Report by PricewaterhouseCoopers to the States of Jersey on taxation matters, being commentary on the paper "Taxation policies: a transparent enquiry" by Senator Stuart Syvret, with reference to the States of Jersey Finance and Economic Committee's publication "Facing up to the Future".

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States of Jersey

PRICEWATERHOUSECOOPERS

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1 EXECUTIVE SUMMARY

1.1 Introduction

This report has been prepared by PricewaterhouseCoopers and in particular by tax partner John Whiting. It follows a response to terms of reference prepared by the Finance and Economics Committee (reproduced as Appendix 1). In essence the request was for a report on the propositions raised by Senator Syvret in his paper.

To do this, we have carried out considerable work on the background to the proposals in the "Facing up to the Future" document and therefore are reporting not only by way of commentary on Senator Syvret's paper but also by including much analysis of and comment on tax matters generally. We would stress, though, that we have not carried out a full evaluation of the proposals in Facing the Future: that was nor our terms of reference, not have we had time for such a project.

Our report follows and is in essence in four sections:

This executive summary.

A discussion of general tax principles (sections 2 – 7).

A review of the tax proposals (sections 8 – 15).

A commentary on Senator Syvret's paper (section 16).

1.2 Ten key points

Our report covers a lot of ground. Trying to summarise it briefly is difficult and we hope that most readers will wish to study it in full. To help the reader, we can perhaps put our findings in terms of ten key points.

(1) Jersey needs to take action on its tax system; it has been left with no choice because of EU/OECD pressures. We think there is a need to take decisions on the main direction of reform quickly, to give business certainty.

(2) There needs to be a clear setting and understanding of the aims of the reform, which we see primarily as ensuring a good climate for the retention and development of the Financial Services Industry. More can be done to explain the aims; more needs to be done on planning and developing diversity strategies.

(3) The 0/10 company tax proposals are sensible and are acceptable to the relevant authorities. They are generally acceptable to the Financial Services Industry. But the 0/10 system cannot be expected to endure forever and Jersey will need to keep its tax system under review.

(4) The changes to company tax will leave a significant gap in Jersey tax revenues. Only income tax or VAT/GST/Sales Tax seems likely to fill the gap.

(5) We think that Jersey needs to keep its 20% income tax as a core component of its tax system. We are not in favour of raising this rate or introducing higher rates. The idea of clawing back personal allowances for those on higher incomes, although perhaps administratively involved, does contribute to spreading the tax burden to the better off.

(6) VAT is our preferred route for raising significant tax funds. Whilst there will be a need for considerable detailed design work on the tax, there is a wealth of experience from the UK and around the world that Jersey will be able to draw on. It spreads the Jersey tax burden away from income tax in a way that means all will contribute.

(7) We do not think Jersey should introduce a capital gains tax. Maintaining the existing probate duty is preferable to introducing a wider form of death duties; we are not in favour of a wealth tax.

(8) We think there is some limited scope for further tax revenues to be raised from what Senator Syvret terms the "accommodation industry". Our preference would be for some form of development levy. We think the rates system needs reappraisal, though we are aware that the parish system makes this a longer-term prospect.

(9) There is some scope for further environmental taxes – perhaps some form of waste disposal levy and higher petrol/diesel duties.

(10) Anti-avoidance will always be an issue. There may be a need to look at tax enforcement, the General Anti Avoidance Rule (Article 134A) and information powers. The proposals for apportionment of company income are reasonable but we have concerns about the administrative burden. Other rules on the income/capital divide may be needed.

2 OUTLINE OF THE PROJECT

2.1 Background

The publication of the "Facing up to the Future" document focussed a great deal of attention on the Island on the tax debate. It is clear that many in the population took considerable interest in what was going on and Senator Syvret's paper has in turn acted as something of a focus for the debate. The decision was therefore taken by the Finance & Economics committee to commission an independent review of the propositions put forward in Senator Syvret's paper.

PricewaterhouseCoopers LLP was appointed to carry out the review project. This was in part due to John Whiting being available to lead the work, being someone with some knowledge of the Jersey tax system and the proposals for change (having recently presented a seminar commenting on the proposals). As the project had a very short timeframe (effectively three weeks from commissioning to reporting), it was therefore possible to start partway down the track.

The formal Terms of Reference for the project are reproduced as Appendix 1 to this report.

2.2 Basis of the project

The basis for the project work was to carry out an independent and objective review on the issues raised in and by Senator Syvret's propositions. It was not to do a full reappraisal of the proposals for change; nor was it to do an analysis of what changes Jersey should make to its tax system. However, to form a view on Senator Syvret's propositions it was clearly necessary to do considerable research into the current proposals and the background to them; to look at alternatives; and to consider what lessons can be learnt from other tax systems. Views could then be formed based on experience from dealing with other tax systems.

2.3 Outline of the work done

The work done in carrying out the project involved:

- discussions with a range of people involved in the Jersey tax system, the current proposals and with other tax systems; these discussions were both face-to-face and via telephone;
- meeting with Senator Syvret;
- extensive study of documents pertaining to the current proposals, background documents and research papers prepared over a number of years (for a listing, see Appendix 2);

- research into aspects of other tax systems that appeared relevant to and which might hold lessons for the Jersey situation, including Guernsey, Isle of Man, Malta, Bermuda and the Cayman Islands;
- research using the PricewaterhouseCoopers knowledge systems, documents and internet sites provided by other organisations;
- posing further questions to a number of informants, both orally and by e-mail.

We are very grateful to all those who have helped us in our work by giving generously of their time and views. In particular we would like to thank Julian Morris, who has been tireless in tracking down documents we have asked to see, and Senator Syvret who met with us for an extensive discussion.

We would stress that we have not in any way tried to carry out a full survey of opinion on the changes proposed or on the Senator's points. Public opinion is being tested by the very open way in which the whole process is being conducted. We have been very impressed by this open approach to change and by the keenness of the people of Jersey to engage in the process.

2.4 The project team

The project has been led by John Whiting, tax partner, assisted by tax manager Leon Clarance. Others involved included Robert Brown, senior manager with PwC Jersey who has acted as our consultant on detailed Jersey tax issues; David Newton, PwC London financial services tax partner who has been consulted on financial services industry issues; and Keith Deacon, recently retired from a very senior position at the UK Inland Revenue and a consultant to the PwC Overseas Tax Authority project teams. A number of other people in the PwC network have been consulted on specific points, including people based in Malta, Bermuda and USA.

CVs for the main team members are not included in this report but can be made available if required.

2.5 Progress of the project work

We have not found any problems in carrying out our work, other than the constraints imposed by the timescale of the project. Clearly this is a project that could have occupied almost any amount of time.

However, we would stress that we have had sufficient time, seen sufficient documents, and carried out sufficient discussions to enable us to come to a proper view under the terms of reference as laid down for the project.

Our basis for saying this is that we have not been asked to rework all the tax proposals contained in Facing the Future; we have been asked to do sufficient to, in effect, enable us to critique the proposals for the purpose of commenting on Senator Syvret's propositions.

2.6 Basis of our report

We have been asked to do an independent study. It will be appreciated that PricewaterhouseCoopers, as a leading international professional services organisation, has member firms or correspondent organisations in virtually all territories in the world, including Jersey. We do not have any direct interest in the Jersey tax system, except that the PwC Jersey practices, their partners and staff, pay tax in Jersey in accordance with the tax law operating in Jersey, in the same way as all other Jersey taxpayers. We have not involved our Jersey firm partners, in particular Jane Stubbs and Philip Taylor, in any of the research work or formulation of this report.

Any change to the Jersey tax system may have an impact on our tax advisory business, in the same way as it may have an impact on any other tax adviser who gives advice to clients in connection with the Jersey tax system. We have taken no account of this in formulating our report.

The basis of our work is to arrive at an independent assessment of the proposals in "Facing up to the Future" and Senator Syvret's propositions. We do so as tax experts; this is not an economics study. It is inevitable that anyone working in the field of taxation will have views on aspects of any tax system. We are able to be dispassionate in our views as we are working from the basis of extensive and wide-ranging experience with tax, in accordance with our terms of reference. We have no political views as a firm and our work is entirely apolitical.

Our report has been prepared as a report to the States of Jersey. Although our work was commissioned by the Finance and Economics Committee, we were given to understand from an early stage in our work that whatever report we prepared would be made available to all members of the States and would thus become a public document.

We are happy for our report to be used on this basis. However, any reader of the report must understand the terms of reference under which the work was undertaken and the objectives of our work. We have prepared it to enable the States to progress the debate on tax reform in Jersey. It cannot be a full analysis of the situation on Jersey; it cannot be a comprehensive statement of all tax options open to Jersey. Nor is it in any way an aid to tax planning. We cannot accept any liability for actions taken on the basis of this report.

We have agreed engagement terms for our work, under the terms of reference, with Ian Black, Treasurer of the States of Jersey.

2.7 **Structure of our Report**

Although we were asked to report on Senator Syvret's propositions, as will be clear we have had to do a good deal of work to put ourselves in a position to respond to the many points made by the Senator. In framing our report we thought it would be helpful to the reader to be taken through some of the main stages of the work we did, rather than simply responding to the Senator's paper.

3 The basic proposition – Facing up to the Future

This document, produced in February by the States, was our starting point. It sets out the way forward for a major revision to the Jersey tax system. It became clear through our researches that this document is the product of many years' work, various research projects, and a good number of working parties, all of which it builds on. It has to be viewed as the culmination of a great deal of work rather than as a first effort. Although it was exposed for consultation and comment, we understand that the intention is that it is to be taken as a final proposal rather than as a starting point. This, we think, is quite reasonable in view of the extensive work that has gone before. It does not, though, mean that all the points made in the document are all that can be said on the subjects – clearly much has been discussed already and is not repeated. Reliance does need to be placed on work that has been done previously and we have seen it as part of our work to satisfy ourselves that sufficient work has been done and that the propositions put forward are well founded. This, after all, is at the hub of Senator Syvret's propositions.

By way of summary, the key tax proposals within Facing up to the Future are:

- Company tax – the 0/10% framework, with apportionment
- VAT/GST/Sales Tax – to be introduced, probably with a 5% rate.
- Income Tax – the "20 means 20" idea, the phasing out of tax allowances for those with high incomes and the introduction of income tax instalment payments.
- No additional capital taxes or property taxes.
- No additional payroll taxes & social security.

We will discuss each of these areas in turn, after discussing some preliminary areas. Throughout this report, we will use "VAT" as a shorthand for "VAT/GST/Sales Tax" except where we indicate to the contrary.

4 Taxes, spending and civilisation

4.1 **Why raise taxes?**

It is worth considering in a project such as this why any territory raises taxes. Reasons put forward are usually in terms of:

- Funding expenditure that the territory wishes to undertake, often of a socially-based nature
- Influencing a certain amount of redistributing of wealth – or at least putting the burden on those who can most afford to pay
- Influencing behaviour (such as tobacco taxes or road congestion charging)
- Running the government machinery

It is sometimes said that civilisation brings taxes – or that taxes are the price that we pay for living in a civilised society.

Jersey has, like almost every territory in the world that does not have huge oil reserves, a need to raise taxes for at least the first and fourth of the above reasons. Again, like most territories, the way that the taxes are levied means that they are progressive to a degree – so that the wealthy pay more than the less well off. Perhaps the prime example of this is the high levels of personal allowances that Jersey has in its income tax system.
Once a territory has crossed the fiscal Rubicon and decided that it has to raise taxes, the amounts that it has to raise are usually driven by its expenditure. So if, like Jersey, it finds itself with the prospect of a deficit, it has some choices:

- Increase taxes (or bring in new taxes)
- Reduce expenditure
- Borrow
- Expand the economy (so that it will deliver more taxes – assuming that such expansion does not also deliver a proportionate demand for further expenditure)

4.2 Taxing options

Jersey has a relatively modest range of taxes in many ways. The UK and other EU countries have many more. However, Jersey would naturally see itself as compared with similar territories – Guernsey and the Isle of Man in the immediate neighbourhood and then places such as Gibraltar and many Caribbean islands.

It is sometimes suggested that places such as Bermuda manage without taxes – or at least without direct taxes. Often study will show that a sales tax of one sort or another will provide a lot of government revenue. Another important source can be fees/charges for licences of one sort or another. For example, landing fees for cruise ships are a useful source of revenue for a number of small Caribbean islands.

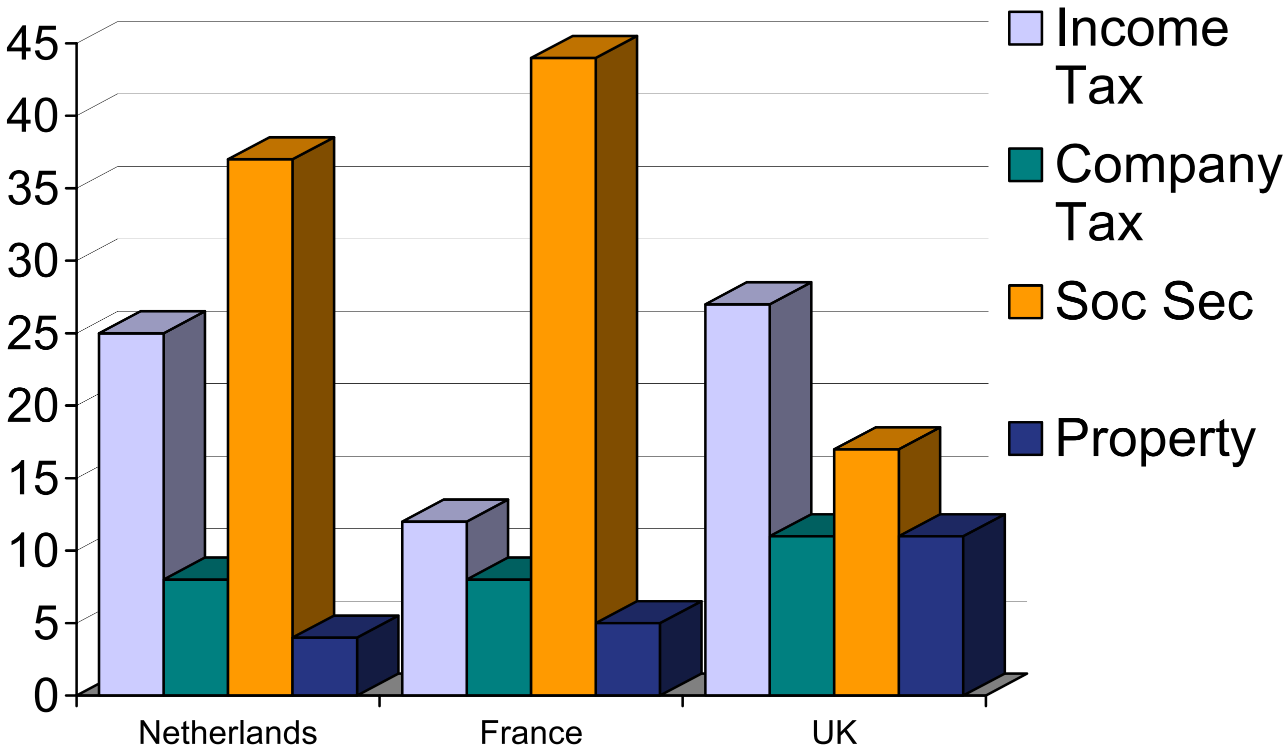
It would certainly be worth Jersey considering some of the charges it makes for some activities and we have suggested some specific items later in our report. However, there is clearly not the scope for taxing cruise liners, for instance, that Barbados has, and there is a risk that increased landing fees for aircraft would damage the air links that Jersey needs to preserve and even enhance.

