STATES OF GUERNSEY

FUTURE
TAXATION STRATEGY

CONSULTATION DOCUMENT

March 2005

FOREWORD

The purpose of this Consultation Document is to assist the States of Guernsey to establish a strategy to safeguard the future economic well being of the Island.

It is emphasised that any decisions on a revised taxation structure will require the approval of the States of Deliberation. However, in order to take those decisions the States must be presented with a well researched and argued case. This Consultation Document is an important part of that process.

Any individual, organisation or representative body who wishes to submit their views are requested to respond by no later than **15 June 2005** to:

The Chairman
The Fiscal & Economic Policy Steering Group
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The importance of the development of a future taxation strategy for Guernsey cannot be over emphasised.

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Chief Minister	Minister	Minister
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INTRODUCTION AND SUMMARY

Guernsey has domestic autonomy with its own international personality based upon its constitutional position and successful history of democratic self-government. It enjoys a unique cultural identity based on the strong traditions of a caring community where respect for individuals flourishes. It is a community that values its past but is also confident about the future.

Guernsey has over the years developed a prosperous and resilient business environment which is able to respond quickly to changing local and international circumstances. It has created a business-friendly and competitive environment that attracts prosperous activity, entrepreneurship and diversification.

As a consequence, Guernsey has developed into a leading global finance centre of the highest reputation and standards. The benefits and income generated by the financial services sector impact on virtually all parts of the economy and, through the taxes collected is a major contributor to funding the provision of public services and infrastructure.

The maintenance and enhancement of Guernsey as a finance centre is therefore of fundamental importance to the economic and social well-being of the Island.

Recent developments in international tax standards and competitive pressures mean that in order to remain a viable finance sector change to the existing tax regime is essential. Not responding and standing still is simply not an option.

Although the finance services sector presently dominates the Island's economy, it is by no means the only sector nor can it hope to provide employment opportunities to meet the expectations of all of the members of the community. To meet the challenges of the future a vibrant diverse economy with many constituent parts is needed. Predicting future trends in business and employment is difficult. Therefore, a key component of the future taxation regime must be to develop a comprehensive package of measures which supports the competitiveness of all sectors of the local economy. It is also important that the proposals are seen as a package which together addresses and contributes to achieving overall objectives.

It is emphasised that the fundamental purpose of the work in this area is to maintain a vibrant and sustainable economy that generates corporate profits, offers well paid job opportunities and makes a positive contribution to the life of the Island. It is only through this economic activity that the States will be able to raise revenues to fund public services and infrastructure improvements.

The purpose of this consultation process, of which this Consultation Document is the first part, is to assist the States of Guernsey in determining a strategy to enhance the Island's competitiveness, encourage more value added business and thereby safeguard the future economic well being of Guernsey.

Following this first period of consultation a second document will be issued that will reflect the reaction to this document. The second document will also quantify the predicted outcomes of the various alternative measures and their impact on the local economy and its competitiveness.

Following this second round of consultation, specific proposals will be put to the States of Deliberation in the Autumn of 2005. This timetable is consistent with that previously indicated by both the former Advisory and Finance Committee and the Treasury and Resources Department.

Background

In December 2002, as part of the 2003 Budget a separate Budget supplement (the "2002 Report") was published which set out the then Advisory and Finance Committee's views for the future direction of Guernsey's corporate taxation strategy. Essentially, this long-term strategy consisted of a general rate of income tax for Guernsey companies of zero per cent in respect of tax year 2008 onwards. The profits of certain companies licensed by the Guernsey Financial Services Commission would be taxed at 10%. (The so-called "Zero-Ten" option). In order to protect the tax revenues, special rules would be introduced to ensure that Guernsey resident individuals were taxed on a proportion of the profits of a company in which they have a beneficial interest.

Since the 2002 Report there has been considerable activity across the world in response to the various international tax initiatives. Most competitor jurisdictions, including Jersey and the Isle of Man, have made announcements to the effect that they intend to adopt the approach set out in the December 2002 Report and introduce some variant of the Zero-Ten model.

As a reflection of the importance of this process the Policy Council has established a Steering Group to oversee the overall strategy. The Steering Group consists of the Chief Minister (Chair), the Deputy Chief Minister, and the Ministers of the Treasury and Resources and Commerce and Employment Departments.

More detailed technical work, including evaluation of options and modelling are the political responsibility of the Treasury and Resources Department with a technical Sub-Group under the chairmanship of its Deputy Minister, Deputy Charles Parkinson.

A considerable amount of work has been carried out to investigate and model the effects of adopting a similar tax regime in Guernsey. Having carefully carried out various modelling exercises, using the best available data, it is estimated that the annual loss of revenue to the States of Guernsey from adopting the Zero-Ten option would be of the order of £45 million.

In the 2002 Report the Advisory and Finance Committee was able to take a very positive approach to the adoption of a revised tax structure. One of the main reasons why it was originally possible to take such a view was that in recent years public finances were so healthy with very high surpluses which enabled reserves to be built up. However, the States finances are no longer that strong. Therefore, this report also addresses some of the options that need to be taken in respect of the delivery of public services.

It is also important to acknowledge that the need to change is not one that is only being faced by this Island. Other jurisdictions, many of which are direct competitors, are also faced with these issues and will, of course, continue to respond in their own best interests.

The main drivers for change are therefore twofold, the need to meet our international obligations (in order to secure access to world markets) and competitive pressures from other similar jurisdictions.

The timetable for responding to that change is not entirely within our own control. However, in order to maintain business confidence clear direction is required, at least on the main areas, by the end of 2005 in order that businesses can plan ahead of an intended implementation date of 2008.

Summary and Initial Conclusions

In order to maintain a vibrant and sustainable economy Guernsey needs, in its own best interests, to change its taxation regime to comply with international standards and combat competitive pressures.

Such fundamental change will be difficult and challenging. However, it can also be the catalyst for future benefits and prosperity.

In order to meet these challenges, it is essential that all parts of the community join together in a positive and constructive manner.

As has been stated on previous occasions, the Policy Council and the Treasury and Resources Department are determined to carry out this vital work in a methodical and measured manner and to avoid the temptation to reach any premature conclusions without these first being fully thought through, costed and consulted upon.

This Consultation Document is a vital part of that process.

The Steering Group's main conclusions are:

- Change is in the best long term economic, social and political interests of Guernsey.

- It is in the long term best interests of Guernsey to maintain and develop a vibrant and sustainable finance industry.

- Any changes must also protect and enhance the business environment of the non-finance sector.

- The basic rate of company taxation on Guernsey business profits should be 0%.

- Captive insurance companies should continue to be subject to taxation at 0%.

- Regulated finance industries, other than captive insurance companies and investment funds, should be subject to taxation at 10%. However, initial consultations with some of the regulated finance companies have revealed a preference for them continuing to pay tax at 20% if this would avoid the need for other charges which would impact adversely on their pre-tax profits.

- Resident individuals should continue to pay tax at 20% on assessable income.

- Guernsey resident individuals should be taxed at 20% on the profits of the company in proportion to their ownership.

- A 10% payroll tax, limited to 20% of the profits of a business, should be introduced. The payroll tax payable by a company would be creditable against the Guernsey tax liability of the shareholders.

- Regulated trading activities should be subject to taxation at the same rate of tax as regulated finance sector companies (i.e. not zero).

- Consideration should be given to taxing significant taxpayers (individuals and businesses) at the standard rate up to a defined income ceiling(s) after which point a reduced level(s) of tax should be payable.

- In order to compensate for the anticipated fall in tax revenues a package of measures should be adopted including:

    - Consideration should be given to revising the present personal income tax allowances and reliefs.

    - Consideration should be given to revising the social security contribution rates and thresholds (employee and employer) to reduce the amount of grant payable by general revenue.

    - Increasing the rates of existing indirect taxes rather than introduce a new general sales tax.

    - Using the Contingency Reserve (estimated to be £200m by the end of 2005) as a short term measure.

    - Greater control of public sector expenditure (revenue and capital).

The Group believes that by introducing a package of measures the challenges of the future can be met with confidence.

In order to take the necessary actions, the States of Guernsey needs to hear the views and opinions of Islanders and the business community. Any individual, organisation or representative body who wishes to submit their views is asked to do so to the address shown in the Foreword to this document.

A Competitive International Financial Services Centre

The financial services sector is the dominant part of the Island's economy, and therefore generates significant revenues to pay for public services. Of the 30,000 individuals employed in Guernsey, over 7,000 (approximately 23%) are directly employed in this sector. The financial services sector directly contributes 35% of the Island's GDP and 65% of the export economy. The indirect effect on the rest of the economy is equally important. Any taxation strategy therefore needs to address the competitive position of the finance industry as a priority. Simply doing nothing to support this industry is not an option as it would lead to the Island's most important economic sector becoming uncompetitive.

