# IFG UPDATE REPORT ON DRAFT FORECASTS OF STATES INCOME FROM TAXATION AND DUTY FOR THE PREPARATION OF MTFP ADDITION 2017-2019

## AS PRESENTED TO THE COUNCIL OF MINISTERS 18TH MAY 2016

## Income tax forecast note for the Income Forecasting Group (IFG) (May 2016)

### A1. Introduction

This note provides an update to the IFG's previous (Budget 2016) income tax forecast from October 2015. The revised forecast is based on:

1. Updated Fiscal Policy Panel economic assumptions for 2015-2017.
2. Outturn income tax data for year of assessment 2014.
3. Updated data on personal and corporate tax for year of assessment 2015.

The rest of the note is set out as follows:

- **Section A2** explains how the forecast is carried out.
- **Section A3** describes the Fiscal Policy Panel's (FPP) March 2016 economic assumptions that have been used to update the income tax forecast, and the reasons for any changes.
- **Section A4** sets out the new information received from the Taxes Office.
- **Section A5** outlines the updated income tax forecast, including the forecast range, on the basis of new data and new economic assumptions.
- **Section A6** looks at uncertainties which may affect the forecast.

There are also a number of appendices which provide further information which was used to inform the income tax forecast:

**Appendices A and B** set out the FPP economic assumptions in full, including a comparison with the previous assumptions and the low and high scenarios.

**Appendix C** contains an analysis of recent trends in the economy which supported the economic assumptions.

**Appendix D** covers recent trends in income tax revenues.

## A2. How the forecast is carried out

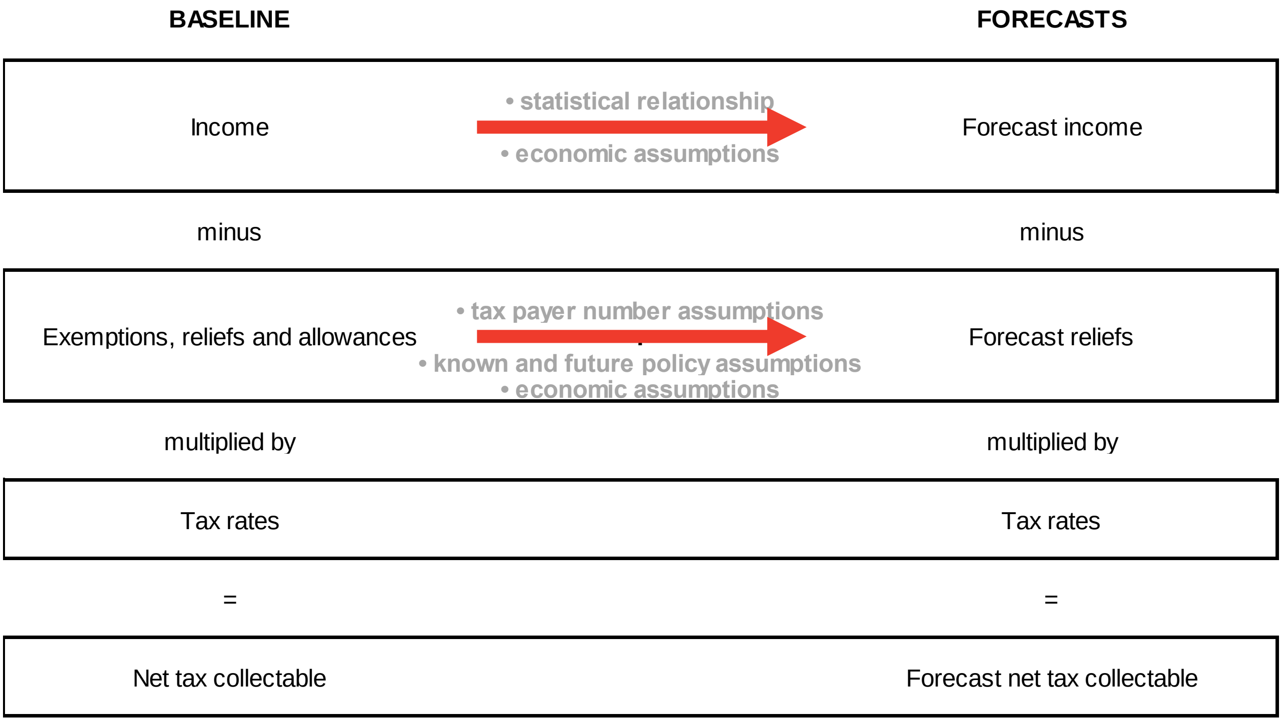
The Taxes Office provides data on personal and company income, personal and company tax collectable and the value of personal exemptions, reliefs and allowances up to the most recent year of assessment (YOA) which was 2014.

An overview of the tax model is shown in **Figure 1**. There are two main parts to it – forecasting taxable income and forecasting the likely yield (i.e. tax collectable per £1 of income) based on the value of exemption thresholds, reliefs and allowances. The forecast of tax collectable is therefore the result of the forecasts of both yield and taxable income.

Taxable income is estimated over the forecast period by taking the data provided by the Taxes Office and projecting this forward on the basis of statistical relationships between income and various economic variables. The economic variables include gross value added (GVA), company profits, employment, average earnings, inflation and interest rates. These assumptions are overseen by the independent Fiscal Policy Panel and the most recent set of assumptions were provided in March 2016.

The yield is then forecast by taking the baseline data for the value of exemptions, reliefs and allowances and forecasting changes in these in line with assumptions about future tax payer numbers, inflation, interest rates and policy announced in the Budget. So, for example, the value of the basic exemption thresholds might be assumed to rise in line with RPI (to represent the annual Budget increase in the threshold) and employment growth (to represent the increase in taxpayer numbers claiming this threshold).

**Figure 1: Model overview**




The forecast is then adjusted for the expectation of the size of bad debts in the future to arrive at a final forecast for income tax revenue.

In order to reflect the fact that there is significant uncertainty in the forecast, a central forecast is produced with a range, with the emphasis on the range rather than the point estimates.

## A3. Final economic assumptions

The Fiscal Policy Panel's (FPP) updated economic assumptions (**Figure 2**) have been used in the tax model to update the income tax forecast. The economic assumptions were shared with the Treasury and Resources Minister and with States Members on 11 March 2016. The FPP's letter to the Minister can be found on the FPP web-site www.gov.je/fiscalpolicypanel

When compared to the previous (September 2015) assumptions, the main changes are:

**Financial services profit growth** – now expected to be slightly faster in 2015 given the latest expectations in the Business Tendency Survey.

**Inflation** – expectations for 2015-2017 are lower than previously. This reflects lower than expected outturns and results in lower expectations for **average earnings** in 2016 and 2017.

**Employment growth** – now expected to be somewhat slower in 2015, due to revisions of past data.

**UK policy interest rates –** now expected to be lower throughout the forecast period, reflecting changes in market expectations.

The changes in these assumptions have had knock-on effects on the nominal and real economic growth (GVA) assumptions, with real growth expected to be somewhat faster in 2015 but somewhat slower in 2016. There are no changes to the trend assumptions for any of the economic variables in 2018 and 2019.

A comparison between these assumptions and the previous assumptions from September 2015 can be found in **Appendix A**, and the updated central, optimistic and pessimistic economic assumptions can be found in **Appendix B. Appendix C** sets out a review of the key economic trends considered by the FPP in March 2016.

**Figure 2: Final economic assumptions used (% change, unless otherwise stated)**
Boxed numbers are outturns

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | Return to trend 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 4.9 | 2.3 | 1.4 | 1.4 | 0.0 | 0.0 |
| RPI | 1.6 | 0.6 | 1.8 | 2.6 | 3.3 | 3.3 |
| RPIY | 1.6 | 0.6 | 1.8 | 2.4 | 3.0 | 3.0 |
| Nominal GVA | 6.6 | 2.9 | 3.2 | 3.8 | 3.0 | 3.0 |
| Company profits | 10.5 | 2.5 | 3.1 | 3.4 | 3.0 | 3.0 |
| Financial services profits | 19.4 | 2.1 | 3.1 | 3.3 | 3.0 | 3.0 |
| Compensation of employees | 4.9 | 3.3 | 3.3 | 4.1 | 3.0 | 3.0 |
| Employment | 2.3 | 1.5 | 0.5 | 0.5 | 0.0 | 0.0 |
| Average earnings | 2.6 | 1.8 | 2.8 | 3.6 | 3.0 | 3.0 |
| Interest rates (%) | 0.5 | 0.5 | 0.5 | 0.7 | 0.9 | 1.5 |
| House prices | 3.0 | 4.2 | 4.0 | 5.0 | 3.0 | 3.0 |

### Financial services profit growth

The central assumption for growth in financial services profits in 2015 has been updated to +2.1% growth on the basis of a weighted average of the finance sector's profit expectations recorded in the Business Tendency Survey June 2015. The 2016 assumption of 3.1% is calculated on a similar basis using expectations indicated in the December 2015 Business Tendency Survey. This was similar to the expectations used in the last set of economic assumptions, which was based on interviews with the finance sector in April 2015. The profit assumption for 2017 is unchanged.

The optimistic and pessimistic scenarios include finance sector profit assumptions +/- 3% around the central assumption, which captures the inherent uncertainty in trying to forecast the financial services sector's profit growth.

### Inflation

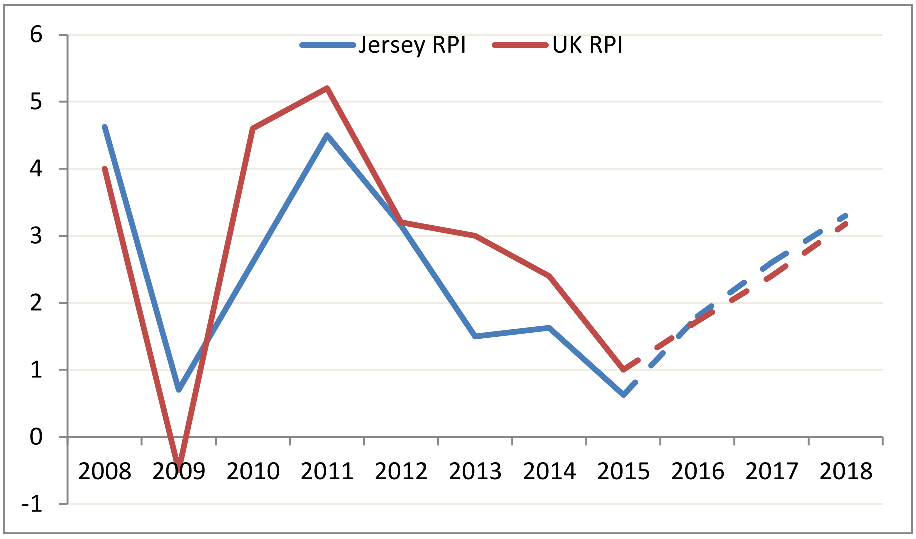
The inflation assumptions have been updated to reflect the outturn for December 2015 and the latest UK policy interest rate assumptions. The outturn for RPI inflation was 0.5 percentage points lower than expected for 2015, and the new assumptions are for a somewhat slower return to trend.

Lower expected inflation has been reflected in lower expectations for increases in average earnings in 2016 and 2017.

Jersey and UK RPI inflation have moved together in recent years but at times can be significantly different (and are measured on a slightly different basis), but the profile of the inflation assumptions are consistent with the latest OBR UK's inflation outlook, given that there are some common factors, such as trends in global energy prices, affecting both **(Figure 3).**

Since the FPP published the inflation assumptions in March 2016, new figures have been published showing the actual rate of RPI inflation in the first quarter of 2016 was 1.4%. This is not out of line with the FPP's expectations of inflation averaging 1.8% over 2016 as a whole.