In any case, comparisons with Caribbean islands can be deceptive for another reason. Jersey is a first world territory, with an enviable standard of living. Many Caribbean islands have very much lower standards, often with a considerable "underclass" that would simply be unacceptable in Jersey.

4.3 Which taxes?

If taxes are to be increased or introduced, it is worth noting which ones are capable of delivering significant revenue.

In most territories, the high revenue raisers are simply those with the highest bases of payers because of the multiplier effect that is inherent in such levies. Accordingly, income taxes, social security charges and VAT are usually the big revenue raisers. Of course this also depends on the rates of taxes and the base on which they are levied – business and residential rates are a big source of revenue in the UK but much less so in France; company taxation is a significant revenue raiser in the UK but less so in Germany and France because of the narrower tax base, despite their higher rates.
By way of illustration, a summary comparison of recent tax receipts from the Netherlands, France and the UK shows in percentage terms:



Accordingly, if Jersey needs to raise significant sums of money, it seems that it has to consider in particular income tax, VAT and social security. This is not to dismiss other taxes and levies, but they may well, even in aggregate, not deliver the volume of money that will be needed. We evaluate all taxing options later in this report.

We appreciate that a suggestion of a move away from dependence on income tax as the main revenue raiser is a big step for Jersey to consider. However, there is an element of spreading the risk or burden in this.

That brings in another aspect that will have to be considered in any changes to the tax system. That is to bear in mind the administrative burden imposed by taxes, both on taxpayers and on the tax collectors. Jersey is a small territory with limited resources; it should be careful before committing to complex taxes that impose a burden on its tax collectors out of proportion to the yield. After all, if the UK with a population of 58m struggles with CGT, could that be an indicator that Jersey should steer clear of it? CGT is, though, clearly a taxing option that has to be considered carefully and we discuss it later.

4.4 Reducing expenditure

We have not been asked to consider whether the expenditure that is undertaken by the States can or should be reduced. Nor does Senator Syvret directly address it as an option in his main propositions, though he does implicitly refer to it as something that needs examination,

However, we have had a number of comments made to us during our discussions that there is scope for expenditure to be reduced. We cannot comment directly on this, as we have not studied the expenditure side of the States' budgets. But we hope we may be permitted to suggest that any territory needs to undertake careful reviews of all its expenditure, in the same way as a business would. In the same way that a business will seek out joint ventures to spread expenditure and scope for co-operation with other entities, territories – particularly small ones – need to look at ways of sharing costs. For Jersey this surely has to mean exploring ways of joint working with Guernsey in certain areas.

We make the points in this and the next two sections cautiously as the subject matter is beyond our terms of reference. But we feel that we would not be presenting a balanced report if we did not say just a brief word about the spending side of the fiscal equation.

4.5 Borrowing

Whether to borrow or not is an issue beyond our terms of reference. For completeness, we have to note that borrowing to bridge a budget deficit is something that many territories routinely undertake. The problem with borrowing is of course that it has to be paid back – and serviced with interest payments in the interim. That burden falls on succeeding taxpayers.

It is notable that in the UK that one of Chancellor of the Exchequer Gordon Brown's key tenets is his "Golden Rule" – primarily that over the economic cycle borrowing will only be undertaken to fund investment, not current expenditure.

4.6 Expanding the economy

Growing the economy traditionally delivers a double benefit to the territory – tax revenues are increased as incomes and profits grow; and social security payments reduce due to lower unemployment or comparable outgoings (this may equate mainly to housing support in Jersey).

Naturally Jersey would like to do this. But it faces some key constraints:

- its dependence on the Financial Services Industry (FSI)
- its relatively small size
- it is an island

It is, for example, unlikely that it would ever become a base for significant manufacturing plants in the same way as some of the new entrants to the EU are achieving.

The importance of the FSI makes its continued health a key issue in any proposals. We note that Facing up to the Future comments, in effect, that the FSI is the only industry likely to deliver growth with good incomes.

However, it seems to us that Jersey does need to work on diversifying its economy. We have seen some ideas in Oxera papers and the Imagine Jersey exercises. It may be that incentives have to be offered to "pump prime", possibly along the lines of the UK's Enterprise Investment Scheme, or that entrepreneurial activities become a criteria for a 1(l)(k) offer to an individual.

5 Why change the Jersey tax system?

We have considered whether there is a need to change the tax system at all. However, it is fairly easy to see that the current tax system, as it applies to companies, cannot be maintained in the light of EU and OECD pressure.[1] (This is well-trodden ground and the issues are not rehearsed here.) Jersey has to cooperate and has decided to do so. Because of this, some change to the company tax system is inevitable.

[1] Taxation: Commission welcomes adoption of package to curb harmful tax competition, ECOFIN, 3 June 2003.

The direction of change to the company tax system is almost inevitably to reduce the tax take. Corporation tax rates generally are going down (e.g. France, Germany, Ireland). As Jersey does not have a massive budget surplus, that must mean that consideration has to be given to other ways of raising money.

One other consideration might be to reduce the level of dependence of the tax revenues on income tax (including company tax). The UK, for instance, raises 40-45% of its taxes in this way; Jersey's percentage is much higher. This is not necessarily bad, but it does mean that the tax burden may not be distributed as smoothly as might be ideal.

6 What is the objective of the changes?

In simple terms, the changes to the tax system are aimed at maintaining the amount of money that flows into the Jersey exchequer. However, there are some important principles that we have detected. Some of these have been expressed openly; others are ones that are implicit.

6.1 Compliance with EU Code of Conduct

The first objective must be to ensure compliance with the code of conduct. The changes to the company tax regime achieve this: we comment below (in Section 8) on the company tax system.

6.2 Preserve the Financial service industry (FSI)

It is clear to us that a guiding principle of any changes must be to maintain the attractiveness of Jersey as a location for the FSI. The proportion of the economy of Jersey that is dependent on the FSI makes it key to the maintenance of Jersey's current standard of living.[2]

The need is to ensure that Jersey remains a competitive location for FSI business. Changes made (or being made) by the Isle of Man and Guernsey suggest there is a degree of urgency for Jersey to agree to the direction of reform, even if some details take longer to complete.

We have looked at the alternative scenarios postulated under the "Imagine Jersey" consultations. These, creditably, do try and contemplate how the island would fare without the FSI. It seems clear that this would lead to major change in the island – in its population, economy and lifestyle.

It cannot be taken for granted that the FSI will remain in its current state in Jersey – or indeed in any other of its locations. The way the FSI is evolving will affect the way

[2] Jersey without the Financial Services Industry, Oxera, 4 April 2003.

business is done in all its locations. Influencers ranging from e business to attacks on money laundering rules will have an impact. As an example, we have noted one or two instances where the type of FSI that Jersey plays host to is less independent than it once was (though this seems to relate to UK-linked business). If this were to continue it could mean fewer top, independent executives running the local operations, with more control from head office. It is the sort of change that will have to be kept under review and evaluation.

There are wider factors. The EU savings directive could lead to more funds being moved away from the EU and adjacent places such as Jersey to territories such as Hong Kong and Singapore. That might argue for Jersey to join in the pressure for the EU's system on a global basis.

Overall, it is impossible to predict what will happen with the FSI. Jersey can surely take reassurance that it has various features that are attractive, including:

- timezone location
- English language
- its regulatory framework
- its reputation and general robustness
- existing infrastructure
- attractive location to work
- low taxes compared with much of the EU

But it is clear to us that Jersey will have work at keeping the FSI. In turn this means the opportunity to diversify: a very large proportion of the FSI is currently offshore private banking. A particular step that should surely be taken is to try and gain better access to the EU's 400m potential customers. Can Jersey reach a better access arrangement to EU markets?

One of the reasons that the FSI chooses Jersey is because of the lower taxes. This is not just corporate taxes; for some the corporate tax paid will be creditable against corporate taxes paid at "home". Tax paid to Jersey would just be a timing difference.

However, that is far from universal – for some, Jersey corporate tax is an extra burden. (It is worth bearing in mind that corporate tax is in many ways a form of double taxation. If company profits are taxed, and then taxed when they reach the hands of the shareholders, that is taxing the same income twice.) It is a cost to be minimised. That is why the "exempt company" route has been successful.

The FSI will be sensitive to its costs in all areas. In particular, the multiplier effect of taxes on payroll will always make such levies a major concern. (As an example, note that the lifting of the "ceiling" on employers' National Insurance Contributions in the UK in the 1980s damaged London's position at the time; the high levels of social security contributions in France and Belgium are factors in their economic positions.) The FSI will look at its total tax bill, from all types of tax.

We have discussed the position of the Jersey FSI with a number of people. Our conclusion is that the FSI is not in any way about to desert Jersey; but at the same time it is a mobile entity. That mobility is in terms both of the actual operation, which can be moved away; and also the people that run the operation. One point that has been made to us a number of times is the way that senior members of the FSI community are typically on a five-year tour of duty (or similar) on the island. The fact that the individuals are rotated regularly means that the head office has a regular prompt to review costs. As many such people are on some form of tax compensation, an increase in their direct tax bills would be an increase in employment costs in the same way as a new payroll levy. Because of the regular rotation, both will feed through to the FSI quickly and potentially lead to a reappraisal of the position. In turn that might mean downgrading or simply a downsizing.

6.3 Simplicity

Taxes need to be simple as far as possible. This is not easy to achieve – as life gets more complex, so do taxes in most cases to cope with more complexities. But we have already commented on the need for Jersey to bear complexity in mind and to avoid imposing levies that are too involved for a small jurisdiction to administer effectively. All taxes have a cost of collection and that should always be kept in mind – both in terms of the cost to the authority to collect/police the taxes and the cost to business and individuals to comply, including record keeping.

6.4 Certainty

Business wants certainty as far as possible to base its decisions on. It is not always possible to achieve certainty in today's environment but the tax system should, as far as possible, not impose further uncertainty. If it does, business may decide that it cannot manage the uncertainty that is imposed and go elsewhere.

One significant cause of uncertainty that is affecting business at present is the uncertainty over the whole tax reform agenda. We have seen a number of documents – notably the submission from the Jersey Chamber of Commerce, Report in respect of the consultation document issued by the Finance and Economics Committee in February 2004, which calls for an early decision. We would endorse this need from experience with UK and other tax systems. Businesses like to know how they are going to be taxed; one of their great fears is that the tax system will change to affect adversely a decision already taken. Whilst it might be thought that the prospect of Jersey's reduction in its taxes on companies will be only to the good for many businesses, they want to know for certain that it will happen – and what is coming in its place to plug the revenue shortfall.

6.5 Fairness

Tax is a burden on taxpayers. No one likes paying taxes – though knowing what the aim of the taxes is and approving of the uses to which the funds are to be put can make the burden easier to bear. One of the aims of the tax raiser has to be to spread that burden fairly.

There is, of course, no universal definition of "fairness" in these terms. Each should contribute something; the better off should pay more; no one sector of society should contribute excessively; business and individuals should both contribute; each of these is a reasonable tenet. The Jersey proposals for reform can be tested against these tenets:

- Each should contribute – the proposal for a VAT would ensure that all contribute, including the 1(1)(k)s.
- The better off should pay more – the proposed phasing out of personal allowances (and the "20 means 20" concept) increases their tax bills.
- No one sector should contribute excessively – the FSI does not do so; nor do the wealthy; nor the less well off, who still benefit from high personal allowances.
- Business and individuals should both contribute – all will contribute but it is arguable that business will, at first sight, contribute less.

The last point deserves further analysis. Business contributes to tax revenues mainly indirectly – by providing employment that in turn generates income taxes from the employees and social security contributions. Thus if it pays less in profits taxes, that does not mean that it is not paying its way.

There is also a potential imbalance between the Jersey-owned company and the company owned outside Jersey. If there are non-FSI businesses, the 0%/10% apportionment gives differing impacts. We discuss this further below in Section 8.

One sector of the economy that may not seem to contribute is what Senator Syvret refers to as the "Accommodation industry". There are clearly significant profits to be made from property in Jersey, as in the UK and many other territories. The profits arguably come in two ways:

- Income flows from the use of the property (which can be hotel-type use, or general retail or similar use)
- Capital appreciation from the increase in value of the land itself

The former must be considered in the same way as the taxation of other income flows; the capital appreciation needs to be considered under the general heading of capital taxes. We discuss both later in this report.

6.6 The position of high net worth individuals (HNWIs)

Jersey makes a profit out of attracting HNWIs. The main category is the 1(1)(k)s: we understand that there are currently 139 of them, contributing income tax of over £10m annually. In addition such people contribute indirectly to the economy through, for example, payments for on-island consumption that may bear tax directly or indirectly (through supporting employment).

It has to make sense to ensure that such people continue to live in Jersey and contribute to its exchequer, directly and indirectly. This suggests ways in which more such people can be attracted – so in terms of the current tax reforms, it is important that they are not scared away. Our work suggests this a potentially mobile population who would be welcomed in other jurisdictions, which would be prepared to do a "deal" for them. The prime example of this at present is Switzerland and we know that the Swiss cantons will compete with each other to attract HNWIs.

