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WRITTEN QUESTION TO THE MINISTER FOR TREASURY AND RESOURCES BY DEPUTY T.A. VALLOIS OF ST. SAVIOUR ANSWER TO BE TABLED ON TUESDAY 10th MARCH 2009

Question

Would the Minister advise the possible implications with regards to exempting items from Goods and Services Tax and would he provide information in relation to any work completed by the Fiscal Policy Panel concerning exemptions?

Answer

This can be quite a complex issue; even the terminology used is somewhat confusing but I will attempt to provide a response in reasonably simple terms.

Under Jersey GST we can exclude supplies from the tax base by listing them under Schedule 5 as an Exempt supply or under Schedule 6 as a Zero rate supply. These are the standard methods of providing exclusions [used in all EU systems and the UK] but there is a difference between the two. This has been explained in the States before but it is worth mentioning again.

The difference between exempt and zero-rated supplies

If a business sells zero-rated goods or services, they are taxable for GST at 0%. If it sells exempt goods or services they are not taxable for GST.

Unlike zero-rated supplies, exempt items are not treated as taxable. No tax is payable, but equally, the person making the supply cannot normally recover any of the GST on their own expenses.

A business selling only exempt goods or services generally cannot register for GST or reclaim GST on purchases. If it sells some exempt goods or services, it may not be able to reclaim GST on all of its purchases and expenses.

Consequences of the difference for both businesses and customers of each can be summarised as:

- Exemption: increased costs to businesses due to irrecoverable GST on overheads and expenses, with prices to customers reducing – if at all – by the amount of GST less GST on the irrecoverable costs. Exemption provides partial relief for GST purposes.
- Zero rating: potential lower customer prices. Zero rating can provide full relief from GST.

Implications of exclusions to GST

If further exclusions (by zero rating or exemption) were to be approved by the States the main implications are as follows:-

1. The tax base is reduced and tax revenue is lost.
2. We complicate the system – which inevitably increases compliance costs for the business community and the administration costs for the revenue agencies
3. As a result of 2. further tax revenue will be lost from reduced compliance.
4. The agencies involved (Income Tax and Customs) will need additional resources.
5. The States would need to consider making up the short fall of revenue (e.g. by increasing the rate of GST; changing the income tax rates/allowances)

The extent of the impact on 1. to 5. above will vary depending on the nature and scope of the supplies involved. In the past most of the additional exclusions approved by the States have been supplies of services which have been added to the exempt listing and the impact as outlined above has been minimised.

By way of illustration I can provide some figures based on the forthcoming proposition P28/2009 lodged by Deputy Labey and due to be debated in the States on 31st March. If this proposition was approved in full with the supplies being treated as zero rated then the direct loss of revenue would be in the region of £6 million [over 10% of the domestic yield] and we would need to increase the staff resources by 3 (full time posts split between Customs and Income Tax).

In addition to the main implications mentioned above there are a range of other factors that would need to be considered if further supplies were excluded.

Other factors that would need to be considered

1. Implementation time:
   - Legislative drafting and securing time in States Assembly,
   - How long it would take businesses to make necessary changes to accounting and stock control systems, advertising and price marking – especially in-store.
   - Consultation followed by design, agreement with businesses and trade bodies, of new Retail Schemes (to deal with mixed liability sales).

2. Extent of public information/education:
   - Publicity campaign, involving all forms of media would be needed to explain to consumers the changes in tax liability,
   - Public guides, Leaflets and Tax Information Sheets covering the different liabilities must be drafted, published and available and advance of the changes being implemented.
   - Those taxpayers directly involved would require educational visits to explain the changed requirements.

3. Other impact on businesses:
   - Does not simply affect those that supply direct to the public but also importers, manufacturers and wholesalers.
   - Increased potential for delays at importation.
   - Cost and availability of software. Many UK software suppliers will not supply into Jersey; they make most of their profit from post-sales support, and the costs of providing this to a customer in Jersey make it unattractive to do so.
   - Many smaller businesses do not have computer based accounting so the impact of complex GST liability may fall disproportionately on them.

4. Increased complexity.
   - Go from one retail scheme to at least six,
   - Reduction in compliance (currently over 90% and better than for VAT in the UK),
   - Increased scope for disagreements – appeals to Commissioners – impact of time and cost on business and Income Tax.

5. Public impact
   - Would prices fall to reflect a change in GST liability to exempt or zero rate? We do live in an open market economy and based on international experience the potential savings seldom happen in full. Most recent example is the reduction of the UK standard rate from 17.5% to 15% in December 2008. Consumers appear to have benefited from the one off reduction mainly on single higher value goods (e.g. cars, electrical goods) and supplies in the service sector. Many retail prices have not changed at all but the VAT registered businesses will certainly be accounting for the tax [to UK Revenue & Customs] at the reduced rate of 15%.

Fiscal Policy Panel

The remit of the Fiscal Policy Panel is to advise the States mainly on high level macro economic issues. Under Section 5 of their 2008 Annual Report they recommended that ***the States does not approve decisions as part of the Business plan or Budget that undermines the tax base.*** More recently during a presentation in January 2009 to States members on their update, the panel commended the States for not exempting food from GST, on the basis that the States Policy of having a broad based tax with few exclusions, and increasing income support and tax allowances, provides far greater benefit to those on low to middle incomes than blanket exclusions. .

They are not alone in taking this stance. GST was the subject of an external post implementation review carried out by HM Revenue & Customs in December 2008. Their report, issued in January 2009 includes the following Recommendation – ***"GST should remain substantially as implemented and bedded in for at least a period of 2 years without any significant changes".***

Invitation to learn more

As I mentioned at the very start of this response many of the issues listed above are complex and I can extend an invitation to the Deputy to visit the Income Office to sit down with the experts in the GST team [some of whom do have extensive experience of the UK VAT system]. I am more than happy to make the necessary arrangements.

Because this is such a complex issue I have also requested the Income Tax Office to produce a brief explanatory note on GST exclusions which I will make available next week and States members will be invited to a short presentation on the subject nearer the debate.