The financial services industry is not one single type of business but is made up of a number of inter-related and inter-dependent sectors. The professional support services (accountants, lawyers, actuaries etc.) also need to be available to provide very high standards of service. The inter-relationship between all these components can also be complex. To remain competitive and differentiate the Island in the marketplace, Guernsey needs this level of diversity and expertise across all sectors.

Therefore an essential part of the initial work on developing a new corporate taxation strategy was to find out in greater detail the workings of the sector. A joint survey carried out by the former Advisory and Finance Committee and the Guernsey Financial Services Commission proved extremely valuable in determining: which areas were growing, which were declining; which were the constraints and opportunities, which areas were contributing most to the economy, which were paying most in direct taxation and how government could strategically encourage growth in those areas.

One of the major benefits from carrying out this work and other various exercises, including numerous meetings with groups of interested parties, is that the degree of understanding and communication between industry, professionals, regulators and government has been greatly improved. This can only be of advantage to all of the parties concerned in the future.

It is worth emphasising that the success of the Island's finance centre is based on a number of factors unrelated to the system of taxation. Most notably:

- Political and economic stability and independence.
- High quality institutions and professional service providers of international repute staffed by a highly skilled workforce.
- Independent professional supervisory and regulatory regimes.
- Respect for the rule of law.
- Accessibility to justice and integrity of the judiciary.
- Good communications and a convenient time zone.

However, it is indisputable that like any other finance centre, be it New York, London or Dublin, an important element of success is the existence of a competitive tax environment.

In view of the recent and growing competitive pressures facing the Island, it is clear that Guernsey needs to amend its taxation regime if the financial services sector is to remain competitive and if the Island's overall economy is to be protected.

It is also recognised that any proposed package of measures for reform of corporate taxation has to take into account international standards in addition to competitive pressures.

The States of Guernsey has always recognised that as a major global financial centre, the Island must demonstrate that it has the highest regulatory standards. The Island has regularly been assessed and its standards endorsed by international bodies such as the IMF and the Financial Stability Forum.

However, it also has to be acknowledged that the international community is also attaching increasing importance to the development of international standards in the field of tax competition.

In 1998 the OECD published its report entitled 'Harmful Taxation: An Emerging Global Issue'. This report set down the criteria by which the OECD would identify so called 'tax havens' and harmful preferential regimes in Member and non-Member jurisdictions.

The former Advisory and Finance Committee reached an agreement with the OECD following its acceptance of the importance of a level playing field in the adoption of international standards and recognition that Guernsey already met the objectives as regards exchange of information on criminal taxation matters. As a result, on 27 February 2002 the OECD declared that Guernsey was a co-operative jurisdiction. This declaration was a significant endorsement of the Island's regulatory standards and co-operative approach to international initiatives.

EU Tax Package: Code of Conduct on Business Taxation

The European Union has also taken an interest in this area and has developed the EU's Code of Conduct on Business Taxation. Guernsey is not within the EU's fiscal territory and is not within the EU single market for financial services. However, Guernsey has always indicated a willingness to participate in a constructive dialogue about the development of genuinely international standards, which must be respected by all jurisdictions.

The Code of Conduct listed a total of 66 measures which it considers harmful in EU Member States and their associated or dependent territories. The following five regimes in Guernsey are listed:

- Exempt Companies.

- International loan business.

- International bodies.

- Offshore Insurance companies.

- Insurance companies.

The main reason that the Code of Conduct listed the above regimes as harmful is that the beneficial tax treatment that they provide is considered to be 'ring fenced' from the domestic economy. (Ring fencing is a term used to describe the situation when a preferential tax regime is available fully or in part only to non-residents rather than to residents in the country providing the regime.)

The existence of a zero or low tax regime is not deemed to be harmful in itself. A regime is deemed to be harmful if it is made available to non-residents tax arrangements that it does not also allow its own residents to participate in.

Hence, a tax regime where the general rate of corporation tax applied to resident and non-resident companies is zero is not deemed to be harmful. Furthermore, a regime that then charges a proportion of its companies at higher rates of tax (specified by industry sector) is also not deemed to be harmful provided that, as a proportion of the overall economy, these companies are a minority. This is why the Zero-Ten option is compliant with international practices and standards.

<u>EU Tax Package: Taxation of Savings Income</u>

At the time of the 2002 Report, discussions on the EU Tax Package had yet to be concluded. However, since that time progress, as expected, has been made and the EU Tax Package was finally adopted (by EU members) on 3 June 2003.

The EU Savings Directive is essentially an attempt to prevent tax evasion by EU resident individuals by ensuring that their savings income, which is primarily interest on bank deposits, is taxed effectively. The automatic exchange of information is a central part of that process.

The Directive does not extend to savings income paid to companies, or with very limited exceptions, to trusts. It does not extend to payments to individuals resident outside the EU, even if they are EU nationals.

Throughout its negotiations with the EU the former Advisory and Finance Committee liaised very closely with the finance industry and it was clear that there was a preference for adopting a system that gave each individual investor the right to choose between a retention tax or authorising disclosure of information to their home authority. If the disclosure option were to be made, interest payments would continue to be made gross in Guernsey without any deduction.

At its meeting on 21 June 2004, in recognition of the need to be seen as a responsible member of the international community and to respond constructively to international initiatives in taxation and transparency, the States of Guernsey resolved to enter into appropriate bi-lateral agreements with EU Member States.

It is emphasised that the Agreements approved by the States in June 2004 contain Suspension and Termination clauses which are an important feature as they recognise the vital importance of a level playing field.

The Agreements are also very significant in that they recognise Guernsey's separate and independent international personality.

Authority to enter into and suspend the bi-lateral agreements has been delegated to the Policy Council. However, the right to terminate resides with the States of Deliberation.

Summary

In summary, if Guernsey is to continue to be a competitive International Financial Centre it must:

- Remain responsive to competitive pressures from other jurisdictions.

- Continue to offer those factors which mean that it remains an attractive place to live and carry on business.

- Comply with international standards on a level playing field basis.

Of course, to a large extent, the above also apply to non-finance sector industries.

General Tax Strategy: Options

The 2002 Report and subsequent States Reports have all acknowledged the need for change. Simply doing nothing is not a viable or realistic option. Not to respond to the competitive and international pressures would result in a very rapid, severe and irreversible decline in the Island's finance industry. This would have the most severe effect on the Island's economy, employment and ability to fund public services.

In general terms the Working Group has concentrated on two main options:

- Zero–Ten
- Flat rate

Both of these main options have their strengths and weaknesses, however, a key part of the Group's deliberation has been to explore those options and how they affect various parts of the Island's business sectors. The Working Group believes that it is essential that not only is the Island's economy protected (and wherever possible its competitive position enhanced) but that, as far as possible, equity across sectors is maintained.

It is important that whichever strategy is finally adopted, all measures, including the proposed direct tax strategy, indirect tax matters and public sector expenditure policies are taken together as a total package.

A Zero-Ten regime was the option that the former Advisory and Finance Committee set out in the 2002 Budget Supplement. Since December 2002 there has been considerable activity across the world in response to the various competitive tax initiatives. Most competitor jurisdictions, including Jersey and the Isle of Man, have made announcements to the effect that they intend to adopt the approach set out in the December 2002 Report and introduce some variant of the Zero-Ten model.

As set out in the 2005 Budget Report, if Guernsey were to adopt the Zero-Ten model, it is estimated that there would be an annual loss of revenue to the States of Guernsey of £45m (around 15% of existing total revenues).

The main features of a Zero-Ten regime are:

- The basic rate of income tax on company profits (from business and investment activities) would be 0%.

- Certain companies regulated by the Guernsey Financial Services Commission would be subject to tax at 10%.

- Guernsey resident individuals would be taxed (at 20%) on the proportion of the profits of a company in which they had a beneficial interest.

If Guernsey was to adopt such a regime it would, in general outline, be consistent with the 2002 proposals and competitive with other jurisdictions. However, initial consultations with some of the regulated finance companies have revealed a preference for them continuing to pay tax at 20% if this would avoid the need for other charges which would impact adversely on their pre-tax profits.

However, unless other measures (such as the introduction of a creditable payroll tax) are also introduced, such a regime suffers from one main potential disadvantage. Resident shareholders will be subject to tax on their company's profits (at 20% i.e. the same rates as now). Non-Resident shareholders will not suffer this liability to Guernsey taxation but will probably be subject to taxation in their home jurisdiction.

Although it is accepted that the majority of finance sector businesses are owned off island, the Group strongly believes that it is important that any new tax regime does not artificially discourage local non-finance sector business from being locally owned. An important part of any consideration on a future tax strategy needs to address this issue.

The present taxation arrangements in Guernsey mean that individuals and the majority of companies trading in the Island are all subject to tax at 20%. This means that the present system has simplicity and a large degree of equity. Therefore, consideration has also been given to adopting a similar flat rate option.

