Green Paper

Business Tax Review

A public consultation on corporate taxation

June 2010

Presented to the States on 22nd June 2010
by the Minister for Treasury and Resources

R.83/2010

States of Jersey

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Appendices

Foreword

Jersey introduced the 0/10 corporate tax regime to replace its previous regime aspects of which were found to be harmful by the EU Code of Conduct on Business Taxation Group. Despite not being a member of the EU, Jersey volunteered to engage with the Code and so the 0/10 regime was designed, with the support of the UK, to comply with the Code and to ensure Jersey remained internationally competitive.

To date, the Code Group has not formally considered the 0/10 regime but will now do so later this year. It should be noted that in 2003 and 2006, assurance had been given to the Crown Dependencies that the proposed 0/10 regimes were not considered to be harmful. In June 2003 ECOFIN issued a press release confirming that the Code Group had found that none of the replacement measures proposed by the Crown Dependencies were considered to be harmful and that ECOFIN agreed that the proposed replacement measures were adequate to achieve rollback of all of the harmful features previously identified by the Code Group. Further, in its report to ECOFIN dated 28 November 2006, the Code Group stated:

> "The UK delegation, recalling the Code Group report dated 26 November 2002, explained that with the introduction of a standard rate of tax for all Isle of Man companies of 0% and a higher rate of 10% on two closely defined types of business…the Isle of Man's six harmful measures were all repealed or revoked. This was accepted as constituting the rollback of the harmful regimes."

It is understood that some EU Member States now consider 0/10 may be in conflict with the "spirit" of the Code rather than the Code criteria per se. The assessment process will start in September 2010. We welcome this assessment as it is the next natural step in the process and we will consider the outcome when it is received.

Jersey has achieved strong independent recognition as a cooperative, transparent and well regulated jurisdiction through its willingness to comply with, and sometimes lead, international standards. This commitment to comply with international standards should be maintained in all aspects of Jersey's activities.

International views on tax are changing and Jersey needs to be ready to respond. But it will only do so having properly considered the impact on the Island's economy. We therefore announced in the 2010 Budget speech that we intended to carry out a review of Jersey's business tax regime, as part of the overall Fiscal Strategy Review. This consultation forms an important part of the Fiscal Strategy Review and focuses only on our corporate tax regime.

It is important to note that:

- Jersey has committed to review its corporate tax regime to ensure that it continues to comply with international standards to the extent they exist.

- Our current 0/10 regime has not been found to be non-compliant by the EU Code of Conduct Group or any other review body.

- The current 0/10 regime will continue to apply until it can be shown to be in Jersey's best interest to justify a change. In judging what is in Jersey's best interest, regard will be had for:

    - any relevant international standards;
    - the retention of tax neutrality;
    - the impact on the Island's competitiveness and thereby on the level of economic activity;
    - any impact directly or indirectly on the Island's residents; and
    - the Island's general good neighbour policy and its reciprocity among EU Member States.

- There will be no retrospective change in Jersey's corporate tax law.

When 0/10 was introduced certain companies with Jersey based business activities effectively ceased to pay Jersey tax on their profits. This review will investigate whether it is possible to recoup any of this loss from these businesses.

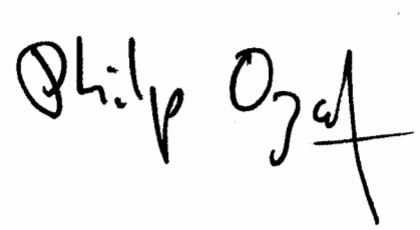
The presentation of the five examples in this report is intended to assist in the consultative process. There is no presumption that any specific one of these alternatives will be adopted. This is an open consultative process.

There will be a full consultation process both on the examples documented and any subsequent draft legislative proposals. Following the experience of other countries including the EU Member States, and indeed our own experience in introducing 0/10, if any of these changes are decided upon it can be expected to take a number of years before they will come into force.

We will ensure throughout this process that it does not undermine Jersey's economy by placing it at a competitive disadvantage to other jurisdictions, whilst providing clarity and certainty over the direction of travel as soon as is practical.

Jersey's future depends on maintaining international acceptability and competitiveness. We are confident that we can find the right answer to secure a successful future for our Island.

We would therefore like to hear your views before preparing the budget statement later this year.



Senator Philip Ozouf
Minister for Treasury and Resources

Section 1 - Introduction and background

Introduction

A stable, competitive and sustainable tax system is vital to ensuring Jersey's continued economic success. With this objective in mind the Minister for Treasury and Resources announced a review of business taxation (the Business Tax Review) in the 2010 Budget.

An integral part of this review is to seek comments, opinion and analysis from the public, business and all stakeholders on the impact of any change to Jersey's corporate tax regime.

This consultation document sets out the background to and reasons behind this review, as well as the principles that should determine Jersey's corporate tax regime. It focuses on technical aspects of corporate tax and sets out some possible alternative structures that could be considered if the outcome of the Business Tax Review shows that a change from the current zero/ten (0/10) regime would be in the Island's best interests.

It is a presumption that any change that reflects our good neighbour policy will be reciprocated by the EU Member States, for example including entering into double tax agreements (DTAs).