**Figure 3: Jersey and UK inflation (annual average % change over previous year)**

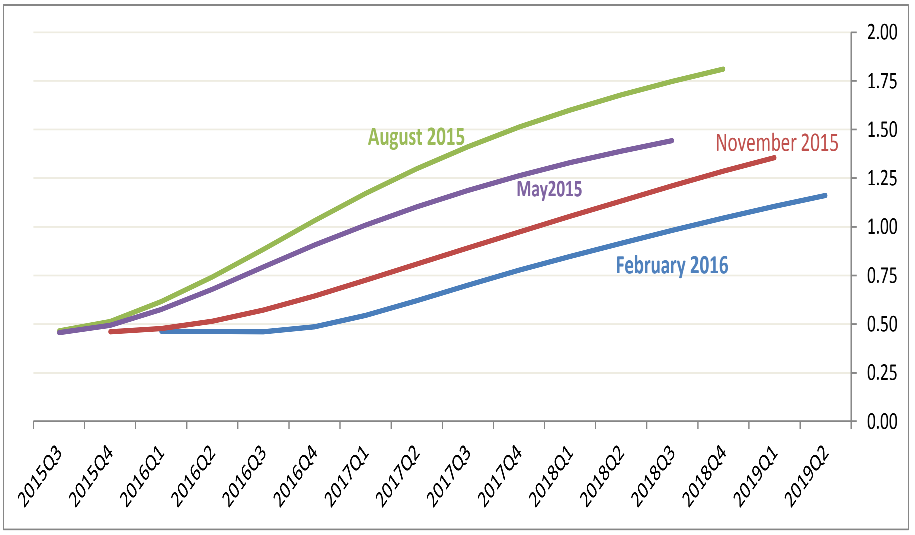



Sources: UK: Office of National Statistics and OBR forecasts; Jersey: Statistics Unit and FPP economic assumptions

### UK policy interest rate

The FPP's updated interest rate assumptions **(Figure 4),** are based on the financial market's expectations published alongside the Bank of England's February 2016 Inflation Report. Expectations for interest rates have moved downward since 2015.

**Figure 4: Updated interest rate assumptions**




Source: Bank of England Inflation Report February 2016.

### Employment

At the time of the previous FPP economic assumptions, the most recent data suggested very strong growth in employment of 3.6% in the year to 2014. Revised figures released in October 2015 pushed this figure downward to 2.2%. The level of employment at the end of 2014 was therefore lower than previously expected, which will have a knock-on impact on the annual level of employment growth which might be expected in 2015.

Since the FPP assumptions were published, labour market data have been published for December 2015 which suggest that employment may have grown by closer to 2% in 2015 as a whole. The FPP forecast the growth in FTE employment, and it is not yet clear whether the number of FTEs has risen at the same rate. The potential impact of employment growth being somewhat higher than forecast is covered in **Section A6**.

## A4. Updated information from Taxes Office

### Outturn data for YOA14

Personal income tax was £3m higher than forecast for YOA14. This was primarily due to a higher than expected increase in employment income (0.5% higher growth than expected), which makes up almost 70% of personal taxable income, though increases in personal business profits and income from distributions will have also have had a positive impact. The yield (i.e. tax collected per £1 of taxable income) also held up in YOA14, in spite of the cut in the marginal rate from 27% to 26%.

Corporate income tax was £5m higher than forecast for YOA14 with higher growth in taxable profits and a slight increase in yield. Taxable profits from the financial services sector grew by 8%, while profits for property companies grew by 10% and utilities by 22% (after taking account of losses and capital allowances). The yield increased slightly, from 9.3% YOA13 to 9.5% in YOA14.

More information on recent trends in income tax revenue are covered in **Appendix 5**.

### Provisional data for YOA15

At the time of the Budget 2016 forecast, the most recent ITIS data suggested that employment income would be approximately 3% higher than in 2014. More recent data, for the full year of 2015, suggest that this is closer to 3.6%.

On the corporate side, the Taxes Office has assessed the likely tax revenues from 88 of the top 100 corporate taxpayers on the basis of data available at the beginning of April 2016. This showed that the tax payable from these companies was expected to be approximately 4% lower in 2015 than the year before. If this is extrapolated across all corporate taxpayers, rather than the FPP assumption of 1.1% growth, this would lead to corporate tax falling by approximately £4m in YOA15.

## A5. Updated income tax forecast

### Personal tax

The updated outturn data, new economic assumptions and the updated information on likely 2015 outturn have been used to update the income tax forecasting model. The forecast for personal income tax has increased significantly over the forecast period, when compared to the Budget 2016 forecast.

**Figure 5: Changes to personal income tax forecast since Budget 2016**

| Budget Year | 2015 outturn | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Budget16 forecast | 358 | 368 | 389 | 411 | 428 | |
| New data[1] | +3 | +4 | +5 | +5 | +5 | |
| New assumptions[2] | | -1 | -4 | -4 | -5 | |
| Faster growth for pension income | | +1 | +2 | +3 | +4 | |
| Faster growth in yield | | +1 | +1 | +2 | +6 | |
| Reverse previous IFG below-the-line adjustments[3] | | +2 | +2 | +2 | +2 | |
| **Tax collectable** | **361** | **375** | **395** | **420** | **441** | **465** |

*Some columns may not sum due to rounding*

*Notes:*

[1] This includes higher outturn data for YOA14 and improved ITIS data for YOA15

[2] This includes the new FPP economic assumptions and new estimates of the relationship between economic variables and the outturn for employment and investment income respectively.

[3] MTFP forecast and Budget16 forecast both included below-the-line adjustments of personal tax, which will now be in the base for YOA14

*New data*

The new data used in the forecast has been described in **Section A4**, including both the outturn for YOA14 and emerging data from ITIS for YOA15. The outturn for YOA14 results in approximately £3m additional income in each year of the forecast, and the revised ITIS data suggests a further £1m-£2m in each year from YOA15.

*New assumptions*

The new economic assumptions (outlined in **Section A2)** result in the forecast being reduced by £1m-£2m when compared to the previous forecast, with the main impact being slower growth in average earnings in 2016 and 2017. New data has also allowed an improved estimate of the relationship between the economic assumptions and taxable income, which results in a further downward effect on the tax forecast of £2m-£3m in each year[1].

[1] The impact is lower in 2016 as the employment income for YOA15 is based on actual ITIS data, rather than on the economic assumptions and estimated relationships.

*Faster growth in pension incomes*

The previous (Budget16) assumption was for around 4% annual growth in pension income. However, data in recent years have suggested that this income is growing significantly faster, with an average closer to 6.5%. The IFG has assumed that the recent average growth rate will be maintained over the forecast period. The impact of this revision is to increase taxable income by an extra £7m in YOA15, when compared to the previous forecast, which quickly compounds up to represent an additional £34m of pension income by YOA18. This would result in approximately £4m of additional tax in 2019.

Over recent years (YOA10 to YOA13) there has been strong growth in both numbers of taxpayers with pension income and in average pension income, each growing by an average of almost 3.5% per year[2]. The figures for YOA14 are not comparable due to an exercise by the Taxes Office to remove low-income pensioners from the requirement to complete a tax return, but after allowing for this effect, it would appear that pensioner income grew by approximately 5.5 per cent[3].

The IFG also considered a second possible scenario, where pension income would grow at the long-term average rate of close to 9%. The IFG considered the lower, short-term average would be a more prudent assumption to use.

*Faster growth in yield*

The previous forecast assumed that the yield would grow by only 0.3 percentage points between YOA14 and YOA18. This is due to the model assumption that the value of exemptions, reliefs and allowances (ERAs) for marginal rate taxpayers growing by an average of 3% per year. However, past evidence suggests that the value of ERAs for marginal rate taxpayers have grown somewhat slower than this – closer to 2.8% on average. Further, the previous forecast assumed that ERAs for standard rate taxpayers would grow by over 2% per year over the forecast period. Changes made in Budget 2016 suggest that the value of allowances in particular will fall, by an average of over 10% per year. The combination of assuming slower growth in the value of marginal ERAs (at the recent average

[2] The available evidence suggests this could potentially continue, with the 65+ population in Jersey expected to grow by around 2.5% per year over 2015-2020 and research from the UK suggesting that pensioner incomes will rise in line with earnings in the longer term.

[3] This also has the impact of increasing the yield for YOA14 by 0.03 percentage points (as the income of these 500 pensioners is removed from the total taxable income, but no tax is lost as their income was below the exemption thresholds).

rate) and a fall in standard ERAs (due to budget policy changes) would mean that yield would grow twice as quickly on average out to YOA18 - by 0.6 percentage points when compared to YOA14.

The impact of this is particularly large in YOA18, when the previous forecast particularly strong growth in ERAs as a result of the economic assumptions suggesting that the value of exemption thresholds (due to increasing RPI) and mortgage interest tax relief (due to increasing interest rates) would grow much more quickly than the trend level. The result of this was that the yield in YOA18 was previously assumed to be largely flat when compared to the previous year.

These two factors are now expected to have less impact[4], resulting in a higher yield assumption and an additional £6m in budget year 2019.

The IFG also considered a second possible scenario, where yield would grow in line with the yield model used in previous years. This indicated a strong increase in yield over the forecast period as a result of relatively slow growth (averaging 2% per year) in the value of ERAs for marginal rate taxpayers. This was due to a combination of low inflation forecasts and the grandfathering of age-enhanced exemptions. The implication of this would be to increase the yield by 0.8 percentage points over four years, significantly faster than has been seen in the recent past.

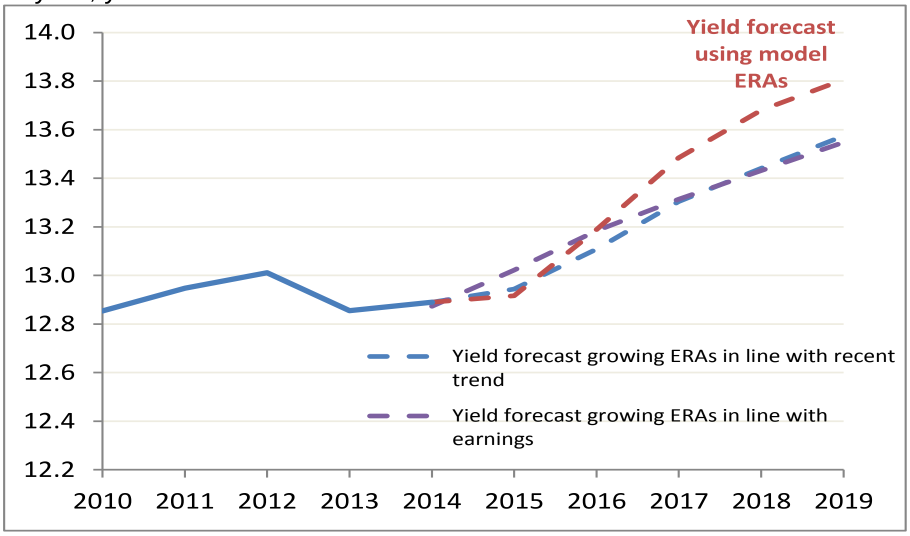
Given the uncertainties within the economic assumptions and the economic outlook generally, the IFG considered the lower yield assumption, based on ERAs growing at their recent trend rate for marginal rate taxpayers, would be a more prudent assumption to use.