The 1(1)(k)s have tax advantages in two ways:

- a fixed income tax charge
- the lack of capital taxes that Jersey offers to everyone

Both aspects are important and a move away from either will damage the chances Jersey has of attracting such people. We have been told that it is not possible renegotiate any of the existing income tax deals with the 1(1)(k)s: they have binding contracts with Jersey. We have not tested this assertion but it rings true. It would not help Jersey's reputation or image if these were renegotiated unilaterally. However, it is an open question whether in future deals should be struck of indefinite duration.

If a capital gains tax or wealth tax is introduced in Jersey we feel that would probably do significant damage to the chances of attracting or retaining the 1(1)(k)s.

The 1(l)(k) tax agreements are well established in Jersey. We have to point to the UK case of Al Fayed & others v Advocate General for Scotland[3], which showed that what might be a UK equivalent – a forward tax agreement - was ultra vires the powers of the Inland Revenue.

We have spent some time trying to assess the extent of a group of HNWIs who are not in the 1(1)(k) category. We have come to the conclusion that such people are

- high earning executives, on a tour of duty
- HNWI Jersey natives
- not in the main incomers, simply because of the housing controls

[3] 2002 STC 910

Our reasons for assessing this group was to see if they too would be vulnerable if the tax system is changed in certain ways. However, it seems that they need to be assessed in the same way as others:

- High earning executives: like other tour of duty people, where their overall tax burden will be a factor for the individuals or for their employer in assessing whether to accept a move to Jersey
- HNW Jersey residents: who will be taxed in the same way as other residents

Such groupings are therefore not significant and in terms of the “special category” of HNWI, only the 1(1)(k) population needs to be considered.

6.7 Sustainability

The Jersey tax changes must also produce a system that is sustainable and so gives business planners a measure of certainty. All will accept that changes will have to be made from time to time but the framework should be robust.

7 How to change the tax law

It is worth reflecting on ways of changing the tax law – comparing the Jersey process with places such as the UK and the USA.

In democracies, the people elect representatives to make decisions on taxation (and everything else) on their behalf. Some places (for example Switzerland and California) make considerable use of referendums to allow the population a direct say on proposals for change. Tax changes can be included in referendums but there is no tradition (as far as we are aware) of so doing in Jersey.

What is important in tax changes is to give the population a say in what changes are being made. That can be through the manifesto of a politician and then the ballot box. It can – and should – also be through consultation. In the UK, the Chartered Institute of Taxation (CIOT), in common with many other professional bodies, has long argued that changes to the tax system should be preceded by full and proper consultation. Whilst in practice this may mean that professional and trade bodies are the main contributors to the consultation, it does mean that the whole population can do so and should at least be aware of the changes under discussion. To paraphrase Colbert’s famous maxim, taxation may be the art of plucking the goose to remove the maximum feathers with the least possible hissing – but the goose will be much happier if it is given a say in which feathers are to be removed.

Jersey’s current proposals and indeed the whole taxation debate has been in many ways a model of consultation. Papers have been published, debates held; phone-ins tried, regular articles written and interviews given. Any visitor to the island will be struck, as we were, by the level of engagement of the population in "The big debate". Most people seem to have heard of the issues, in many cases have a view and as far as we can tell feel that they have been able to express their views. They feel well involved, which is a credit to the elected representatives who have been able to engage them and indeed to the local paper which has highlighted the issues regularly. However, there is scope for publishing more background documents to those who wish to study them.

One of the reasons that the CIOT is so keen on proper consultation in the UK is that once the Budget speech takes place and the Finance Bill is published, there is little realistic opportunity of getting changes to the draft legislation. Tax law changes go through very quickly and efficiently. This is in marked contrast to the USA where tax bills can meander through Congress for some time, attracting amendments reflecting parochial interests in return for support.

Overall, the Jersey process scores well for the level of engagement.

8 The company tax proposals

8.1 The proposals in concept

Currently Jersey taxes companies in three ways:

- the "exempt company"
- the normal income tax rate
- the international business company

The essential proposal is to change this to

- a standard company tax rate of 0%
- a rate for the financial sector of 10%

This is the "0/10" system.

8.2 Why the change?

We have looked into the reasons for the change and these are well documented. The pressure Jersey has come under from the EU & OECD on "harmful tax practices" means that the exempt and international business company routes are no longer acceptable.

We are convinced that Jersey has no choice but to change that and is faced with imposing company tax in a uniform way.

8.3 The standard rate of company tax

It has been decided to propose a 0% rate of company tax in Jersey. This will be the standard rate, applicable generally. This basis is important: we have seen that the EU/OECD wants a uniform rate and will accept (in effect) a higher rate for a certain activity. What will not be accepted is a discount on a rate for certain sectors.

We have questioned whether it would be possible to have a standard rate of 10%, which would be reduced to nil for (say) Jersey owned businesses or any other definition. It seems clear that this will fail the EU/OECD criteria and code of conduct. Having a 0% rate with certain sectors subject to a higher rate will also fail if those sectors are extensive. Thus it seems that whilst it is acceptable to EU/OECD to have a nil rate and a 10% for the FSI, extending this positive rate to (say) the hotel industry would cause the EU/OECD to view the rate being 10% with discounts instead –and that that would be unacceptable.

We have based our views on this important point on our various discussions, a letter from the UK Lord Chancellor[4] and our reading of various EU/OECD documents.[5]

It might be thought that having a nil rate of company tax might be seen as unacceptable by the EU/OECD. This does not seem to be the case. Jersey is far from the only territory proposing or having a nil company tax rate. Some of the new EU accession countries have made or are contemplating moves in this direction.

It is worth noting that there is considerable tension within the EU – currently more important to Jersey than the OECD – between those territories who favour more or less central control on taxation. The EU treaty concentrates on indirect taxes – so VAT is the standardised EU indirect tax – and leaves direct tax to the individual states. Although some favour more central control on direct taxes, that seems to be being left to the European Court of Justice in its interpretation of the freedoms conferred by the EU treaty. Thus there seems no likelihood in the short or medium term of there being an attempt to impose an EU minimum level of company tax, which might then lead to pressure on Jersey to comply.

Part of the reason for this is that the current drive in the EU is towards transparency and exchange of information – which Jersey has of course been caught up in. With Jersey subscribing to these principles, it is clear from such documents as the Lord Chancellor's letter and notes of meetings that the UK, effectively on behalf of the EU, will support Jersey in its proposed tax system. In other words, Jersey will be seen to have done enough to reform its company tax system to comply with current EU opinion.

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[4] Correspondence between Senator Walker and the Lord Chancellor re bilateral tax agreement negotiations, 3 March 2004.

[5] Taxation: Commission welcomes adoption of package to curb harmful tax competition, ECOFIN, 3 June 2003.

8.4 Will the users accept the company tax system?

One cannot see any company objecting to a nil rate of company profits tax.

What of the companies – the financial services industry (FSI) – who are faced with the 10% rate?

We have seen evidence that this rate will be generally acceptable to them and will not cause a significant exodus of the FSI from the island. As already discussed, the FSI will in many cases be relaxed about company taxes – because they will be creditable against the "home" tax liability. On these grounds, it might be thought that the rate could be extended to 20% (or more). However, the offset will not be fully achieved at that sort of rate due to the vagaries of the calculation of double tax relief/foreign tax credits in other territories. So 10% seems to be an acceptable compromise that the market will bear and which will deliver significant funds to Jersey.

The FSI will not just look at company tax but at its total tax bill – so including payroll taxes, irrecoverable VAT and any other levies. Jersey scores well as a total package and there is some scope for the island to emphasise this more strongly.

The 0/10 rate compares well with onshore locations that the FSI might consider. It is comparable with competitors such as Guernsey and the Isle of Man. On the surface it gives the FSI a higher tax bill than somewhere such as Bermuda, but that island has a less practical location, a smaller employee pool and greater indirect taxes (which returns to the total tax bill point).

Perhaps the key consideration for the FSI, and indeed business generally, is certainty. They want to be able to plan on the basis of knowing what is happening, and that any changes will bring a stable regime. Jersey has traditionally offered stability; now that it has to change, it needs to move ahead and confirm its changes.

8.5 Could the 0/10 system be abused?

Any nil rate of tax means that income or gains potentially escape taxation and do not pay a share to the exchequer.

The types of companies that could potentially benefit from the tax freedom can be categorised in two ways:

- those owned outside Jersey
- those owned by Jersey residents

8.6 **Jersey-owned companies: Apportionment**

The current proposals include a plan to impose a tax charge through apportionment on the Jersey-owned company.[6] We can see the attractions of this for reasons of perceived fairness – which is one of our key principles. But we do have concerns about how easy it will be to administer. Apportionment (of close company[7] income) was a longstanding feature of the UK tax system but was complex to administer and did not deliver significant revenues. It was defended as a necessary anti-avoidance measure but once capital gains tax was introduced in the UK, anyone retaining low-taxed profits in a company against the day that they could sell out for a significant capital gain would face a capital gains charge. Apportionment was eventually abolished in the 1980s.

We have discussed apportionment with, among others, the Comptroller of income taxes. He is confident that it is manageable – and that the Jersey system of universal tax returns and generally good compliance is a good basis for this assertion. We have questioned whether the use of the GAAR in Article 134A can tax people who seek to build up funds in a company but this seems difficult on the way it is currently phrased. We then discussed whether an equivalent of the UK's s703[8] legislation could be introduced to attack deliberate warehousing of profits later sold out for a gain (see cases such as *Cleary v IRC*)[9]. There is a concern that such a route would be less certain and more complex than the proposed apportionment route. We have some sympathy with this view.

There is an argument that there should be no apportionment and that profits made by Jersey-owned resident companies should be left to be tax-free. We can see that this is viewed as unacceptable for reasons of fairness and have to accept that.

Accordingly we accept the need for the apportionment route but are still concerned about its practicalities. We would suggest that the administrative effort required is kept under review and assessed at intervals. If it becomes too involved, then a S703 type charge may have to be considered.

8.7 **The company owned outside Jersey**

If a Jersey company is owned outside the island, apportionment will not be effective. Thus profits made in Jersey by such companies will escape Jersey tax, though they would normally be taxed elsewhere.

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[6] Outline proposals for imputing corporate profits to Jersey resident participators – an explanatory leaflet, Office of Comptroller of Income Taxes, March 2004.
[7] A "close company" in the UK is essentially one owned by five or fewer people.
[8]An anti avoidance rule that taxes a "tax advantage" obtained from a "transaction in securities" – typically manipulating a company to extract profits in a tax-advantaged manner. S703 Income and Corporation Taxes Act 1988.
[9] 1968 AC 766

As already discussed, any attempt to impose a company tax rate on such companies will mean that the EU/OECD will not accept that the Jersey rate of tax is nil. So it is not possible to try and impose a positive rate of tax on such companies.

Another route to consider is a withholding tax (WHT) when profits are remitted. The problem that we see with that route is that any WHT would also have to be imposed on the financial sector and that would be potentially above creditable amounts in recipient countries, once the 10% company tax rate is added in. It would also considerably add to the tax burden of existing exempt companies. The EU is also trying to eliminate WHT within its boundaries; although not directly relevant to Jersey it is clearly something that Jersey has to have regard to.

We have seen that consideration has been given to a territorially-based form of withholding tax, i.e. one that would only apply to Jersey income. We understand that the Inland Revenue have objected to such a system; it would in any case be complex to administer. Other forms of tax including levies such as the Estonian distribution tax and the new UK non-corporation distributions rate. Both allow profits to be retained tax-free but then charge company tax when distributions are made. Again, though, any such charge would impact the FSI as well as other businesses.

Overall, it does not seem practical to go down the WHT route.

The next stage is to consider extra charges on such companies – registration duties, capital duties etc. But again, such charges would also have to be levied on the FSI. Such taxes would not be creditable against company tax back home and would be perceived as additional costs. Accordingly, whilst there may be some scope for small amounts of money to be raised from this sort of route, it is one to approach with care.

The conclusion has to be that with the 0/10 system that is proposed, the non-Jersey owned company would simply have to be regarded as a beneficiary. There is the benefit that such companies will be more prepared to come to Jersey and trade – thus indirectly reducing the price of goods and services to the island. This is an important consideration for an island and must be borne in mind. Additionally there is employment created by such companies, with more tax being paid in turn.

9 Income tax

The basic plan is to leave the 20% income tax rate in place for individuals. Higher – and lower - rates have been considered. The main way that the rates are planned to be altered is to start phasing out the personal allowances for those on higher incomes (£80,000 and above).

9.1 Personal allowances, exemptions and reliefs

We are struck – as are many who look at the Jersey tax system – by the high levels of personal allowances and exemptions. These mean that many people of modest incomes pay no income tax. That is in many ways fair – but it does mean that the income tax is more narrowly based than is the case in many countries. An increase in income tax rates will bear more heavily on the better off, simply because those who are of modest means will not be affected. But whilst at first brush that might be appealing, it needs to be borne in mind that the heaviest burdens of income tax increases will be on those who are still on relatively modest incomes but who are firmly in the tax net. They will see their relative tax rates climb and will have less free disposable incomes out of which to meet the increased tax bills with compared with the truly well off.

We are not advocating the personal allowances/exemptions are altered in any way – that would be beyond our remit – but we make the point that they are relatively generous (compared with places such as Guernsey and the UK) to show how the Jersey tax system bears lightly on those of modest incomes. It also produces the relatively high marginal rate of 27% when people enter the tax system (before the impact of social security is considered).

The plan to phase out the personal allowances once incomes are above a certain level has two problems:

- administrative complexity
- high marginal rates when the allowances start to be withdrawn

Again, we have concerns about the administrative burden imposed on the tax authorities. There is also the issue of how well such a system will be understood by the individuals affected. We have received assurances that systems can be easily developed to minimise the burdens imposed by the withdrawal. As for the burdens on those affected, it will be something to be tackled in the coming years as the system is introduced.

The main justification for the way the allowances will be phased out for those on higher incomes is that this makes them contribute more to the exchequer. Whilst this does in some ways meet the fairness criteria, it must be borne in mind that many of those affected will be working in the FSI, will see this as making the Jersey regime less attractive and possibly contributing to a reappraisal of their positions in due course. It could lead to demands for higher pay. Or, if their employers meet their tax bills, it will increase their costs and again affect the industry. It has been suggested to us that the impact of this will be marginal and we can accept that – but there is a risk here of an impact on the FSI in due course. The work we have seen on analysing the categories of people likely to be affected by this move – noted above – suggests that there are few outside the FSI who will be affected. It does need to be considered whether it is worth doing in this way so as to impose a further burden on the FSI.

