# QUESTIONS TO BE ASKED OF THE PRESIDENT OF THE FINANCE AND ECONOMICS COMMITTEE ON TUESDAY 30th MARCH 2004, BY DEPUTY G.P. SOUTHERN OF ST. HELIER

**Question 1**

In answer to my question of 16th March 2004, regarding the proposed new tax reforms, the President gave a maximum figure for additional tax payable under his proposed reductions in allowances of £5,720 for a couple with 2 children earning £150,000 and having a mortgage of £300,000. Will the President inform members by how much this figure will be raised if –

(a) the children were in higher education?

(b) the wife/spouse was working? and,

(c) either partner was paying additional voluntary contributions (AVCs) to top up a States pension, or was paying contributions into a private pension fund of, say, £10,000 per annum?

**Answer**

The figure of £5,720 would be raised as follows –

(a) if full child allowance were given for both children in higher education, by another £1,000;

(b) if the wife was working and earning at least £4,500, by another £900

(c) there would be no increase in the couple's tax bill as pension contributions to an approved scheme will continue to be allowed as a deduction from assessable earnings.

Deputy Southern's example demonstrates the merits of the Finance and Economics Committee's proposals to phase out tax allowances and reliefs for those on high incomes. The current very generous level of tax allowances for those on high incomes means that, in Deputy Southern's example, the couple earning £150,000 making pension contributions of 5% would pay tax of £20,880. This is an effective rate of tax of 13.9%. Under the Committee's proposals, the tax paid would rise to £28,500, which is an effective rate of tax of 19%.

**Question 2**

Would the President inform members whether the Committee intends to introduce any tax avoidance measure such as or similar to that introduced in the United Kingdom, whereby all those offering tax-planning schemes involving payments to employees or financial products are required to seek the approval of the Inland Revenue by registration of any scheme prior to offering it to the public as failure to do so would render the selling of any such scheme illegal?

**Answer**

The Income Tax Law has had, for many years, a general anti-avoidance provision at Article 134A, which has proved useful in tackling tax avoidance in Jersey. For example, in the last 6 months alone, the Comptroller of Income Tax has ruled in 154 cases where a degree of tax avoidance was involved. It is, however, likely that the introduction of a measure similar to the one proposed in the United Kingdom would prove useful in further reducing tax avoidance in Jersey, so the Committee awaits, with interest, the detailed draft legislation that will be published in the U.K. Finance Bill 2004. It may well be that the Committee shall propose amendments to Article 134A, or perhaps introduce new legislation to make it a condition that any person who engages in any scheme or structure to avoid Jersey income tax must declare such a scheme to the Comptroller of Income Tax, who will have the power to counteract any schemes that entail the avoidance of Jersey income tax. However, as with so many

matters to do with tax, there are potential difficulties, as experience internationally has shown that such draconian arrangements can get bogged down in legal challenges. It may also impact on what taxpayers would regard as legitimate commercial activity aimed at, for example, making them more competitive. Such a system would also inhibit the current constructive and reasonable working relationship that the Comptroller has with taxpayers and professionals. If the Committee does decide to proceed with such a measure, the time to do so may well be in conjunction with the proposed 'look through' arrangements to tax corporate profits on Jersey resident shareholders, as these provisions will have to be very tightly drawn to ensure that there in no leakage of tax revenues through avoidance schemes being put in place by taxpayers and professional advisers.

**Question 3**

With regard to answers given by the President in reply to questions asked by Senator P.V.F. Le Claire on 16th March 2004, regarding a new fiscal policy, would the President inform members –

(a) why provision is made for exempt companies to pay 20% tax on income arising in Jersey when the information available suggests that their tax contribution is no more than the exempt company charge of £600;

(b) how many International Business Companies (IBCs) pay tax at rates of 2% and under, and how much income this has generated in 2003? and,

(c) How many IBCs paid tax in 2003 at the rates between 2% and 30% on income or profits other than those arising from international activities, and how much revenue this produced?

**Answer**

(a) The Income Tax Law provides that, if certain conditions are met, an exempt company shall be treated for all purposes as not resident in the Island. Being treated as not resident means that the exempt company is exempt from Jersey income tax on income arising outside Jersey and on bank and building society interest arising in the Island, (in accordance with the usual concession). However, other income arising in Jersey, such as rental income, and profits arising in Jersey through an established place of business, are liable to Jersey income tax at the standard rate of 20%. As exempt companies are exclusively used by non residents of Jersey, virtually all of their activities and income arise outside Jersey, but provision had to be made in the Law to ensure that those exempt companies that do receive any Jersey source income pay tax on it at the standard rate of 20%.

