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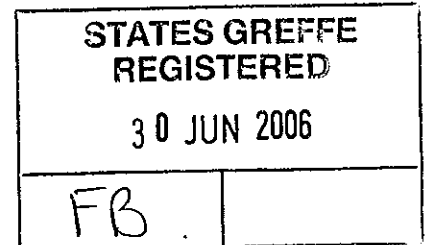

29 June 2006

Mr Julian Morris
Fiscal Strategy Programme Manager
Treasury and Resources Department
2nd Floor
Cyril Le Marquand House
The Parade
St Helier
Jersey, JE4 8UL

Dear Mr Morris

Please find attached our firm's comments on the Zero/Ten Design Proposal document issued by the Treasury and Resources Department on 5 May 2006.

Our comments are fairly detailed but as a general overriding comment we feel that the proposals are generally rather complex and not in line with the present spirit of the existing Income Tax legislation, which has been relatively straightforward in the past.

We also note in section 32 that your consultation procedures extended to the 'Big Four' accountancy firms in particular.

In Jersey, the 'Big Four' have limited exposure to local trading companies and residents as the bulk of their work tends to involve large scale financial institutions and offshore business. It may have been beneficial, with hindsight, to have involved a smaller local firm in the consultation procedures.

For your information we have copied our reply to the relevant Scrutiny Committee.

We look forward to receiving your comments in due course.

Yours sincerely

for Le Rossignol, Scott Warren and Company

cc Scrutiny Committee

COMMENTS FROM LE ROSSIGNOL, SCOTT WARREN AND COMPANY
(CHARTERED ACCOUNTANTS)
ON THE ZERO/TEN DESIGN PROPOSALS.

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COMMENTS FROM LE ROSSIGNOL, SCOTT WARREN AND COMPANY (CHARTERED ACCOUNTANTS) ON THE ZERO/TEN DESIGN PROPOSALS.

Our comments below are numbered in accordance with the document:

6.4.5

a) The proposal to impose a £150 charge in respect of foreign incorporated investment companies would appear to be discriminatory and not in compliance with the Code.

b) While the charge may encourage the formation of Jersey companies in future it still leaves a substantial number of FIICs already incorporated and administered in the Island for which the charge will apply. There is no perceivable benefit to the client in imposing this charge and it begs the question why such companies should have to bear the charge simply to aid Jersey's tax raising measures. This is undoubtedly a matter that will be raised by clients who, it should be said, are already paying fees to their Jersey administrators as well as registration fees to the location of domicile.

We therefore suggest that either existing companies are grandfathered so that the charge is not payable by them or that its imposition be deferred for a period, say three years.

The implication we read into paragraph 6.4.6 is that regulated entities may choose to absorb the charge into their overheads thereby reducing profits. In practice this will not happen; one way or another client will bear the cost and to this extent the charge will be inflationary.

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 are to be taxed under Schedule D Case VI clarification is required as to the taxation of dividends paid by investment companies subject to "look through" otherwise the same income will be taxed twice. The same problem should also be addressed in regard to trading companies.

7.3.7

It is not explicitly stated what information would be imparted by introducing 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.

7.3.8

We consider that the time has come for the provision of unilateral relief to be placed on a statutory basis rather by extra statutory concession. At present the relief is very much at the Comptroller's discretion and the "rules" under which the relief is granted can vary from case to case. A statutory basis will, it is suggested, provide better clarity for the taxpayer and will confer the normal rights of appeal where disputes over interpretation arise.

The impact of double taxation is highlighted at paragraph 7.3.6. As indicated by the "tick the box" proposal at paragraph 7.3.7 it is likely that, should the measure pass into law, foreign income will in many instances suffer double taxation. This already happens in the case of Jersey resident taxpayers. The lack of a general unilateral relief provision in the law is a source of concern and disquiet for many Jersey taxpayers; they are often worse off than they would otherwise be under the tax laws of many competing jurisdictions if they were to reside there. For instance, applying the figures at 7.3.6 and comparing the UK with Jersey, a Jersey resident would pay 44% overall and his UK counterpart would, by virtue of double taxation relief, pay 40%. We therefore urge Treasury and Resources to consider this matter and put before the States a proposition for the granting of unilateral relief in respect of all foreign taxes suffered not otherwise covered by a double tax convention.

7.10.4 & 7.10.7

In general we welcome the introduction of statutory group relief. 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.

8.2.6

Presumably this will cover partnerships. The position of a limited partnership, often used in venture capital investment programmes, should be clarified as the imposition of a 20% tax charge on such entities will result in a loss of business to the Island.

