STATES OF JERSEY

EXPENDITURE PROPOSALS FOR 2012 AND 2013 AND DRAFT BUDGET STATEMENT 2011 (P.157/2010) – SECOND AMENDMENT (P.157/2010 Amd.(2)) – COMMENTS

Presented to the States on 6th December 2010
by the Council of Ministers

STATES GREFFE

COMMENTS

Part 1

The Council of Ministers opposes this part of the amendment for the following reasons –

1. The proposed increase in exemption thresholds from 1.1% to 3.1% will reduce States income and increase the deficit by £2.85 million a year from 2012.

2. If this is not to have a negative effect on the financial position, this must be paid for by increasing taxes or fees elsewhere.

3. However, as explained in more detail in the comment to Part 2, doubling the ISE fees without consultation would have a detrimental impact on the finance industry and would make Jersey less competitive. Therefore, another source of funding would need to be found to pay for the lost income tax revenues.

4. The reduction in States income would effectively be postponed until 2012, because of the way people pay their tax in Jersey.

Supporting analysis

Senator Le Gresley proposes that income tax exemption limits for the year of assessment 2011 should be increased by 3.1% instead of the 1.1% proposed in the draft Budget statement.

The Council of Ministers recognises that many Islanders have been negatively affected by the global economic downturn. When preparing the draft 2011 Budget, the Council recognised the need to assist to those Islanders with low incomes but who are not eligible for income support. At the same time, the States faces a difficult financial position that the Council of Ministers has to deal with.

The average increase in earnings in the Island last year was 1.1%. Raising the income tax exemption thresholds by the same percentage will mean that Islanders whose earnings are at or just below the exemption threshold and who have seen those earnings rise in line with the average will not pay more income tax as a result.

Any further increases in exemption thresholds will reduce the amount of income tax collected by the States. If this is not to have a negative effect on the financial situation, this would have to be funded from other taxpayers or from other taxes or fees.

However, in raising extra revenue from other sources, we should not risk the competitiveness and prosperity of the Jersey economy. Any increase in taxes or fees that makes Jersey appear more expensive compared to our nearest competitors, particularly Guernsey, risks encouraging our international financial services industry to take its business away from Jersey, which will affect all Islanders at all income levels. This is discussed in greater detail in the comments to Part 2 of this amendment, below.

Part 2

The Council of Ministers opposes this part of the proposal for the following reasons:

1. *The amount of revenue anticipated to be raised through this measure is uncertain.*
Senator Le Gresley estimates that doubling these ISE fees would raise £2.1 million in revenue (thus reducing the deficit by a similar amount) per year from 2011. However, because ISE status is not compulsory, doubling the fees is likely to lead to some companies opting out of the regime, thereby reducing the revenue earned through ISE fees. The net effect is extremely uncertain, and may even lead to a fall in the total revenue earned from ISEs.

2. *The proposal risks having a negative knock-on impact on the revenue earned from the basic ISE fee.*
A trust company that is an ISE itself must automatically pay the basic ISE fee of £100 (due to be increased to £200 under the original 2011 Budget proposals) in respect of all of its clients apart from trusts. If a trust company decided not to apply for ISE status for 2011 because the fee was too high, then the basic fee would not be payable in respect of its clients. 67% (£3.1 million) of all ISE fees are paid in respect of the clients of the finance industry, and the revenue lost could therefore be significant, given there would be no advantage in most of these companies applying on their own account.

3. *The proposal forestalls the review of the ISE structure already planned for 2011.*
In the draft Budget 2011 the Minister for Treasury and Resources announced a full review of the ISE fee structure to be carried out in 2011. Proposals arising from this review are to be included in the 2012 Budget. Further significant changes to the ISE fee regime should not be made until the full review of the ISE structure is complete.

4. *Jersey should not make itself appear uncompetitive compared with Guernsey.*
Jersey's finance industry pays most of the income tax collected from companies. It employs the greatest number of employees in the Island, and will therefore be impacted the hardest by the proposed increase in social security. By contrast, much fewer company profits are subject to tax under zero/ten in Guernsey than in Jersey, Guernsey does not have ISE fees, and there is a limit to the amount of social security contributions payable. It is important that Jersey does not encourage highly mobile financial services business to leave the Island because it is cheaper to do business elsewhere.

5. *Fees should not be increased without consultation.*
If approved, the increase in the fees would apply from 1st January 2011, with the businesses affected having had 3 weeks' notice of the increase. While the States is not obliged to undertake consultation before increasing fees, nonetheless it is considered to be best practice to ensure that affected organisations are given ample notice and an opportunity to respond. Doubling the ISE fee virtually overnight would damage the relationship between government and industry, and risks seriously damaging the finance industry.