All business sectors are important to Jersey's continued success and the Business Tax Review will consider the impact of any change on every sector. **Responses from all business sectors within Jersey are welcomed.**

It is already clear from the work undertaken to date that any change to Jersey's corporate tax regime should not adversely affect the overall income tax position of locally owned businesses although there may be indirect consequences.

In parallel to this, a review is underway to clarify the economic impact of any potential change. It is critical that any positive and negative economic impact is understood to ensure that the strength of Jersey's public finances is not put at risk.

Background

Aspects of Jersey's tax regime were found to be harmful by the EU Code of Conduct for Business Taxation Group (the Code Group) in 1999. After significant discussion and consultation with the other Crown Dependencies and the UK, in 2002 Jersey agreed to move to a new corporate tax regime known as 0/10. The new tax legislation has generally applied since 2009.

Under 0/10 the general rate of corporate tax is 0%. The profits of some financial services companies, which comprise the minority of companies, are subject to tax at 10% and utility companies at 20%.

Introducing 0/10 cost the Jersey economy in the region of £100m, which had to be, and was, recovered by other means[1]. Jersey's public finances are stronger as a result of the action taken at that time and it is important that this position is maintained.

In 2003 and 2006 assurance had been given to the Crown Dependencies that the proposed 0/10 regimes were not considered to be harmful. In June 2003 ECOFIN issued a press release[2]

[1] Goods and Services Tax (GST), Income Tax Instalment System (ITIS) and 20 means 20 were introduced.

confirming that the Code Group had found that none of the replacement measures proposed by the Crown Dependencies were considered to be harmful and that ECOFIN agreed that the proposed replacement measures were adequate to achieve rollback of all of the harmful features previously identified by the Code Group. Further, in its report to ECOFIN dated 28 November 2006[3], the Code Group stated:

> "The UK delegation, recalling the Code Group report dated 26 November 2002, explained that with the introduction of a standard rate of tax for all Isle of Man companies of 0% and a higher rate of 10% on two closely defined types of business…the Isle of Man's six harmful measures were all repealed or revoked. This was accepted as constituting the rollback of the harmful regimes."

Jersey's 0/10 regime has not yet been formally assessed by the Code Group and will now be assessed, with the process starting in September 2010.

Tax neutrality

> *Tax neutrality is not, and does not facilitate, tax evasion; lack of transparency and poor regulation do. Jersey has been independently recognised as being highly regulated, as clearly demonstrated in its recent IMF report[4], and also as meeting international standards of tax transparency and exchange of information, through its inclusion on the original OECD "white list"[5].*

Jersey competes globally with other international finance centres and tax neutrality, particularly for highly mobile capital such as investment funds, is an important feature of these jurisdictions. All international finance centres offer a form of tax neutrality – that is, a regime that does not subject companies to additional taxation, recognising that underlying profits should be subject to tax where the assets that give rise to those profits are located and investors are taxed on their returns in their home jurisdictions. Many other countries achieve tax neutrality with specific exemptions particularly for highly mobile capital and in ways which are often complex and opaque.

Tax neutrality is an important feature of Jersey's tax system which underpins much of the provision of international financial services from Jersey and to remain competitive access to tax neutral structures must be maintained. Although certain finance companies pay tax at no less than 10% on the profits they generate, the majority of international clients rely on the availability of tax neutrality. Tax neutrality is also important to non-financial services businesses and can influence developments in other parts of the economy.

Tax neutrality prevents unnecessary additional layers of taxation, provides certainty in tax treatment and allows fiscally efficient cross border investment which facilitates global capital

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[2] EU Council of Economic and Finance Ministers; *Press release 9844/03 (Presse 149) dated 3 June 2003*

[3] EU Code of Conduct Group (Business Taxation), *Report to ECOFIN Council 15472/06 LIMITE FISC 145 dated 28 November 2006*

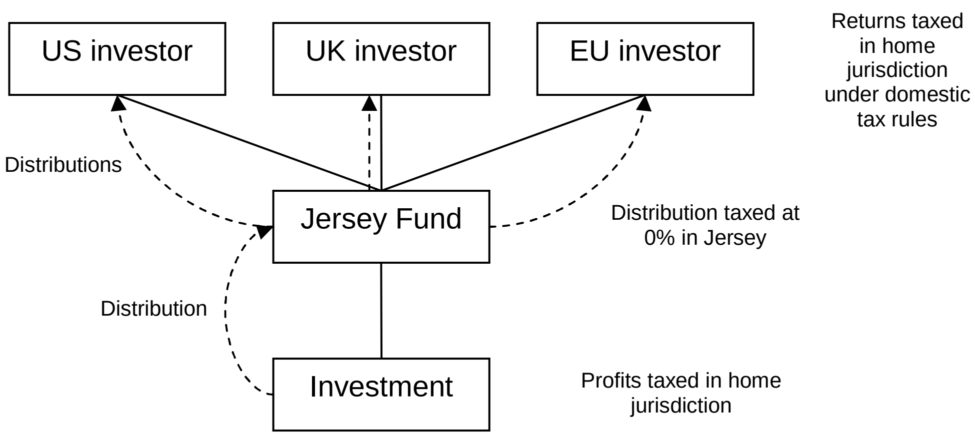
[4] International Monetary Fund, *Financial Systems Stability Assessment Update (2009), IMF Country Report 09/282*