The main features of a flat rate 10% regime are:

- The basic rate of income tax on companies (including those previously exempt from tax) would be 10%.

- Guernsey resident individuals would be taxed (at 20%) on the proportion of the profits of a company in which they had a beneficial interest.

- Collective investment schemes would continue to be subject to tax at 0%.

Under a flat 10% regime locally owned business would, in effect, still continue to be liable to income tax at 20% (as the 10% tax suffered by the company would be creditable against the 20% liability of the shareholder).

Companies not owned by locally resident shareholders would be liable to tax at 10% of their profits, regardless of business activity. Hence, there would be equity across business sectors.

There is more uncertainty in calculating the possible loss of revenue to the States of a flat 10% regime. With one set of assumptions (including captive insurers being liable to the 10% tax) the loss to the States could be less than that under the Zero-Ten model.

However, adopting a tax regime so fundamentally different to that of its closest competitors could be a very high risk strategy. Without a general zero tax regime the effect on the reputation and long term commitment and confidence in the finance sector in Guernsey is very difficult to predict.

The above summary sets out in outline of the two fundamental approaches (Zero-Ten and Flat rate). The following paragraphs examine in more detail some of the other matters that need to be considered in implementing an overall tax package.

Zero Tax Arrangements

As set out in the 2002 Report, and confirmed by the initial work streams and consultations of the Working Group, in order to be an effective and competitive International Financial Centre, a zero tax arrangement needs to be available. The existence of a zero tax arrangement is already a fundamental principal element of the taxation strategies of the Island's competitors.

In particular, Collective Investment Schemes, including closed ended investment vehicles, were **not** one of the regimes in Guernsey (or elsewhere) identified by the EU Code of Conduct Group as being considered harmful. Therefore, it is proposed that Collective Investment Schemes, including closed ended investment vehicles, will continue under the current arrangements.

Captive Insurance Companies

Guernsey is one of the leading captive insurance centres of the world. It is a sector that is often cited as being a part of Guernsey's finance industry which distinguishes it from its main competitor jurisdictions.

At present the majority of captive insurance companies are exempt from taxation (the captive managers are subject to 20% taxation).

In addition to making a substantial value added contribution to the island's economy (the contribution per employee in this sector is higher than banking and investment funds), it also makes a major contribution to other sectors. Substantial sums are invested locally with banks and investment managers. The captive insurance sector also generates substantial fees in the accountancy and legal support professions and spends large sums of money in the hospitality, travel and service industries.

The Working Group recognised the importance of the captive insurance very early on in its deliberations and commissioned a separate targeted consultation exercise during October and November 2004.

During that exercise a large proportion of interested parties in this sector were contacted directly and asked for their views.

The views of the captive insurance industry were very clear. If captive insurance companies were made subject to taxation, (of say 10%), there would be an immediate decline in the captive insurance industry in Guernsey. New business would cease and existing business would very soon relocate to other jurisdictions where a zero tax regime was available. A loss of critical mass for the sector would soon be reached and very soon this part of the Island's finance industry would be lost with the commensurate loss of the Island's international reputation and knock on effects on banking, etc.

If captives were subject to Guernsey taxation in many cases this would then be creditable in the home jurisdiction (i.e. no overall effect to the captive's Group tax liability) and therefore, at least in theory, there should be little disincentive to locate a captive in Guernsey. However, in reality, if other jurisdictions are offering a zero tax regime for captive insurance companies (as already announced by the Isle of Man) it is difficult to see why any would chose to locate, or remain, in Guernsey. This is why in the 2002 budget supplement a 0% tax rate was identified as being appropriate for captive insurance companies.

Regulated Finance Industries

As set out in the 2002 budget supplement, under the Zero-Ten regime, the profits of certain companies licensed by the Guernsey Financial Services Commission would be subject to taxation at 10%.

The types of regulated entities to be taxed at 10% (or 20%) include:

- Banks
- Fiduciaries
- Insurance Managers
- Fund Managers

Types of regulated activities which would **not** be taxed at 10% (or 20%) include:

- Domestic and off-shore insurers (including Captives)
- Collective Investment Schemes
- Former exempt companies (including general partners of limited partnerships)

As emphasised throughout this and previous Reports, the Finance Sector in Guernsey needs to continue to remain internationally competitive. The above proposals recognise this and are a measured response to that competitive pressure.

As set out below, there are further tax strategies that can be considered which, for certain activities, could be introduced to further enhance the Island's attractiveness for high value added business.

Referred Business

For many years there has been a published concession by the Income Tax Office for what is commonly known as "referred business".

This concession has encouraged a significant amount of business to be placed in the Guernsey offices of some of the larger financial institutions and has made a significant contribution to their local profitability.

However, this automatic concession was identified as being one of the harmful tax practices as, under the present regime, the rate of tax paid on such activity (effectively 2%) is not available to, and is lower than, that applied to the majority of local companies (20%).

Such arrangements are therefore to be withdrawn with effect from 1 January 2008 (or, if later, on the date when the equivalent regimes in the other Crown Dependencies are abolished).

If a Zero-Ten regime is adopted, referred business could then be taxable at 0% (i.e. the basic rate of tax).

Non-Finance Industries

Although the Finance Sector is presently the dominant part of the Island's economy, it is by no mean the only sector. There are also a whole range of economic activities on the Island including retail, wholesale, construction, tourism, agriculture, horticulture, support and personal service industries etc.

These businesses are carried out by companies which may be owned locally, by non-residents, or by a combination of the two in varying proportions.

Under the Zero-Ten option, the general rate of income tax paid by Guernsey companies would be 0% from 2008 onwards.

In order to prevent avoidance of personal tax liabilities and to protect the Island's tax revenues, Guernsey resident individuals will be taxed (at 20%) on the profits of the company in proportion to their ownership.

The tax charged will be on an assumed 100% distribution of profits basis, not on an actual distribution paid basis (i.e. shareholders will not be able to avoid taxation simply by not paying out dividends).

For a company that is wholly owned by Guernsey residents the effective tax liability will be the same under the new regime as the present time. However, tax will be charged to the shareholders rather than to their companies.

For non-Guernsey resident shareholders, no tax will, of course, be due to the Guernsey authorities. Profits accruing to a UK based shareholder from a Guernsey business will be liable to taxation in the UK, not in Guernsey.

In order to minimise this reduction in receipts in Guernsey caused by adopting the Zero-Ten option, other measures will need to be introduced. These are included elsewhere in this document.

Although it is accepted that the majority of finance sector business are owned off Island, the Group strongly believes that it is important that no tax regime artificially discourages local non-finance sector business from being locally owned. An important part of any consideration on a future tax strategy needs to address this issue.

Significant Tax Payers

Guernsey, like many small economies, has a number of taxpayers (businesses and individuals) who because of their exceptionally high business profits or personal wealth can potentially pay income tax of an amount far in excess of any possible drain on public services.

In Guernsey such high taxpayers have typically kept a low profile. Nonetheless many of them have made significant contributions to the Island's economic and social well being by paying tax, supporting local industries and (in some cases to a large degree) supporting social and charitable activities.

Such businesses and individuals are therefore extremely important to the Island and potentially the target of other jurisdictions. It is therefore very important that the Island remains attractive to such businesses and individuals.

It may therefore be desirable to introduce a system whereby significant taxpayers pay taxation at the standard rate up to a certain ceiling and thereafter pay taxation at a reduced rate. As a result, the effective tax rate for large taxpayers would be less than the standard rate.

For example, for those activities where significant extra income can be attracted to the Island, with very little or no increase in employment, a reduced rate of income tax above a certain ceiling could be introduced. Such a system could apply to individuals, finance sector and non-finance industries.

In determining the value of the ceiling and the reduced rate of tax, several factors (such as employee numbers, commitment to the Island, footprint, etc.) can be built in to complement the businesses objectives and the overall economic strategy of the Island.

Such a system would mean that the individual taxpayer would be paying the standard applicable rate of tax on income well in excess of most normal taxpayers, but overall would be liable at rates much lower than in the UK, Continental Europe, USA, etc.

Regulated Trading Activities, Utilities and States Trading Entities

In considering their fiscal strategies some jurisdictions have sought to treat utilities as a distinct sector for taxation purposes. Utilities usually include such services as water, telecoms, gas, post and electricity.

Guernsey has a relatively complicated structure for utilities. Telecoms is a regulated market with more than one supplier, Electricity and Postal services are provided by States owned companies operating as regulated monopolies, water is provided by a States trading entity (unincorporated body) and gas is provided by the private sector company, but outside of the mandate of the Office of Utility Regulation ("OUR").

The States also carries out some trading activities through its own unincorporated entities (Airport and Harbours, Dairy and the Works Department).

It is essential that whatever tax strategy is adopted that it does not inadvertently affect the relative attractiveness of the provision of these services as a result of their corporate and regulatory structure. It is also important that the taxation strategy does not determine which trading activities (States owned or otherwise) are regulated.