Supporting analysis

Senator Le Gresley proposes that £2.1 million of additional revenue should be raised by doubling the following ISE fees –

Type of company	*From*	*To*
Deposit takers	£30,000	£60,000
Trust company business affiliation leaders	£7,500	£15,000
Fund functionaries	£2,500	£5,000
Managed managers	£500	£1,000

In general, VAT/GST-registered businesses do not suffer VAT/GST; rather they merely act as collection agent and pass the tax on to the customer. The finance industry, however, is different. Financial services companies will often make a mixture of supplies, some of which will be subject to VAT/GST and some of which will be exempt.

Because of the difficulty of establishing which elements of the services they provide should be subject to VAT/GST, most financial services products are exempt.

Experience in other countries with a similar system of exemptions from GST has shown that administering the regime can be complex and expensive. The ISE regime was designed to minimise the complexity of the GST system, while at the same time ensuring that the financial services industry contributes to GST revenues.

The amount of revenue that this measure is predicted to raise is uncertain
In Jersey, by opting for ISE status, a financial services company can become exempt from GST. This exemption means that they cannot charge VAT/GST on the services that they provide, or cannot recover the tax that they incur on purchases made in connection with those services.

ISE status is not compulsory. An eligible company has the option of whether to apply and pay the fee, or to be treated as any other business. A company will generally only pay the fee to be an ISE if there is a sound economic reason for doing so.

A company considering whether to opt for ISE status will consider the amount of irrecoverable GST it would otherwise suffer, as well as the compliance cost of administering GST. If the company considers that the cost of the ISE fee is higher than the overall benefit it obtains, it will simply choose not to apply for ISE status, and Jersey will lose the revenue it would otherwise have earned from the fee.

Already, nearly 40% of the banks and 20% of the trust companies that operate in Jersey do not claim ISE status as they consider that the fees currently charged are too high. Doubling the ISE fees will inevitably lead to more companies opting out of the ISE regime. For this reason, it is unlikely that the proposed amendment will raise the amounts of income predicted.

There may be a knock-on impact on revenues from the basic ISE fee
The basic ISE fee of £100, due to be increased to £200 under the Budget proposals, raises 67% of the total ISE revenues. Most of the entities subject to this fee are the clients of trust and company administrators.

One of the conditions of a trust company business becoming an ISE is that it must pay the basic ISE fee of £100 (£200 from 2011) in respect of all of its eligible clients apart from trusts.

If a trust company chose not to apply for ISE status for 2011 on the basis that the fee payable was higher than the GST the company would otherwise suffer, then the basic fee would not be automatically payable in respect of its clients. Each of these clients would then consider whether it was in its interests to make an application in its own right. There would be no advantage for most of these companies to make the application and pay the fee. The ISE fee revenue lost could be significant.

Need for proper review

Although in general the ISE system works well, the Minister has announced a review of how the ISE regime operates in relation to service providers. The post-implementation review report undertaken by HM Revenue and Customs (HMRC) in the UK in the year following the introduction of GST recommended that the system be allowed to "bed down" for at least 2 years before making any changes. Now that the system has been in place for 2½ years, a review is to be undertaken in 2011.

The Council of Ministers believes that it would be unwise to double the ISE fees now, when a fundamental review of the way in which they operate is to be undertaken within the next year. They recommend that, pending the outcome of that review, no further increases should be proposed other than the increase of the basic fee to £200 previously proposed. Proposals arising from that review will be included in the 2012 Budget.

Competition

Jersey must ensure that it does not appear as a markedly more expensive place for businesses to operate relative to our closest competitors. The finance industry contributes most of Jersey's corporate tax revenues and is the biggest employer in the Island. In common with other businesses, the finance industry is feeling the impact of the global economic downturn. At a time when groups are actively seeking ways to cut costs, Jersey must not come to be considered as too expensive, particularly when our nearest competitor, Guernsey, is not levying similar charges.

Guernsey does not have a GST and does not charge ISE fees. The range of profits that are taxed under Guernsey's 0/10 regime is much narrower than in Jersey. Guernsey also caps the social security contributions payable by employers.

Although there are other reasons for business to choose Jersey over other places, the Island has become a more expensive place for the finance industry to do business in over the past few years, with the introduction of GST, increases in regulatory fees, enhanced compliance obligations and now the proposed increase in social security contributions by 2% above the cap.

Many of Jersey's banks, and all of the main UK retail banks, have operations in all three Crown Dependencies. There are increasing pressures within the industry to rationalise corporate structures. It is quite possible that the next few years will see some banks consolidate their operations into one or two islands at most.

While it is unlikely that this one increase by itself would be the trigger for business to leave Jersey, nonetheless we must be aware of the impression given by the gradual increase in costs across the board. Jersey cannot afford to send the message that we are too expensive.