**Figure 6** shows that the yield continues to grow under either scenario, but grows much more slowly under the prudent scenario used in the IFG forecast, in which ERAs for marginal rate taxpayers are assumed to grow at their recent trend rate. A third scenario has been included, in which ERAs for marginal rate taxpayers grow in line with earnings; this gives a similar yield (by the end of the forecast period) to that produced by the IFG's chosen scenario.

[4] Both interest rates and inflation are expected to increase more slowly, while the impact of increasing interest rates on mortgage interest tax relief will be more limited than before; due to the decision to phase this relief out by gradually reducing the cap.

**Figure 6: Forecast of yield on personal income**

% yield, year of assessment




*The longer term trend is shown in Appendix E - Recent trends in taxable Income*

The scenario used in the IFG's forecasts (i.e. the blue dotted line) does not explicitly include the Budget 2016 measures for marginal rate taxpayers (though the removal of further allowances from standard rate taxpayers is included). Rather, it is based on the total value of exemptions, reliefs and allowances growing at their recent average rate for marginal rate taxpayers. However, the impact of this scenario is an additional £6m in 2019, which is largely in line with the £6m estimated impact of the Budget measures (see figure 16 of the 2016 Budget).

As mentioned in footnote [3], the yield calculations above include a small increase in yield in budget year 2015 due to the exercise to remove low income pensioners from the income tax administrative system. However, the impact of this was to remove from the model, pensioner income by approximately £7m so this would have less than 0.05% impact on the yield.

*Reverse previous below-the-line adjustments*

The IFG previously made downward adjustments to the forecast for personal tax in YOA14, due to emerging taxes data. These impacts will now be incorporated into the base and therefore need to be removed from the forecast for future years.

**Corporate tax**

The forecast for corporate tax has fallen slightly over the forecast period, when compared to the previous (Budget 2016) forecast.

## Figure 7: Changes to corporate income tax forecast since Budget 2016

| Budget Year | 2015 outturn | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Budget16 forecast | 86 | 89 | 88 | 91 | 94 | |
| Higher actual receipts for 2015 | +5 | +5 | +5 | +5 | +5 | |
| Lower expected receipts for 2016[4] | | -6 | -6 | -6 | -6 | |
| **Tax collectable[5]** | **91** | **87** | **87** | **90** | **93** | **96** |

*Some columns may not sum due to rounding*

*Notes:*

[4] Lower expected receipts for 2016 are due to latest esimate of tax due from top88 companies being 4% down on 2015

[5] Corporate tax includes £3m downward adjustment for significant changes for individual corporate tax payers

Corporate tax in YOA14 was £91m - approximately £5m higher than the Budget 2016 forecast. This has been built into the base, in the absence of any significant evidence that this was due to one-off factors. However, the most up-to-date expectations on corporate tax for YOA15 from 88 of the top 100 corporate taxpayers suggest a potential fall in tax from this group of £2.5m, which represents 4 per cent of the YOA14 tax payable from this group of companies.

If this 4 per cent fall is extrapolated across all corporate taxpayers, it would result in approximately £6m less tax from YOA15, when compared with the previous assumption of 1.1 per cent growth. This fall has again been built into the base for future years.

The IFG also considered an alternative assumption – that while tax from 88 of the top 100 companies would fall by 4 per cent, the tax from the remaining companies could still grow at 2.1 per cent (the FPP's updated economic assumption for financial services profit growth). The IFG considered the lower assumption, where corporate profits as a whole fell in line with the most up-to-date data for the largest corporate taxpayers, would be a more prudent assumption to use.

Other than for 2015, the FPP's assumption for financial services profit growth has not changed. Therefore there is no impact from the updated assumptions.

The yield has been assumed to remain at the same level as for YOA14. This is considered prudent, given that changes have been made to the corporate tax regime intended to prevent the repayment of tax credits to companies taxable at the 0% rate, which might be expected to increase the yield somewhat.

### CYB adjustment

As a result of the change in Accounting Policy in 2015, to recognise current year basis taxpayers for the first time, an assessment has been made of the effect on the forecast for future years. IFG received a paper from the Finance Director – Corporate Group, as **Appendix 6 of P68/2016** which provides a recommendation to the IFG.

IFG agreed that a prudent approach would be to take the average of the years 2013 to 2014 of approximately £7 million increase per annum.

The impact of the CYB accounting policy change will therefore add a further £7 million per annum to the income tax forecast and to the variation from the Budget 2016 forecast.

### MTFP Addition Forecast

The net impact of the above is to increase the forecast in 2016 by £12m and by £13m in 2019. The IFG have extended their forecast of income tax to include 2020.

**Figure 8: Updated income tax forecast**

| Budget Year (£m) | 2015 outturn | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Previous (September 2015) forecast | | | | | | |
| Personal tax | 358 | 368 | 389 | 411 | 428 | |
| Corporate tax | 86 | 89 | 88 | 91 | 94 | |
| Bad debts | -1 | -2 | -2 | -3 | -3 | |
| **Tax collectable (IFG Forecast)** | **443** | **455** | **475** | **499** | **519** | |
| Estimated impact of Budget measures | | | +4 | +5 | +6 | |
| **Revised Forecast Budget 2016** | **443** | **455** | **479** | **504** | **525** | |
| | | | | | | |
| Updated (May 2016) forecast | | | | | | |
| Personal tax | 361 | 375 | 395 | 420 | 441 | 465 |
| Corporate tax | 91 | 87 | 87 | 90 | 93 | 96 |
| Bad debts | -1 | -2 | -2 | -3 | -3 | -3 |
| **Tax collectable** | **451** | **460** | **480** | **507** | **531** | **558** |
| CYB Proposed adjustment | +7 | +7 | +7 | +7 | +7 | +7 |
| **IFG MTFP Addition Forecast** | **458** | **467** | **487** | **514** | **538** | **565** |
| | | | | | | |
| ***Difference since Budget 2016*** | ***+15*** | ***+12*** | ***+8*** | ***+10*** | ***+13*** | |

*Some columns may not sum due to rounding*

### Forecast range

The IFG previously agreed a forecast range starting at +/-2% in the first year of the forecast, rising to +/-9% by the fifth and final year of the forecast. The impact of continuing this range has been illustrated below:

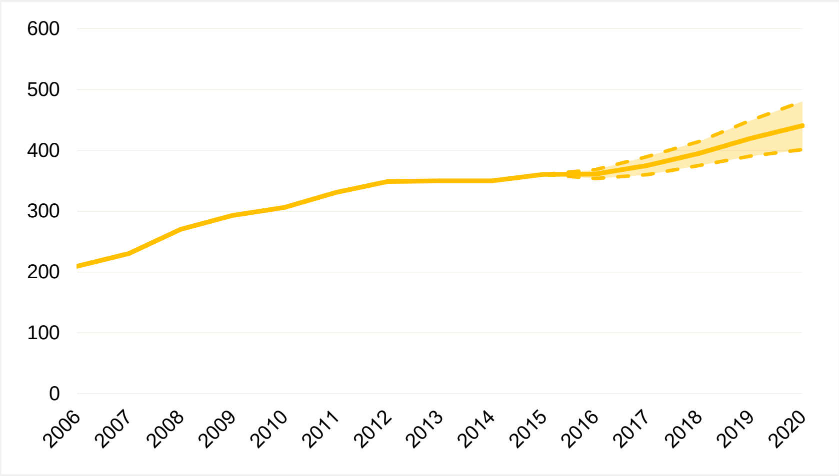
**Figure 9: Updated forecast range (including CYB adjustment)**

| Forecast Range (£m) | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|
| Upper | 458 | 476 | 506 | 540 | 576 | 616 |
| **Tax collectable** | **458** | **467** | **487** | **514** | **538** | **565** |
| Lower | 458 | 458 | 468 | 488 | 500 | 514 |
| ***Range as % of forecast, +/-*** | | ***2%*** | ***4%*** | ***5%*** | ***7%*** | ***9%*** |

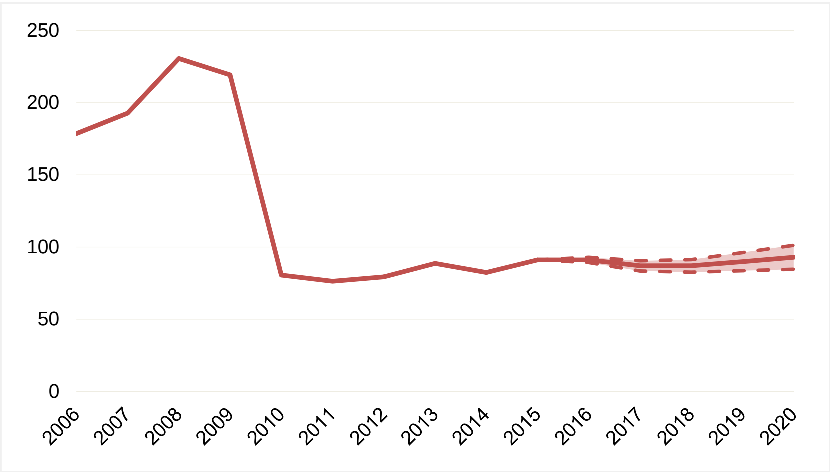
Charts of the forecast are shown in **Figure 10**.

## Figure 10: Income tax forecast by taxpayer type

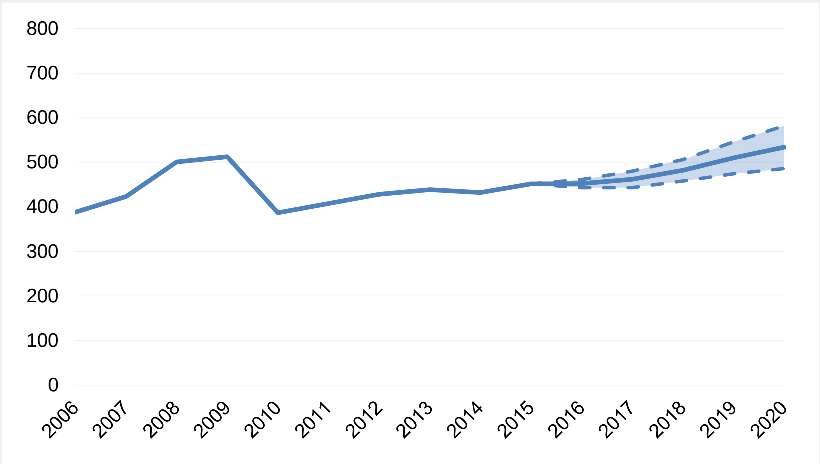
### Personal, £m




### Company, £m




### Sum of personal and corporate income tax, £m



## A6. Uncertainties and sensitivities

### Economic growth rate

The impact of economic growth on income tax revenue depends on the exact nature of the economic growth and the extent to which it increases personal employment income and taxable company profits.

If economic growth were to be 1% higher a result of both employment income and taxable profits increasing by 1%, this would result in an additional £5m of income tax revenue. A similar decrease in the economic growth rate assumption would have the opposite effect.

If economic growth were to be 1% higher as a result of only growth in employment income, and assuming the yield is unchanged, this would result in more significant growth in income tax – of £8m, still within the forecast range. However, this could be higher or lower depending on the type of employment created as the yield on higher-paid jobs is generally higher; the impact of the sectoral mix of employment is covered in the next sub-section.