The main alternatives are:

- Treat the incorporated utilities in the same way as all other companies (i.e. zero tax on profits but chargeable to payroll taxation and shareholders tax).

- Treat all regulated incorporated utilities as a special category subject to taxation on their profits (say 10% or 20%).

- Treat all corporate and unincorporated utilities as a special category subject to taxation (say 10% or 20%).

The Group's initial conclusions are that any entity subject to regulation by the OUR should continue to be subject to taxation as this was a key principle of the commercialisation process.

Further consideration is required on the other States trading entities in the future, in particularly those entities which trade in competition with the private sector.

Payroll Tax

As set out above, one of the main issues arising from the adoption of a Zero- Ten type tax package is that business activity on the Island carried out by those companies whose shareholders are not resident in Guernsey will not contribute to the funding of public services.

The introduction of a payroll tax (which is creditable against resident shareholders tax liabilities) could be an important part of any new taxation strategy.

In summary, companies would be liable to a payroll tax (say 10%). The payroll tax would be the liability of the company in the first instance. (However, initial consultations with some of the regulated finance companies has revealed a preference for them continuing to pay tax at 20% if this would avoid such other measures such as payroll tax).

For any company, payroll tax would be payable to the States of Guernsey and is therefore a contribution to public sector revenues in Guernsey which can then be used to fund public sector expenditure.

The payroll tax would then be available as a credit or deduction against the Guernsey tax liability of the shareholder on their part of the profits of the business.

The amount of payroll tax payable would be limited to 20% of the profits of the company.

In terms of the actual payment of payroll tax it is envisaged that this would be done as part of the annual tax return process rather than as an extension of the present ETI system (i.e. cash flows for local businesses would not be adversely affected).

For Guernsey companies subject to the payroll tax but owned by non-residents, there would be no Guernsey tax against which to credit the payroll tax. Furthermore, it is highly unlikely that any overseas parent company of such a Guernsey company would be able to credit the Guernsey payroll tax against any corporation tax liability that the parent might have in its home jurisdiction in respect of its income arising from its Guernsey subsidiary. In such a case, the Guernsey payroll tax would increase the overall tax cost of doing business in Guernsey. It could therefore act as a disincentive to investment by non-residents in the non-finance sector industries of Guernsey.

Personal Income Tax Rates, Allowances and Reliefs

The basic rate of income tax in Guernsey for resident individuals is 20%. In the December 2002 Report, the stated intention was to continue with such an arrangement as it was well established, competitive, equitable (in that those who earn more contribute more) and administratively simple. The Group believes that a basic 20% income tax rate for resident individuals remains appropriate.

In common with other jurisdictions, deductions or allowances are given against an individual's income when calculating their tax liability. The main deductions, in terms of financial effect, are personal allowances and relief for interest payments.

In recent years Personal Allowances have been increased above the general rate of inflation. The single persons allowance for 2006 will be £8,250.

The main reason for increasing personal allowances in excess of inflation is that by doing so it benefits those on lower incomes most. However, increasing the personal allowances in such a blanket manner is a relatively expensive measure. For example, increasing the personal allowances by 3% increases the weekly take home pay of a single person by just £1, but "costs" the Treasury around £2m in reduced income tax receipts. This, of course, means that there is less money to spend on health, education and other public services.

It may therefore be appropriate, over a period of time, to introduce much more targeted allowances to benefit those who need it most.

The system in Guernsey in respect of giving interest payments relief is very simple and, compared to some other jurisdictions, generous. At present, the majority of interest payments are allowable as a deduction against assessable income without limit.

Tax relief on interest paid is, in effect, a subsidy to borrowers from the general taxpayer. Whilst it could be argued that there may be valid reasons for such subsidies in limited circumstances (for example, to encourage an expansion of home ownership although even this could be regarded as preferential treatment for homeowners compared to the rental sector) it is difficult to support the case for subsidising holiday homes, cars, boats, aircraft, holidays and other personal borrowings without limit.

The desirability of restricting the amount of interest payments relief was included in the 1999 Budget. As a result a change to the relevant legislation was made to enable amendments to be made to interest rate relief to be implemented promptly and conveniently (i.e. by Ordinance).

In the expected tighter future financial climate, it is not unreasonable to expect that the existing wide ranging interest relief system should be modified. However, it is likely that interest relief will continue to be provided on the vast majority of principal private residences.

In addition to personal allowances and interest reliefs, deductions are also available for a range of items, including charitable deductions (total annual tax "cost" £0.5m), life assurance (£2m) and personal pension plans (£2m).

Review of Income Tax Legislation and Procedures

In addition to the work to prepare and implement any changes in Taxation required for 2008, it is also intended that the general review and overhaul of the income tax system will continue.

During 2004, proposals aimed at simplifying and updating various taxation matters have been brought to the States including:

- Updating pension arrangement legislation.
- Residence for taxation purposes.
- Revising the basis of assessment for incorporated and non-incorporated businesses to bring it into line with that for other sources of income.

Work is currently ongoing on a number of areas, including proposals to update the capital allowances regime to ensure that it is flexible, operated proactively and able to react to prevailing economic conditions and, where necessary, enable specific industries to be given encouragement.

In developing any proposals careful consideration will be given to the effect on individuals, businesses and their professional advisers, as well as the income tax staff involved, to ensure that administrative and compliance costs are unaffected, or if possible, reduced. In order to achieve this the Administrator of Income Tax and his staff will continue to liaise closely with business and relevant professional groups.

It should also be noted that the customs and excise legislation (covering many indirect taxes) saw a substantial overhaul during 2004 and that treizieme was abolished in 2003.

Social Security Contributions

The States of Guernsey has a long established and well administered Social Security Benefits system, which due to consistent and prudent management over a long period, is well funded.

The long standing principle for the collection of contributions (from employees, employers and the self-employed) is that contributions are not a tax, they are a contribution for potential social security benefits (unemployment, old age pension, sickness benefits), i.e. a type of insurance payment.

The current contribution rates (for an employed person) are 5.5% for the employer and 6% from the employee (a total of 11.5%). The contribution rate for self-employed persons is 10.5%.

Another long standing principle of the funding is that those individuals who are on incomes less than the upper earning limits (2005: £34,320 per year) have the difference paid by the States by means of an annual grant from general revenue (i.e. direct and indirect tax sources). The grant from general revenue sources is set following periodic review by the UK Government Actuary's Department. With effect from 1 January 2004 the grant was reduced to 50% (from 57%) of contribution receipts, as a result of this change, the grant paid by general revenue was reduced by £3.6m per year.

From a general revenue point of view, the mechanics of the contribution matching process means that as more people are employed and pay more contributions (because of a buoyant economy) there is an increased drain on general revenue resources.

Despite the above change, the amount of grant paid by general revenue has increased steadily in recent years. In 2005 the grant from general revenue is projected to be £37.38m which represents 13% of total States revenue expenditure (in 1999 the grant from general revenue was £25.2m which also represented 13% of total States expenditure).

The present social security arrangements mean that if an individual has income in excess of the upper earnings limit (2005: £34,320 per year) then the amount paid by the employer and the employee is the same whether that individual earns £35,000, £75,000 or even more than £100,000.

Compared to Jersey and the Isle of Man (which has replicated the UK social security legislation) the amounts raised annually by social security in Guernsey are much less. Although the rates of contribution and earnings limits are designed to finance different ranges and levels of benefit, if Guernsey adopted the Jersey scheme, an extra £11.5m would be raised or £59.6m for the Isle of Man.

Although it is acknowledged that it would be a fundamental change to a long standing set of principles, the Group believes that consideration must be given to revising the present system with a view to reducing the grant payable from general revenue.

Indirect taxes

In common with most developed economies, Guernsey has a long established tradition of levying indirect taxes. The major indirect taxes (and their projected income levels for 2005) are set out below:

	£'000
Alcohol duties	6,425
Tobacco duties	7,850
Duty on foreign goods	500
Document duty: other	4,900
Document duty: property	11,650
Tax on Rateable Values	4,050
Motor Vehicle Tax	6,000
Motor Spirit	2,040
	43,415

As set out in appendix II of this consultation document, in recent years the rates of indirect taxation (with the exception of tobacco) have not been increased in line with inflation. Nonetheless, the actual amounts collected in indirect taxes have increased since 1999 mainly due to increased document duty as a result of increased property prices. (Document duty is an ad valorem tax).

The duty on tobacco has been increased, as a deliberate States policy, in excess of the increase in Guernsey RPI, as a measure to discourage smoking.

The Tax on Rateable Value has already been identified as requiring fundamental review. The Treasury and Resources Department is committed to bring forward outline proposals for a simplified system during 2005. This is seen as a preliminary step to raising significantly the amount currently raised from this source.