[5] Organisation for Economic Cooperation and Development (OECD), *A Progress Report on the jurisdictions surveyed by the OECD Global Forum in implementing the internationally agreed standard (Original Report 2 April 2009, subsequently updated).*

flows. Double taxation agreements ("DTAs") are used by many jurisdictions to ensure that income generated in one jurisdiction and remitted to another is, rightly, only taxed once. In the absence as yet of an extensive double tax treaty network, Jersey can only prevent unnecessary additional layers of taxation through the provision of a tax neutral regime.

Tax neutrality also maximises the return to investors and hence, potentially, the tax revenues in their home jurisdiction. This is particularly important for structures that are set up to achieve a specific purpose, where it is desirable not to incur an unnecessary additional tax liability. Take, for example, a fund that is investing in a particular asset class such as emerging market equities and wants to attract investment from parties based in the UK, the US and the EU. If this fund is established in a jurisdiction that does not provide tax neutrality, investors in that fund may be subject to tax at the fund level in addition to their tax liability in their home country, potentially resulting in double taxation of the same income. Furthermore, such a fund may create different liabilities for investors depending on their location. By precluding additional layers of tax, a tax-neutral regime is efficient and creates a level playing field for multinational investors.

Diagram 1 – illustrative multinational fund structure



Similar tax treatment is achieved by other higher tax jurisdictions using DTAs or specific exemptions and reliefs.

As a consequence jurisdictions offering tax neutrality provide an ideal platform for conducting business related to international finance and trade, structuring investment deals or infrastructure projects that involve participants across a number of countries and establishing structures that can be used for a variety of other purposes, such as securitisation or the protection of assets. These legitimate activities will be primarily motivated by real economic concerns – such as the raising of finance – rather than purely for tax purposes, but locating them in a tax neutral jurisdiction, whether onshore or offshore, can avoid unnecessary extra taxation.

Tax neutrality for the finance sector

As noted above, tax neutrality is an important feature of Jersey's tax regime on which many clients of the finance industry rely.

Jersey is a significant international finance centre with an excellent reputation built on many years of experience in financial services. The finance sector is crucial to the success of the Island, being directly responsible for a significant proportion of economic activity and nearly a quarter of all employment, and with a large indirect effect on both.

In 2008 the finance industry in Jersey was worth almost £2.3bn and directly employed nearly 13,000 people[6]. The main activities within the finance sector on the Island are:

- Banking and private wealth management
- Fund administration and management
- Structuring and administration of trust, company and partnership arrangements.

The sector also relies on a substantial number of professional support services such as lawyers and accountants. Banks contribute over 70% of this sector's economic activity[7]. Trust and company administration together with legal services create around 20%, with fund management and accountancy services contributing the rest.

Jersey services the financial needs of many UK nationals living abroad and provides a tax neutral pathway for funds into other financial centres, mainly the City of London. Jersey, together with the other Crown Dependencies, therefore makes a significant contribution to the liquidity of the UK market through the "up streaming" of funds, thereby substantially benefiting the UK banks and the UK exchequer. Up streaming enables deposits to be gathered by subsidiaries or branches in a number of different jurisdictions and then concentrated in one centre, such as the City of London, where the bank has the necessary infrastructure to manage and invest these funds. A recent independent report for HM Treasury[8] has demonstrated that the stock of net financing provided by the Crown Dependencies to UK banks was $332.5 billion in the second quarter of calendar year 2009, largely accounted for by the up-streaming to the UK head office of deposits collected by UK banks in the Crown Dependencies.

Tax neutrality for other sectors

Although arguably not critical to the continuing success of non-financial services sectors, many other sectors benefit substantially from the existence of tax neutrality and a tax neutral platform is a key feature in attracting new non finance related industries particularly in the absence of a comprehensive double tax treaty network. Non financial services sectors also benefit indirectly from the success of the financial services industry.

A level playing field

Jersey's competitors are not just jurisdictions with zero rate or no corporate tax, but also countries, including EU Member States, with higher rates of corporate tax that achieve tax neutrality by other means[9]. Jersey operates in a global financial services market where all jurisdictions seek to ensure that their tax regimes are competitive. Though there are other more important drivers for doing business in a particular jurisdiction, such as a stable legal and political environment and the expertise available, tax neutrality remains a critical factor, particularly in the absence of an as yet extensive network of double taxation treaties.

Jersey wishes to see a more level playing field develop internationally and remains committed to assist whenever and wherever it can. The Island also continues to encourage the development of improved international standards where these are lacking, alongside the introduction of strengthened arrangements for independently and objectively assessing compliance with international standards.

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[6] States of Jersey Statistics Unit, *Jersey in Figures 2009.*

[7] It should be noted that banks depend on both financial and non-financial sectors for business and this reference represents all of their activity.

