

STATES OF JERSEY



DRAFT GOODS AND SERVICES TAX (AMENDMENT) (JERSEY) LAW 200- (P.17/2008): COMMENTS

**Presented to the States on 7th March 2008
by the Corporate Services Scrutiny Panel**

STATES GREFFE

COMMENTS

GST Amendments and Regulations – comments of GST Sub-Panel

Executive Summary

The Sub-Panel has carefully examined the Minister's proposed amendments to P.10/2008 and P.17/2008 and has discussed the proposed changes with representatives of Jersey Finance Limited and the Minister for Treasury and Resources. The principle for dealing with the finance industry previously agreed by the States is not being changed; the lodged Law and Regulations (as amended) merely make the Law easier to use. We support the Minister's latest amendments as we believe that they implement the policy in a better way.

Nevertheless, we have concerns about the process by which amendments to the Law have been lodged and swiftly amended by the Minister. The Draft Goods and Services Tax (Amendment) (Jersey) Law 200- (P.17/2008) deals in the main with Part 12 of the GST Law which relates to the application of GST to the finance industry. When the States debated the GST Law last April, the parts relating to financial services were amended by the Treasury at a very late stage, without time to subject them to proper scrutiny or consultation. Once again, draft legislation has been lodged, only to be amended before being debated. An acceptable and consulted version has finally been produced. However, we believe that, to some extent, the Island's reputation will have been adversely affected by the apparent indecision. Lessons can be learnt for the future.

The Sub-Panel wishes to acknowledge the technical assistance provided by its adviser, Mr. Richard Teather, in the course of its discussions with Jersey Finance and the Minister for Treasury and Resources.

Background

Treatment of the Financial Services Industry under GST

The vast bulk of the services provided by Jersey's finance industry are for off-Island clients: i.e. they are "exported" services.

The usual GST/VAT treatment (including in the EU) is that businesses do not charge GST on exports, and they can reclaim the GST that they are themselves charged on their export-related expenses (including purchases and overheads).

For example, if 98% of a bank's business is off-Island, and it buys a computer for £10,000 to use in its business, then if Jersey adopted an EU-style VAT system the treatment would be –

1. The supplier charges the bank £300 GST on the computer; the bank pays that £300 to the supplier, who pays it on to the Tax Office.
2. The bank reclaims 98% of the GST (i.e. £294) from the Tax Office

That would therefore collect very little money at a high administrative cost for the finance industry, for their suppliers, and for the Tax Office (who will have to process and audit the reclaims).

The principle adopted by the States is therefore that –

- Instead of being charged GST and recovering it, the finance industry will not be charged GST by their suppliers.
- However, to ensure that the industry contributes to Jersey's GST revenues, they will be charged an annual fee for this non-GST status.

After now having had the opportunity to investigate this proposal, the Sub-Panel accepts this system as

providing substantial tax revenues at a minimal administrative cost.

How will the system work?

Companies, trusts and other bodies can apply to be listed by the Comptroller as an “International Services Entity” (“ISE”), provided they qualify and pay a fee.

Trust companies (i.e. those who administer or manage trusts) can also apply to keep their own lists of clients who are ISEs. This will reduce the administrative burden for the Tax Office, as trust companies can each administer hundreds of trusts or client companies.

A trust (or other client vehicle) can therefore become an ISE by being either on the Comptroller’s public list or on its manager’s private list. To be named as an ISE, an entity would have to meet the conditions set by the Treasury, namely that it has no real connection with the Island in terms of local provisions or local consumption.

We were initially concerned at the concept of a private list maintained by a Trust company and the apparent lack of a direct government control and auditing system for those ISEs on such a list. The Minister for Treasury and Resources however confirmed to us that there were sufficient powers to audit Trust Company lists –

There are powers indirectly within the Jersey Financial Services Commission to investigate the probity of trust service providers, and I think if those providers were knowingly to submit false lists of income tax, the J.F.S.C. (Jersey Financial Services Commission) would not be particularly enamoured of them. From the service providers’ point of view, I cannot see it is a great deal of incentive to them to make false declarations.^[1]

Jersey Finance informed us that, in their view, the general powers of audit on site inspection contained in the principal Law would allow for onsite visits by the Income Tax Office. The Technical Director explained the reason for Trust companies maintaining their own list of ISEs –

The biggest issue for the trust company is to ensure that the names of those entities that qualify for I.S.E. are on a list they maintain so therefore it is private information as opposed to publicly listed at the Tax Office. That was their biggest concern. The Tax Office have expressed that these onsite audits will be a very light-touch approach because it is very easy to quickly determine how many entities they have and whether they are paying the correct fees.^[2]

We are satisfied with this explanation.

Once listed, an ISE will not be charged GST by its suppliers (except on small purchases, see below), and does not charge GST to its customers. The only GST it will pay is the annual fee.