Although some indirect taxes can be considered to be regressive, they are a generally accepted method of raising public sector revenue. They also provide an element of choice in terms of behaviour (smoking, alcohol consumption, motor vehicle ownership and usage) and can, in certain circumstances, provide a mechanism for encouraging (or discouraging) certain behaviour.

It is also probable that taxpayers would more readily accept an increase in indirect taxation if there was an element of choice of consumption involved and if the extra revenues were to be directed towards beneficial related projects. For example, the increased tobacco duty has funded health measures.

Indirect taxation rates in Guernsey have traditionally been low compared to other neighbouring jurisdictions (Jersey, United Kingdom, France etc.) and in recent years have been further eroded in real terms.

Increasing indirect tax levels, using existing legislative and administrative processes, would therefore be an efficient method of increasing States Revenues. It is estimated that if the rates of existing indirect taxation were raised to the equivalent levels elsewhere, then between £10m and £15m per year extra would be raised.

General Sales Tax

In addition to raising revenues from duties on certain goods (alcohol, tobacco, motor spirit etc.) many jurisdictions have a general sales tax (for example VAT in the UK).

The advantages of a broad based sales tax regime are that it can be seen as fair in that it is widely applied to the majority of citizens (who benefit from public services), gives relatively stable income flows, once established can be efficient, and is capable of raising substantial sums of money for the public purse.

There are a variety of ways in which a general sales tax could be implemented. However, all of them, to a greater or lesser extent, result in increased administrative burden and expense on businesses and the public sector administration. Furthermore, in order to raise substantial sums of money they need to be levied on a very wide range of goods and services. Even if initially the goods and services to be included in the regime are limited, and the rates low, experience in the UK and elsewhere has shown that once a general consumption or sales tax is introduced it sooner or later has a wider coverage and rates are increased.

However, in order to raise such a significant amount of revenue, the tax would need to be applied to a wide range of everyday goods and services. As a result, those on lower incomes would experience a relatively significant increase in their cost of living.

If the States wished to hold true to the principles of the Corporate Anti-Poverty Programme, those on lower incomes would need to be protected from the impact of the introduction of a general sales tax (i.e. benefits would need to increase).

A general sales tax regime will increase the cost of visiting and doing business in the Island and therefore acts as a disincentive for businesses to locate in the Island and for tourists to visit.

Other Income Streams

In addition to the direct and indirect taxes, (which are accounted for "centrally" and then allocated to individual Departments to fund their revenue and capital programmes), a wide variety of fees and charges are levied by individual Departments (and retained by them). Some of these charges raise several million pounds a year, others just a few thousand.

Examples of such fees and charges include admission charges to the Museums, property rents, various health service fees, refuse disposal fees, sewage cart fees etc.

Although many of the fees and charges have been kept under careful review, others have been allowed to reduce in real terms, in particular in the last decade where Committees and Departments have been under less financial pressure.

The level of charges and fees is currently the subject of a comprehensive review by the National Audit Office on behalf of the Public Accounts Committee. It is anticipated that this review will identify those areas where charges and fees can be considered for increase.

As has been stated on many occasions, the States of Guernsey has a large and varied portfolio of property. Some of this property is not being used to its full potential. The Treasury and Resources Department is already committed to reviewing the States property portfolio to ensure that it is rationalised. This process will identify any properties that can be released, either by sale, lease or used more effectively for another purpose, including by another Department.

Borrowing

Most major western governments borrow, and in many cases, borrow substantial sums. The States of Guernsey has traditionally had a very prudent approach to borrowing and as a result the taxpayer has not had to bear the cost of interest charges.

In the 1930s the States issued bonds to the public to fund a major capital project (the St Saviours Reservoir) the last of these bonds was redeemed in 2002. The States currently has a £5m private sector borrowing specifically to part finance the Housing Development and Loan Scheme.

In recent decades the States has not borrowed to fund either ongoing revenue or individual capital projects. The Corporate Agenda included the following statement on borrowing:

"Take a cautious approach to public sector borrowing, only doing so where the debt can be serviced by a secure, associated income stream".

The Group believes that this remains a sensible and prudent approach.

Contingency Reserve

The purpose of the Contingency Reserve Fund is to provide protection against major emergencies including significant economic downturns having a severe adverse effect on the Island.

Since 1998 the Contingency Reserve fund has increased from £71m to £190m at the end of 2004 and is expected to reach £200m by the end of 2005.

The increase since 1998 has been the result of appropriations from General Revenue (£47m), the sale proceeds of Guernsey Telecoms (£23.8m) and net increase in investments (£48m).

Although the Contingency Reserve is expected to continue to increase in size as a result of investment growth (the Fund investments are gilts and similar financial instruments), it is unlikely that any further significant appropriations will be possible from General Revenue.

Although the Contingency Reserve cannot be used to make good any shortfall in revenue over an indefinite period, it could be used in the short to medium term to help balance the books in order to smooth any transitional arrangements.

(Note: When the Contingency Reserve was established in 1987 it was envisaged that the income from the Fund could be utilised as part of general revenue income.)

Other Reserves

In addition to the two major reserves specifically mentioned elsewhere in this report, (the Contingency and Capital Reserves), there are a small number of other reserves.

The largest of these is the General Revenue Account Reserve. This reserve has been established for many years at a minimum level of 5% of total income (i.e. around £15m). The purpose of this reserve is to act as a buffer to fund any shortfalls in projected income or additional unexpected expenditure (including pay awards). The reserve is an essential part of the States Financial Procedures and it would be unwise not to have such a buffer. However, in the future it may no longer be appropriate to have one at such a high level.

As part of the States Financial Procedures a number of other smaller reserves have also been established, some of which, have in the past been excessively prudent in their operation and have built up unnecessary amounts. During the past few years the States Treasury has adopted a policy of releasing those reserves (to the General Revenue Account) to increase the transparency of the States accounts and the overall financial position.

Public Sector Expenditure

In 1999 the total income of the States of Guernsey was £238.2m and total revenue expenditure £190.8m. Of the resulting operating surplus of £47.4m, £10.4m was spent on capital projects and the remainder, was transferred to reserves (Capital and Contingency). In financial terms, the States was significantly better off at the end of the year than it was at the beginning.

During the three years 2000 to 2002, the operating surpluses averaged over £50m and, as a result, by the end of 2002, the Capital Reserve had a balance of in excess of £100m and the Contingency Reserve £148m.

During the next three year period (2003 to 2005), income receipts have plateaued but revenue expenditure has continued to rise so that the operating surplus for 2005 is estimated to be considerably less than in previous years. Furthermore, capital expenditure in that period is to average £50m per year. As a consequence, the States was financially worse off at the end of the year than it was at the beginning, although the island's infrastructure was much improved. In the short term this level of capital expenditure was sustainable because of the amounts put into the Capital Reserve in the previous decade or so.

States revenue expenditure over the period 1999 to 2005, adjusting for accounting treatment changes, has increased from £184m in 1999 to £289m by 2005. This is an increase in ongoing expenditure of £105m, 53% in cash terms, or 25% in real terms.

General increases in revenue expenditure have been experienced in most areas, in particular, in many areas of health and education. However, a number of new initiatives, and associated increased expenditure, have been introduced or substantially increased during that period. Each of these projects were approved by the States, and in isolation were considered worthy of support, however, cumulatively they have increased the ongoing burden on the taxpayer.

In addition to the increase in revenue expenditure there has been an unprecedented increase in capital expenditure in the past few years. (It is estimated that for the years 2000 to 2005 inclusive, capital expenditure will total around £250m). This level of capital expenditure (which has largely been funded by the operating surpluses of previous years accumulated in the Capital Reserve) has resulted in major improvements to a whole series of public sector infrastructure assets, including schools (in particular special needs schools), health care facilities, housing developments and improvements, foul water network extension, ICT projects, Royal Court extension, prison extension, recreational facilities (Beau Sejour Centre), new service buses etc.

The above figures do not include projects funded from the Ports Holding Accounts (such as the new Airport Terminal, marina facilities) and water service improvements which are funded by their own trading operations.

The increase in revenue and capital expenditure was seen to be affordable at the time because of the significant increase in income tax receipts (increasingly from ETI, i.e. from individual taxpayers). Furthermore, during this period personal income tax allowances were increased in excess of inflation, indirect taxes (with the exception of tobacco duty) decreased in real terms. In short, increased public sector expenditure was financed by increased economic activity and the use of reserves. Although increased economic activity is a key part of the island's future prosperity, it has to be realistically assumed that it will not be of the same degree as in the late 1990s and early 2000s.

As set out in recent Budget reports and in the 2002 Report, the States will have to take some of the burden. It has to be accepted by all Departments, States Members and staff, and indeed the public, that the culture of increased public sector service provision and ever growing expenditure needs to be reversed. In the coming years the introduction of any new services can only be contemplated in very exceptional circumstances and then only if existing (lesser priority) services are reduced or withdrawn.