Lack of consultation
Although it is not obliged to do so, the States of Jersey endeavours to give notice of increases in fees where possible, in order to allow those affected to consider the impact and to respond if appropriate. Jersey's reputation for stability in fiscal matters has been built in part on the understanding that government will try to give industry sufficient time to plan for increases in fees and taxes.

The increase in the basic ISE fee of £100 was only proposed following a full consultation on the level of annual company fees payable in Jersey. Indeed, the action that had been originally proposed was changed as a result of listening to the responses to that consultation process.

If this proposal were adopted by the States during the Budget debate, the increase in fees would come into effect on 1st January 2011, a mere 3 weeks later. Businesses must decide whether to apply for ISE status by 31st January. It is considered that adopting this amendment without proper consideration of the implications would damage the relationship between government and industry.

Part 3

Senator Le Gresley proposes to raise £750,000 a year (thus reducing the deficit by a similar amount) by increasing the basic ISE fee from £200 to £225 in 2011.

The Council of Ministers urges States Members to oppose this part of the amendment for the following reasons –

1. A review of company fees was undertaken during 2010, which included the issuing of a Green Paper. This identified that a £100 increase could be borne by the clients of the financial services industry. It was felt that this increase could be less easily borne by companies trading and holding property locally.

2. For this reason it was decided that the basic ISE fee should be increased instead of the annual company return fee, as this would shelter local companies from the increase.

3. Respondents to the Green Paper indicated that even apparently minor differences in fees between territories can influence the decision on where to locate structures.

4. Increasing the ISE fee to £225 instead of the £200 proposed would make the total annual fees payable in Jersey higher than in the Isle of Man. Fees would be £100 higher than the basic fee in Guernsey, but still lower than the fee payable by certain clients of the finance industry there.

5. Without having consulted on the impact of this increase, it is difficult to say what the impact on the financial services sector might be. However, it is likely that it will lead to some loss of business.

Supporting analysis

During the course of the 2010 Budget debate in December 2009, the Minister for Treasury and Resources committed to review the annual company fees payable by Jersey companies in order to establish if there was any scope to increase revenues.

Deloitte was commissioned to review total company fees in a number of Jersey's competitors. The report identified that companies in Jersey were potentially subject to two annual fees –

- The annual company return fee payable to the JFSC of £150; and
- The £100 ISE fee.

The total fee payable by these companies of £250 is lower than in certain of Jersey's key competitors, as shown in the table below.

Annual company fees	**Annual**	**Other**	**Total**	**Variation from Jersey**	
	£	**£**	**£**	**£**	
Key competitors					
Cayman	485		485	+235	
BVI	400		400	+150	
Isle of Man	360		360	+110	
Jersey	**150**	**100**	**250**	+0	*(i)*
Guernsey	250		250	+0	

Notes

(i) Other fees are ISE fees.

It was considered important that Jersey's total fees should not exceed those in Guernsey or the Isle of Man. An increase of £100 was considered appropriate on the basis that this would raise the total annual fee in Jersey to £350, which was less than the Isle of Man. Although it is £100 higher than the annual fee chargeable to most Guernsey companies, it is less than the fee payable by certain companies that are themselves administered by financial services companies in Guernsey.

A Green Paper was issued in September 2010 which proposed that either the annual company return fee or the basic ISE fee could be increased by £100. The Green Paper suggested that the annual company return fee should be increased, but the responses received suggested that it would be preferable to increase the ISE fee. The two main reasons for this were –

- Companies operating in Jersey are not typically eligible for ISE status and therefore would not be affected by the increase, at a particularly difficult time for Jersey businesses; and

- Increasing the ISE fee should raise more revenues because there are more ISEs than there are companies incorporated in Jersey, because the status is available to limited partnerships and other legal entities as well as companies.

As a result of the consultation exercise it was decided that the ISE fee should be increased in place of the annual company return fee.

Increasing the ISE fee by an additional £25 would mean that the total fees payable by clients of the financial services sector would be £375. This would make the fees in Jersey higher than the in the Isle of Man, although they would be lower than the fees payable by certain clients of the financial services industry in Guernsey.

Respondents to the Green Paper on company fees pointed out that even apparently minor differences in fees could make the difference in determining the location of business. Overall they felt that an increase of £100 would not lead to a significant loss of business since the fees would still be lower than in our closest competitors. The impact of raising our fees above the Isle of Man is unknown.

Finally, Senator Le Gresley estimates that increasing the basic ISE fee by £25 would raise an additional £750,000 in revenue for 2011. This has been calculated on the basis that no business will be lost to Jersey as a result of the increase, which is far from guaranteed.