The annual fees paid (in simplified terms) will be –

- For a bank, £30,000.
- For a registered trust company, £7,500 (plus £100 for each trust that it manages).
- For a collective investment fund manager, £2,500 (and each fund will also pay £100).
- For any other company or partnership, £100.

The Treasury expect this to raise £5-10 million, i.e. 11-22% of the total projected £45 million GST revenues. Their current estimate is about halfway across that range, at £7.3 million (figure given by the Minister for Treasury and Resources in the Scrutiny public hearing of 15th February 2008).

The proposed Law (P.17/2008) and Treasury amendments

The agreed principle for dealing with the finance industry is not being changed; the lodged Law and Regulations (as amended) merely make the Law easier to use.

When the States debated the GST Law last April, the parts relating to financial services were amended by the Treasury at a very late stage, without time to subject them to proper scrutiny or consultation.

The Sub-Panel's view is that, although technically correct, those parts were drafted in a way that did not make their meaning clear. According to Jersey Finance this view is shared by off-Island clients, and Jersey has lost business because the GST Law on financial services passed last April is seen as being too complicated to work with.

The draft Law (P.17/2008) to amend the GST Law was lodged by the Minister for Treasury and Resources on 29th January, but from consultation it was still felt to be too complex, and so the Minister has lodged amendments (on 26th February) to simplify further the language of the Law.

Mr. Kirkby of Jersey Finance explained the situation as follows –

The thrust of what we have been trying to do is effectively ensure that a gatekeeper providing work for Jersey will look at part 12 and very quickly look at part 12 on a stand-alone basis so they do not have to refer to the rest of the legislation. It will be on one page or so and they can look at part 12 and determine quite rapidly from Article 57 through to 66 that if there is an International Service Entity, they are not subject to registration for G.S.T. They are not a taxable person. They are not obliged to charge G.S.T. on services they provide or be charged G.S.T. on services they receive^[3].

Having examined this draft Law, and having had the opportunity to discuss the proposed changes with Jersey Finance and the Minister for Treasury and Resources, the Sub-Panel agreed to support the Minister's amendments dated 26th February 2008.

Nevertheless, we have concerns about the process by which amendments to the Law have been lodged and swiftly amended by the Minister. Once again, draft legislation has been lodged only to be amended before being debated. Finally an acceptable and consulted version has been produced. We believe that, to some extent, the Island's reputation will have been adversely affected by the apparent indecision. Clearly it would have been better if sufficient time had been taken last April to subject the Treasury's proposals to proper scrutiny and consultation, rather than rushing in legislation that subsequently has to be amended. Lessons can be learned for the future.

Remaining issues concerning the finance industry

De minimis on purchases

In our early discussions with the Minister for Treasury and Resources we were concerned that this system could push the administrative burden onto local non-finance businesses. GST is not charged on any supply to an ISE, so any business supplying finance industry customers would have to keep records dividing its sales into ISE and non-ISE customers.

Whilst this is appropriate for some suppliers (such as lawyers or accountants) who are closely involved in the finance industry, this would be more difficult for other suppliers. For example, office equipment suppliers, stationery suppliers, maintenance firms, hotels and caterers, and even the corner shop selling coffee could be affected. It would also be difficult for the Tax Office to audit these suppliers and ensure that all non-ISE sales do have GST charged on them.

For this reason we suggested that a *de minimis* should be considered.

Jersey Finance was initially supportive of this proposal but, after further consideration, came to the view that a *de minimis* provision would serve to create complexity and uncertainty, and that commercial reality would apply. It

was felt that ISEs would be unlikely to reclaim small amounts of GST. On more expensive items such as computer equipment, they felt that it should be left to the local business to decide where to set the *de minimis*. This would be self-regulating because it will be at a point where the seller loses business due to the GST-inclusive price he wishes to charge proving unacceptably high to the purchaser.

The GST Director explained the position which has been arrived at in the current amendments –

We have learnt a lot over recent weeks from the business community themselves, and this attempt I think was suggested even by Scrutiny quite some time ago. So I do not think anybody is against the principle of trying to relieve the burden of remitting or relieving tax in the smaller businesses, particularly the retail outlets. The way the law has been worded does not achieve that at all, so I think we accept that it does not achieve what we were trying to do originally. I think it would be better, if in fact there was a limit, that the limit didn't apply to retailers particularly of goods or anybody on a retail scheme, and that normally is a retailer supplying goods. For anybody else, then it does not apply. Equally, the ability for an I.S.E. (International Services Entity) to recover any G.S.T. paid should not have a financial limit on it. They should have the ability to recover if they decide to.^[4]

The draft Regulations impose a *de minimis* of £1,000. This means that an ISE will be charged GST whenever it makes a purchase of less than £1,000 (i.e. with GST of less than £30). The ISE can then decide whether to reclaim that GST in the usual way, or (if the administrative cost is too high) bear the cost of that GST itself. This imposes some extra costs on ISEs, in order to avoid more onerous costs for local suppliers.