[8] Foot, Michael, *Final Report of the Independent Review of British Offshore Financial Centres (2009).*

[9] Such as through exemptions, reliefs and often complex, opaque arrangements.

Section 2 - Why review Jersey's business tax regime?

In the 2010 Budget speech the Minister for Treasury and Resources committed to review Jersey's business tax regime in conjunction with the Fiscal Strategy Review.

Continuing commitment to international standards

Jersey remains committed to complying with international standards as is evident from the recent IMF and Foot Reports and Jersey's inclusion on the original OECD white list. Jersey has actively embraced and continues to lead work on developing and extending the OECD global standard on tax transparency[10]. Furthermore, although tax is not included in the terms of the EU protocol which defines the relationship between Jersey and the EU, Jersey voluntarily implemented the EU Savings Directive and engaged with the EU Code of Conduct for Business Taxation (the Code).

International standards are by their nature fluid and Jersey needs to ensure that its corporate tax regime can accommodate future developments. Appendix 2 sets out further commentary on international standards on business taxation and concludes that there are few international standards relating to the content of business tax regimes or tax rates, although there are indications of more standards emerging from common practice.

International standards on taxation exist in the following areas:

- transparency and exchange of information;
- non-discrimination by reference to the nationality, residence or similar features of the owner; and
- arguably, seeking not to deliberately create opportunities for tax arbitrage.

As is its practice, and commitment, Jersey will comply with international standards to the extent that they exist and as they develop.

International focus on lower tax jurisdictions

International views on tax are changing rapidly, with increased focus on lower tax jurisdictions.

Following the finding that aspects of its former corporate tax regime were harmful in 1999, Jersey voluntarily agreed in 2002 to comply with the Code and subsequently introduced its current 0/10 regime. Although Jersey's 0/10 tax regime has not yet been formally considered by the Code Group, it is understood some EU Member States now consider that 0/10 may be in conflict with the "spirit" of the Code. Jersey's 0/10 regime will be subject to assessment later in 2010, which is the next natural, and fully anticipated, step in the review process of the Code Group. This assessment process should clarify what if anything there is about the 0/10 structure that is in conflict with the Code. The outcome of the assessment will be considered when it is received. Appendix 1 sets out further information about the Code Group, the Code criteria and Jersey's engagement with the Code.

Despite the independent recognition Jersey has achieved as a well regulated, cooperative and transparent jurisdiction there continue to be unilateral measures discriminating against Jersey based on its tax regime. An example is the recent publication of a "black list" by Belgium, which includes Jersey, Guernsey, the Isle of Man and other countries despite many of them being included on the OECD white list. It is clear that such action is based on low general rates of tax rather than being an uncooperative jurisdiction.

[10] Jersey is one of the four vice-chairs of the Global Forum Peer Review Group alongside India, Japan and Singapore and is a member of the Steering Group.

Whilst Jersey has had significant success in negotiating tax information exchange agreements, in many cases with additional benefits, there continue to be barriers to negotiating comprehensive DTAs. The most common barrier is that the other party is not prepared to enter into a DTA with a perceived "no tax" jurisdiction. In Jersey's case this is an unjustified position given that most financial services companies suffer tax of no less than 10% and Jersey resident individuals pay tax at 20%[11]. In addition, a number of OECD countries have signed comprehensive DTAs with countries with no effective direct tax systems such as the United Arab Emirates. Arguably there would be less need for a simple 0% rate of tax with an extensive DTA network.

Increasing international competition
Other jurisdictions are looking at their business tax policies to ensure that they:

- remain competitive;
- increase their attractiveness for business and capital;
- seek to reduce administrative burdens;
- achieve the best balance of mobile and fixed tax bases; and
- seek tax responses to the economic downturn.

Since the 1990s, corporate income tax rates in Europe have been cut from a 35.3% average in 1995 to 23.5% now, and this trend has continued with five EU Member States cutting their rate in 2009.

The use of competitive tax rates and regimes as a policy and economic tool is commonplace in many jurisdictions. For example, the new UK Government has committed to create the most competitive corporate tax regime in the G20[12].

Jersey is an international business centre and so competes for business on a worldwide basis. Jersey is highly rated in the Global Financial Centres Index (GFCI) which measures competitiveness and maintaining this competitive position is paramount. Whilst continuing to meet international standards and operate as a well regulated, cooperative and transparent jurisdiction, Jersey will continue to support moves to create a global level playing field. In particular, Jersey is committed to supporting the OECD in and is directly involved in the new peer review process of reviewing the effectiveness of transparency and exchange of information.

Surveys have shown that corporate tax rates are only one factor – and in many cases not the primary factor - taken into account by businesses when considering the attractiveness of alternative locations. Stable political and regulatory environments, good infrastructure and availability of labour with the required expertise may be considered more important than corporate taxation but all other things being equal, tax can be an influential factor. Even so, Jersey's corporate tax structure will aim to reflect its commitment to international standards and to reflect our good neighbour policy.

This review may identify aspects of a regime which will be beneficial to the Island while still protecting its competitive position. For example, as part of this review there is room to consider the business limitations Jersey has sometimes experienced in the absence of an extensive DTA network and whether any move to an alternative regime could improve those business opportunities.

