to this paper

As a result of international competitive pressures, the States of Jersey identified the need to change the way in which companies are taxed in Jersey. In February 2004, the Finance and Economics Committee published its draft tax reform proposals in a document entitled 'Facing Up To The Future'. This document was the prelude to a lengthy round of public consultation and debate, after which the States approved its Fiscal Strategy in July 2004.

Two of the changes agreed in the Fiscal Strategy were a reduction in the general rate of tax on corporate profits, from the current 20 per cent rate to a rate of zero percent for most companies, but with a higher (and yet internationally competitive) rate of ten per cent for financial services providers. Taken together, these changes are known as "zero/ten" and it is planned to implement them on 1 January 2009.

In April 2005, Finance and Economics published an update on the whole fiscal strategy in 'Facing up to the future-Why we are changing Jersey's tax structure.'

Much of the ensuing dialogue has been concerned with the proposals to make up the tax shortfall that will result from zero/ten, including the implementation of a goods and services tax (GST). JHA has responded separately to the GST proposals and will continue to make comments on behalf of the hospitality, tourism and leisure industry whenever consultation is invited.

This paper deals with the industry's response to the specific proposals of zero/ten, published on 5 May 2006.

3. Involvement of the Tourism Industry in the consultation process

JHA responded to 'Facing Up To The Future' in its report dated 12 May 2004, in which it endorsed the views presented by the Jersey Chamber of Commerce and Industry, published on 25 March 2004.

JHA and its members also participated in the Tourism-specific consultation on GST, which was published in November 2004. JHA responded to the latest GST proposals on 20 June 2006.

Prior to the advent of Ministerial Government, JHA was a member of the Tourism Board under the former Economic Development Committee. In this capacity, JHA was able to give regular feedback to the States as to its views on matters affecting the hospitality, tourism and leisure industry throughout the evolution of these fiscal proposals.

Under the new structure of government, JHA is working with the Minister for Economic Development and the Chief Executive of that ministry in the continuing best interests of the hospitality, tourism and leisure sector.

4. Bibliography

The findings of this report have involved consideration of the following documents: -

1. Facing Up to the Future-reforming public spending and taxation to sustain a prosperous and competitive economy (February 2004)
2. Response by the Jersey Chamber of Commerce and Industry Incorporated to Facing Up to the Future (25 March 2004)
3. Response by the Jersey Hospitality Association to Facing Up to the Future (12 May 2004)
4. Fiscal Strategy (lodged au Greffe 1 June 2004)
5. Facing up to the future-Why we are changing Jersey's tax structure (April 2005)
6. The Zero/Ten Design Proposal-Treasury & Resources Department (5 May 2006)

5. General comments on the Zero/Ten Design Proposal

JHA is primarily an association of business people. Our overriding impression of these proposals is that they are incredibly difficult for the ordinary businessperson to understand and we have therefore needed to consult our professional advisors in order to make some meaningful comments on this matter.

It should be remembered that zero/ten comes on top of a range of recently introduced or impending tax changes, including: -

- Benefits in kind
- Restriction of interest relief
- ITIS
- GST
- Business rates

These changes have all created a huge administrative burden on traders to the extent that we have become unpaid tax collectors. The majority of these changes have arisen to protect the finance industry, but little apparent heed has been paid to the collateral effects on operators in other sectors such as ours.

6. Specific comments on the Zero/Ten Design Proposal

References below are to the section numbers of the Zero/Ten Design Proposal published on 5 May 2006. Comments have been confined to those matters directly concerning the hospitality, tourism and leisure industry.

7.2.8

Often there is a clear distinction between what is revenue or capital. However, there are times when the distinction is blurred and we question how this is to be handled by company secretaries responsible for the content of the distribution voucher. We note from paragraph 31.2.4 that companies and their agents would be expected to seek agreement with the Comptroller prior to the distribution of profits to shareholders of the split between income and capital. Such discussions can often be protracted and could lead to tension between the shareholder, the company, its advisers and the Comptroller. It appears that in such cases it would be preferable for the distribution to take place on the basis that the split between income and capital would be notified to the shareholder at a later date.