9.2 Higher or lower income tax rates

There has been some discussion of higher tax rates – either raising the standard rate or introducing a higher rate on top of the 20% rate. Another route suggested is to introduce a lower rate to apply to a first tranche of income.[10]

A lower rate does not seem necessary with Jersey's standard 20% rate and, more importantly, the high levels of personal allowances. Whilst those who just get into the tax system arguably find themselves with a high marginal rate at the point of entry, the blow is softened simply because it hits relatively far up the income scale.

Raising the income tax rate would raise significant money. But it would damage one of the key parts of Jersey's appeal – the low general rate. A 25% rate, for instance, would look uncompetitive with Guernsey and the Isle of Man when a simple comparison was done (even if more careful sums would show that the impact is affected by the higher personal allowances available).

Similarly a higher rate on top of the basic 20% rate – say 30% - would also look uncompetitive and would be getting close to the UK's 40% top rate. It is also questionable how much money this would really raise, particularly if the 1(l)(k) agreements were honoured.

It is for these reasons that higher or lower rates have been ruled out in "Facing up to the Future" and we endorse the conclusions from the review work that we have done. It is a cardinal principle of Jersey's system that there is a low general rate of tax to appeal to people to come and work in the island – and to benefit those who are its permanent residents.

9.3 Extending the income tax base

It is usually possible to extend the base to which a tax applies and thus raise more revenue. Income tax in Jersey has recently significantly extended the base with interest relief restrictions and an extension to most benefits in kind. We would have certainly recommended such moves and wonder if there is further scope to extend the base of the tax. Areas such as tax relief for life assurance might bear examination – but the amounts of tax raised will be small, as no doubt relief would have to be maintained for existing policies.

The freezing of personal allowances also widens the tax base steadily; although it is a difficult decision to take, we think it is sensible against the backdrop of the high effective entry point for paying income tax.

[10] See Assessment of new taxes options, Oxera, 18 June 2003.

10 VAT/GST/Sales taxes

One of the key proposals within the Facing the Future document is that of introducing a VAT or equivalent. This will be a major step for a territory that has hitherto managed without such a tax. We needed to examine the general reasons for the popularity of such taxes –and whether they would fit Jersey's situation.

10.1 VAT/GST v Sales tax

The difference between VAT and GST (Goods and Services Tax) is often no more than nomenclature. Both tax a wide range of economic activities; both allow the trader to take credit for tax that has been paid when calculating how much is owed to the tax authority; both in principle act at all stages of the production chain though GST can start to apply later. Both give the taxpayer a measure of choice in that, unlike income tax, which is lost at the point of earning, the taxpayer can choose to spend and thus pay the levy on their purchases. (If the tax is levied universally this may be thought to be a bit illusory but there can still be differences such as between employing someone to do some work and buying a finished item from the shop. Wages do not have VAT etc on them; the finished item usually will.)

Sales taxes are in principle just applied at the point of sale. In many cases they apply only to goods and not services.

VAT/GST (from now on VAT will be used to cover both terms) can be found in almost all OECD countries and in many others. Increasingly, it seems only the USA is outside the VAT ambit. With indirect taxes being primarily for the States to operate, a federal VAT seems impossible. Countries such as Japan and Australia have introduced VAT; India is soon to; interestingly for Jersey, so has Malta (as a condition of EU entry). We have looked at the Malta experience and feel this may have lessons for Jersey.

The advantage of VAT against a Sales tax is its wide impact, capable of applying to a much wider range of economic activities. It lends itself to self-assessment; it is cheap for the authorities to collect – though of course the trader is turned into an unpaid tax collector. It can be simple, but it can also be complex if multiple boundaries between taxable and non-taxable items are frequent and complex. It is possible to reduce the impact of the tax on certain sectors by zero rating or exempting some items – but this can be at the expense of complexity.

10.2 VAT as a money raiser

VAT has the potential on Jersey to raise a good deal of money. Facing up to the Future suggests a rate of 5%.[11] We have reviewed the estimates of tax revenues this will achieve and endorse the bases used.

[11] Analysis of tax packages, Oxera, 3 September 2003.

Clearly much depends on how widely VAT is applied. We instinctively prefer a wide-based tax, potentially at a low rate, rather than a narrower basis with a higher rate. However, there are system design considerations.

10.3 The burden of VAT

We have seen a number of studies of the potential impact of VAT on the Jersey population.[12] The questions these seek to answer include:

- Does the tax impact more heavily on the less well-off sectors of the population?
- Do the better off pay their share?
- Does it impose a disproportionate burden on registered traders, i.e. the organisations that have to collect the tax and account for it?

Studies of the impact of VAT do indicate that it its introduction is a little regressive, in that the poorer sectors have to pay more of their income in VAT than do the wealthy. This is because they will have to devote a greater proportion of their income to purchases that bear the tax. The system can try and ameliorate this by, for example, not taxing basic foodstuffs. The disadvantage of this is the difficulty of defining the boundaries, leading to a plethora of cases on whether something is subject to VAT or not. (Perhaps the most famous in the UK being the action taken on whether a Jaffa Cake was a cake or a chocolate-covered biscuit – only the latter bearing VAT.[13]) If it is felt that VAT is disadvantaging some sectors of the population, there is much to be said for compensating them by way of benefit rather than imposing complexity on all with some exemptions. But with the high personal allowances that benefit so many people, it is perhaps not unreasonable to ask them to pay something by way of VAT and so share the burden of taxation.

The better off – and in Jersey terms that includes the 1(1)(k)s – will pay their share of a VAT. They will not devote the same proportion of income to VATable items but will in absolute terms spend more and so pay more in VAT.

It is also worth bearing in mind that the visitor to the island will also contribute by way of VAT. So that is an indirect way in which parts of the accommodation industry will contribute to the new taxes. It does have the risk that the visitor will see the VAT as increasing the cost of Jersey as a destination but it has to borne in mind that the vast majority will be familiar with VAT from their own homes and so will not resent it in the way that they might another form of indirect tax. Jersey is not a cheap destination for the visitor so any increase in costs is not to be taken lightly. But at the same time it is arguable that a modest VAT will not have a significant impact on costs.

[12] See Scope of GST, Oxera, 22 April 2004.
[13] United Biscuits (UK) Ltd, Lond/91/160

The burden on the average trader is not to be dismissed and if Jersey is to introduce the tax, work will need to be done to minimise the burden as far as possible. Steps should include:

- good education campaigns
- light touch administrative regimes
- above all, a simple system

There is a major issue for the FSI that will need to be considered: partial exemption. VAT normally exempts supplies in the FSI, meaning that such businesses cannot recover all their input VAT. That adds to their total tax bill. It is a quirk of VAT, in many ways, that a business is often better off being "taxable" (i.e. having to charge VAT) than being exempt.

Another advantage of VAT is that there is much experience for Jersey to draw on from around the world in designing the system. We are aware of the work that is being undertaken on aspects of this and there will naturally be much more to be done if the decision is made to go ahead.[14]

10.4 Introducing VAT for Jersey

We see no reason why VAT should not be successfully introduced in Jersey. We have looked at the impact on Malta, another island economy though rather different from Jersey, of the recent introduction of VAT. We have included some notes on our findings as Appendix 3. There are some points here that Jersey may care to consider in the design and implementation of a VAT.

One concern is the impact on inflation. We have seen an Oxera study that suggests there will be little or no impact if VAT is introduced at a low rate. Whatever impact there is, it will be a one-off factor in the main and should be stressed as such to avoid it becoming part of a wage spiral.

At the end of the day, we find it hard to see how Jersey is going to fill the potential hole in its budgets left by the changes in company taxation without resorting to VAT.

11 Capital taxes

Jersey currently does not tax capital through taxes such as capital gains tax (CGT) Inheritance tax (IHT) or a wealth tax. There is an existing probate duty.

There have been calls that at least one of these taxes should form part of the current reform package.

[14] Principal characteristics of consumption taxes and implementation issues, Oxera, 8 April 2003.

11.1 Comparable jurisdictions

It is notable that comparable jurisdictions do not have capital taxes. In general they are regarded as part of the appeal of a lower tax regime. The introduction of a CGT would run the risk of scaring away capital.

11.2 CGT: yield and complexity

CGT has been a feature of the UK's tax system since 1965. The current yield of CGT is around £1.5bn; this excludes the tax yield from companies who pay corporation tax on their chargeable gains. Whilst the money raised by CGT is undoubtedly useful, it is small compared with the £400+bn projected tax revenues in the UK. The penalty of the tax is its complexity; it is probably the most complex tax in the UK and one of the most expensive to administer when all compliance costs are factored in. It is a regular source of tax cases.

Part of the reason for this is that people will try and plan their way out of CGT. That is not of itself a reason for not proceeding with the tax but it will inevitably lead to complexity.[15]

CGT may block flows of capital and discourage entrepreneurs. This was one of the main drivers for the UK's reform of its CGT in recent years with the introduction of taper relief to reduce the rate of tax to 10% for entrepreneurs and others who can qualify (such as those with shares in their employing company). These moves have significantly reduced the burden of CGT for many at the expense of more complexity.

These comments are made by way of background but it is inevitable that any CGT along UK lines will be complex and relatively low yielding. The only way to make it a significant revenue earner would be to impose the tax on the disposal of houses. The UK has always exempted "principle private residences" from CGT; other jurisdictions apply similar rules, sometimes requiring reinvestment to qualify. Clearly imposing CGT on housing in Jersey would be a way of taxing the accommodation industry but it is highly questionable whether it would be seen as acceptable by the population. It would also potentially damage housing values in Jersey.

We have discussed the practicalities of introducing a CGT in Jersey. The tax authorities are concerned about its complexity and whether the difficulties of administering it would detract from their efforts on policing the major taxes. With the 0/10 corporate tax rate, there would be no CGT-equivalent for the 0% companies (assuming they are taxed on gains at the same rate as income). This might mean further apportionment issues if it

[15] The original legislation on CGT in 1965 covered some 70 pages. The current rules are now mainly in the Taxation of Chargeable Gains Act 1992, of some 420 pages (in a smaller typeface) with the rules of company capital gains mostly elsewhere.

were wanted to impose a CGT on such organisations. Again, whether it is worth so doing is questionable.

A final point is to reflect on is who would pay Jersey CGT. The main categories to consider are:

(1) 1(l)(k)s – if imposed on their transactions, would probably be seen as a breach of their agreements.

(2) The landowner realising a development gain.

(3) Someone achieving a gain through speculation.

(4) The FSI company – though the vast majority of what might to others be capital transactions will be taxed as trading profits.

(5) Other companies – might legitimately expect to pay tax on capital gains in the same way as on other income, i.e. nil.

(6) Other taxpayers – would normally be covered by an annual exemption.

It seems that only categories (2) and (3) would pay CGT. As we explain later, category (2) might be better taxed by a development levy. Category (3) undoubtedly troubles the Comptroller of Income Taxes, who does try and assess such gains to income tax. This is not always successful; if the category is a concern to us we wonder if a targeted supplement to Article 134A might work, perhaps laying down a way of taxing short-term gains. (Though the UK's short-lived Schedule D Case VII short term CGT, introduced in 1962, was not entirely successful.)

Our view is that a CGT is not an attractive route for Jersey to follow.

11.3 Inheritance tax

As with CGT, IHT is not a big yielding tax in many jurisdictions. In the UK it operates as a form of death duties and brings in around £2.5bn. Unlike CGT, its yield is rising, mainly in line with house price rises. A number of countries, France being one example, levy the tax by reference to the size of inheritance – in other words, a dissipated estate attracts less tax than a concentrated one. Arguably that form of taxation is imposed for social/redistributive reasons rather than simply tax yield. There is also the argument that death duties, however calculated, are a form of double taxation as most wealth these days is accumulated out of taxed income.

Would an IHT work in Jersey? Again, such taxes are not normally found in lower tax areas and its absence is seen as important in attracting the wealthy. As much wealth would be situated outside Jersey there would have to be careful consideration of international aspects so as to be seen as fair.

We would not rule out consideration of an IHT but suspect that the prospective yield would make it of dubious value, particularly when set against the potential damage to the image of the island. In any event, the existing probate duty and stamp duty on transfers on death probably constitute a sufficient framework of death duties and already contribute to the Exchequer.

11.4 Wealth tax

A standalone wealth tax is used in some jurisdictions, France being a prime example. It is an annual levy based on an assessment of individual wealth. We note that Sweden's 1.5% wealth tax is under attack and may be abolished. It is cited as a major reason for capital and wealthy businessmen leaving the country[16]. As with the other capital taxes, wealth tax is not something found in the traditional lower tax area and would not do much for Jersey's image. Its complexity and uncertain yield would also seem to rule it out.[17]

11.5 Conclusion on the capital taxes

We do not rule out Jersey introducing one of the capital taxes. However, it seems to us from our work that all have been considered carefully and rejected for proper reasons. If it decided to try and introduce one, it must be with the potential dangers firmly in mind.

12 Social security and Payroll taxes

We have seen that the Jersey system of social security contributions is a true insurance-based system, with employees understanding that they are contributing to their pension and other benefits. This does in some ways limit its potential for raising more money.

12.1 Social security contributions by individuals

The monies paid by employees and employers are a big part of the tax revenues in many countries – the second largest after income tax in much of the EU. But this is on the basis that the monies thus raised go into general tax revenues in the main, rather than being ring-fenced as in Jersey.

We have discussed the possibilities of raising more monies through social security contributions with a number of people. One thing that has been brought home to us is the demographic challenge that the fund already faces with the inevitable growth in pension entitlements in the coming years. That seems to demand increases in contribution rates. With these possibly in the offing, it seems that there is much less scope for increases that

[16] See, for example, Financial Times 14 April 2004 page 8.
[17] See, for example, The taxation of wealth (or can we make things better), John Endacott, 12 April 2004.

might generate "free" funds than might otherwise be the case. It has also been made clear to us that the acceptance of the contribution system depends significantly on the ring-fenced nature of the funds.

Accordingly, we do not see much scope for increasing the general tax revenues through employee social security contributions. Indeed with the demands on the public purse increasing and with the possibility of unemployment benefit being introduced, it is likely that the rates of levy will have to go up significantly to keep the fund in balance in any case.