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[11] Other taxes also exist such as Goods and Services Tax and Social Security.
[12] HM Government; *Programme for Government, May 2010*

Jersey's fiscal strategy
Alongside the Business Tax Review, a Fiscal Strategy Review is underway which is consulting on the key personal tax options for dealing with the drop in Jersey's income resulting from the global economic crisis, together with the need to maintain improvements in public services and strengthen financial planning. It is recognised that businesses must continue to contribute appropriately to Jersey's economy. There is a strong desire to ensure that tax revenues are not materially disadvantaged and if it is sustainable and commercially feasible certain businesses should contribute more to the economy of Jersey. A full economic impact analysis of the alternatives is being undertaken to ensure that any positive and negative economic impacts are fully understood.

Expected timeframe
The international tax world is changing and Jersey needs to be prepared to respond and to fully understand the impact of maintaining the status quo or of potential future changes that might be made.

Meanwhile there is no cause for uncertainty about our corporate tax regime. The current 0/10 corporate tax regime continues to apply and there will be no retrospective law changes. Grandfathering provisions are also anticipated to apply for existing companies for a period of time if a change is made.

In order to achieve the best outcome for Jersey's economy, this review has to be comprehensive and a full consultation process is essential. This review process will take time and early consultation is important. Jersey will not move quickly to a new regime without detailed knowledge of the potential impact.

Should the outcome of the Business Tax Review conclude that a fundamental revision of Jersey's tax law is beneficial, Jersey's Government is committed to a sensible and well paced period of change. The complexity of making such a change should not be underestimated and to ensure that the detailed law is properly drafted and operates efficiently, the design and implementation process may take a number of years.

Section 3 - Business tax: Key principles for the future

Whatever business tax regime is operated by Jersey, it must meet the following key criteria:

1. ***Compliance with international standards.*** There are few truly global standards on what constitutes an "acceptable" business tax system, although it could be argued that some common practices are developing into standards. However, while ensuring that Jersey can maintain stability and certainty in its corporate tax regime it is important that it is capable of responding to international standards as they develop.

2. ***Competitiveness.*** The tax system must allow Jersey to remain internationally competitive in order to protect, grow and diversify its economy.

3. ***Tax neutrality.*** Large parts of the finance industry in Jersey rely on the ability to offer clients a way of holding their investments that does not expose them to unnecessary additional Jersey tax. Tax neutrality is an important feature of Jersey's tax system which must be maintained and is replicated in various forms in many other "onshore" jurisdictions including within the EU. Jersey's international clients are expected to meet their proper tax liabilities in their home jurisdictions.

4. ***Appropriate contribution.*** Companies that carry on a business in Jersey should make an appropriate contribution to the cost of running the Island.

5. ***Sustainability.*** Jersey must be sure that its tax system will raise enough tax over time to fund essential public services of the required standard. The system must be flexible enough to be able to respond to changes in the global economy, and to accommodate growth and change in the business that is done here.

6. ***Simplicity.*** The regime must be easy for business to understand and comply with, and inexpensive for the revenue authorities to administer.

7. ***Certainty.*** Businesses in and clients of Jersey must be able to be certain of how they will be taxed.

These principles will be used to evaluate any proposals for change to Jersey's corporate tax regime. These principles are not mutually exclusive: the commitment to compliance with international standards is not to preclude the objective to maintain Jersey's competitiveness.

Section 4 - Examples of alternative structures

Jersey has committed to review its corporate tax regime to ensure that it continues to comply with international standards to the extent they exist.

The current 0/10 regime continues to apply and will continue to do so until it can be shown to be in Jersey's best interest to justify a change.

Any changes to the tax law will not be retrospective and, due to the potential complexity of properly drafting effective tax law, may take a number of years to design and implement.

During recent months Government has considered the technical aspects of business tax regimes globally and how other jurisdictions compete on tax in the international arena.

The presentation of five examples of alternative regimes in this section is intended to assist in the consultative process. There is no presumption that any specific one of these will be adopted and respondents are not restricted to commenting only on these examples if they feel there are other possibilities worth exploring.

The following are offered as alternatives to the present 0/10 regime should the Business Tax Review indicate that Jersey's best interests justify a move away from the present 0/10 regime:

1. Flat rate of corporate tax
2. Treatment as transparent
3. A territorial system of tax
4. Repayable tax credits
5. Abolition of corporate tax

Note that these are **not** listed in any order of preference.

All of these regimes are in operation in some form in different territories, including within the EU, and therefore may be considered to be both internationally recognised and acceptable.

Each of these regimes achieves tax neutrality by different means but the extent to which tax neutrality applies varies. Each operates differently and at this time the impact on Jersey's business is difficult to predict with certainty. This consultation seeks to understand the impact of each alternative more fully.

If this review indicates that a move to one of the alternative regimes is in the best interest of the Island, the corporate tax rate would need to be determined. On the assumption that Jersey will remain competitive, its general rate of corporate tax should be as low as appropriate. Across Europe, the lowest general rate is 10%. Therefore for the purpose of example within this consultation any non-zero rate should be assumed to be no lower than 10%.