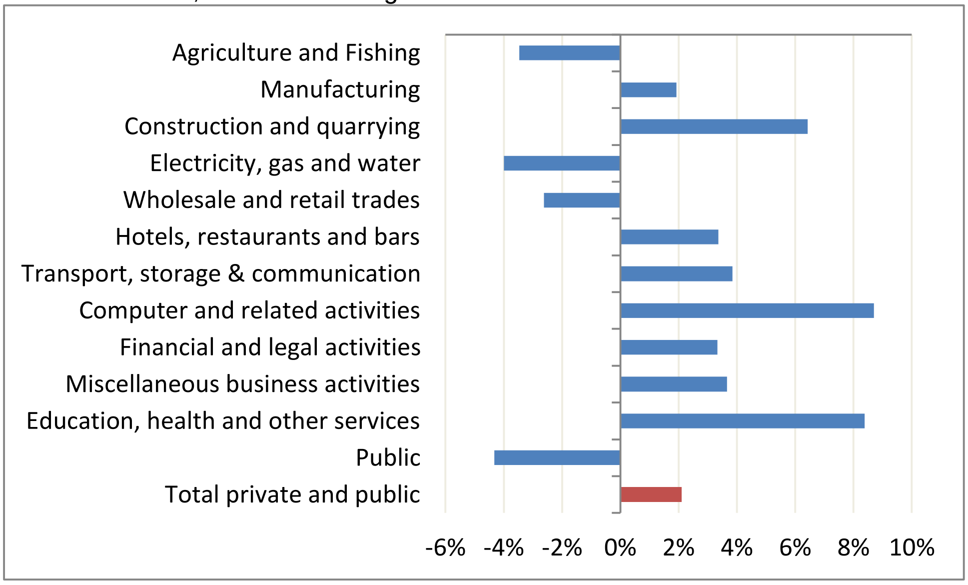
Similarly, if the additional 1% economic growth were to be entirely driven by higher corporate profits, and assuming taxable corporate profits increased by the same amount, this would result in an additional £1m of income tax.

### Sectoral employment mix / productivity

During 2016-2018, the economic assumptions are for employment to grow by approximately 1%. The assumptions are made on the basis that employment growth is in the same sectors as the existing mix, i.e. there is no change in productivity as a result of sectoral change.

However, the December 2015 labour market figures show that while employment was 2.1% higher than a year before, this was due to increases in employment in education, health and other services (up 8%), financial services (up 3%) and construction (up 6%) with a number of sectors seeing falls in employment.

**Figure 11 Changes in sectoral employment**
December 2015, annual % change




Source: Jersey Labour Market December 2015, Jersey Statistics Unit

If employment grew by 1% based on the sectoral mix of employment growth in 2015 (and assuming sectoral productivity was static), this could be expected to result in £0.5m of additional income tax when compared to employment increasing in line with current proportions.

Conversely, if this 1% increase in employment were to be seen through increases in employment only in the non-finance sectors, this would result in approximately £1.5m less income tax than if employment growth were proportionate to existing employment.

The latest information from Social Security on contributions suggests that the value of the average contribution grew by 1.4% in 2015. This is slightly below the average earnings increase of 1.8%, but most contributions are capped at £48,000 of earnings.

It is not clear at this early stage in what is anticipated will be the growth phase of the economic cycle what the make-up of employment growth will be going forward. However, given the low levels of employment growth forecast over the period any moderate variations in the make-up of employment growth is not deemed significant for the forecast.

### The impact of the public sector reform agenda on the forecast

The public sector reform agenda is intended to result in some reduction in overall employment numbers and pay restraint and will therefore have some impact on the level of public sector pay.

It is not clear what the overall impact of these reforms would be on tax revenue. Consideration would need to be given as to what alternative fiscal measures would be put in place if savings had to be achieved or revenue raised in another way. In any case, the economy could adjust to the changes, for example through the supply-side, which could partly, or more than, offset the initial impacts of the public sector reforms over the next few years.

A sensitivity has been performed which shows that reducing the assumption for growth in public sector compensation of employees (i.e. total wages and salaries) by one percentage points in a single year would result in a only a moderate fall in personal tax of approximately £0.5m, so no specific adjustment has been included. However, if this was to occur in multiple years over the forecast, the impact would be cumulative.

However, in addition to public sector reform there is also uncertainty about the scale of potential positive impacts from public sector capital expenditure in the forecast period. Given the uncertainty about the nature, timing and scale of the combined impact of future changes in fiscal policy the income tax forecast has not been adjusted either way to reflect changes in the overall fiscal stance.

**Uncertainty regarding shareholder income and tax payer behaviour**

The profits of Jersey companies (other than those companies taxed at 20%) are assessed on Jersey resident individual shareholders (under the heading of “shareholder income”) following their distribution.

The zero-ten corporate tax regime creates an incentive for Jersey resident individuals to envelop trading activity and investment holdings into companies. If held personally the trading profits/investment income arising would be subject to tax at the individual’s marginal personal tax rate; whereas when they are in the company they are subject to tax at 0%. In response to this situation the “distribution rules” were introduced with effect from 1 January 2013. Broadly what these rules seek to do is identify the pool of profits which have been subject to tax at a rate below 20% which are in a particular company. Whenever a Jersey resident individual shareholder seeks to extract value from that company (irrespective of how the value is extracted), it will be treated as a distribution made from the pool of identified profits (until such time as the pool is exhausted) and hence taxed on the shareholder.

Based on the data available to date (2013 and 2014 years of assessment) there is no clearly identifiable trend towards the enveloping of investment holdings into companies, however the incentive to envelop such assets has only existed for a short period of time and hence similar reviews will need to be undertaken in each subsequent year to determine whether such a trend is developing and the corresponding impact on the personal income tax forecast.

It should be highlighted that bank interest and dividend income (excluding distributions from Jersey companies) constitutes approximately 2.55% of the “total income” reported by individual taxpayers for the 2014 year of assessment. Furthermore although difficult to anticipate changes in taxpayer behaviour, it is unrealistic to assume that all individual taxpayers will envelop assets in this way. For many taxpayers:

- no significant tax deferral would be achieved as they are not in a financial position to defer the receipt of income;
- the costs of establishing and maintaining the required company would negate the benefit of the tax deferral; and
- the “hassle factor” of maintaining a company and complying with the distribution rules would act as a disincentive to envelop assets.

Forecasting shareholder income (i.e. the distributions made by Jersey resident companies to Jersey resident shareholders) is particularly difficult because there is currently little information on which to estimate the profile of distributions going forward. There have been significant changes to the tax rules in recent years which affect the amount of shareholder income assessed on taxpayers and therefore past experience is not much of a guide to the future and there is a risk that some of this income may not occur again in future years. Bearing this in mind, the central forecast is based on shareholder income growing at the rate of inflation.

However, there is a risk that taxpayer behaviour may change such that shareholder income may fall, rather than grow, and it is not possible to gauge by how much it could fall. The outturn data currently available does not appear to show any significant change in taxpayer behaviour to date, but the risk remains. It should be highlighted that the amount of shareholder income for the 2014 year of assessment 2014 totalled £196m. If the shareholder income were to half to £98m (which we consider very unlikely) the potential loss of tax revenues, based on the estimated overall tax yield for the 2015 year of assessment of 12.9%, would be £12.6m. It should also be noted that a significant proportion of shareholder income is accompanied by tax credits, therefore the actual yield on shareholder income is less than the overall tax yield, reducing the amount of tax revenues at risk.

### Other uncertainties

The new assumptions include a slower increase in interest rates. If interest rates were to increase more quickly than the assumptions, this could have some impact on both investment income and on mortgage interest tax relief, particularly towards the end of the forecast period. However, initial increases are likely to be slow and the impact on mortgage interest tax relief will be limited as it is being phased out by gradually reducing the maximum amount which can be claimed. Since the economic assumptions were published, new market expectations for interest rates have been published which suggest an even slower increase in Bank Rate over the forecast period.

The impact of other budget policy changes on marginal-rate taxpayers has not been explicitly built into the forecast; given that the IFG forecast assumes that exemptions, reliefs and allowances for marginal-rate taxpayers will grow in line with recent averages. This may see some additional revenue if exemptions in particular rise more slowly than the average – as could be the case if they continue to rise in line with RPI, and if inflation increases slowly in line with the FPP’s assumptions. Budget policy measures are also expected to have an impact on standard rate taxpayers – particularly phasing out standard child allowance and APA from standard rate taxpayers – but this has been built into the forecast.

## Appendix A – FPP economic assumptions compared to previous

**New assumptions**

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 4.9 | 2.3 | 1.4 | 1.4 | 0.0 | 0.0 |
| RPI | 1.6 | 0.6 | 1.8 | 2.6 | 3.3 | 3.3 |
| RPIY | 1.6 | 0.6 | 1.8 | 2.4 | 3.0 | 3.0 |
| Nominal GVA | 6.6 | 2.9 | 3.2 | 3.8 | 3.0 | 3.0 |
| Company profits | 10.5 | 2.5 | 3.1 | 3.4 | 3.0 | 3.0 |
| Financial services profits | 19.4 | 2.1 | 3.1 | 3.3 | 3.0 | 3.0 |
| Compensation of employees | 4.9 | 3.3 | 3.3 | 4.1 | 3.0 | 3.0 |
| Employment | 2.3 | 1.5 | 0.5 | 0.5 | 0.0 | 0.0 |
| Average earnings | 2.6 | 1.8 | 2.8 | 3.6 | 3.0 | 3.0 |
| Interest rates (%) | 0.5 | 0.5 | 0.5 | 0.7 | 0.9 | 1.5 |
| House prices | 3.0 | 4.2 | 4.0 | 5.0 | 3.0 | 3.0 |

**Previous (September 2015) assumptions**

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 5.6 | 2.0 | 1.8 | 1.5 | 0.0 | 0.0 |
| RPI | 1.6 | 1.1 | 2.0 | 3.0 | 3.3 | 3.3 |
| RPIY | 1.6 | 1.1 | 1.8 | 2.5 | 3.0 | 3.0 |
| Nominal GVA | 7.2 | 3.0 | 3.6 | 4.0 | 3.0 | 3.0 |
| Company profits | 11.2 | 2.1 | 3.0 | 3.7 | 3.0 | 3.0 |
| Financial services profits | 22.0 | 1.1 | 3.1 | 3.3 | 3.0 | 3.0 |
| Compensation of employees | 4.1 | 3.8 | 4.0 | 4.3 | 3.0 | 3.0 |
| Employment | 1.5 | 2.0 | 0.5 | 0.5 | 0.0 | 0.0 |
| Average earnings | 2.6 | 1.8 | 3.0 | 4.0 | 3.0 | 3.0 |
| Interest rates (%) | 0.5 | 0.5 | 0.8 | 1.3 | 2.0 | 2.5 |
| House prices | 3.0 | 2.9 | 4.0 | 5.0 | 3.0 | 3.0 |

**Change since September**

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | -0.7 | 0.4 | -0.4 | -0.1 | 0.0 | 0.0 |
| RPI | 0.0 | -0.5 | -0.2 | -0.4 | 0.0 | 0.0 |
| RPIY | 0.0 | -0.5 | 0.0 | -0.1 | 0.0 | 0.0 |
| Nominal GVA | -0.6 | -0.1 | -0.4 | -0.2 | 0.0 | 0.0 |
| Company profits | -0.7 | 0.4 | 0.0 | -0.3 | 0.0 | 0.0 |
| Financial services profits | -2.6 | 1.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Compensation of employees | 0.8 | -0.5 | -0.7 | -0.2 | 0.0 | 0.0 |
| Employment | 0.8 | -0.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Average earnings | 0.0 | 0.0 | -0.2 | -0.4 | 0.0 | 0.0 |
| Interest rates (%) | 0 | 0.0 | -0.3 | -0.6 | -1.1 | -1.0 |
| House prices | 0.0 | 1.3 | 0.0 | 0.0 | 0.0 | 0.0 |