12.2 Payroll taxes & employers' social security

There is already an employers' social security charge in the Jersey system. There is, on the surface a case for introducing a further levy on employers – something that is a feature of many tax systems.

The two levies are largely synonymous – the UK employers' national insurance contributions being largely a payroll tax, in that it depends on the amount paid to the employee. At the same time there is no benefit to the employer, nor a link to additional benefit to the employee.

Whilst there are attractions in terms of the amounts that such a levy could raise, the downside is that it does of course add to employers' costs. For those based solely on Jersey, this might be argued to be in exchange for the nil rate of profits tax, though they face apportionment. For those based in the FSI and so subject to the 10% company tax rate the snag is that it adds to the companies' costs in a way that is not creditable against home country taxation.

From what we have studied and discussed, and from what we know of international organisations, they would much prefer to be taxed in a way that is creditable against tax at home – and which will therefore not add to overall tax bills. Of course they cannot always have this but it is the case that a payroll tax that adds to costs will be a factor in their deciding where to locate operations (the total tax bill issue). Coming back to one of the key aims of the tax reforms in Jersey, it seems to us that there is no real scope for the introduction of a payroll tax because of the dangers of destabilising the FSI. It would be better to raise the money by way of direct taxes on the business – but, as already discussed, there is little scope to go higher than the planned 10% rate.

We therefore conclude that it is reasonable to rule out payroll taxes other than those already in place.

12.3 Enforcing Social Security

One aspect that may need attention, as in all tax jurisdictions, is possible evasion (rather than avoidance) of social security through cash payment rather than proper employment. We have not discussed whether the Comptroller needs additional powers in this area.

13 Property taxes & the accommodation industry

Property taxes are arguably the oldest form of taxation and still form part of the revenue raising activities in most jurisdictions. The advantage is that real property is immovable and thus the tax base can be controlled and monitored. Property values tend to increase and so there is a way for the exchequer to share in that increase.

Property taxes include such levies as

- rates
- occupation tax
- development charges
- CGT
- IHT
- stamp duties

Of these, stamp duties and rates already form a part of the Jersey tax system.

13.1 Stamp duties

Stamp duty is already a feature of the Jersey tax system. We are aware that the system has been changed after detailed review.

With stamp duty in place as a progressive levy, there is already a tax that applies to property values, in that on every transfer it is charged. It also applies to transfers on death, meaning that there is tax charged on death even without IHT.

It may be possible to increase the yield from stamp duty by increasing rates which are still not high compared to the sort of levels charged in much of the EU. However, it is an unpopular tax as it is something of a levy on mobility and an increase would not deliver significant revenues.

13.2 Rates

We have discussed the rates system with a number of people and have been made well aware that the rates system is the preserve of the parishes. Thus there is limited scope for revenue raising to benefit the "centre". We do wonder, however, in view of the modest amounts charged by way of rates whether people should pay more to reflect the services that are delivered to them. We feel that some study of the cost/benefit would pay dividends and might lead to increases that are accepted by property occupiers who can see the services they receive.

However, this would be a long-term route to follow in view of the need to operate through the parishes.

13.3 CGT

We have already discussed this and have suggested that it is reasonable to rule it out. However, it is clearly the case that there are significant gains to be made from development projects. If there is to be no CGT, then one has to look at a development levy of some form.

13.4 Development tax

Development on Jersey is tightly controlled and when some land is recategorised as allowing development (or redevelopment) on it, there is inevitably a significant profit to be made by the owner. That profit could be taxed as trading profit of a company under the 0/10 regime it ranks as a trading profit, but in most cases it would be capital. If undertaken by an individual it is unlikely that it would contribute income (being one-off in nature) so would count as capital. (We have commented already on the possibility of strengthening the Article 134A regime.[18])

As the rezoning of land for development has come from the decision of (in effect) the community, the development gain thus conferred might logically accrue to the community. This was the basis of the UK's Development Land Tax (DLT) introduced in the 1976. This tax was triggered by development and was paid by the owner/developer. DLT was a complex tax to administer, requiring many valuations, and did not raise a great deal of money. It was abolished in 1985 as largely unworkable, raising insufficient amounts and being a drag on development. Because of these complexities, a DLT does not seem the right route for Jersey to go.

However, the tightly controlled nature of development on the island surely makes it possible for some sort of licence fee possible when development is permitted.[19] This would not necessarily catch all redevelopment but some sort of comparable levy for permitting such activities would be worth examining. The possible danger is that such charges would become a block on (re)development, as happened to a degree with DLT in the UK. It could, however, also be used positively, to encourage socially-responsible developments.

13.5 Occupation tax

In the UK, a form of occupation tax was levied on the notional rental value of occupied property under what was then Schedule A. This was abolished in the early 1960s. Some sort of imputed value tax is still used in some jurisdictions.

[18] See the CGT section, part 11.2 above.

[19] The recent Barker report into the UK housing stock does point towards a re-examination of a DLT or, more likely, a development levy.

The problem with this form of taxation is that it arguably doubles up with Rates as a tax on property occupation. It needs regular valuation work – or banding of properties. It is tied to property values rather than ability to pay and in Jersey one feels it would lead to considerable increases in the housing benefit paid out.

Overall, this would seem to be a tax that is best left alone; a better route is surely to look at the rates (business and residential) to ensure, as noted above, that they are recovering properly for the services provided.

14 Other taxes and levies

There are other ways of raising taxes that can be considered. The main ones are:

- excise duties/impots;
- environmental taxes;
- fees and licences.

14.1 Excise duties /Impots

Impots are already a feature of the Jersey fiscal system. The levels of taxation are considerably lower than in the UK, but are higher than Guernsey. There is probably not a lot of scope for raising significant amounts through higher duties on alcohol; tobacco duties could be raised a little; but the main source that might be considered is petrol and diesel.

Any visitor to the island cannot help but be struck by the volume of cars on the island and the level of car ownership on Jersey is apparently the highest in Europe. It does seem that in view of the inevitably small amounts of mileage that the average driver must do, then further tax on petrol & diesel is worth considering.

It is also plausible that a further tax on the actual purchase of cars, or road taxes would raise useful money. We have seen the requests from the motor trade against this route and are aware that road taxes were withdrawn in favour of increased petrol duties. Clearly "transport taxes" should be looked at as an entirety; it may be possible to raise the registration duty further.

14.2 Environmental taxes

Environmental taxes are an area that many jurisdictions are tackling. Recent examples include the UK's Climate Change Levy and Landfill tax and Ireland's tax on plastic bags. However, these taxes show the basic dilemma of environmental taxes – are they there to raise money or to influence behaviour?

If the aim is to raise money, the impact can be to choke off the action being taxed. Arguably this has happened with the London congestion charge where its introduction has led to a reduction in traffic to the extent that revenues from the tax are not as high as predicted. But taxes can be a good force for behaviour change – witness the Irish plastic bag tax which has succeeded dramatically in reducing the use of such bags.

Jersey clearly has scope for environmental taxes. It is a small island, with space under pressure. Perhaps the best source would be a levy on waste. With the need to replace the island's incinerator, and landfill sites at a premium, there is a need to encourage recycling and care over waste. So some form of waste levy is indicated – though it is unlikely to raise significant monies as some would be needed for policing (to prevent fly tipping) and the aim would be to influence behaviour. But any surplus could be clearly earmarked for the new incinerator or other waste disposal activities, making it clear to payers where their money was going.

14.3 Other fees and licences

We have seen a number of suggestions that money can be raised through fees and licences. Undoubtedly there is scope and we have seen from our studies of some West Indian islands that they can raise significant sums from such levies as cruise ship-landing fees. This route would not be significant for Jersey and an airport tax might damage travel to the island. But it is an area to keep under review. Should a casino be permitted on the island, no doubt there would be a source of revenue from licence fees or betting duties.

However, we do not see this as an area for significant money raising.

15 Summary to date

As will be seen from the above, we have tried to evaluate the work done on the various tax options and then consider the impact on the various categories of taxpayer and the principles that we have detected in the Jersey system. Our reason for this approach has been that without the understanding this gives we could not begin to consider Senator Syvret's propositions.

Having outlined our generic findings, we will now proceed to explain our view on the Senator's propositions.

16 A commentary on the paper presented by Senator Syvret "States of Jersey Taxation Policies: A call for a transparent enquiry"

The main aim of this report is to comment on the points raised by Senator Syvret in his extensive and thought-provoking paper in response to the report published by the Finance and Economics Committee of the State of Jersey, "Facing up to the Future: reforming public spending and taxation to sustain a prosperous and competitive economy". To do so, we have in the previous sections of this report commented on many areas of the Jersey tax system and the results of our analysis and findings.

Turning now to Senator Syvret's paper, we comment on each of the main questions raised in the summary section. In commenting as we do, we are also implicitly responding to the points in the Senator's full paper.

Q1: To commission and make available to all States members an independent risk assessment of the committee's tax proposals with particular reference, but not limited to, the likely acceptability of the proposed rate of 0% corporation tax to the European Union and the OECD over the medium and long term.

Comments:

We have found evidence that the Jersey authorities have done a lot of work in this area. The 0/10 company tax rate is a response to the problem that Jersey faces with the EU/OECD finding that the existing exempt company tax and international business company regimes are unacceptable. Thus Jersey is faced with the need to change its tax system: it cannot keep the existing regime. The Jersey proposition is in essence that the standard rate of company tax is 0%, with a sector of the economy being taxed at 10%. The important point is that the main rate is 0%.

It seems that the EU & OECD are interested in the standard rate and object to discounts/special deals. That seems to be causing the problem currently faced by Gibraltar with its current proposals. (The Gibraltar situation is not entirely on all fours with Jersey as the EU regards Gibraltar as being part of the UK for the purposes of assessing the company tax regime and is therefore objecting to what it sees as a special discount on the UK's standard rate of corporation tax. The EU thus has more influence over Gibraltar than it does Jersey, but its stance is a useful indicator of what its concerns are.) Jersey has had assurances from the UK Lord Chancellor over how it negotiates with EU and OECD member states, effectively enabling Jersey to remain independent from the UK when negotiating agreements.[20]

Another key reason for concluding that the current proposals are acceptable is that the emphasis in the EU & OECD is very much on transparency rather than tax rates as

[20] Correspondence between Senator Walker and the Lord Chancellor re Bilateral tax agreement negotiations, The Lord Chancellor, 3 March 2004.

such.[21] What they want to ensure is that territories will exchange information and generally help in tracing evaders. Jersey has subscribed to the exchange of information concept and has clearly generated goodwill in so doing. There is no evidence to suggest that they will have problems with EU/OECD in the foreseeable future.

But nothing is forever. Senator Syvret's point that this is not a permanent solution is valid. The new company tax regime may only be a breathing space – company tax rates are generally reducing and countries such as the USA & UK may have to adjust to life with lower company tax revenues in the medium term. Accordingly, we believe that Jersey will have to keep its company tax structure – indeed its whole tax system - under review, in much the same way as most countries do, and anticipate that more changes will have to be made in the medium to longer term. We would stress that this probability that the tax system will have to change further at some point in the future should not be seen as a reason not to proceed with the current reforms. As we noted at the start of this section of the comments, Jersey has to change its tax system.

2: in co-operation with other Committees of the States to investigate and report upon the likely social and economic impacts of the taxation proposals contained in the Finance & Economics Committee document "Facing up to the Future", with particular reference, but not limited to, the effects upon –

- *(a) individuals and families across both income & wealth spectrums*
- *(b) the cost of living in the island*
- *(c) the labour market & employment trends*
- *(d) local businesses*
- *(e) population trends*
- *(f) States income*
- *(g) The provision of services by the States, and the likely future role of 'user pays charges'*

Comments:

This question is to a large extent beyond our terms of reference. However, we have seen a number of papers, primarily prepared by Oxera, which cover many of the areas that Senator Syvret focuses on. We therefore comment as follows:

(a) The hub of the taxation proposals is a shift from taxation paid by companies to more tax being paid by individuals. The extra burden will be spread over all sectors, from the less well-off to those covered by the 1(1)(k) agreements. The analysis we have seen,[22] which can presumably be published if it has not already been, suggests that the burden is spread fairly; this is not to say that a decision may be taken to mitigate the burden placed

[21] Improving access to bank information for tax purposes, OECD, 24 March 2000.
[22] Analysis of tax packages, Oxera, 3 September 2003; Assessment of new tax options, Oxera, 18 June 2003.

on the least affluent by making available further benefits or lowering the VAT rate on some supplies.

In saying this, we have to point to the high levels of allowances and exemptions which mean that income tax only starts to affect people when they have a much higher income than is the case in many other territories.

(b) An Oxera study that we have seen suggests that the introduction of the VAT – the main thing in the proposals that will affect the cost of living – will not affect the cost of living to any significant extent.[23] Indeed they suggest that the impact will be negligible. This was indeed the case for Malta, where the reintroduction of VAT did not noticeably alter the general trend growth of rates of inflation there (see appendix 3).

(c) The main issue with the labour market and employment trends in our view is to ensure that the financial services industry (FSI) remains buoyant and thus a good source of (well-paid) employment. We think the proposals have been framed with this objective in mind. With the economy of Jersey being so dependent on the FSI, it is important that this is a prime aim. But other sectors also have to be borne in mind. We can see no evidence that the proposals will damage any particular sector.

(d) Local businesses will benefit from the 0% rate of company tax (as will non-local business), though there will then be apportionment of income to the Jersey owners. We have concerns about the administrative complexity of apportionment but have received assurances from the Comptroller of income taxes that the concept is manageable. We also understand the point that without apportionment there would be scope for avoidance of tax by companies outside the FSI.

All businesses will face an administrative burden with the introduction of VAT but the familiarity of the tax within most countries means there are plenty of administrative aids available. We also hope that the system introduced in Jersey will be a simple and broad-based one.

(e) We have seen work undertaken by Oxera, and by the Jersey authorities under the "Imagine Jersey" scenarios, in this area. The impact on population seems to be dependent on retaining the FSI and on other factors such as whether population controls are maintained. We were struck in this regard to the general responses received in the field-testing of the "Imagine Jersey" scenarios where we understand that there was some acceptance of population growth as a price to pay for economic growth.