10.1.4

a) The proposal to deny relief for management expenses is a tax raising measure. The paper gives no explanation as to why the measure is being proposed. The proposal will be seen as a tax on "middle Jersey" and penny pinching. We hope that it will be seriously debated by the States, should it proceed to that stage.

Investment companies are used by the relatively well off. The main reasons for this are to provide a central repository for internationally structured investment portfolios which, if owned directly by the owners of the investment company, on their demise, could involve application for grant of probate in many foreign jurisdictions with the inherent costs and time delays. Secondly, the investment company provides a shelter from taxation that could otherwise apply to directly held assets. UK inheritance tax is a case in point where ownership of assets through a Jersey investment company mitigates the impact of a 40% tax charge. Thirdly an investment company will be used as part of the beneficial owner's overall financial planning strategies, especially in passing assets from one generation to the next.

Many such investment companies are managed by third-party Jersey based administrators. The management fees and directors fees charged for these services form part of the taxable income of the provider and will therefore continue to bear tax under the 0/10 proposal. Consequently, by denying relief to the investment company for its expenses of management double taxation will result so that for each Pound of investment income received paid out in expenses the overall tax rate will be a maximum of 40%. This does not sit well in an Island that is attempting, as part of its economic growth strategy, to attract high value residents.

We would urge that the proposal to deny relief for management expenses be abandoned.

b) The look through proposal does not address the position of minority interests and we would be interested to know what consideration has been given to this issue. Presumably the draft legislation, should it progress to that stage, will be reviewed by the Attorney General and we would be surprised if he will be content for the position of minority shareholders to be effectively ignored. There would appear to be Human Rights questions implicit in the proposal. We believe that it will not be an adequate remedy to simply say that an investment company may declare a dividend to reinstate the financial loss suffered by its shareholders. Those controlling the company may not wish to receive a dividend which leaves the minority holder without any effective remedy. Furthermore the imposition of a tax charge on a minority shareholder will diminish the value of his investment in the company making it even less attractive for him to sell his shares to anyone other than a controlling shareholder. This in turn diminishes the marketability of his shares. We believe these are important matters that should not be overlooked.

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, in particular:

- Will the shareholder be assessed on a proportionate share of the income of the year of assessment by reference to his period of ownership?

- Will the measure of the income assessable be the calendar year income or the income of the accounting year ended in the year of assessment?

- As the shareholder will no longer be such by the time he receives his tax assessment how can he be compensated for the tax he is expected to pay?

d) The case has not been adequately made for treating investment companies on a look through basis compared with the proposed treatment for trading companies. Why do the challenges listed at paragraph 23.1.3 not also apply to investment companies?

10.3.4 & 10.3.7

These proposals presuppose that the questions raised in the preceding paragraph have been satisfactorily resolved. However, we would question whether in 10.3.6 leading up to the proposal at 10.3.7 the test as to what is "the expected yield from the investment of its reserves" is to be subjective or objective; will this be a matter for legislation and will a draft thereof be issued for public comment prior to implementation?

10.4.3

If the various proposals as presently conceived pass into law there will be a place for the limited trading partnership. However, there will be a cost to business in making the switch which, it should be said, is unwelcome. Continuity of contract is essential but legal costs in achieving this will in most cases be inevitable. Any assistance the States can give to business to smooth the transition will be welcomed. A standard form document approved by the Law Society at the expense of the States would be a good start. Legislation for the limited liability partnership is already on the statute book and we question if this could be adapted to cover the LTP. It would present an opportunity to broaden the use of that law and remove the onerous requirements presently imposed which have served only to deter those who might otherwise regard the vehicle as attractive.

While the paper refers to the use of LTPs by local traders, in principle the vehicle could appeal to non residents as well.

The proposal does not say if the LTP will be limited to trading concerns or whether it could embrace investment activity as well. Clarification would therefore be welcomed.

10.5.2

While there have been discussions between interested parties and the Comptroller concerning the proposals to change to a current year basis of assessment, we observe that a finalised proposal has yet to be issued by the Comptroller.

10.5.4

This proposal appears to address the point raised at 10.1.4 c) above concerning the measure of profits for the year of assessment but the questions raised in that section remain unanswered.

10.7.2

Unless the matter is to be covered in the final proposal referred to at 10.5.2 above, we question whether the implications of companies making up their accounts for more than a twelve month period has been considered.

16.1.4

In essence it appears that the proposed RUDL charge will be an absolute cost to those incorporated businesses owned by non residents and residents of Jersey whose businesses qualify for the zero tax rate and who, in the case of Jersey owners, do not opt for the LTP regime.