OUTTURNS

## Appendix B – The economic assumptions for the optimistic and pessimistic scenarios

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 4.9 | 2.3 | 1.4 | 1.4 | 0.0 | 0.0 |
| RPI | 1.6 | 0.6 | 1.8 | 2.6 | 3.3 | 3.3 |
| RPIY | 1.6 | 0.6 | 1.8 | 2.4 | 3.0 | 3.0 |
| Nominal GVA | 6.6 | 2.9 | 3.2 | 3.8 | 3.0 | 3.0 |
| Company profits | 10.5 | 2.5 | 3.1 | 3.4 | 3.0 | 3.0 |
| Financial services profits | 19.4 | 2.1 | 3.1 | 3.3 | 3.0 | 3.0 |
| Compensation of employees | 4.9 | 3.3 | 3.3 | 4.1 | 3.0 | 3.0 |
| Employment | 2.3 | 1.5 | 0.5 | 0.5 | 0.0 | 0.0 |
| Average earnings | 2.6 | 1.8 | 2.8 | 3.6 | 3.0 | 3.0 |
| Interest rates (%) | 0.5 | 0.5 | 0.5 | 0.7 | 0.9 | 1.5 |
| House prices | 3.0 | 4.2 | 4.0 | 5.0 | 3.0 | 3.0 |

**FPP central scenario - upper range**

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 4.9 | 3.8 | 2.9 | 2.9 | 1.5 | 1.5 |
| RPI | 1.6 | 0.6 | 3.3 | 4.1 | 4.8 | 4.8 |
| RPIY | 1.6 | 0.6 | 2.8 | 3.4 | 4.0 | 4.0 |
| Nominal GVA | 6.6 | 4.4 | 5.7 | 6.3 | 5.5 | 5.5 |
| Company profits | 10.5 | 3.9 | 4.3 | 4.7 | 4.0 | 4.0 |
| Financial services profits | 19.4 | 5.1 | 6.1 | 6.3 | 4.0 | 4.0 |
| Compensation of employees | 4.9 | 4.9 | 6.9 | 7.7 | 6.6 | 6.6 |
| Employment | 2.3 | 3.0 | 2.0 | 2.0 | 1.5 | 1.5 |
| Average Earnings | 2.6 | 1.8 | 4.8 | 5.6 | 5.0 | 5.0 |
| Interest rates (%) | 0.5 | 0.5 | 1.2 | 1.4 | 1.6 | 2.2 |
| House prices | 3.0 | 7.2 | 7.0 | 8.0 | 6.0 | 6.0 |

**FPP central scenario - lower range**

| | 2014 | 2015 | 2016 | 2017 | Return to trend 2018 | 2019 |
|---|---|---|---|---|---|---|
| Real GVA | 4.9 | 0.8 | -0.1 | -0.1 | -1.5 | -1.5 |
| RPI | 1.6 | 0.6 | 0.3 | 1.1 | 1.8 | 1.8 |
| RPIY | 1.6 | 0.6 | 0.8 | 1.4 | 2.0 | 2.0 |
| Nominal GVA | 6.6 | 1.4 | 0.7 | 1.3 | 0.5 | 0.5 |
| Company profits | 10.5 | 1.0 | 1.7 | 2.1 | 1.5 | 1.5 |
| Financial services profits | 19.4 | -0.9 | 0.1 | 0.3 | 1.5 | 1.5 |
| Compensation of employees | 4.9 | 1.8 | -0.2 | 0.6 | -0.5 | -0.5 |
| Employment | 2.3 | 0.0 | -1.0 | -1.0 | -1.5 | -1.5 |
| Average Earnings | 2.6 | 1.8 | 0.8 | 1.6 | 1.0 | 1.0 |
| Interest rates (%) | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.8 |
| House prices | 3.0 | 1.2 | 1.0 | 2.0 | 0.0 | 0.0 |

OUTTURNS

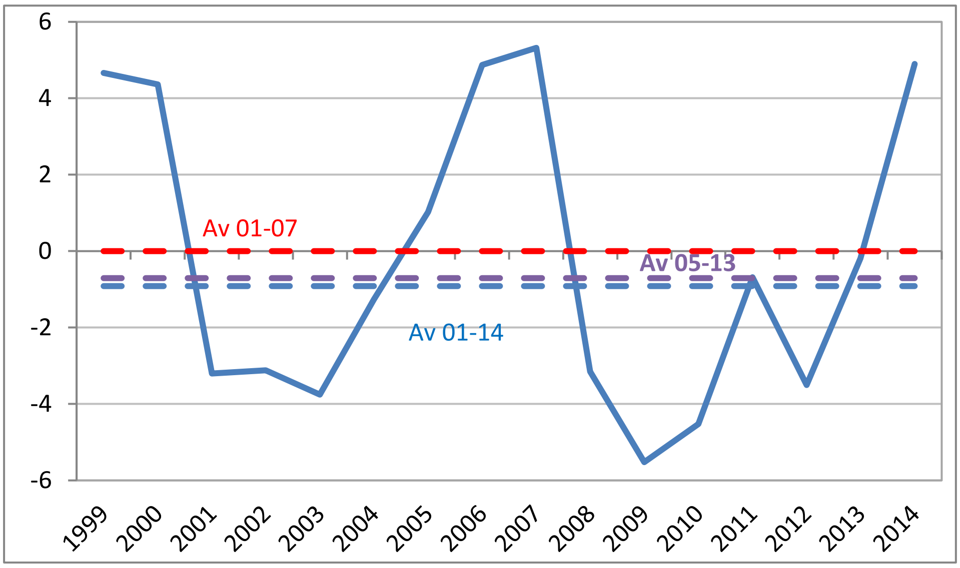
## Appendix C – Analysis of economic developments which supported the March 2016 economic assumptions

This note was produced using data available up to March 2016 and was used to inform the economic assumptions produced by the Fiscal Policy Panel.

### GVA

GVA fell significantly from 2008, with six consecutive years of falling output. As a result, output had fallen by 17% by 2013, back to a level last seen in the mid-1990s, with much of this fall due to a fall in profits for the financial services sector. 2014 saw some recovery in GVA, again driven by changes in finance sector profits, though finance profits remained 40% below their 2007 level while GVA excluding finance profits had grown by 4% over the same period.

**Figure 12 - GVA**
% change on year ago

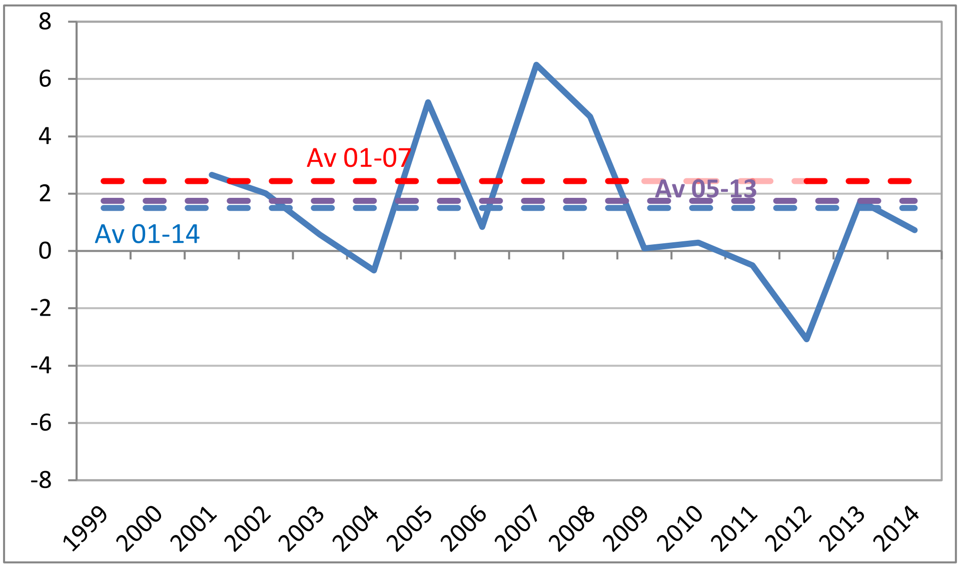



Source: States of Jersey Statistics Unit

### GVA excluding finance profits

**Figure 13** shows that if the profit from financial services is excluded from overall GVA (i.e. non-finance GVA plus compensation of employees for finance) the overall trend is relatively flat in real terms since 2008, lower than the longer-term average. The only year of any significant decline (i.e. greater than ½%) was 2012 but this has largely been recovered in 2013 and 2014.

**Figure 13 - GVA excluding finance profits**
% change on year ago

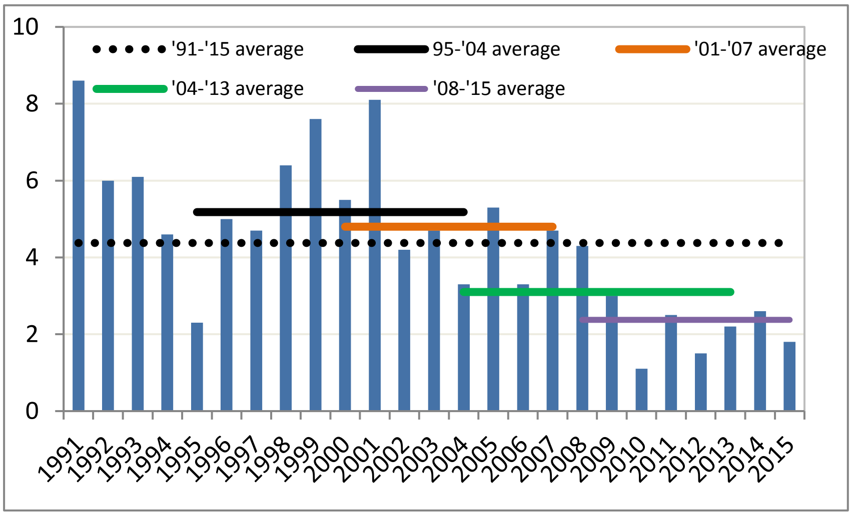



Source: States of Jersey Statistics Unit

### Average earnings

The long-term trend in average earnings growth in the last ten years (2006-2015: 2.7%) was half the rate of the previous ten years (1996-2005: 5.5%). While these periods do not directly correlate with the economic cycle, Figure 14 shows that more recent periods have seen significantly slower growth. It is difficult at this stage to judge whether recent trends are purely cyclical, structural or a combination of the two.