(f) It is a clear objective of the proposals that States income should be maintained, or at least that a balanced budget be achieved. (We have not in any way audited the tax yield figures.) There are decisions to be made that are not within our terms of reference that will govern this: if States expenditure rises, for example, then taxes will have to rise and

[23] Scope of GST, Oxera, 22 April 2004.

that might mean an increased rate of VAT. It seems to us that the proposals give scope for the States to increase or lower taxes.

(g) The provision of services by the States and the future of "user pays" are interesting questions. These are surely questions of policy that we have to leave to the States. It seems to us that the taxation proposals do not constrain action in this area.

3: to produce and publish a strategic analysis of the risks, effects, opportunities and economic alternatives faced by the island in a potential post-financial services industry future, such analysis to include positive strategic proposals for the community should such an outcome occur;

Comments:

We have looked at the work done by various Oxera studies and in the "Imagine Jersey" scenarios, which test out views under various different possible routes for the FSI. These seem to be sensibly founded in terms of the likely impact of the possibilities – for example, a much-reduced population if the FSI largely disappears.

We think this is the sort of planning that should be continued. In effect, Jersey is in the position of a large corporation that needs periodically to do some "what if" planning (as pioneered in many ways by Shell some years ago). It should be periodic work rather than continuous, but it would ensure that alternatives are kept under review. By doing so, it may well focus minds on the preferred routes and thus on what decisions need to be taken to keep the Jersey plc business going down that preferred route. A current example is of course the decision that there is a need to retain the FSI and therefore that leads to the 0/10 company tax system.

4: to produce and make available to all States members a list of all reports, advisory notes and analysis produced either in whole or in part at public expense, concerning taxation and economic issues during the last 10 years;

Comments:

We assume this can be provided by the Finance & Economics Committee to the extent possible. We would simply note that there has been a considerable volume of reports and analyses that we have seen and we suspect we have not seen all that have been produced over the 10-year timespan contemplated by the question.

5: to produce and publish a plain English description of all tax planning / avoidance mechanisms and devices available under the present regime, such description to include, as far as possible, an estimate of the tax foregone.

Comments:

We studied with interest a paper prepared by the Comptroller of income taxes in May 2001 on "Ways to legally avoid tax".[24] That listed

- benefits in kind (then not taxed)
- speculation in land
- high fees charged in commencement accounts
- repairs v capital issues
- conversion of income into capital
- use of the wife's earned income allowance
- private/domestic expenditure in business accounts (which may in some cases become evasion rather than avoidance)

To this list we would have added unlimited interest relief (now curtailed) and the scope for ownership of assets and income via offshore structures. Further issues identified included taxing share options, the need for a PAYE (now in hand) and the possibility of excessive deduction claimed in business accounts. Senator Syvret has also suggested that directors and partners have excessive opportunities to avoid tax.
Some of the issues have been tackled by changes in the law; some are policed by legislative mechanisms such as the GAAR; some are tackled by effective application of basic law. The "20 means 20" philosophy in Facing up to the Future also signals the way the system will be enforced.

We discussed the whole area with the Comptroller and with our own Jersey colleagues.[25] Much was made of the existence of the GAAR in the Jersey tax regime and we were quoted statistics on its use. We also discussed the success that the Comptroller has in taking cases before the appeal commissioners.

As a general observation it does seem to us that Jersey taxpayers are reasonably compliant with their responsibilities and that the whole system benefits from good relations between the Comptroller and tax advisers.

Our terms of reference do not extend to suggesting how the tax regime can be enforced more strongly. But we are aware that the Comptroller feels wider information powers are necessary. We wonder also whether there is scope for more publication of the Comptroller's and Commissioners' decisions to ensure that time is not wasted on unnecessary appeals and arguments. A complete assessment of the efficacy of the existing collection system is outside the scope of this report.

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[24] Ways to legally avoid tax: briefing note for the Finance and Economics Committee, Malcolm Campbell, 30 May 2001.
[25] During discussions with Malcolm Campbell, tax investigations were said to have generated £12m in back taxes from 6,500 reviews over 12 years.

It may be that reliance on Article 134A could lead to a challenge under Human Rights legislation; this is in some ways taxation by discretion. But there are parallels in many continental jurisdictions. It is perhaps something to evaluate.

6: to produce and publish a plain English description of all tax planning / avoidance mechanisms and devices that might be available under the proposed regime, such description to include, as far as possible, an estimate of the tax foregone.

Comments:

We cannot give the comprehensive response required because the details of the system have not yet been designed.

Some of the issues raised in the Comptroller's paper referred to under the previous comments would still be of concern.

One of the main new areas giving scope for avoidance would be by using the 0% rate of company tax. The response to this is apportionment. We have our reservations about this system simply because of the administrative burdens and complexity it generates. We wonder if an equivalent to the s703[26] regime in the UK tax code may be an alternative route. However, that would not bite until a company is sold or the funds extracted in a tax-free way, so apportionment may deliver tax revenues more steadily.

A VAT could generate scope for avoidance on boundary issues – arguing that supplies are exempt rather than taxable. There is also scope for avoidance if input tax recovery is denied leading the taxpayer to try and devise ways of recovering the denied tax. The response to these issues is in many ways to keep the VAT system as simple and comprehensive as possible.

7: to produce and publish a detailed examination of the opportunities for applying wealth taxes, including but not limited to, capital gains tax;

Comments:

We have spent a good deal of time examining this area. Compared with the UK and many EU states, Jersey does not have the capital taxes that many use. Most have a capital gains tax (CGT), some form of death duties (Inheritance tax – IHT – in the UK) and some use a wealth tax (for example France).

It has to be noted that these taxes are not big revenue raisers. CGT is in many ways an anti-avoidance measure, catching transactions that are not caught by income tax. (We note that the Comptroller has had some limited success applying Article 134A to some speculative transactions.)

[26] See earlier, section 8.6. S703, Income and Corporation Taxes Act 1988.

However, the comparison with the rest of the EU is not the correct one. The better comparison is surely with territories such as Guernsey and the Isle of Man. The image, and part of the selling proposition of low tax areas such as these, is that they do not use capital taxes: this is part of the attraction to wealthy residents.

It must also be borne in mind that the 0/10 rates of company tax would logically also have to apply to capital gains – so many capital gains would be excluded from taxation.

Our views on CGT are that it is a complex tax to run with limited scope for revenues. We do not think Jersey should follow that route. IHT or its equivalent and wealth taxes could lead to an exodus of wealthy people – the sort of people the tax would be designed to catch – in favour or what would then be more favourable regimes. That exodus might not be immediate but for the high earning tour of duty manager might lead to his not being replaced; for the high wealth person covered by 1(1)(k) we have seen some suggestions (partly in a report on these people) that capital taxes would be a major issue for them and would make some likely to leave fairly soon.

All this is not to say that there is no scope for charging to tax some capital transactions. We note below some thoughts in respect of development profits. It may also be necessary to strengthen the Comptroller's powers in respect of speculative transactions so that these can be assessed as taxable to income tax.

8: to produce and publish a detailed analysis of the fiscal impacts and opportunities presented by the island's accommodation industry, such analysis to include –

- *(a) a detailed consideration of the flow of public money into the accommodation industry,*
- *(b) a detailed description of the tax planning / avoidance mechanisms available to and furnished by the accommodation industry, such description to include, as far as possible, an estimate of the amount of tax revenue foregone in unlimited interest tax relief to activity within the accommodation industry,*
- *(c) a detailed examination of the opportunities for applying capital gains tax to the accommodation industry,*
- *(d) a detailed examination of the opportunities for applying development taxation to the accommodation industry,*
- *(e) a detailed examination of the opportunities for applying commercial property taxes to the accommodation industry, and such examination to take into consideration potential reforms to the parish rates system;*
- *(f) a detailed examination of the opportunities for applying a Land Valuation Tax, and such examination to take into consideration potential reforms to the parish rates system;*

Comments:

We spent some time with Senator Syvret discussing the accommodation industry and have also researched a number of papers. In essence the Senator is pointing to the considerable values inherent in land and property in Jersey and suggesting more taxation be applied to them. We have some sympathy with that view and such taxation does have the potential to deliver some additional funds to the States revenues from a resource in scarce supply. However, it will not be possible to use them to close the complete revenue gap.

a) We are not in a position to answer the first of Senator Syvret's points: this is beyond our terms of reference. But we note that under the heading of "accommodation industry", one has to consider hotels and other holiday accommodation, property development, rented property and the entire housing market.

b) The main possibility for tax avoidance in the accommodation industry is essentially that of making capital profits that are not then taxed. Much development activity is in principle taxed, as it will form part of the trading profit of a business. There are also considerable gains to be made by individual householders and indeed property owners who sell some of their property for development. These will normally be tax-free. The Senator also points towards interest relief: Jersey has of course introduced a certain amount of restrictions on mortgage interest relief for the purchase of properties but it is still true to say that, for example, a developer will be able to claim unlimited interest relief when it comes to calculating the profits of the development. However, this would be regarded as normal commercial expenses rather than tax avoidance. Similarly, those running traditional accommodation businesses, such as hotels, will be able to deduct interest relief but again that is something of a normal expenditure in such activities.

   Turning to the shape of the future tax system, the 0% company tax rate will clearly leave out of charged tax a large swathe of commercial property activities. Thus hotels and other accommodation activities will not pay tax on their profits. However, this could well be seen as balancing the possible downside of the introduction of VAT which some will argue will affect the accommodation industry (depending on its design). Whilst VAT is not a tax on profits, it may cause those operating it to feel they have to absorb some of the tax so as not to put the price up to their customers so much. Thus instead of paying company tax the businesses may face a certain reduction in profits. The other way of looking at it is that the eventual consumer who currently pays, indirectly, the company tax through higher prices being charged by the hotel operator will instead pay VAT. This is not a complete cross-match but there is some evidence of a potential set-off.

It is of course possible that the States decide to further restrict interest relief for private purchases of property. But restricting interest relief for commercial transactions would have no effect, other than in the financial services industry, because of the nil rate of company taxation.

c) Capital Gains Tax could undoubtedly be applied to the accommodation industry. What it would tax in the main would be disposals of private property by individual taxpayers. Commercial transactions would also be taxed but if the company tax rate is used, that leads back to 0/10; in any event, a good number of such transactions would be trading in nature. In any event, a CGT does not tax directly the development gain.

As we have discussed elsewhere in the body of the report, CGT is by its nature a complex tax. This is something that should be approached with care by a small jurisdiction such as Jersey. If the accommodation industry is to face a capital gains charge in general, that would clearly depress prices of property. Against that, some revenue would be generated. However, there might be a considerable call to exempt from the charge gains made by individuals on their "principle private residence" as happens in the UK. That would in turn reduce the yield considerably.

d) There is a strong argument for introducing some form of development levy into the Jersey tax regime. This could be a better route to follow than the capital gains tax in that it will of course potentially capture development gains without change of ownership whereas capital gains tax would require a sale. There are two routes that could be followed:

(i) An actual tax charge on the notional development value created, along the lines of the UK's Development Land Tax.
(ii) A levy/licence fee for the permission to develop or rezoning of the property as suitable for development.

The history of the UK's DLT and similar levies in other countries is not an altogether happy one.[27] They tend to be very complex to administer with a great number of valuations required to try and isolate the actual development value created by the agreement for change of use or other trigger point. The possibility is also that the existence of the tax acts as a drag on development. Certainly this was the case in the early days of DLT in the UK when the tax rate was 80% with a vision of it rising to 100%. Whilst this was theoretically attractive in that it made sure that the increase in value from the development grant accrued to the community that had granted it, perhaps inevitably it meant that developers simply did not see development as worthwhile. Alternatively, the only way that they could make the development worthwhile was to increase their charges considerably and generate bigger trading profits (which under Jersey's propositions will not be taxed).

[27] See also Section 13.4 of this report.

Thus we think a better route for Jersey to explore is the licencing of development. This could be by way of a fee for development or redevelopment; it could be by way of a charge for rezoning property; there are a number of precise routes that could be followed. Although this might seem to be an ad-hoc approach, the relatively small amount of rezoning of sites for development/redevelopment that occurs in the island makes this route probably a practical one. In principle it could well be that almost an auction is conducted by sealed bids for the amount that should be charged by way of the fee.

e) We have looked at the parish rates system and the general rates activities within the island. We agree with the Senator's basic contention that there is scope for reform here. However, when we tried to raise this possibility, many people we talked to said that such reform would be impossible or at best extremely difficult because of the way rates are levied – essentially by the parishes. (That being said, it is understood that certain aspects of the system may soon be subject to centralisation and reform.) We note that this has produced very low charges and we question whether this is realistic for the sort of services that are traditionally associated with the rates charge.

We have suggested in the earlier part of our report that more work is done on the services that are delivered to houses and businesses to ensure that, in effect, the rates ensure these "pay their way". We have not been able to undertake detailed work on this because of the limited timescale of our work and also because it has been made clear to us that this would have to be a long-term project requiring considerable political change before such moves could even be contemplated. But we do point to the area as a way of getting more revenues into the general taxation pot.

There is of course a downside to increasing the amounts paid through the rates system. For business they will be a simple addition to the cost base, making the operation that bit more expensive. As with so many other things, this could cause a reappraisal of the viability of the operation (the total tax bill issue again). For the individual, there will always be the risk that householders in the "asset rich/income poor" category find such increases difficult to bear. Many will have seen reports of complaints in the UK by (usually elderly) homeowners who have found significant increases in Council Tax bills unacceptable. Jersey does have its housing benefit system and this may well offer scope for further compensation in this area should that be necessary – though we note that the housing benefit paid out is already quite generous.

But we do not think that the rates levels charged in Jersey are yet at the level paid by Council Tax in the UK and, as noted, there may well be scope, if the parishes are willing to work together, for increasing general revenues in this area.

f) A possible Land Valuation Tax would probably be along the lines of the old style Schedule A in the UK, where property owners were charged on a notional rental value imputed to them of their property. This tax was abolished in 1962; the preferred route for property taxes in the UK was the rates system.

This is not to say that a land valuation tax is impossible. However, it would require full and regular valuations of property to be undertaken and that in itself might lead to many arguments and appeals. If, instead, properties are put into a banding mechanism to obviate the need for precise annual valuations, the tax does then seem to be heading more towards a rates system. Thus we would suggest rates and a land valuation tax are alternatives rather than taxes that could be brought in in parallel. As the rates system already exists, we believe it is better to work with that, as noted in our previous comments, rather than invent a new tax.