The Sub-Panel accepts this approach, although the level of (and need for) a *de minimis* will need to be monitored once the system is in place.

Local supplies by an ISE

Registered financial services businesses (banks, trust companies and collective investment fund managers) will all be able to be listed as ISEs regardless of the proportion of their business that is off-Island. In view of the overwhelming dominance of off-Island work for this sector, we do not fear any distortion or significant loss of revenue from this.

However the Law allows for other businesses to register as ISEs, provided at least 90% of their supplies are off-Island. This could cover law and accounting firms, patent agents or suppliers of downloaded Internet files. We were concerned that this conceivably could also apply to companies exporting goods such as fulfilment companies.

The 90% test means that an ISE could make 10% of its supplies in the domestic market without charging GST on them, which would give them a price advantage over local firms.^[5] Given Jersey's small size, a major exporter could easily dominate the local market and yet still export enough to meet the 90% test.

The GST Director explained that the ability to register as an ISE applied only to providers of services, not providers of goods –

There have been inquiries under the law as it currently stands as to whether they would be eligible as I.S.E.s or not. The answer is, in terms of an interpretation, the legal advice given is that they probably would be eligible. In many ways it would be perhaps of benefit to the States to include them because we would not then have to register them. First of all, they would be eligible not to register in any case because there is an exemption from registration for somebody in exactly those circumstances. So they have a range of alternatives. They can notify a liability and request the Comptroller to be exempted from registration because effectively most of the sales are zero rated, or they could register in the normal way, or they could register as an I.S.E., pay the flat rate fee and in effect we would not have the administrative burden of repaying them. But these are businesses involved in services only. ... Goods for resale are excluded specifically under the law.

The GST Director went on to say that he did not think that there were many non-financial service providers who were thinking they were eligible for treatment as an ISE. He also favoured a cautious approach to this issue. He explained in a further briefing note to the Sub-Panel –

“For many reasons my view is that we should initially limit the approval of ISEs to what was originally proposed – the FSI. If we do extend then it should be to a very specific and limited number of other service providers”.

We believe that the extension of the flat rate scheme to certain non-financial services entities with an international services nature, such as information technology or intellectual property, has the potential to provide further business opportunities to Jersey. These are high value service industries which might provide the Island with options for future diversification.

This is a complex situation, and it may be difficult to draw a firm dividing line. The situation will have to be monitored, and the Law may have to be tightened if there is evidence of abuse.

The proposed Regulations

The Regulations, as amended by the Treasury’s lodged amendment, provide the additional detail for the Law relating to charging GST on financial services –

Regulation

- 1: definitions.
- 2: sets the £1,000 *de minimis* (see above) and has various provisions intended to stop the ISE status being abused in the local market.
- 3 & 4: set the annual fees for ISEs.
- 5: Under the Treasury’s amendment, the Regulation in their original lodged proposition will be in Article 60 of the Law.
- 6: specifies that regulated businesses (banks, trust companies and collective investment fund managers) can be ISEs even if more than 10% of their business is on-Island. Since Jersey’s finance industry is predominantly off-Island, this is unlikely to have any impact other than simplifying the application process.
- 7: gives the ability for ISEs to reclaim GST on invoices below £1,000 (see Regulation 2 above).

Other amendments to the Law

The other provisions of the lodged Law, which do not deal with the financial services industry, are –

Article

- 2: imposes the same definition of whether a company is “tax resident” in Jersey as is used for income tax.
- 3: permits the Comptroller to impose valuation rules (previously this had to be done by the States by way of Regulations).
- 4: permits the Comptroller to impose valuation rules for imports (previously this had to be done by the States by way of Regulations).
- 5 & 6: exempts retailers from the requirement to give a detailed GST invoice

(alternative retailer invoices will be covered by general notice).

- 7: corrects a minor error.
- 8-19: finance industry matters, as outlined above.
- 20: allows partnerships (and limited liability partnerships) to join a GST group (to avoid the administrative cost of charging and reclaiming GST on transactions within the group).

The Sub-Panel is happy with these amendments.

Minor issues and drafting points

In reviewing the draft amendment to the Law and the draft Regulations the Sub-Panel raised a number of minor issues and drafting points on the lodged drafts which were communicated directly with the GST Director. A short paper covering these points, some of which have been incorporated in the latest Treasury draft, is available on the Scrutiny website.

Hearings

The Sub-Panel held a series of public hearings with Jersey Finance and the Minister for Treasury and Resources on the GST treatment of the Financial Services Industry. Transcripts of these hearings are also available on the Scrutiny website:

<http://www.scrutiny.gov.je/panel.asp?panelid=26>

[1] *Hearing dated 15th February 2008.*

[2] *Hearing dated 15th February 2008.*

[3] *Hearing dated 15th February 2008.*

[4] *Hearing dated 15th February 2008.*

[5] *In some cases that advantage would be reduced because the ISE would still be charged GST on its purchases, despite its ISE status.*