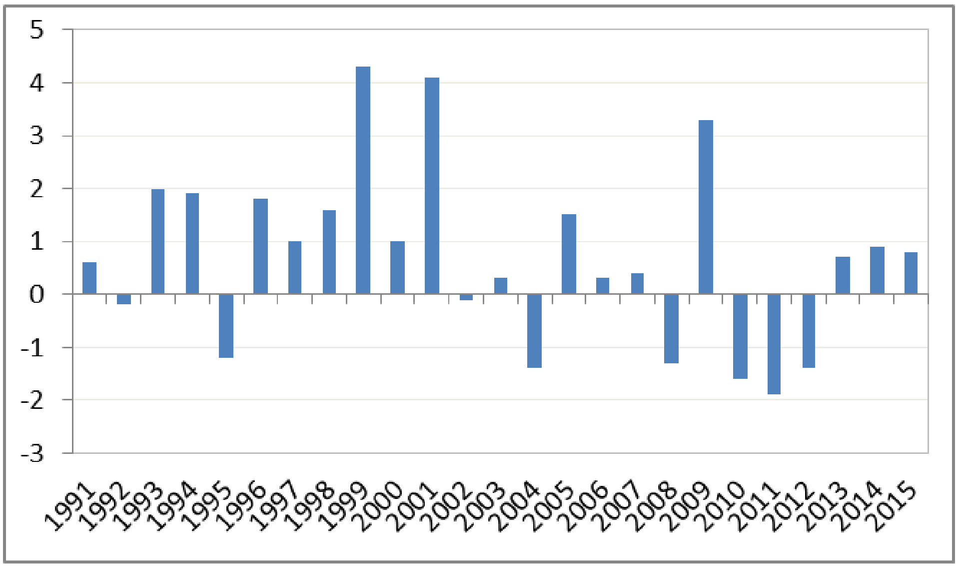
**Figure 14 - Average earnings growth**
% change on year ago




Source: States of Jersey Statistics Unit

In understanding trends in average earnings it is also important to consider trends in inflation as often the wage-bargaining process uses them as a reference point. **Figure 15** shows the long-term trend in average earnings relative to RPI. In the long-term (1991-2015), earnings growth has averaged 0.7% above RPI and this is similar to the 0.8% above RPI achieved over the recent economic cycle (2000 to 2007). However, over 2004-2013, real earnings fell by an average of 0.1% per year.

**Figure 15 – Real growth in average earnings**
% change on year ago

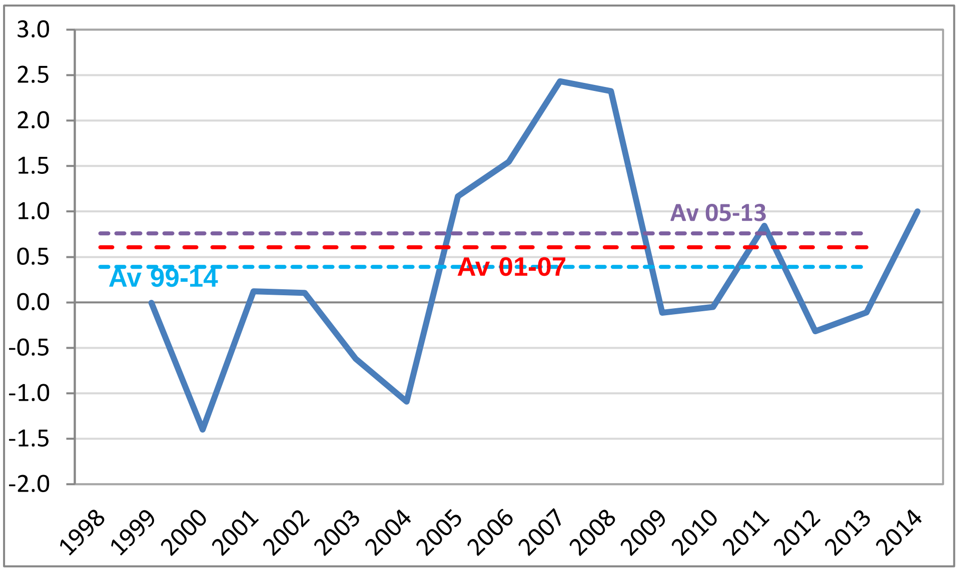



Source: States of Jersey Statistics Unit

### Employment

Employment growth (in FTE terms) has averaged around 0.4% a year since 1998. Recent economic cycles have seen growth of 0.4% during 2000-2007 and 0.8% during 2004-2013 **(Figure 16**). This has been influenced by external economic conditions, and productivity, demographic and migration trends. Looking forward, it is difficult to see how any of these are going to be more supportive of employment growth given the weak global economy, concern about levels of inward migration and the ageing population (i.e. a risk that the working age population becomes smaller).

**Figure 16- Trends in employment**
% change on a year ago



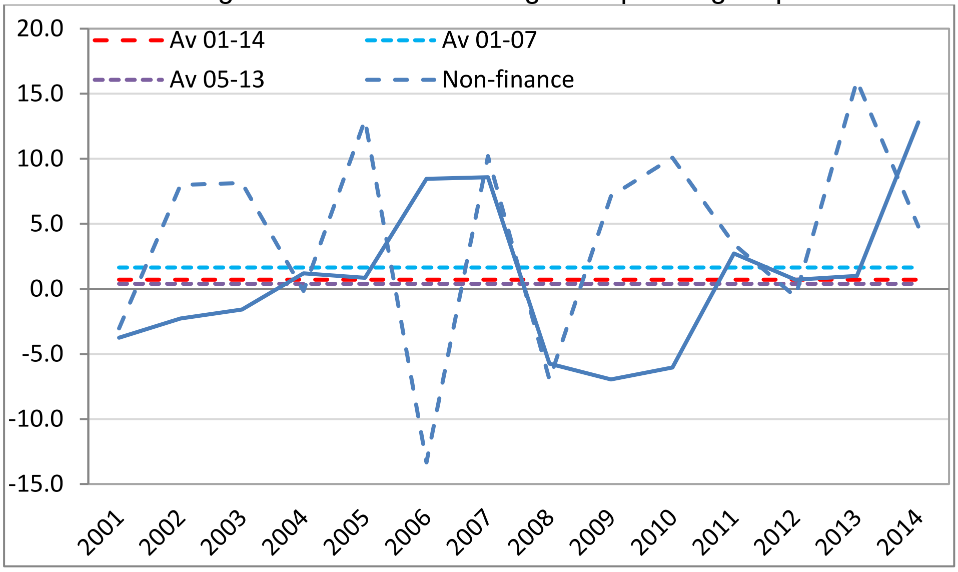

Source: States of Jersey Statistics Unit

## Company profits

**Figure 17** shows that company profits have increased by an average of 0.7% a year between 2001 and 2014 in nominal terms. The 2001-2007 saw much faster growth averaging 1.6% while the 2005-2013 economic cycle saw only 0.4% average annual growth.

This is influenced by profits of the finance sector (which make up more than half of the total) but non-finance profits have also been volatile in the past.

**Figure 17 - Company profits**
Nominal % change for all businesses in gross operating surplus




Source: States of Jersey Statistics Unit

### Finance profit and employment expectations

The Business Tendency Survey in December 2015 included questions on 'long-term' profit and employment expectations for 2016. Weighting each of these responses results in an aggregate expectation of flat employment and approximately 3% growth in profits. Both were somewhat lower than projections at the end of 2014, when finance firms expected employment growth of 1% and growth in profits of almost 4%.

However, when finance firms were asked again in June 2015, their in-year expectation for profits was much lower, at 2%.

**Figure 18 - Finance profit expectations**

| **Survey** | Decrease | No change | Increase | **Weighted change** |
|---|---|---|---|---|
| **Dec14 (for 2015)** | 12% | 18% | 70% | **3.7%** |
| **Jun15 (for 2015)** | 29% | 26% | 45% | **2.1%** |
| **Dec15 (for 2016)** | 18% | 10% | 73% | **3.1%** |

Source: Jersey Statistics Unit

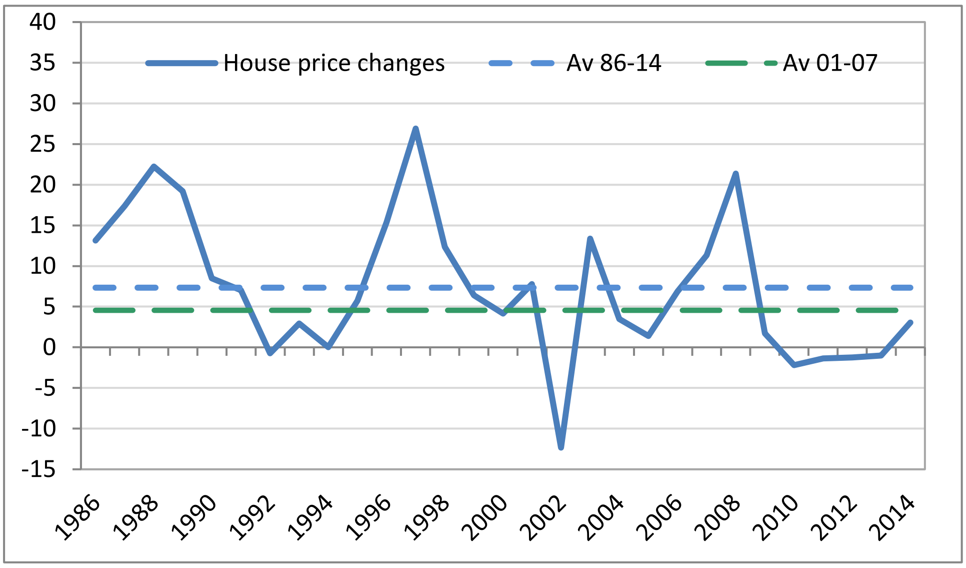
## House prices

The long-term average increase in house prices is 7.3% a year (1986-2014) although both the 2000-07 and 2004-13 cycles have seen slower annual average growth of between 4% and 5%. Over the last few years, changes in house prices have been lower than expected with prices falling 1% in 2012 and 2013. However, in 2014, house prices increased slightly more than expected (3%).

2015 has seen further strong growth of 4.2%, based on the first three quarters compared to a year earlier.

Taking this into account, house prices are now assumed to increase gradually until 2017 and then grow at a longer term trend rate of 3% a year afterwards - similar to the longer term assumption for average earnings growth. This is equivalent to 0% real growth each year, after taking into account the assumptions for future inflation.