9: to produce and publish a detailed examination of the opportunities and effects of potential taxes & charges upon the labour market, such examination to include, but not be limited to –

(a) payroll taxes upon employers, taking into account potential sectoral variations,

(b) a training levy, taking into account potential sectoral variations,

and such examination to include the potential reform of the Social Security system;

Comments:

It is undoubtedly the case that many jurisdictions raise considerable amounts of money from the Social Security systems, including payroll taxes on employers. One only has to look to France and Belgium, among other territories, to see the very significant proportion of State revenues that are so raised. The UK's National Insurance Contributions are its second greatest tax earner. Thus there is scope for examining these areas and when we started our work we were of the view that some increases might well be made.

As we have progressed and learnt more about the Jersey system, we are less persuaded of this. Our reasons for saying so are twofold:

(i) Any payroll taxes levied on employers add to the cost base of the employer. Having researched the impact of this with the financial services industry, we are persuaded that they would see such a charge as unacceptable. Their reasoning for this is simply that whereas company profits taxes are creditable against company profit taxes in their home jurisdictions, payroll taxes are not. Of course it will be a judgement for the States to make as to whether this is a reason not to proceed with a possible payroll tax. But we do point to one of the main aims of the reforms – to maintain Jersey's attractiveness to the financial services industry.

That remains, surely, a key principle and thus we are less keen to propose a payroll tax than we initially were. It would be something of a blunt instrument; difficult to vary by industry. Thus it would also be something that would just as equally be suffered unprofitable and loss-making businesses – which is one reason why in countries such as the UK and France it is regarded as something of a tax on jobs and attacked as such.

(ii) Turning to the Social Security side, we note that the Jersey Social Security system is a fully insured one where the funds generated are ring-fenced for the benefits secured, primarily pensions. We have seen from some reports that there is a need to increase the contribution rates because of projected deficits due to the inevitable demographic issues.[28]

It would not be impossible to break the ring-fenced nature of the Social Security system in Jersey. The UK and most other countries have long since done this. However, we do see that this is a matter of pride within Jersey and a step not to be taken lightly. On balance, given the existing demands on the Social Security system and the likelihood of charges having to rise further to fund further pensions, we think it better to leave the system as it is.

Turning therefore to the Senator's direct questions, we do not think a payroll tax is the route to follow. We would have concerns about the impact on employers and the attractiveness of employing people. If you make people more expensive to employ, that naturally causes businesses to look at employing less of them.

We do however pause at that point because in Jersey at times the labour market has been a tight one. Thus there is undoubtedly an argument that making employment more expensive will force investment in labour-saving activities. But looking at the way the Jersey employment market breaks down, there are many people who work in and related to the FSI. Again, we are cautious about adding to that sector's burdens. Arguably they are paying their levy with the proposed 10% company tax rate and we think Jersey should be wary of adding further to their burden.

Away from the FSI, employment is in a variety of sectors and it could well be that imposing additional costs on relatively low wage employment such as accommodation and agricultural industries could lead to displacement of some employees. That might not be a welcome move and might increase the cause for unemployment benefit to be provided in Jersey.

The Senator has also suggested a training levy. On discussion, the argument is that the financial services industry should provide monies under which training could be undertaken for other industries. We are unpersuaded of this. We keep coming back to the need to put a modest burden on the financial services and allow it to generate income

[28] e.g. The economic situation in Jersey, Oxera, 27 January 2003.

for Jersey by way of generating employment and funds rather than direct taxes. The need is to make sure the climate for the FSI is benign.

However, this should not detract from the basic idea of generating more funds for training and retraining. One route that might be followable is to offer an enhanced deduction against trading profits for training activities. That would, for example, allow a business to deduct £150 from its trading profits for expenditure of £100 – thus recognising that certainly to a small business, training is a double cost, both in terms of the cash cost of the training and the time foregone when an employee is given time off. However of course in Jersey the proposition is that businesses other than the financial services industry will not be subject to taxation. Thus the idea of a "super deduction" is probably impractical.

The need for a better-educated and trained workforce is something that preoccupies the UK among other countries. The Senator's suggestion of a University of Jersey bears examination though such matters are really outside the scope of our report.

10: to produce and publish a detailed examination of the opportunities and effects of introducing sectoral taxes, such examination to include, but not be limited to, utility taxes.

Comments

The current proposals for company taxation in "Facing the Future" do in effect have sectoral taxes in the sense that one of the key proposals is to tax the financial services industry. Thus the concept has been broached in many ways. It is an interesting question whether this concept should then be extended more widely.

The problem that we see in imposing different taxes on different sectors is, as we have already alluded to, the risk that the EU/OECD would then claim that the Jersey tax rate was not 0% but a different, positive rate with discounts. They might then object to the discounts being given to certain sectors and so call into question the whole structure. Thus we think it will be difficult to establish the basis of taxing certain sectors.

However, it must be borne in mind that with the imposition of the VAT, in one sense all sectors are being taxed. That tax will hit the consumers of the services of the sectors and thus the impact on the sectors is indirect; imposing a direct tax on, e.g., the utility sector would no doubt lead to that additional cost being passed on to the consumer. Thus although the mechanism might be different, the end result is the same in many ways.

Much of the above discussion might be read in terms of profits taxes of one sort or another. There is another way of taxing certain sectors, perhaps exemplified by various transport levies. Airport duties of one form or another are widespread; road tolls and/or congestion charging is being tried out; high energy users are also targeted under some regimes with surcharges. There are then various charges that fall under environmental banners (see next section). We were minded to suggest an airport tax, in parallel to those duties imposed in many other territories. However, the point has been made to us that air travel to and from Jersey needs to be encouraged and imposing extra charges on it is not the right way to go. The decision is a fine one and in view of the relatively limited amounts of money that it would raise, it may be better not to proceed with it simply to avoid giving the wrong sort of signal to the air travel sector. However, it is perhaps something that could be kept under review and if, for example, Guernsey was also minded to introduce such a levy then it could be introduced on a common basis.

Another sector that has been considered at times for particular treatment is the telecommunications sector. Surcharges on calls made have been contemplated in some areas. However, we would come back to the potential VAT, which would charge on the telecommunications sector and would make it surely unnecessary to proceed with a separate levy.

11: to produce and publish a detailed examination of the potential opportunities and effects of environmental taxation;

Comments

We think there is undoubtedly scope for Jersey proceeding with more environmental taxes. However, decisions would have to be taken on the objectives of such taxes. Our view is that environmental taxes have two possible purposes:

(i) Influencing behaviour
(ii) Raising money

We make the distinction because in many ways what is sought to be achieved with many environmental levies is a change in behaviour to discourage a particular activity. Thus money raising is not the prime objective and indeed, if it is successful, the yield may be much less than might be anticipated. The prime example here is the plastic bag tax in Ireland – undoubtedly successful in reducing the numbers of plastic bags thrown away but not yielding any significant money to the Irish Exchequer.

If, on the other hand, the environmental tax seeks to raise money, then other consequences may flow. Firstly, the activity may simply become too expensive, it is stopped, and therefore no money is raised. Secondly "avoidance" behaviour ensues. The example of Landfill Tax in the UK might fall into this category. Although it does have a positive yield, there was certainly concern in the early days that it would lead to an increase in fly tipping. With the prospect of the Landfill tax rate escalating considerably in the coming years, that concern has been revived. Thus money will have to be spent on controls. Similarly, it might be argued that high tobacco taxes have something of an environmental aspect; one of the results of them (certainly in the UK and a number of other high duty territories) is to encourage smuggling with a consequently lower yield to the taxation than was intended.

Having made these points, we would stress that environmental taxes do, in our view, have a part to play in Jersey's fiscal agenda. They will not, however, raise large amounts of money but may usefully be used to encourage/discourage behaviour. Those that we think would be worth exploring are:

(i) Levies on waste – to encourage recycling, to provide funds for waste disposal etc. This could be a rates supplement.
(ii) Petrol/diesel duties – whilst we are aware that petrol (and especially diesel) is taxed more heavily than in Guernsey, we still think there is scope to raise the duty rates a little in view of the wide range of cars that are used so much in the island. On diesel, there is an argument that there could be a differential between diesel and petrol duty to reflect the greater MPG typically obtained from a diesel engine compared with a petrol one. However, whether this is worth introducing is a separate issue.
(iii) Car taxation – whilst we are mindful of the comments made by the motor trade in Jersey, we have to observe that Jersey does have a profusion of cars. Thus one feels that there has to be scope for Jersey to impose higher taxes on cars – perhaps as increased registration duty. (The impact could be to encourage smaller cars.) It may be appropriate to look at the equivalent of MOT fees for older vehicles as well.

If these increased taxes on transport are proceeded with on an environmental basis, then we accept that there may be some need to look at public transport on the island. This may well be as part of a long-term strategy as Jersey decides the level of car ownership and usage that it can manage.

We would not, however, recommend environmental taxes along the lines of:

(i) Duty on air fuel – simply because it would be so easy for the airline to fill its tanks at another airport outside Jersey.
(ii) Surcharge on heavy energy consumers – because of its uncertain impact and the need at times to rebate to certain more-favoured heavy energy consumers, such a tax does tend to be rather haphazard and unsatisfactory in its impact.
(iii) Congestion charge – this seems unnecessary on an island like Jersey and taxes on motoring would be better via the simple route of higher petrol duties.
(iv) Landfill taxes – probably not appropriate; better to look at waste disposal generally.
(v) Pesticides duty – this has been mooted in some sectors, partly to encourage more responsible use of pesticides. In view of the pressure on Jersey agriculture and the careful way that it is controlled, it is probably inappropriate in Jersey to proceed with a pesticides duty.
(vi) Duty on specific areas – whether plastic bags or any other commodity needs to be specifically targeted is perhaps something that could be evaluated in terms of things that cause a nuisance to the community. But if there is such an item,

it might well be taxed via a particular licence fee/duty and would have as its aim the control of that item rather than serious revenue raising.

12: to produce and publish, on the basis of both existing information and information produced as a result of the above proposals, a full menu of all taxation options to facilitate informed debate.

Comments

We think in our report we have given and considered a wide range of taxation options. Our conclusions are essentially that Jersey has been through a good range of considerations and has come up with some plans that meet the needs of the island in a reasonable way. They have been designed with the clear objective in terms of the important aim of facilitating the retention and growth of the financial services industry. We think the way forward is to proceed with the key reform to company tax – indeed it seems that Jersey has little choice but so to do – but then introduce a VAT to meet the serious shortfall in revenues that will ensue. The other actions in Facing up to the Future document are then things to proceed with as well. But we have pointed to some further areas that might also be considered as part of that secondary process of change.

In conducting our work we have been impressed at the amount of work that has, over the years, gone in to arriving at the proposals now being put forward by the Finance & Economics Committee. There has been public debate on them. The efforts made by those proposing reform compare well with what occurs in some other territories. The level of engagement by the population reflects creditably on those in charge and the populace.

Clearly this debate can continue. However, we feel that there is a need to decide on the main planks of reform – and that, inexorably, means the reforms to the company taxation system. Jersey has little choice, in our view, but to proceed with the scheme that it has set out. It has done a lot of work to ensure that as far as possible it will be accepted by all affected parties. Whilst it is surely certain that it cannot last as a structure in the same way as the tax system laid down in the 1920s did, it should last for a good number of years as a main framework.

Having arrived at the move on company tax, Jersey is left with the problem of plugging what is a significant hole in its budget. It seems to us that the best way of addressing this is to introduce a VAT. That can be done at a modest rate and will deliver significant amounts of money to the Exchequer. At the same time, it will ensure that all residents and visitors to Jersey contribute to it. This seems to be beginning to be understood by the Jersey population and, probably a little reluctantly, they have come to accept it. More probably needs to be done to emphasize the relatively modest rate of its likely introduction; we would also recommend that as far as possible the tax is broad-based rather than narrowed through multiple exemptions. Not only would that ensure it raises more revenue but it makes it simpler to administer and leaves less scope for boundary disputes.

The only other tax that can practically lead to significant revenue income is income tax as applied to individuals. The Facing up to the Future document points the way to extract some more money from the better off with the phasing out of personal allowances. We have our concerns about the practicalities of this but see it as an acceptable way of presenting a balanced package.

Clearly raising the rates of income tax, either by changing the standard 20% or by introducing a higher rate on top of this could deliver significant money to the Exchequer. But in fact a "super rate" attacking simply high incomes would not deliver the sort of funds that are needed and would dent Jersey's image of an island that levies modest taxation. We think from what we have seen that it is important to preserve the 20% tax rate that is part of Jersey's "image". People generally do need to be reminded of the high levels of exemptions and allowances that they receive.

As Senator Syvret points to, there is clearly always going to be more scope to ensure the public do appreciate what the tax system does for them. We think that there needs to be a continued effort on explaining the main aims of tax reform and showing how the main taxes bear on the population, including making documents available to those who want them.

As we have discussed, there are then many other taxes that could be attempted in Jersey. By way of summary, we do not think that capital taxes are the way forward: again they would seem to detract from Jersey's main objective as a lower tax area. But some form of development levy should be researched and introduced and there is undoubtedly scope for more environmental taxes. The latter in particular are ideally suited to public consultation: the public may well sign up to extra duties on certain areas provided they are made well aware as to what the impact of them will be and how the funds thus raised will be used.

In conclusion, we think that the Finance & Economics Committee has over the years done a good job in canvassing views and putting forward options for tax reform. Many of these have been well debated. Whilst it may be difficult, we feel that the States now needs to take a decision on the way forward for the main reforms. One of the reasons for saying this is with regard to the business community. They accept that changes will have to be made but business wants certainty and there is undoubtedly a significant call for decisions to be taken so that business can plan.[29] Agreeing to a main framework of the tax system does not preclude further work being done on some of the detailed points or smaller taxes. Indeed, if there is one final thought that we would wish to leave States members with it is that tax systems seem to need changing far more frequently nowadays

[29] Report in respect of the consultation document issued by the Finance and Economics Committee in February 2004, the Jersey Chamber of Commerce and Industry Inc, 25 March 2004.

than used to be the case. We suspect that the tax agenda is one that the States will have to return to at regular intervals. In doing so, they will not in any way be admitting failure but reacting in a controlled and sensible way to developments in their efforts to keep Jersey in the forefront of financial centres.