Such an approach is one that has not been necessary in the past decade due to the buoyant level of States revenues. However, a measure of caution is needed. Although the level of States expenditure has risen in the past few years, the benchmarking exercise carried out in cooperation with Jersey and the Isle of Man, showed that, in general, Guernsey has a well deserved reputation for delivering public services at a cost which compares favourably with the other jurisdictions. Nonetheless efficiencies are possible, and must be targeted for delivery.

In addition to new services, significant increases have also been seen in the public sector pay bill. Increases in staff numbers (in many areas) and pay costs, have all contributed to increase public sector expenditure. Furthermore, in common with other similar Schemes, the pension costs for States employees may well need to rise significantly. In the future it must be questioned whether “RPI plus” pay awards in addition to promotions and a final salary pension scheme are sustainable.

Another area of States general revenue expenditure that has seen significant above inflation growth is the amount of money collected from taxpayers which has been transferred to the Social Insurance, Health Service and Long Term Care Funds. In 2005 it is estimated that grants to these Funds will total £37m compared to £25m in 1999. This is an area which is addressed in more detail elsewhere in this document.

A Business Friendly Approach

One of the key themes of the Corporate Agenda and the Consultation Document issued by the Commerce and Employment Department (Building Confidence) is the need for the Island to be business friendly in a way that encourages entrepreneurship, business growth and diversification.

Although it is sometimes difficult to exactly quantify what makes a business friendly environment, it is nonetheless something that all parts of government and the local community generally can contribute to.

It is also a two way process, those individuals and businesses that benefit from the Island’s business friendly approach must be expected to reciprocate by being Guernsey Friendly.

LIST OF APPENDICES

LIST OF CHARTS

APPENDIX I

States Income 2005 vs 1999

	2005 £m	1999 £m	Increase %
Income Tax	257.0	188.6	36%
Excise duties	16.8	13.6	24%
Document duty	16.6	10.9	52%
Exempt Company fees	5.0	4.9	-
Motor Vehicle Tax	6.0	4.5	33%
TRV	4.0	3.1	29%
Miscellaneous income	2.6	2.4	-
	308.0	228.0	35%

In 2005 income tax is estimated to account for 83% of total income (1999: 83%).

Note: Miscellaneous income includes, interest receivable, dividends from States Trading Companies, court fines and fixed penalties and surplus on notes and coins.

APPENDIX II

SUMMARY OF RECENT BUDGET PROPOSALS: INDIRECT TAX

Duty on Tobacco

2005	8.2% (RPI plus 3%)
2004	6.3% (RPI plus 3%)
2003	6.9% (RPI plus 3%)
2002	11.1% (RPI plus 8.5%)
2001	13.0% (RPI plus 8.5%)
2000	10.3% (RPI plus 8.5%)

Document Duty

2005	No change
2004	No change
2003	Document duty reduced on modest value properties
2002	Document duty reduced on modest value properties
2001	General rate of document duty reduced by 1%*
2000	No change

Tax On Rateable Value

2005	No change
2004	No change
2003	No change
2002	No change
2001	18% increase to compensate for document duty cut*
2000	No change

Duty on Alcohol

2005	10 % increase
2004	No change
2003	No change
2002	No change
2001	No change
2000	No change

Duty on Fuel

2005	No change
2004	No change
2003	No change
2002	No change
2001	No change
2000	No change

- Compensatory adjustments

APPENDIX III

CAPITAL EXPENDITURE 2000 TO 2005

	£m
Major Construction & Development Projects	126.4
Miscellaneous Capital Works	43.5
Transfers to Corporate Housing Programme	30.4
Equipment, Machinery and Vehicles	20.9
ICT Projects	27.6
	248.8

The major projects completed or substantially started in the period include:

	£m
Beau Sejour Centre	9.0
Royal Court extension	17.5
Prison extension and visitor centre	6.5
Alderney Commercial Quay	4.0
Energy from Waste: preparatory works	2.5
New service buses	3.1
Traffic signals	1.7
St Sampson firemain and pumping station	2.1
Le Rondin Special Needs School	13.9
College of FE: Phase A	8.1
Grammar School Sixth form facilities	5.6
Planning and associated costs for EDP	6.0
Les Nicolles Secondary and Special Needs	48.0
Schools ICT project	5.8
PEH fourth theatre and critical care	3.5
La Corbinerie continuing care wards	6.3
States Analysts Laboratory	3.3
Alderney- Mignot Memorial Hospital	4.0
John Henry Court: Nurses accommodation	2.6
St Martins Community Centre	1.4
Foul Water Network Extension Plan	17.9
Corporate Housing Programme	30.4
Corporate ICT	5.0

Expenditure on the new Airport Terminal, marina facilities and water services improvements are not included in the above figures as they are funded from trading activities.

APPENDIX IV

MOVEMENTS ON THE CAPITAL RESERVE

	£m	£m
Balance 1 January 2004		55.5
Appropriation (2004 Budget)		7.0
Withdrawals:		
Education Development Plan 2004	12.75	
John Henry Court	2.9	
PEH Parking	0.8	
Health: Accommodation	1.1	
		(17.6)
Interest 2004		5.8
Balance 31 December 2004		50.7
Appropriation (2005 Budget)		10.0
Withdrawals:		
Alderney Quay	4.0	
Les Nicolles Pool	1.0	
Education Development Plan 2005	12.75	
Education Development Plan 2006	12.75	
		(30.5)
Interest 2005		5.0
Residual Balance		35.2

The Residual Balance on the Capital Reserve is before any appropriation in the 2006 Budget (December 2005) and is available to Fund the PEH Clinical Care Wards project (estimated £25m to be sought from the States in 2006) and additional funding to part fund the Corporate Housing Programme (£5m).

APPENDIX V

EXTRACTS FROM 2005 POLICY AND RESOURCE PLAN

To manage public finances and taxation so that Guernsey remains competitive internationally and financially independent.

In pursuit of this aim we will:

- Restrain expenditure on capital projects and public sector service provision by committing expenditure only when clearly identified and stated community objectives will be met.

- Strive to achieve a fair and equitable burden of taxation and to provide simplicity and transparency in the application and administration of public finances for all concerned.

- Implement a package of measures to manage changes in Corporate Taxation

- Avoid a "spend first, tax later" environment by ensuring the States Budget is either balanced or in surplus.

- Acquire resources and commission capital projects achieving best value for money, balanced with a duty of care to local providers. Commercial risks will be allocated to those best placed to manage those risks. The design and specification of such projects or resources will be evaluated in the light of future maintenance costs, replacement costs and general cost in use and cost in operation criteria.

- Maintain an adequate level of reserves to provide protection against economic and operational uncertainties

- Take a risk-averse approach to managing public assets.

- Take a cautious approach to public sector borrowing, only doing so where the debt can be serviced by a secure, associated income stream.

- Avoid earmarking income for expenditure in the area from which it was raised, but be prepared to use taxation as an instrument to achieve States objectives in meeting social and/or environmental aims.

- Always have regard to inflation when formulating fiscal policy.

APPENDIX V (Continued)

Public Sector Services

To provide high quality public sector services in situations only where need and value for money can be demonstrated.

In pursuit of these aims we will:

- Prioritise public sector service delivery and, where appropriate, having regard to both cost and quality, withdraw from providing services or pass them on to private sector or non-governmental bodies.

- Maintain the number of public sector employees within a level that the community can afford in the long term.

- Direct services specifically to the people who need that form of help so that limited resources are used to best effect and without waste.

- Develop an achievement and "can do" culture across the States, and subject this to both benchmarking against recognised monitoring systems and to review by both the Public Accounts Committee and the Scrutiny Committee.

- Improve the design of operational systems and processes that deliver public sector facilities in order to maximise the efficient use of staff and other resources.

- Explore appropriate opportunities to work with other administrations to improve services and/or secure better value for money.

- Ensure that career development processes and employment policies and practices are structured in order to lift quality and motivation of public sector staff.

- Undertake a broad review of the current approaches towards charging for public services in order to develop a consistent corporate policy in this area.

- Recognise that meeting the needs of an aging population will be an increasingly important factor in the provision of public services and that Islanders need to be enabled and encouraged to remain economically and socially active and to make private arrangements for their futures to supplement States provision.

APPENDIX VI

2003 Budget supplement: Core Principles and Objectives

In the Budget supplement the following fundamental aims were identified:

- To maintain and enhance the competitiveness of the key industry sectors.
- To adhere to international standards including the principles of the EU Code of Conduct on Business Taxation, if adopted.
- To retain a fair and equitable burden of taxation.
- To secure the levels of revenue necessary for the Island's public services.
- To ensure that the revised structure has minimal effects on individuals, in particular those on lower incomes.
- To ensure that any necessary alternative revenue streams come primarily from the industry sectors which may directly benefit from the revised structure.
- To minimise volatility in public revenues throughout the economic cycle.
- To promote simplicity and transparency in application and administration for all concerned.