(b) It is impossible to answer this question accurately in the time available as the Comptroller of Income Tax has to undertake a detailed examination of the manual records relating to some 100 international business companies. The Comptroller has now started such an examination and it is anticipated that, if the Deputy contacts the Comptroller after the end of next week, he will have the information that the Deputy seeks.

(c) It is impossible to answer this question accurately for the same reason as given at (b), but it is anticipated that this information will also be available for the Deputy at the end of next week.

**Question 4**

Would the President provide details to members of what proportion of the possible £100 million of lost revenue produced by the Committee's zero/ten proposals will come from each of the following sectors?

International business companies
Exempt companies
Financial administration companies associated with the above
Non-finance businesses – locally owned
Non-finance businesses – not locally owned.

**Answer**

The loss of some £100 million in tax revenues is a worse case scenario and it can be broadly categorised as coming from the following areas –

International business companies – 10%. Many of the international business companies who pay substantial tax revenues are already close to an effective rate of tax of 10% so the majority of that business should stay once the proposed 10% rate is introduced, but a few may go.

Exempt companies – 10%. This relates to the loss of the exempt company fee of some £10 million as they will all be categorised as zero rate. However, it should be possible, subject to international competitive pressures, to recoup this loss through, for example, increasing the annual filing fee.

Financial administration companies associated with the above –

It is not possible to give a percentage loss to this kind of business as it is not known which, if any, financial administration companies deal solely with international business and exempt companies. The percentage figure is not expected to be significant.

Non-finance business – locally owned and not locally owned. In broad terms, some 40% of the potential loss relates to non-finance business. Of that, I estimate some 20% to 30% relates to non-finance business trading locally whose shareholder base is outside the Island. The balance relates to locally owned businesses. It will, of course, be possible to claw back some of the tax lost through levying a zero corporate rate on locally owned companies by taxing the Jersey resident shareholders of such a company on the actual company profits under 'look through' arrangements. We are also pursuing ways of recovering some or all of the tax attributable to non-resident shareholders.

The majority of the loss, perhaps 50%, is estimated to come from the income tax companies involved in the finance industry currently paying at an effective rate of tax close to the standard rate of 20% which will fall to be taxed at 10% under the Committee's proposals. Again, some, but by no means all of these, are locally owned.

**Question 5**

With regard to the Committee's plan to raise revenue by £100 million, which includes an increase in the Island's economic output of 2% resulting in raising £20 million in extra tax, would the President inform members –

(a) whether this would mean an actual increase of 6% in economic growth if the current rate of inflation remains the same as this year.?

(b) whether an increase in economic growth of this magnitude can only be achieved by creating more jobs and thus putting more money into circulation? and,

(c) whether the addition of a sales tax on top of proposed economic growth of this magnitude could cause double digit inflation?

**Answer**

(a) In theory, economic growth should be measured against an indicator such as GNI, (Gross National Income). In this instance, the Committee is using the Retail Price Index as the yardstick, and on that basis the 2% real increase in output would equate to 6% in cash terms given the current R.P.I. of 4%.

(b) It is conceivable that such a rate of growth could be achieved without creating more jobs and by simply improving productivity and/or increasing investment in the economy. However, realistically if such growth is to be sustained it should lead to higher employment levels on the island, and therefore inward migration, (given the prevailing low level of unemployment). Higher growth should also generally mean more transactions in the economy and an increase in the circulation of money, although this does not necessarily mean higher inflation.

(c) The imposition of a Sales Tax or other form of Goods and Services Tax, (GST), will have two opposing impacts on inflation. Firstly, it will constrain or reduce inflation by reducing aggregate demand in the economy. Without the GST, (or another tax increase of similar magnitude to replace it), the government deficit will be higher, adding greater stimulus to the economy and therefore adding to inflationary pressure. Secondly, to the extent that the GST will increase retail prices it will in the short term add to inflation. This impact can be reduced if it is prevented from feeding through into higher wage demands and prices elsewhere in the economy. This can be achieved by breaking the link between RPI and wage demands, managing inflation expectations and increasing competition across the economy. Under such circumstances the introduction of a GST should have a largely one-off impact on inflation. Even allowing for economic growth, I would be amazed if the proposed rate for a Goods and Services Tax of 5% caused anything like double digit inflation.