The alternatives set out in this section have to be fully considered against the principles in section 3.

Flat rate of corporate tax

Overview

The corporate income tax rates currently imposed would be replaced with a positive standard rate of tax applicable to all companies[13].

Description

A standard non-zero rate of corporate income tax would be imposed on the worldwide income of all Jersey resident companies and on the profits of Jersey branches of foreign companies. This regime is similar to regimes operated in numerous countries.

The following features are incorporated into such a regime in other jurisdictions:

- An **exemption for dividends** received from participating holdings in subsidiary companies. This is a common exemption in many jurisdictions, often called a participation exemption.

- An exemption for income, profits and gains of **funds and securitisation vehicles**[14]. Funds and securitisation vehicles are exempt from tax or subject to a very low tax charges in many jurisdictions.

Further exemptions or reliefs may also be available but further research is needed to identify those which would be internationally acceptable.

Treatment as transparent

Overview

All companies would be treated as transparent for Jersey tax purposes.

Description

A tax transparent company would not be subject to Jersey corporate income tax but effectively treated the same as a limited partnership for tax purposes. The beneficial owners would be subject to tax on the company's profits.

The tax treatment of the company's income would then be determined by reference to the residence of its beneficial owners. Where the beneficial owner is not resident in Jersey, it would be subject to Jersey tax only on certain Jersey source income.

Under existing Jersey law non-residents are not subject to Jersey tax on certain Jersey source income such as some interest and dividends. Such treatment is common in other countries and would be maintained under this regime.

A number of EU jurisdictions have tax transparent entities, such as the UK Limited Liability Partnership (LLP), the French Société en nom collectif (SNC) and the Luxembourg SICAR (when established as an SCS). The US also has an elective transparent regime known as the 'check the box' regime[15].

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[13] Consideration will be given to whether companies currently taxed at 20% would continue to be taxed at that rate.

[14] An exemption from tax for funds and securitisation entities is being introduced in Jersey effective from 1 January 2010 to reflect the treatment in many other jurisdictions.

[15] However under proposals announced by the Obama administration in May 2009, this regime may be withdrawn.

A territorial system of tax

Overview

Companies would generally only be subject to tax on income that has its source in Jersey. Non-Jersey source profits would not be subject to Jersey corporate tax.

Description

Currently, Jersey operates a residence basis of taxation, whereby the liability of a company to Jersey tax is defined by reference to the place of residence of that company. A Jersey resident company is subject to Jersey tax on its worldwide income while a non-resident company is only taxable on income arising in the Island.

In a territorial system, the concept of residence becomes largely irrelevant[16]. A company's tax liability is calculated by reference to the source of its income, with only profits sourced from that jurisdiction being subject to tax in that jurisdiction.

Variations of this regime operate in a number of territories, including France, Gibraltar, Cyprus, Hong Kong and Singapore. The UK is also moving towards a partial territorial system with the introduction of an exemption from UK tax on foreign profits.

There are broadly three recognised variations of a territorial regime.

i) The first model taxes all income "arising in or derived from" a territory. The nature of the income is not relevant and so this would capture all types of income, including trading, rental and investment income arising in or derived from that territory. This regime is largely employed by Gibraltar[17], although Gibraltar also exempts most investment income regardless of its source.

ii) The second model, employed in Hong Kong, taxes companies only on the income arising in and derived from "business activities carried on" in the territory. Profits that arise in a territory but are not earned by a company carrying on a business – for example certain investment income[18] and rental income – are not subject to tax there.

iii) A third model taxes companies on the income derived from business carried on through a permanent establishment in a territory. In this model, a company that did not have a permanent establishment in Jersey would not be subject to Jersey tax on any of its profits. A company with a permanent establishment in Jersey would only be subject to tax on Jersey source profits which are directly attributable to that permanent establishment. Certain investment income, such as passive bank deposit income, could therefore fall outside the scope of Jersey tax even if it is Jersey source.

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[16] Residence is only relevant in a territorial system in determining the source of income paid by that company.

[17] Gibraltar also currently taxes income "received in" Gibraltar although revised draft law issued on 16 June 2010 appears to have removed this condition for companies.

[18] Locally sourced investment income directly related to the carrying on of business activities is subject to tax.

A repayable tax credit system

Overview

Jersey resident companies would be subject to tax on their worldwide profits at the standard rate, with a credit for overseas tax suffered. On distribution, shareholders can reclaim a proportion of the tax suffered, leading to a lower effective rate of tax overall.

Description

Maltese model

This regime is operated in Malta, where resident companies are subject to tax at the standard rate of corporate income tax of 35% on the majority of their profits. Companies are required to divide their income into five separate accounts.

When a distribution is made, the company is required to state out of which class of profits it has been paid. The class then determines the treatment in the hands of the shareholder. For foreign shareholders, an effective rate of between 0-5% is often achieved through a tax repayment mechanism although the repayment is not made until there is a distribution. Until the distribution is made, the effective rate of tax is therefore 35%. The tax repayment is made within 14 days of the claim.