7.2.15

If, as proposed, dividends received are to be taxed on the recipient under Schedule D Case VI, clarification is required as to the taxation of dividends received from companies that have already been taxed under "look through," otherwise the same income will be taxed twice.

7.3.7

It is not explicitly stated what information would be required to be given by the tax payer under a "tick the box" approach. More clarity is therefore required before any meaningful comment can be made. At this juncture, we merely state that the position of minority shareholders should be fully considered before the introduction of any new statutory provisions.

7.10.4 & 7.10.7

In general we welcome the introduction of statutory group relief, which may be relevant to some of our larger members. However, there will be some instances where the payment of a management fee is still the preferred option and we would request that this form of relief be continued in parallel with the proposed statutory relief.

The proposal would seem to deny group relief to an investment holding company other than a holding company with trading subsidiaries. The case has not been made for this. There will often be commercial reasons for holding what might be termed as passive investments through a subsidiary separate from its fellow trading subsidiaries. We would ask that the proposed restriction of relief be reconsidered.

The proposal does not detail how group relief will apply in regard to quantifying profits for the deemed distribution charge. Further information would therefore be appreciated.

10.1.4

- a) The proposal to deny relief for management expenses appears to be simply a tax raising measure and not strictly within the remit of zero/ten. The paper gives no explanation as to why the measure is being proposed. If, for example, a property investment company is held as part of a commercial group, there seems to be no logical reason why management expenses should not be allowed.
- b) The look through proposal does not address the position of minority shareholders and we would be interested to know what consideration has been given to this issue. The particular concern we have is that minority shareholders could be taxed on profits that they may never receive in the form of dividend.
- c) The paper does not state what the treatment under look through will be if there is a change in shareholding of the investment company during the year under review. Clarification on this aspect is therefore requested.
- d) Under the proposals a trading company and an investment company within the same group will receive different treatment, i.e. look through and deemed dividend basis respectively. The differing bases for companies within the same group will lead to unwanted complications, particularly on change of ownership.

10.3.4 & 10.3.7

The definition of an investment company appears to be arbitrary; will this be a matter for legislation and will a draft thereof be issued for public comment prior to implementation?

10.4.3

The LTP solution is a contrived solution to a by-product of the zero/ten structure and is yet another change for traders to have to confront. There will undoubtedly be a cost to business in making the switch, which is unwelcome.

We have concerns that the LTP will be an unfamiliar structure to the outside world (principally the UK) in terms of their contractual dealings with Jersey operators.

10.5.2

We have yet to see details of the proposals to change to a current year basis of assessment and we are therefore unable to make specific comment on this point. Given that the proposed introduction date for this change is 2008/9, we suggest further consultation without delay.

16.1.4

The RUDL proposal is designed to address the apparent inequity of non locally-owned companies not paying any Jersey tax. The proposal appears to create the possibility of three differing treatments: -

- 1) Non locally-owned trading companies will suffer the RUDL charge to their bottom line.
- 2) Locally-owned trading companies (who choose not to convert to LTPs) will bear the RUDL charge as an allowable expense in their P&L and effectively suffer 80% additional cost.
- 3) For LTPs, the RUDL will effectively be treated as a payment on account of their income tax liability (i.e. LTPs achieve 100% tax relief for this payment.)

There could be legitimate commercial reasons why a business does not opt for the LTP, particularly in the early years of its existence until the legal and business sectors becomes comfortable with it as an acceptable legal concept.