**Figure 19 - Trends in house prices**
% change in annual average (nominal)

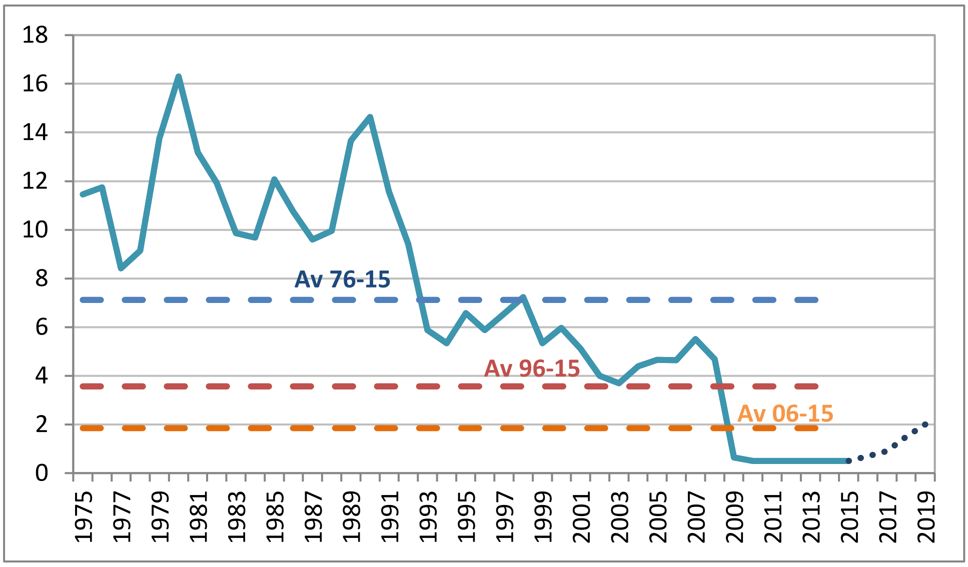



Source: Jersey Statistics Unit / Economics Unit calculations

## Interest rates

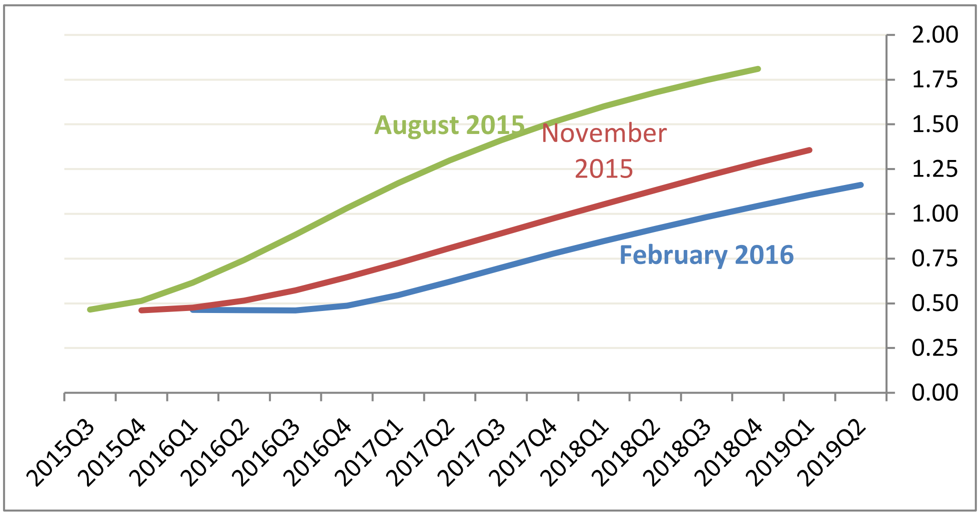
The Bank Rate in the UK has been at historically low levels since 2009 (**Figure 20**), significantly below longer-term averages. While the Federal Reserve made a small increase in rates in 2015, market expectations for an increase by the Bank of England have diminished since last year (**Figure 21**).

**Figure 20 - Interest rates**
% Bank Rate




Source: Bank of England (and forecast assumptions 2016+)

**Figure 21 - Market interest rate expectations**
% Bank Rate




Source: Bank of England Inflation report February 2016

## Appendix D – Recent trends in taxable income

Recent developments in employment income, pension income, shareholder income, and company profits are considered in this section.

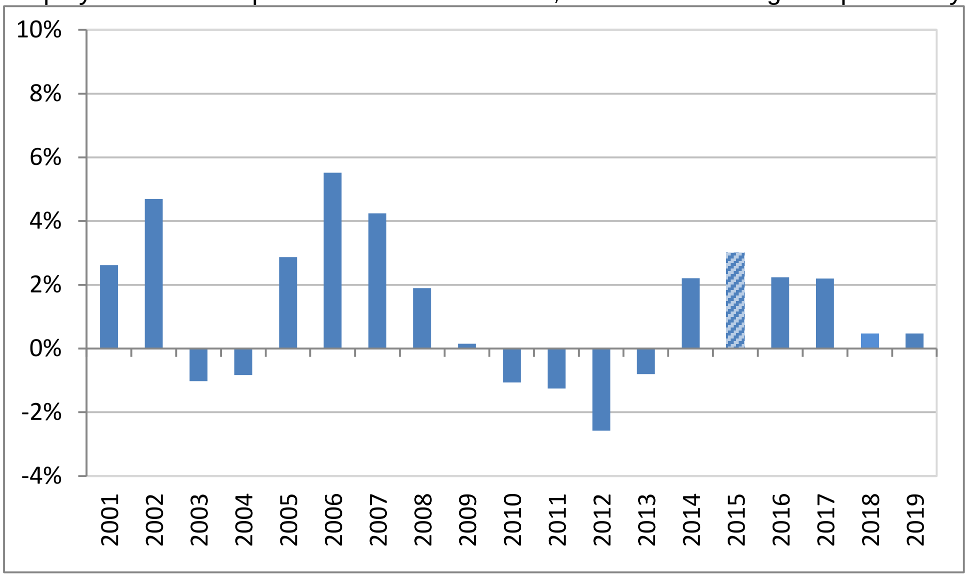
### Income from employment

Income from employment is the largest component of personal income and amounts to nearly 70% of the total. Employment income is forecast to grow as Jersey's economy recovers, and employment and earnings growth return to previous trends.

The chart below shows that growth in employment income has been relatively weak in real terms (i.e. after adjusting for inflation) since 2008 and there is uncertainty as to how quickly and by how much this will grow in future. There is some improvement expected in YOA15, based on ITIS data and on the low inflation outturn for 2015. The following two years are similar to the outturn for YOA14, with employment income growing around 2% per year in real terms.

**Figure 22 - Taxable income from employment**

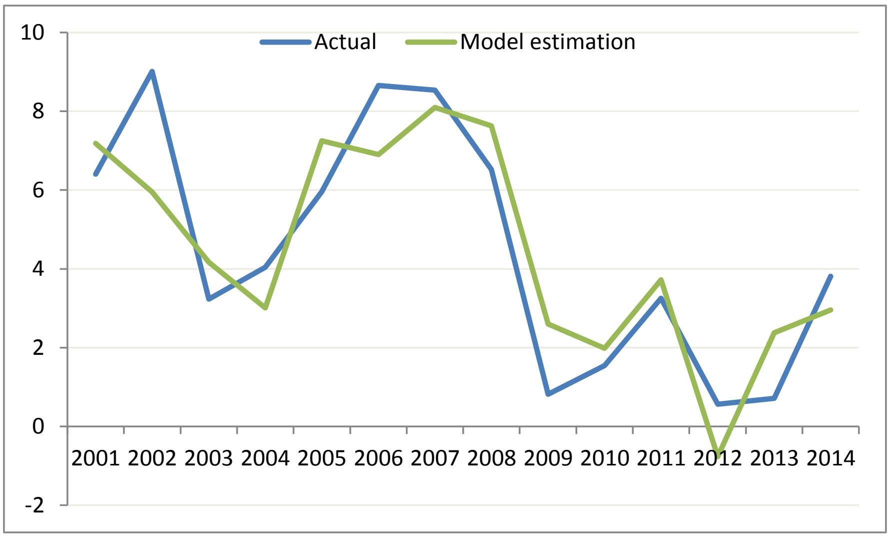
Employment income plus other earned income, real terms –change on previous year of assessment




Source: 2001 to 2014 from Taxes Office data, 2015 from ITIS data, 2016-19 based on forecast data

The income tax model uses a statistical regression to predict movement in this component based on the variation in overall *compensation of employees* (the wages components of GDP). Income from employment increased by 3.8% in YOA14 and the chart below shows that this was slightly higher than the model would have predicted on the basis of the actual outturn level of compensation of employees. In general though, the model appears to be relatively accurate, explaining over 75% of the past variation in income from employment.

**Figure 23 - Actual and predicted variation in income from employment**
% change YOA.




The FPP's economic assumptions anticipate compensation of employees growing at 3-4% per year between 2015 and 2017 which would suggest further growth in income from employment, should the past relationship continue to hold in YOA15-17.

**Pension income**

Pension income makes up just less than 10% of personal income and has generally shown strong growth in recent years, growing at an annual average of 7% over 2010-2013. This occurred both through increases in pensioner numbers (2013 saw 11% more taxpayers with pension income than 2010) and increases in average income from pension (up 10% from £17k in 2010 to £19k in 2013).

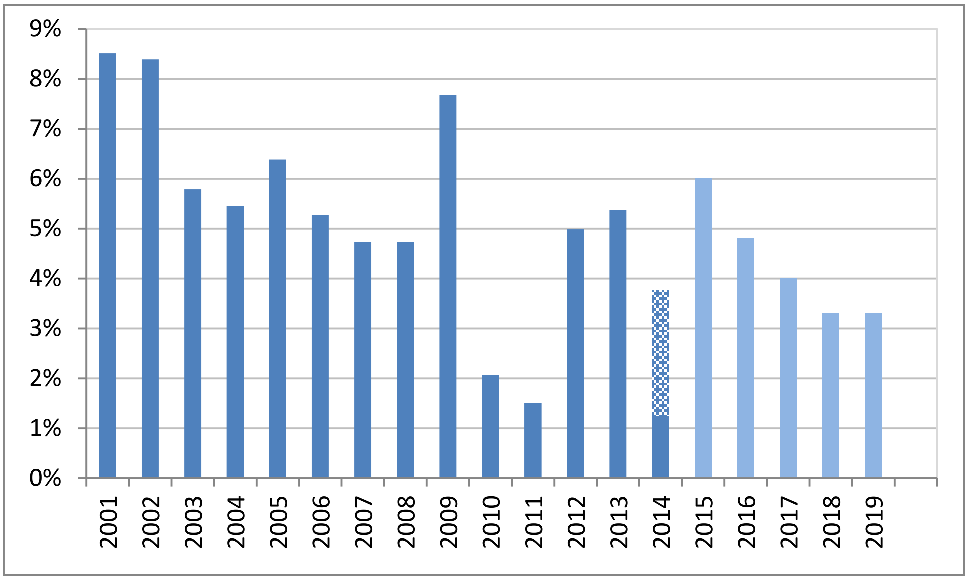
Growth in pension income slowed significantly in YOA14, to less than 3%, well below the average in recent years. The slowdown in the growth of this component seems to be primarily due to a fall in the number of those with low incomes (<£10k) who were included in the total. This was partly due to an exercise undertaken by the Tax Office at the end of 2013 to remove some 500 pensioners from the database as they were not paying tax and had pension income only which was not likely to change.

Looking only at pension income for those with more than £10k income, this increased by 6.2% in YOA14 – much closer to the long-term average. In recent years, the pension income of this group has moved 10-20% faster than the all income group so to account for this a fair assumption for growth in pension income overall in YOA14 might be closer to 5.3%.

After making this adjustment, the five year average growth rate is 6.6%, which compares to the fifteen year rate of 8.6%.

**Figure 24 - Annual growth in taxable pension income**

Real-terms change on previous year of assessment, 2014 adjusted to take account of removal of low-income pensioners from database




Source: 2001 to 2014 from Taxes Office data, 2015-19 based on forecast data. 2014 includes adjustment for removal of low income pensioners from the tax database (hatched pattern),

### Shareholder income

Distributions (including shareholder loans and intermediary service income) make up around 7% of personal income and increased by 21% in YOA14. More than half of this increase was due to two large one-off distributions, which may not result in significant revenue to the States. For the purposes of forecasting future revenues, therefore, these two large distributions have been excluded from the base for YOA14. If these two one-off distributions are excluded, and distributions to 11ks are excluded, income from distributions grew by just over 8% in YOA14.

There have been some changes in the way distribution of company profits has been taxed and recorded in recent years, particularly the introduction of the new regime in YOA13. This tax base has been very volatile over the last four years, increasing by 30% in 2011, before falling by 24% in YOA12 and 18% in YOA13. The average of the last four years has been a fall of approximately ½%.

While the five year average suggests a slight fall, there is no clear pattern which can be identified.

### Comparison of personal income forecast with UK forecast

The UK's Office for Budget Responsibility published its 'Economic and Fiscal Outlook' in March 2016 which sets out their latest fiscal forecast for the UK's public finances, and the economic and market assumptions that underpin the forecast.

The OBR's income tax forecast is driven by assumptions for growth in the total wages and salaries in the UK economy, in nominal terms, which is made up of assumptions for employment growth and average earnings growth. The IFG's forecast for personal income tax is also driven by a similar assumption (changes in employment growth and average earnings growth drive employment income and other earned income changes).