Potential model for Jersey

The Maltese tax system in general is more complex than that which could be operated in Jersey, with a number of features which are not considered necessary. It may not be necessary, for example, to import rules distinguishing between resident and domiciled companies, nor to introduce capital taxes.

If Jersey were to adopt a tax repayment system similar to that operated in Malta, it is envisaged that it would include the following features:

- Profits of utility companies and domestic property investment/development income would continue be taxed at 20% and no repayment of that tax would be made.
- Some form of statutory double tax relief would be available in respect of foreign tax paid.
- There would be no tax refund in respect of trading profits arising from a permanent establishment in Jersey.
- A participation exemption would be provided for in the law in order to exempt dividends received from subsidiary companies from tax.

Abolition of corporate tax

Overview

A number of jurisdictions, including the Overseas Territories of the UK, impose no direct taxes. A further alternative might therefore be to abolish corporate income tax in Jersey.

Jersey resident companies would no longer be subject to income tax on their profits. In order to compensate for this loss of tax revenues, it would be necessary to increase or introduce other taxes or fees.

Description

Income tax for companies would be abolished. There would be a significant further loss of corporate tax revenues which would need to be recovered through other means.

Under this example it would be necessary to find a way of replicating the incidence of the current corporate tax system, without affecting the international competitiveness of the financial services industry.

Full consideration would be needed as to who would benefit under the abolition of corporate tax - the shareholders of financial services companies, their customers or other governments (through additional tax revenue).

In order to recover the tax revenues lost by abolishing corporate income tax, it would be necessary to introduce other taxes and/or charges such as those which exist in other jurisdictions which have no or zero corporate income tax[19]. This might include:

Payroll taxes	A charge payable by employers calculated by reference to the number of people employed and/or the wages they are paid.
Business licence fees	Companies wishing to carry on a business activity in Jersey are required to apply for a business licence fee annually. A fee for this licence would be payable, potentially based on the type of business undertaken.
Bank transaction taxes	A charge payable for each transaction undertaken through a Jersey bank.
Commercial property taxes	Taxes levied on occupiers of property calculated by reference to the notional rental value of the property.

Each of the measures used elsewhere could be considered for Jersey but it is not clear which, if any, of them would be appropriate.

[19] Consideration would also need to be given to retaining Jersey's deemed distribution regime or some additional personal income tax anti-avoidance to prevent such a regime being abused.

Section 5 - Consultation questions

Responses are invited to the following questions from **all business sectors, whether or not directly affected**. Please provide as much detail as possible to support your response.

1. Introduction and background

a. Page 3 refers to the presumption that our good neighbour policy would be reciprocated by EU Member States. What reciprocal benefits would you attach highest priority to in return for continuing to be a good neighbour if such reciprocal benefits were achievable?

b. A level playing field is important to protect Jersey's international competitive position. What barriers are there to achieving this and who are the key players on that field?

2. Why review Jersey's business tax regime?

a. Page 10 refers to the business limitations Jersey sometimes faces in the absence of an extensive double tax treaty network. Are the potential benefits to be gained from a comprehensive DTA network greater than maintaining a 0% rate of tax or another form of tax neutrality?

3. Business tax: Key principles for the future

a. In your view, how will international standards on business tax develop in the future and should Jersey seek to lead the way on developing and implementing such standards?

b. Are there any key principles other than those set out on page 11 that need to be met?

4. Examples of alternative structures

a. Other than those examples included in this consultation document, are there any other alternative structures that meet all of the key principles and so should be considered?

b. What do you consider to be the key risks of moving away from our 0/10 regime generally?

c. What would be the best regime to maintain, diversify and grow business (financial services and non-financial services) in Jersey and what business would benefit?

`In respect of **each of the examples** set out in this section:

1. Flat rate of corporate tax
2. Treatment as transparent

3. A territorial system of tax
4. Repayable tax credits
5. Abolition of corporate tax

d. What impact would the regime have on Jersey as a place to do international business and on the business you do?

e. What features of the regime would be problematic and what features would be beneficial to your business?

f. What would your business's response be to a move to each regime?

g. What do you consider to be the key risks and opportunities of moving to each regime?

h. What opportunities for new business would each regime present?

5. Any other comments

a. Please provide any other comments you may have in respect of this review.

How to respond

The deadline for responses is **30 August 2010**.

All respondents should indicate the capacity in which they are responding (i.e. as an individual, company, representative body).

If you are responding as a company or representative body, please indicate the nature of your business and/or your clients' business.

Representative bodies should identify on behalf of who they are responding and the methodology they used to gather responses.

Please send your responses and any additional comments to:
Wendy Martin
PO Box 140
Chief Minister's Department
Cyril Le Marquand House
St Helier
Jersey JE4 8QT

Or by email to Business.tax.review@gov.je

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Appendix 1 – Summary of the EU Code of Conduct for Business Taxation

The European Union Council of Economics and Finance Ministers (ECOFIN) set out the Code of Conduct for business taxation in 1997. By adopting this Code, EU Member States undertook to roll back existing tax measures that constituted harmful tax competition and to refrain from introducing any such measures in the future ("standstill"). The Code is not legally binding but it has political force.