While noting the stated rationale for the RUDL charge it appears that its purpose is also to compensate the Island in some small way for the loss of tax it will suffer in respect of those businesses not otherwise covered by the specified financial services company regime referred to at section 11 of the Paper. This would cover, for example, the high street shops beneficially owned by non residents of Jersey who under the proposals will qualify for the zero rate of tax. The Paper does not explain what alternatives means of taxing such businesses have been explored, for example at the 10% rate in the case of publicly owned companies operating through a permanent establishment. Consequently the reader is left wondering if the proposed RUDL charge is the best option. To this extent, without any meaningful discussion, the proposal is unsatisfactory. It is noted that HM Treasury suggests that publicly owned companies fall outside the scope of the Code – paragraph 19.1.1.

20.2.3

At present, capital allowances are available to all trading entities. While it is noted that consideration has been given to not allowing capital allowances to specified financial services companies, the Paper is silent in regard to all other businesses and their continuing ability to claim relief for capital expenditure. Confirmation that such claims will still be available would be appreciated.

24.3.1

This point implies that some trading companies have a long-term hidden agenda to enhance the capital value of their operation in order to liquidate this tax-free at a future date. We do not agree with the statement that the retention of trading profits within a company over the long term or indeed indefinitely should be viewed as simply "fattening up" the company for eventual tax free extraction of profits. Some of the profits may be paid as dividend but the balance remaining is invariably invested or applied for business purposes. In any case, the retained profits have already been subject to Jersey income tax when earned.

24.3.3

It is proposed that shareholders will pay tax on "dividends" from trading companies, regardless of whether or not a physical dividend has been paid out.

The assumption in this paragraph is that the regular payment of dividends is part of the "normal economic cycle" of a trading company. While this may be so in regard to some established profitable businesses it will not be the case in all businesses. Nor will it be so in the case of businesses that are in their start up phase or businesses encountering difficult trading conditions, either actual or prospective. In any event the proposed deemed distribution relates to 100% of the profits whereas those companies that do pay dividends may pay only a fraction of their reported profits.

The deemed distribution basis does not address the position of minority shareholders referred to at 10.1.4 b) above.

25.1.2

It appears that the proposal to tax loan benefits will not apply to investment companies that are subject to look through.

Clarification is required where:

- a) Immediately prior to the introduction of the benefits charge there is a loan outstanding. Logically the benefits charge should not apply to such a loan, as it will have been made out of taxed profits.
- b) A loan benefit tax charge is raised on the shareholder and the profits out of which the loan has been made are subject to the deemed distribution charge. Will there be a set-off to prevent a double tax charge?

26.1.2

We disagree that "profit retention by a company means that the shareholder gives the company an interest free loan who is thereby not achieving an economic return from his investment". The shareholder's economic return where the company retains its (currently) taxed profits is reflected in the capital value of his shares.

26.3.1

The proposed system of deferred distribution charges and deemed distributions is complex and will result in additional compliance costs for taxpayers and increased work load for their professional advisers. The present deadline date for filing tax returns would have to be reviewed and extended.

The situation of minority shareholders has not been satisfactorily resolved (see comments above).

The deemed distribution charge and its application to companies within a group have not been discussed.

Where there are changes in shareholders, a new shareholder could find himself paying tax on profits earned during a period when he was not a member of the company.

In addition there is proposed a two tier system, one for investment companies and another for trading companies. The matter is further complicated where a company is conducting both types of activity requiring special rules to determine on which side of the line it falls. It is suggested that there should be one system applicable to all companies.

7. Conclusions

The zero/ten proposals are lengthy and complex and the JHA has consulted with its professional tax advisors in compiling this report.

JHA represents the interests of its members who range from small local enterprises to large groups, employing several hundred staff. These tax changes are clearly a significant undertaking for all concerned, both government and industry. We strive to ensure that none of our members, regardless of size, will be unfairly disadvantaged by any aspect of these proposals.

In designing a system by which ordinary local business is to be taxed, we would ask Treasury and Resources to aim for **simplicity and transparency** wherever possible.

8. Sign off

The Management Committee of the Jersey Hospitality Association, chaired by Robyn Lapidus, has commissioned this report.

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