In the case of Jersey owners it is proposed that the charge would not flow through to frank distributions, deemed or actual, in respect of which they would be taxable at 20%. On the other hand it appears that those opting for the LTP will receive credit against their income tax liabilities. We suggest that the different treatment discriminates unfairly in favour of LTP members. 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.

17.3.2

Confirmation that development profits in the hands of individuals, partnerships and limited trading partnerships will qualify for earned income relief would be welcomed.

19.3.2

It appears that this proposal is confined to public companies incorporated in Jersey as the same are referred to in the preceding paragraph, 19.3.1. The proposal to tax stock dividends as income, being dealt with under the same heading: "Public companies", also appears to relate only to Jersey incorporated public companies. Clarification of these matters would be welcomed.

20.2.3

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

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. The idea that profits are retained with a view to tax free extraction will be an affront to most business people.

24.3.3

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.

Nevertheless, 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 does not thereby receive an economic return from his investment". The statement that the shareholder has made an interest free loan to the company has no foundation in law. The shareholder's economic return where the company retains its profits is reflected in the 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.

The deemed distribution charge and its application to companies within a group has 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. The example at paragraph 26.3.7 highlights this problem where there is a deemed distribution in year four out of profits earned three years previously. If the shares in question are sold , say in year two, there could be an added complication in valuing the shares unless the new shareholder can be certain that cash will be available to him from the company to settle his tax due on the deemed distribution.

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 and although this has no doubt been considered by the Paper's authors, there is little information provided as to why this approach has not been adopted.

Furthermore it is suggested that the 0/10 system should seek to minimise the complications and keep to the absolute minimum any additional administrative burdens thereby imposed on the taxpayer.

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

Such a system would take care of the problems noted above concerning minority shareholders. It would rid the system of the deferred distribution charge and loan benefits charge, thereby making life much simpler for all concerned. The shareholders of investment companies and trading companies would receive identical treatment. The treatment of companies within a group would be simplified.

Any concerns that such a system might lead to the company being treated as agent for its shareholder could be dealt with by an amendment to the company law requiring that this would not be the case. The amendment would be cross referenced to the income tax law.

There will be non resident shareholders of Jersey companies that are quite content to pay Jersey income tax at 20%. Under the proposal at paragraph 21.1.3 this would not be possible where dividends are paid as these would be tax exempt by statute. It is therefore suggested that non resident shareholders should be entitled either to waive exemption or opt into the shareholder tax system proposed above in respect of deemed distributions.

29.5.3

It is noted that new anti-avoidance measures are to be introduced. Until recently one of the main advantages of the Jersey tax code has been its relative simplicity. Latterly it has become rather more complex and the matters covered in the Paper will only add to this. The simplicity of the Jersey tax system has undoubtedly been instrumental in attracting to the Island high value residents. It is part of the Islands economic strategy to continue attracting such residents. We therefore urge that any new anti-avoidance legislation should focus on the bigger picture and not do anything to upset the delicate balance that has hitherto prevailed.

30.2

One accepts that from the Comptroller's point of view the more information he has the better placed he will be to investigate the affairs of the taxpayer. However, we suggest that the delicate balance referred to above could easily be upset and one should be very wary of introducing new rules that may be seen as a sledgehammer to crack a nut.

While the authors of the Paper may find it remarkable that individuals do not file a balance sheet, one can only say that this is a state of affairs that prevails in many jurisdictions with far more sophisticated tax systems than Jersey's. Again, the authors may not regard the provision of the information set out at paragraph 30.2.5 as onerous or intrusive but we would say that this is a matter of opinion. From our initial conversations on this subject to

date the overall assessment is that the proposals are disproportionate to the perceived abuse, whatever that might be.

From the proposal it is not clear whether high value residents who have undertaken to pay a minimum amount of tax will be asked to detail their capital contributions.

The means of dealing with the perceived abuse is to introduce targeted legislation. The reason for this approach is one of fundamental human rights whereby the taxpayer ought to know in advance how the legislature views his proposed capital transactions. Under the proposal at 30.2.5 the taxpayer will be faced with uncertainty because he will not know how he stands until the Comptroller has had an opportunity to review his transactions and this with the benefit of hindsight.

Should it be proposed, we suggest that it is not sufficient for the taxpayer to be expected to have to apply to the Comptroller on each and every occasion he intends entering into a capital transaction for a ruling. The danger of this is that it can have the effect of putting the Comptroller in the position of lawmaker when this duty properly lies with the States.

One of Jersey's attractions for many residents has been that, with one exception, it does not tax capital. The exception is the tax regime for premiums on leases. When that legislation was debated by the States words to the effect that the proposal was the thin end of the wedge and the beginning of the taxation of capital in Jersey were uttered by at least one States member. It is hoped that the principle will rest there and not be further extended.