John Whiting
PricewaterhouseCoopers LLP
London
May 2004

Terms of Reference for an external review of the following issues, which have been identified as being of concern in respect of the Finance and Economics Committee's proposals for Fiscal Review

Introduction

The Committee published its tax reform proposals during February 2004.

There has been a series of public consultation meetings and further discussions with interested groups.

The publication and discussion of the proposals has resulted in a number of important matters being identified and the Committee intends to publish a response as soon as it is able. Senator Syvret has helpfully lodged a detailed proposition (attached) identifying a comprehensive list of concerns, which he wishes to be addressed before the Finance and Economics proposals are considered. The Committee considers that these are a helpful summation of the many issues which have been identified; it therefore requires a thorough evaluation of these issues in order to allow the Committee members to consider how best to advise the States to respond to the proposition.

Scope of the work

The successful consultant will be required to consider each of the detailed issues [points (a) to (I)] and for each point answer the following questions:

1. is the issue one which should be of significant concern when deciding how to respond to the Finance and Economics' proposals? Whether the response is yes or no; what is the reasoning behind the yes or no response?
2. if it is a matter of significant concern, review the documentation and research available to the Committee to identify issues to be addressed. As per (1) comment on the significance of outstanding issues.
3. where an outstanding issue is of significance provide sufficient analysis to identify key points to be considered.

The consultant is not required to comment on the overall question of an independent, transparent enquiry.

Timescale

The Committee wishes to be able to comment on the proposition early in May. The consultant should therefore produce a report by the end of April 2004.

Access to documents, staff, advisers and States Members

The consultant will have full and open access to all documents and any staff, advisers and Members which they consider necessary to enable them to complete the commission.

States of Jersey
Tax Reform

Papers and publications referred to during the project

Paper Title	Author / Issuing body	Date of publication
2000 & Beyond : Strategic Policy Review 1995 Parts 1 & 2	Policy & Resources Committee	15 August 1995
2513rd Council Meeting - Economic and Financial affairs - Provisional version	Ecofin / Nikos Christodoulakis presiding	3 June 2003
A confident future for Jersey	Senator Frank Walker	10 June 2003
Analysis of tax packages	Oxera	3 September 2003
Assessment of new tax options	Oxera	18 June 2003
Budget 2004	Finance & Economics Committee	4 November 2003
Capital Gains Tax (CGT)	Malcolm Campbell BA. FTII, Comptroller of Income tax	26 March 2003
Corporate tax reform in Jersey - the potential "£80 - 100 million hole in the States budget"	Finance & Economics Committee	28 August 2003
Correspondence between C Powell and J Whiting in respect of the taxation of wealthy individuals	Colin Powell, O.B.E.	23 April 2004
Correspondence between C Powell and S. Syvret in respect of fiscal review working group	Colin Powell, O.B.E.	14 August 1998
Correspondence between Senator Walker and the Lord Chancellor re Bilateral tax agreement negotiations	Lord Chancellor	3 March 2004
Different budgets, but same pressures	Peter body / Business Brief	1 December 2004
Draft Competition (Jersey) Law	Economic Development Committee	9 March 2004
Draft culture strategy - consultation document	Education, Sport and Culture Committee	
Effects of a corporate tax regime change in Jersey	Oxera	9 September 2002
Facing up to the future: reforming public spending and taxation to sustain a prosperous and competitive economy	Finance & Economics Committee	February 2004
Fiscal strategy - Jersey without the financial services industry	Finance & Economics Committee	28 August 2003
Fiscal Strategy meeting - reviewing the response to the tax reform proposals	Finance & Economics Committee	23 April 2004

Fiscal Strategy: Background paper	Oxera	February 2004
Improving access to bank information for tax purposes	OECD	24 March 2000
Jersey in figures	Statistics Unit, Policy and Resources Department	2003
Jersey in the new millennium: a sustainable future; summary of the consultative report	Policy & Resources Committee	October 1998
Jersey without the financial services industry	Oxera	4 April 2003
Just Taxes: The politics of taxation in Britain 1914 - 1979	Martin Daunton, Cambridge University Press	2002
Options for new taxation measures	Oxera	7 April 2002
Outline proposals for imputing corporate profits to Jersey resident participators - an explanatory leaflet	Comptroller of Income Taxes	1 March 2004
Policies for growth: proposals for the reform of public spending and taxation in Jersey	Finance & Economics Committee	February 2004
Press release: A confident future for Jersey	Policy & Resources Committee	June 2003
Press release: Consultation milestone reached for Fiscal Strategy proposal and UK tax expert appointed to undertake independent review of F&E's proposals	Finance & Economics Committee	April 2004
Principal characteristics of consumption taxes and implementation issues	Oxera	8 April 2003
Proposition re Airport charges	Harbours & airport Committee	2003
Q & A brief - Reform of corporate taxation in Jersey	Finance & Economics Committee	28 August 2003
Questions to be asked of the President of the finance & economics committee on Tuesday 20th April 2004 by Senator R.J. Shenton (plus answers)	Senator R. J. Shenton / Finance & Economics Committee	20 April 2004
Regulation 1(1)k Research Project	KPMG	April 2004
Report in respect of the consultation document issued by the finance and economics committee in February 2004 entitled "Facing up to the future…etc"	The Jersey Chamber of Commerce and Industry Inc.,	25 March 2004
Report on the Bermuda tax system	Harry Gutman and Eric Toder	4 August 1999
Scope of GST	Oxera	22 April 2004
Strategic Plan 2005 - 2010	Policy & Resources Committee	2004
Taxation policies: a transparent enquiry	Senator Stuart Syvret	March 2004
Taxation: Commission welcomes adoption of package to curb harmful tax competition	ECOFIN	3 June 2003
Taxes and welfare stir old Swedish emotions	Financial Times - Christopher Brown-Humes	April 2004
The 0/10% Tax regime : an explanatory note	John Harris, Director International Finance	15 April 2004
The economic situation in Jersey	Oxera	27 January 2003

The future of Jersey's tax and spending policies	Oxera	May 2002
The future of our tax and public spending policies (a first consultation paper issued by the finance & economics committee)	Finance & Economics Committee	23 July 2001
The future of our tax and public spending policies (a second consultation paper issued by the finance & economics committee)	Finance & Economics Committee	May 2002
The future of our tax and public spending policies (a third consultation paper issued by the finance & economics committee)	Finance & Economics Committee	August 2002
The OECD's project on harmful tax practices: the 2004 progress report	OECD	4 February 2004
The OECD's project on harmful tax practices - a briefing note for journalists	OECD	4 February 2004
The taxation of wealth (or can we make things better)	Taxation Journal - John Endacott	12 April 2004
Ways to legally avoid tax: briefing note for the finance and economics committee	Malcolm Campbell BA. FTII, Comptroller of Income tax	30 May 2001

The Maltese VAT Regime: some notes

Introduction of VAT

- VAT first introduced on 1 January 1995. Flat rate 15% with exemptions for power/water, education, health services and most foods.
- Introduction of VAT increased government revenue. Lm78.1m was raised in VAT in 1995 (22.8% of tax revenue); this was partially offset by the decrease in Import Duties replaced by VAT. Total tax revenue increased by Lm69.0m though increases in indirect taxes accounted for Lm49.5m of this increase.
- Introduction of VAT partially motivated by plan to join EU.

Reactions to introduction of VAT:

- Government stated that VAT also helped to uncover the "hidden economy". A further 5,000 declared their employment when their income was not previously registered (currently the number of employees in Malta is approximately 136,000 and seems relatively stable (+/- 2000) since 1998. Therefore this represented an increase in registered employment of approximately 4%. An increase in total revenue from personal taxes was observed in 1995 compared with 1994, however this could be ascribed to being in line with the general trend rather than the increase in workforce (see appendix).
- VAT viewed as intrusive by Malta's many family retailers
- General feeling in Malta was that introduction of VAT led to rapid price increases. This does not however seem to be borne out by the retail price index (see appendix).

- Opposition political party (Labour party) campaigned against the government (Nationalist Party) in the run up to the general election in autumn 1996 on the basis that it would repeal VAT.

Repeal of VAT

- VAT was considered to be the major contributory factor in the defeat of the government in 1996.
- The new Labour government scrapped VAT and replaced it with a new 3 tier system of customs & excise duties coming into force on 1 July 1997.
- Incoming Labour government claimed that the introduction of VAT had caused a slowdown in the economy.

Reintroduction of VAT

- Nationalist party re-elected in September 1998
- Application to join EU was renewed. The EU insisted on the reintroduction of VAT.
- VAT was reintroduced on 1 Jan 1999 at a flat rate of 15% and similar exemptions as before. Populist rebates such as the 5% reduced rate for hotels were included ("to safeguard the competitiveness of the Islands tourism industry").
- Caused strike action amongst Malta's largest trades unions as VAT was seen as "hurting low and middle income earners"

Recent Developments

- Oct 03 speculation grew that VAT would be introduced on all printed material at a rate of 5%.
- Nov 03 VAT rate increased from 15% to 18%. The government stated that the bulk of the extra revenue generated was earmarked for the health service.

Economic factor

- The budget deficit rose from 4% of GDP in 1995 to over 11% in 1998(1997, 9.7%). The trend has now reversed: 6.7% in 1999, 6.6% in 2000, 6.3% in 2003 but current projection is 9.7% in April 2004.

- The government's aim is to reduce the deficit to 3% of GDP as this is an entry criterion for the Euro.

- According to the Central Bank of Malta on 19th April 2004, the Maltese economy is projected to pick up slightly this year but growth will remain below potential.

- The European Commission in their report on Malta noted that economic activity remained weak, affected by low external demand and the downturn in the tourism sector.

EU accession requirement for VAT

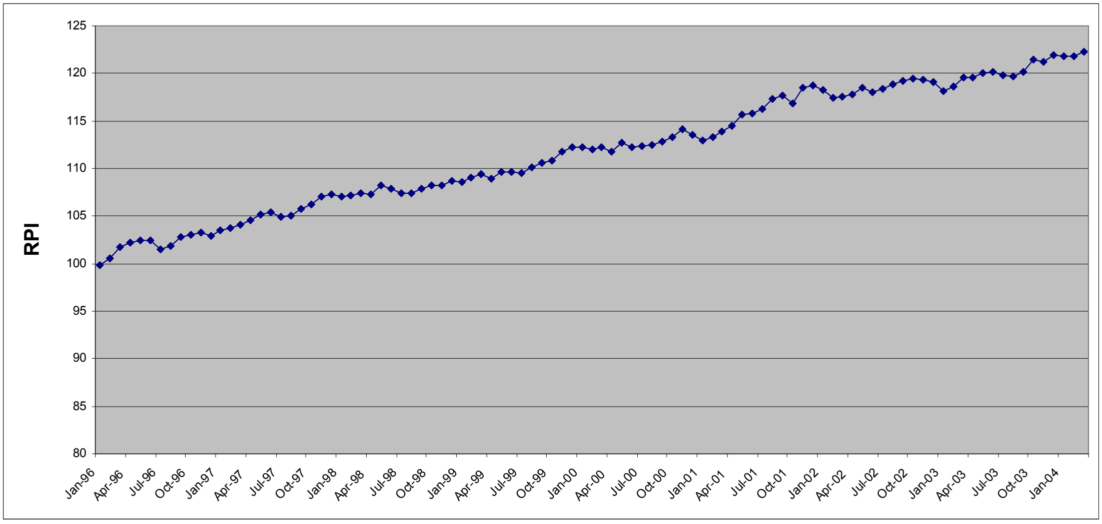
- The Sixth Council Directive of 17 May 1977 outlines a framework, which all countries acceding to the EU must broadly follow. Member states should modify their present value added tax systems in accordance with the Articles set out in this directive.

- There is a EU wide agreement on a minimum standard rate of 15% for VAT and maximum of 25% on most goods and services, but exceptions are possible.

- A lower rate is also possible and exemptions for some items. Generally these are restricted to the necessities of daily life, such as food and medicine.

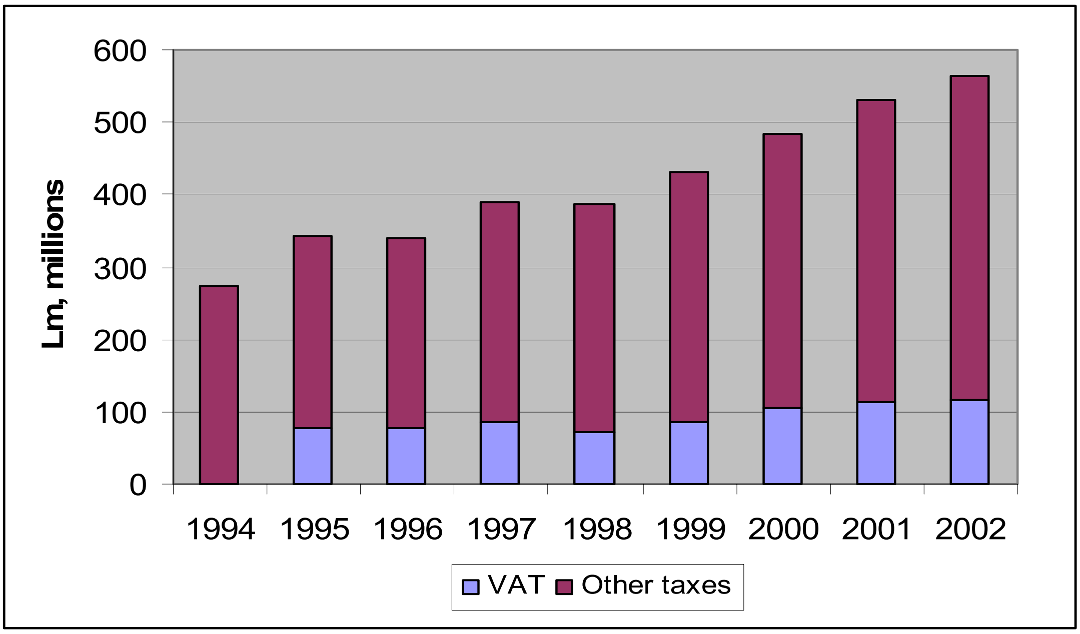
Accompanying charts

2 Retail Price Index



Note: RPI was rebased to 100.0 in Jan 2000, for the purposes of this graph the effect of this have been reversed. Furthermore, due to a change in the method of calculation of RPI this trend cannot be extended backwards.

Income from tax, by type.



States of Jersey

PRICEWATERHOUSECOOPERS

3 Government Income from Personal taxes