Jersey, although not a member of the EU, voluntarily agreed to adopt the principles of the Code in 2002 following the finding in 1999 that some aspects of its business tax regime were harmful.

The Code defines a harmful tax measure as one which affects or may affect, in a significant way, the location of business activity. Tax measures which provide for a significantly lower effective level of tax than the general level of tax in the country concerned are considered to be harmful.

Account is also taken of the following criteria for identifying whether a measure is potentially harmful:

- tax benefits reserved for non-residents;
- tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- granting of tax advantages even in the absence of any real economic activity;
- the basis of profit determination for companies in a multinational group departs from internationally accepted rules, in particular those approved by the OECD;
- lack of transparency.

The Code of Conduct Group (Business Taxation) was established to assess tax measures that may fall within the scope of the Code.

The Group reviews the extent to which states are complying with their commitment to roll back measures that had previously been found harmful, and also considers whether any newly introduced tax measures breach the commitment to “standstill”. The Group then reports its findings to ECOFIN, which comes to a final conclusion. In its initial report in 1999, the Group identified 66 tax measures with harmful features, of which four were in Jersey and have since either been abolished or are in the process of being phased out.

It should be noted that in 2003 assurance had been given to the Crown Dependencies that the proposed 0/10 regimes were not considered to be harmful. In June 2003 ECOFIN issued a press release confirming that the Code Group had found that none of the replacement measures proposed by the Crown Dependencies were considered to be harmful and that ECOFIN agreed that the proposed replacement measures were adequate to achieve rollback of all of the harmful features previously identified by the Code Group. Further, in its report to ECOFIN dated 28 November 2006, the Code Group stated:

“The UK delegation, recalling the Code Group report dated 26 November 2002, explained that with the introduction of a standard rate of tax for all Isle of Man companies of 0% and a higher rate of 10% on two closely defined types of business…the Isle of Man’s six harmful measures were all repealed or revoked. This was accepted as constituting the rollback of the harmful regimes.”

Appendix 2 – Summary findings of Deloitte's report on emerging international standards for business tax

Introduction
Jersey remains firmly committed to meeting international standards:

- The latest review of Jersey by the IMF[20], published in September 2009, assessed the Island as either complying or largely complying with 44 of the 49 recommendations of the Financial Action Task Force (FATF), placing Jersey among the top four jurisdictions for compliance out of a total of more than 120 jurisdictions that have been assessed.

- Jersey was included in the original OECD "White List'[21] in April 2009, confirming it as a jurisdiction that has substantially implemented the internationally agreed standard on transparency and information exchange, alongside our UK and French neighbours.

- Jersey actively supports the OECD Global Forum on Transparency and Information Exchange for Tax Purposes, both as one of the Vice-Chairs of the Peer Review Group and in volunteering for early assessment embracing both Phase I and Phase II of the Peer Review process.

- Jersey's high standard of regulation and international compliance was also recognised in 2009 by the Independent Review of British Offshore Finance Centres (the Foot Review) commissioned by the UK Treasury[22].

To help Jersey understand further how international standards on business tax might be developing the Treasury and Resources Minister asked Deloitte to consider, specifically in relation to a number of specific aspects of business taxation, whether there is evidence that such standards exist or are emerging.

Summary of Deloitte's findings
The key finding was that there are few accepted international standards on content and rate of business tax.

- The clearest example of a global international tax standard is that on transparency and exchange of information following the work of the OECD through the Global Forum on Harmful Tax Practices (the Global Forum) and the Forum on Tax Administration (FTA).

- The EU Code of Conduct on Business Taxation identified a number of harmful tax regimes, the key feature of which is that tax rules should not discriminate inappropriately in the tax treatment of business by reference to nationality, residence or similar features of the owner. This however is restricted in its application to EU Member States and those jurisdictions which voluntarily engage although a substantially similar principle is endorsed by the OECD in their approach to harmful tax practices and their model treaty. Arguably therefore there is an emerging standard

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[20] International Monetary Fund, *Financial Systems Stability Assessment Update (2009), IMF Country Report 09/282*
[21] Organisation for Economic Cooperation and Development (OECD), *A Progress Report on the jurisdictions surveyed by the OECD Global Forum in implementing the internationally agreed standard (Original Report 2 April 2009, subsequently updated).*
[22] Foot, Michael, *Final Report of the Independent Review of British Offshore Financial Centres (2009)*

on preventing discrimination by reference to nationality, residence or similar features of the owner.

- Arguably, there is an emerging standard under which tax jurisdictions should refrain from deliberately creating opportunities for tax arbitrage.

As regards whether the residence of the taxpayer, source of income, the nature of the tax base should determine the tax regime, any existing common practices appear to be primarily determined by economic and pragmatic considerations.

There are no international standards which determine the rate of tax that a jurisdiction should apply.[23]

[23] A copy of the full Deloitte report will be available on www.gov.je from 22 June 2010

States of Jersey
Etats de Jersey
£20
Vingt Livres
£5
Cinq Livres
£10
Ten Pounds
£1
One Pound
Fifty Pounds