These aims were designed to provide a framework for the taxation review process and are intended to be a long-term benchmark against which the Island's corporate taxation strategy can be judged.

APPENDIX VII

2003 Budget Supplement: Proposed Measures

The Budget Supplement set out an outline package of measures which provided an indication of the long term policy that it was intended to follow. The package can be summarised as follows:

1. The general rate of income tax paid by Guernsey companies to be reduced to 0% in respect of tax year 2008 and subsequent years.

2. The profits of certain companies which are licensed by the Guernsey Financial Services Commission, to be taxed at 10% in respect of tax year 2008 and subsequent years. Examples of entities to be taxed at 10% are banks, fiduciaries, insurance managers and fund managers. Domestic and off-shore insurers registered under The Insurance Business (Bailiwick of Guernsey) Laws 1986-1999 to be subject to the 0% rate. Collective investment schemes, including closed end investment vehicles to continue under the current arrangements.

3. The statuses of exempt company and international company to be abolished with effect from 1 January 2008, after which to be subject to the 0% or 10% rate as appropriate.

4. The published concession, allowing an automatic 90% deduction for 'referred loan business', to be withdrawn with effect from 1 January 2008, or on the date when the equivalent regimes in the other Crown Dependencies are abolished, whichever is the later.

5. The current regimes for insurance companies to be abolished with effect from 1 January 2008, after which to be subject to the 0% rate.

6. Registered Guernsey companies to pay annual filing fees set at a rate that is competitive in the international market.

7. Other taxation and revenue raising measures to be considered in consultation with local industry, the impact of which would be structurally 'complementary' to the reduction in the rate of corporate taxation.

8. Special rules to be introduced to ensure that Guernsey resident individuals are taxed on a proportion of the profits of a company in which they have a beneficial interest. These rules to be introduced in order to protect the Island's tax base.

9. Resident individuals would continue to pay tax at 20% on assessable income.

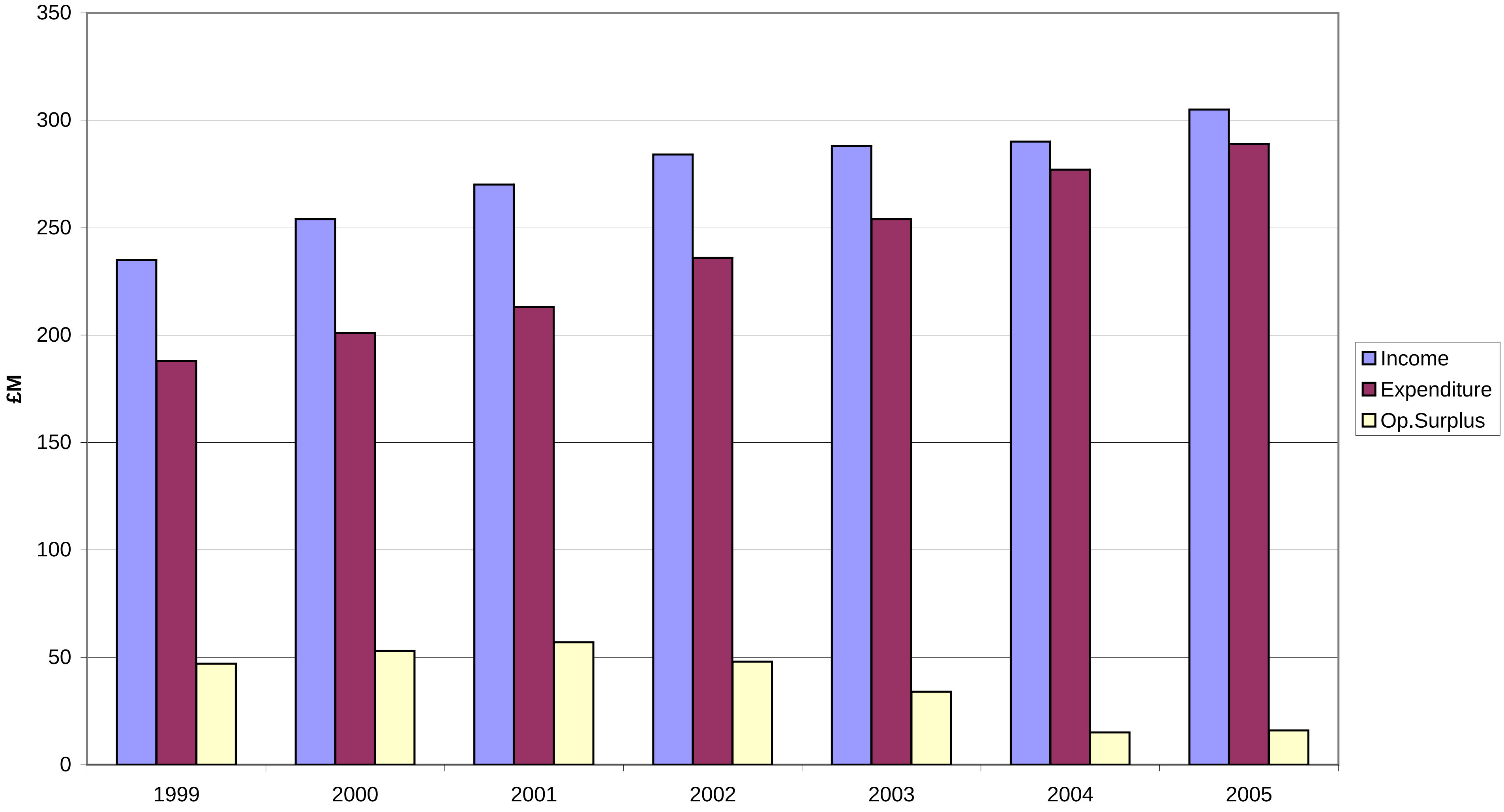
10. The appropriate date for the implementation of the new corporate taxation structure would be 2008.

APPENDIX VII (Continued)

11. In considering alternative income streams there was no intention of proposing the introduction of so-called ‘wealth taxes’, such as inheritance and capital gains taxes.

12. The States will have to take some of the burden. Budget surpluses could not be expected to continue at the record levels of the last decade and there would need to be enhanced scrutiny and restraint in the commissioning of new public projects.

FINANCIAL REVIEW

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2001
2002
2003
2004
2005
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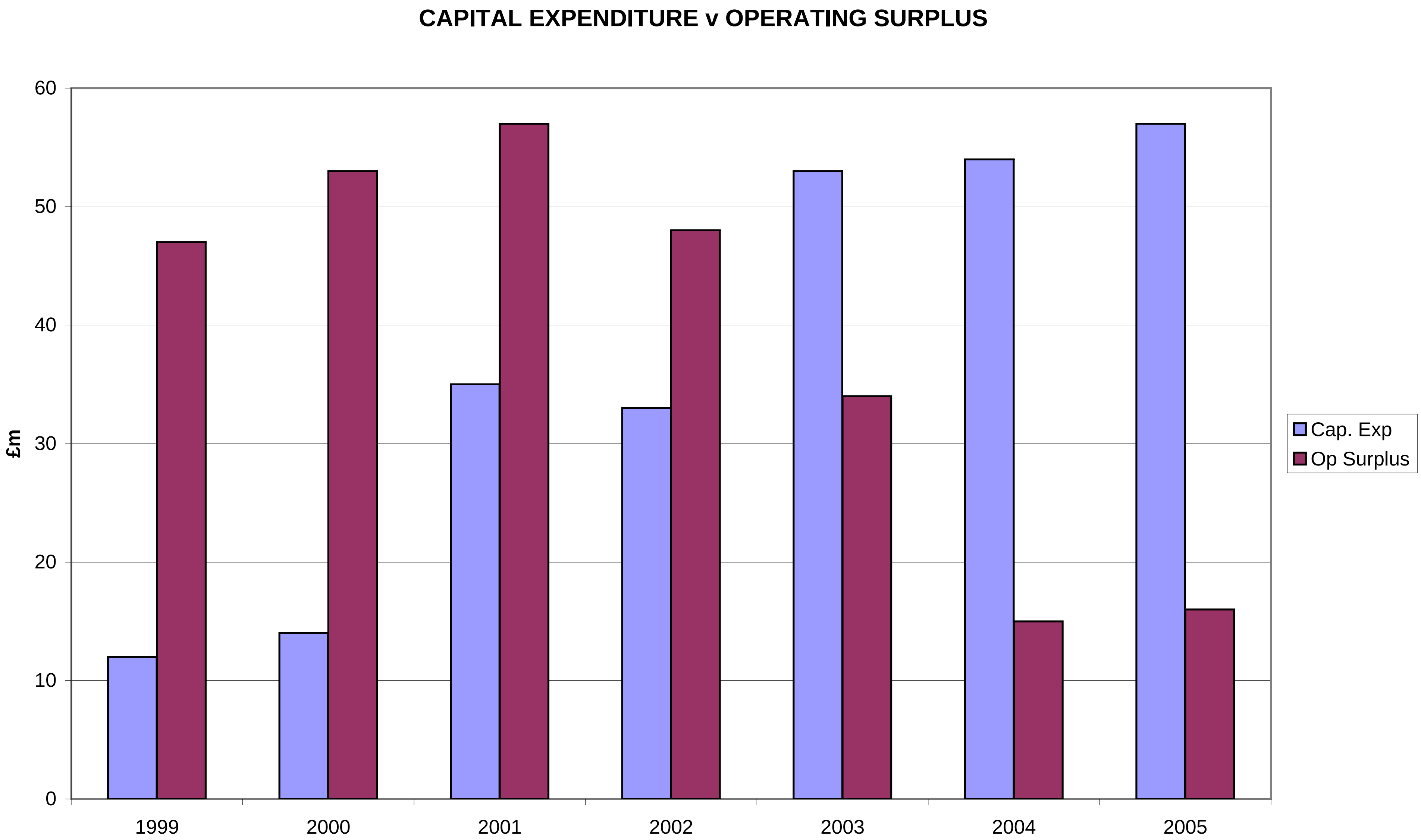
Non-ETI