**Figure 25** shows the OBR's assumptions for UK employment and average earnings growth compared to the assumptions for Jersey employment and average earnings growth. Between 2014 and 2017 the assumptions for both economies are fairly similar. In 2018 and 2019, the OBR's assumptions are about 1% higher altogether than the FPP's assumptions.

**Figure 25- OBR forecast for employment and earnings growth**

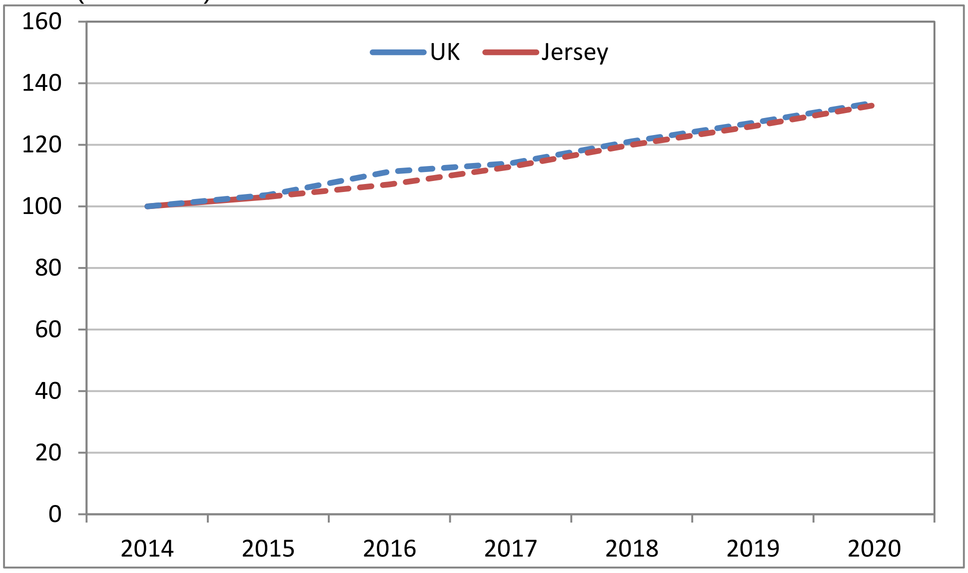
% change from previous year

| | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|---|---|---|
| **UK** | | | | | | | |
| Employment growth | 2.3 | 1.6 | 1.3 | 0.3 | 0.6 | 0.3 | 0.3 |
| Average earnings growth | 1.4 | 2.3 | 2.6 | 3.6 | 3.5 | 3.4 | 3.6 |
| **Jersey** | | | | | | | |
| Employment growth | 2.3 | 1.5 | 0.5 | 0.5 | 0.0 | 0.0 | 0.0 |
| Average earnings growth | 2.6 | 1.8 | 2.8 | 3.6 | 3.0 | 3.0 | 3.0 |

On the basis of these economic assumptions, the OBR is expecting the UK's personal income tax revenue to grow from £164bn in 2014/15 to £219bn in 2020/21 (34% growth). This is comparable with the central forecast for Jersey's personal income tax revenue growing from £350m in 2014 to £492m in 2020 (33% growth) over a similar period.

**Figure 26 - UK and Jersey personal income tax forecasts**

Index (2014=100)




Note: UK personal income tax years run from year beginning 6 April. For the UK line, 2014 = April 2014 to April 2015.

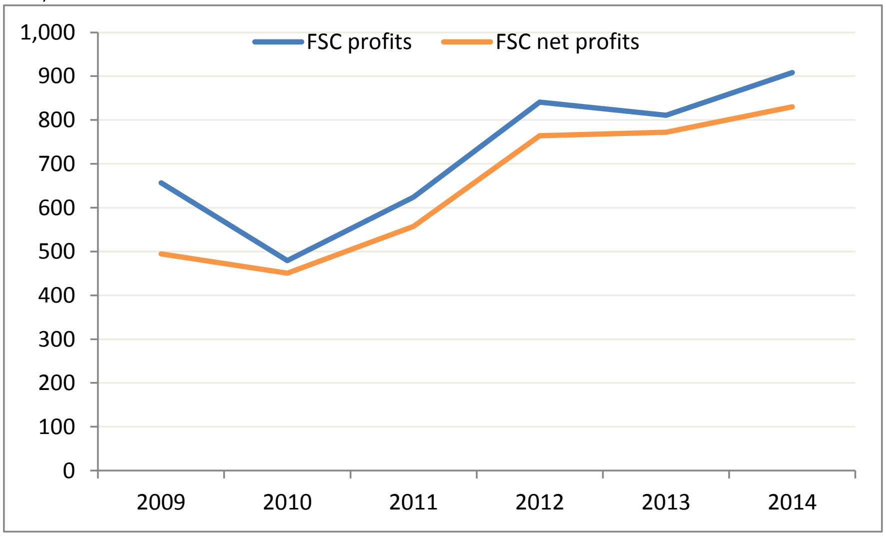
Source: OBR Economic and Fiscal Outlook March 2016.

## Company tax

*Financial Services*

About three quarters of corporate tax comes from financial services. Financial services taxable profits grew by 12% in YOA 2014, although losses offset against profits more than trebled so the net position was only 8% up on the previous year. A significant part of the increase in profits (and in losses offset) was due to one company who made profit in YOA14 (and therefore were able to offset previous losses against this), whereas the same company had no profits in YOA13 (and therefore did not offset any losses).

**Figure 27 - Financial services taxable profits**
£m, YOA



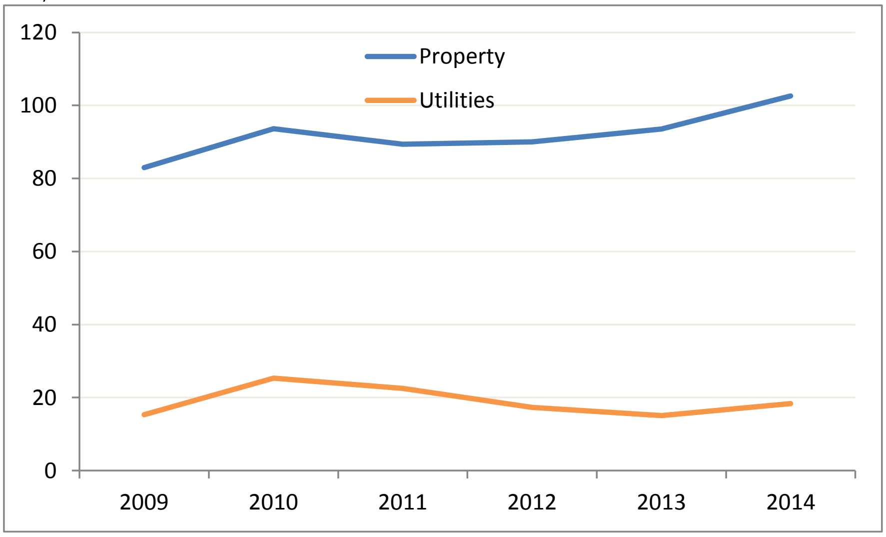

After taking into account rental income (taxed at 20%), taxable profits from financial services increased by 8%. The profit element of GDP (gross operating surplus) grew by 20% for the financial services sector in 2014.

*Property and utilities*

Tax on property makes up 20% of corporate tax. Within this, the main component is tax on rental income, which increased by 7% in YOA14. Development income increased more significantly, by more than 40%, while development losses offset against profits also fell. Overall taxable net profit for property companies (including a small amount of trading income also taxed at 20%) was up by 10%.

Tax on utilities makes up 4% of corporate tax. Trading profits were up 4% in YOA14, and there were no losses offset against profits. However, trading profits in this sector are generally subject to significant capital allowances. The increase in capital allowances did not keep pace with the increase in profits in YOA14, and overall taxable net profit for utilities (including a small amount of rental income) was up by 22%.

**Figure 28: Trends in utility and property profits**
£m, YOA




### Yield trends

The yield on personal income has increased strongly over the last fifteen years, from approximately 9.5% in YOA00 to 13% in YOA14. There have been a number of factors at work in recent years, in particular the implementation of 20-means-20 which saw the gradual removal of most allowances from standard rate taxpayers between YOA07 and YOA11.

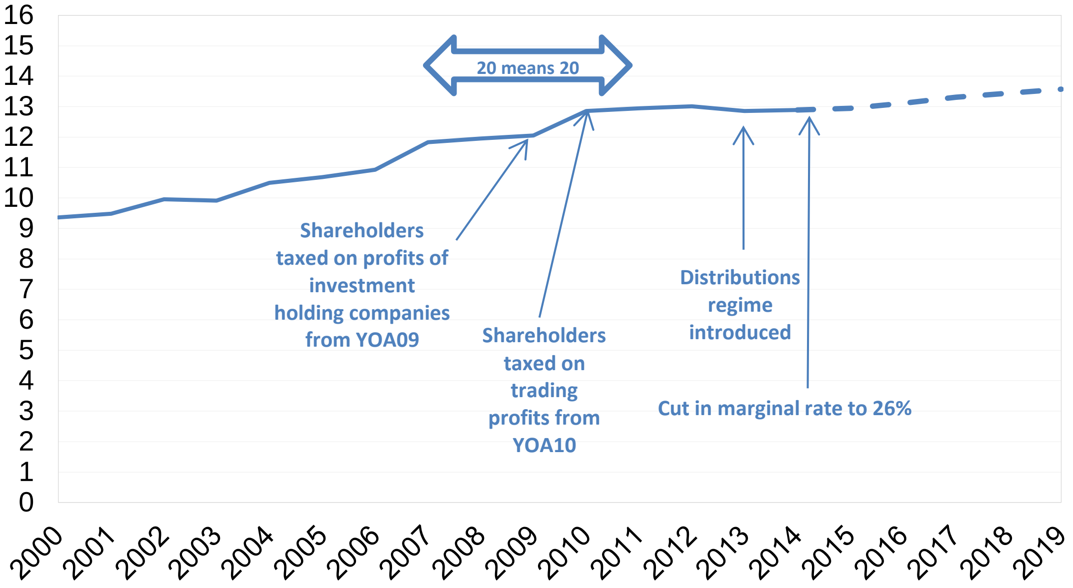
The changes to the tax regime for shareholder income will also have had an impact. Taxation was introduced for shareholders of investment holding companies in YOA09, with shareholders also taxed on trading profits from YOA10. From YOA13, this regime was replaced by the distribution rules. **Section A6** sets out the uncertainties regarding the impact of the new regime on yield in the future.

While the cut in the marginal rate in YOA14 was expected to result in a fall in the yield, the yield in fact held up when compared to the previous year.

Going forward, the yield is expected to rise as incomes increase faster than the value of exemptions, reliefs and allowances (ERAs) which can be offset against that income. The assumption is that ERAs for marginal rate taxpayers grows at their recent trend rate, while ERAs for standard rate taxpayers continue to fall.

**Figure 29: Trend in yield on personal income**

Tax collectable as % of taxable income, year of assessment




Corporate yield has been calculated based on tax collectable as a proportion of the net taxable income, after allowing for capital allowances and losses offset against profits. The yield has fallen somewhat in recent years, due to increases in credits which reduce the tax assessment, but has seen a slight increase in YOA14 when compared to the previous year. The assumption is that the yield will remain at this level over the forecast period. This is considered prudent, given that changes have been made to the corporate tax regime intended to prevent the repayment of tax credits to companies taxable at the 0% rate.

**Figure 30: Trend in yield on corporate profits**

Tax collectable as % of profit after allowing for capital allowances and losses, year of assessment