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2002
2003
2004
2005
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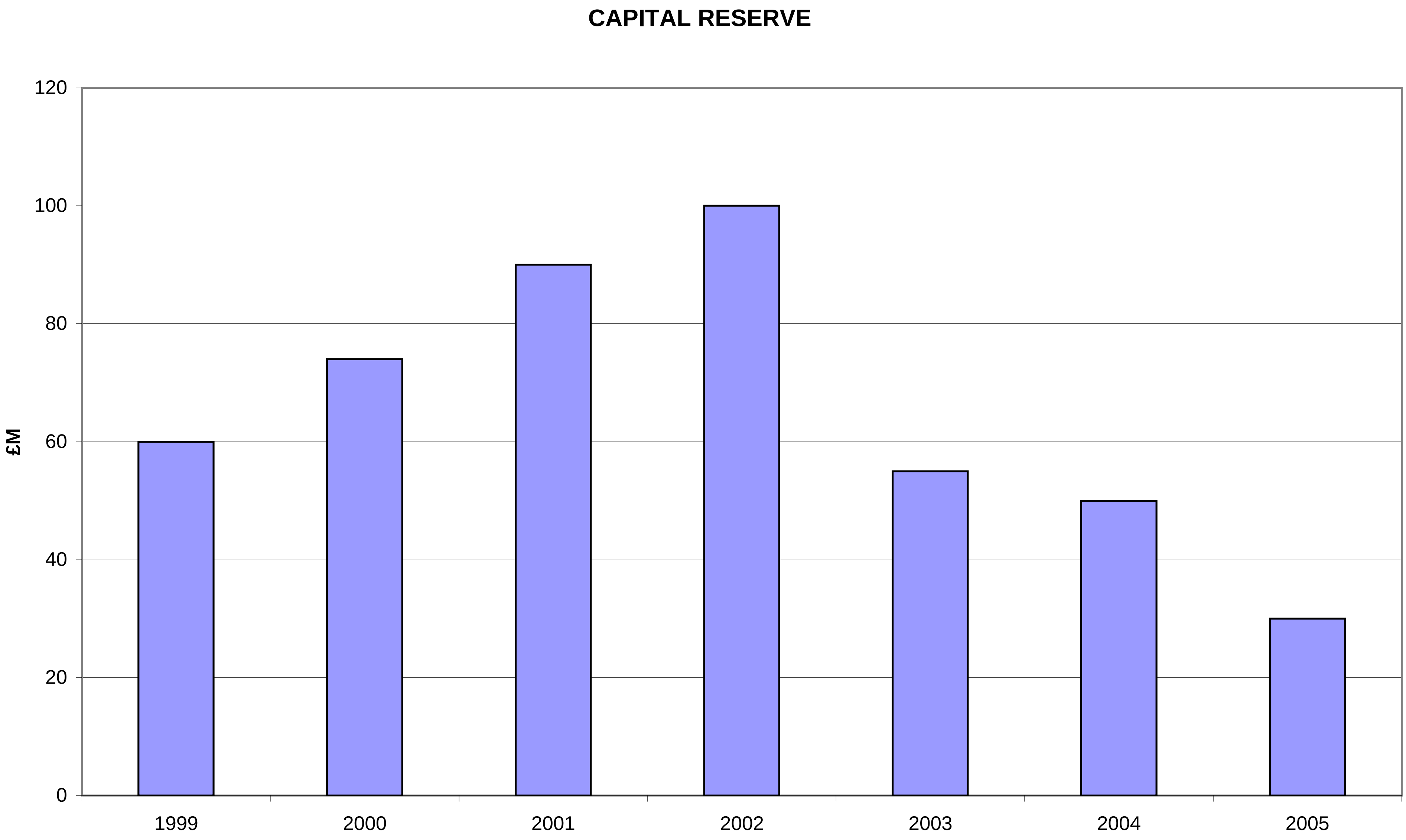
Op Surplus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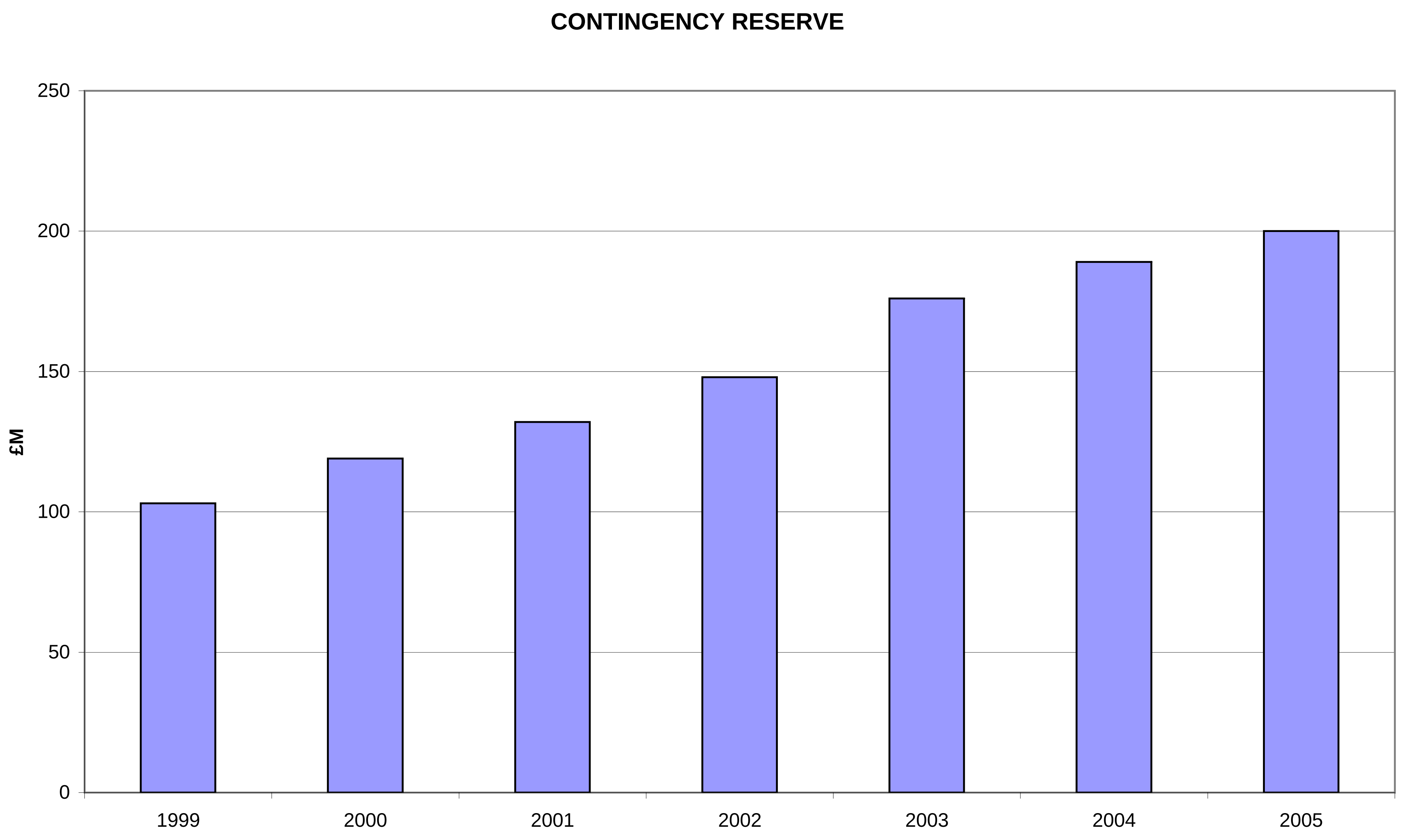
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100
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