STATES OF JERSEY

EXPENDITURE PROPOSALS FOR 2012 AND 2013 AND DRAFT BUDGET STATEMENT 2011 (P.157/2010) – SEVENTH AMENDMENT (P.157/2010 Amd.(7)) – COMMENTS

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

STATES GREFFE

2010 Price code: A P.157 Amd.(7)Com.

COMMENTS

The Council of Ministers opposes this amendment in its current form.

The Minister for Treasury and Resources is considering lodging an amendment to this proposal.

The Deputy of Grouville proposes that the Minister for Treasury and Resources be required to introduce measures to tax non-financial services, non-Jersey-owned companies with effect from 1st January 2012.

Summary

Although the Council of Ministers agrees with some of the objectives behind this amendment, they cannot support it in its current form for the following reasons –

1. The Minister for Treasury and Resources has already committed in the Budget statement to make announcements in 2011 regarding the ways in which certain non-finance companies that do business in Jersey can contribute to the Island's tax revenues. This is currently being reviewed as part of the Business Tax Review.

2. However, it would be unwise to take steps now that could prejudice the outcome of the EU Code of Conduct Group's review of our corporate tax system.

3. Because the timing of the EU's review of 0/10 is not within the control of Island authorities, the Minister is not in a position to make an absolute commitment at this time as to when alternative revenue-raising measures could be introduced or the nature of those measures. The Council of Ministers does not believe that the States would wish him to do so. These measures will be implemented as soon as it is prudent to do so.

Comment

The Council of Ministers has long acknowledged that one of the unintended consequences of the zero/ten tax regime is that non-financial services companies do not pay income tax on the profits they earn in Jersey.

The Minister has already committed, in his Business Tax Review consultation document, to consider whether it is possible to recoup the corporate tax revenue lost from certain non-finance companies with Jersey-based business activities on the introduction of zero/ten, without unintended economic consequences. In the 2011 Budget statement he confirmed that announcements will be made in 2011.

Much time and effort has been put into trying to find a way to resolve this without jeopardising the zero/ten regime itself. As the Deputy herself acknowledges, achieving this is complex and time-consuming. Measures have already been introduced in Budget 2011 which bring extraction and oil companies within the charge to tax at 20%.

The Deputy also recognises that this could be achieved by means other than a tax by introducing, say, a charge of some nature. A number of alternatives are currently being considered, including an alternative charge as well as a direct tax on profits.

The scope of such a charge also needs careful consideration. What does "non-financial services companies" mean? To bring in a charge or tax on profits for all foreign-owned companies registered in Jersey would be highly detrimental to the Island's economy. One of the alternatives considered in the Business Tax Review consultation was a flat rate of tax, and the overwhelming response was that this would result in a net decrease in tax revenues.

One other factor which is relevant to this issue is that Jersey's company tax system is based on the premise that 0% is our general rate of tax. This is currently being assessed by the European Union Code of Conduct (Business Taxation) Group (Code Group). It is vital that any changes proposed do not jeopardise the acceptability of the zero/ten regime to the Code Group. Extending the 10% band to other companies without fully understanding the impact on this analysis is critical. The measures noted above that bring extraction and oil companies within the charge to tax at 20% were carefully considered and this does not impact on the analysis. It is also important to await the outcome of the assessment so that we can fully understand any issues that the Code Group might have and therefore ensure that any changes that we make are acceptable.

The Minister's intention is that if it is practicable, proposals for increased revenue raising will be introduced from 2012. The outcome of the EU review of zero/ten will influence what these measures are, but the timing of this review is outside our control. Therefore, the Minister is not in a position at this stage to guarantee that he will be in a position to bring legislation before the States in 2011 to be implemented in 2012, although that is his firm intention.

Finally, the Deputy's assertion that the current fiscal deficit has been caused by the introduction of zero/ten must again be refuted. The current fiscal deficit has been caused by a fall in company tax revenues from those companies that pay tax at 10%, principally the banks, combined with an increase in States spending over a period of years.

2009 was the first full year in which 0/10 applied, and also coincided with the worst of the global economic downturn. The banking sector, which contributes most of Jersey's company tax income, was particularly badly affected, with its profits falling by more than a half. Not surprisingly, given how heavily Jersey relies on tax revenues from the financial services industry, income tax received from companies has decreased significantly.

The deficit which arose from the necessary introduction of 0/10 was recovered through GST, 20% Means 20%, ITIS and the other alternative revenue-raising measures introduced. <u>0/10 is not the cause of the current structural deficit.</u>

Prior to the introduction of 0/10, the financial services industry, and in particular a small number of banks, paid the majority of the income tax collected from companies in Jersey. This is still the case under 0/10, but the amount of tax collected is now significantly lower for 2 reasons. Firstly, financial services companies generally paid tax at 20%. This was reduced to 10% under 0/10 to protect Jersey's competitive position. Ireland had at that time reduced its corporate tax rate to 12.5%, prompting

the rate for financial services companies in the Crown Dependencies to be set at 10% when 0/10 was introduced. This was anticipated, and the compensating measures noted above were introduced. The second reason for the reduction as noted above is the economic downturn. The tax lost from other non-finance, non-Jersey-owned companies as a result of 0/10 is comparatively minor, and has not contributed to the current economic position of the States due to the compensating measures previously taken.

Financial and manpower implications

The Deputy acknowledges that her proposal will take a certain amount of officer time in order to bring forward workable proposals. This is certainly true; the officers in question are those that are currently working on responding to the EU review of our business taxation regime. The Council of Ministers assumes that all States Members would agree that this is the most appropriate use of their time at present. When the outcome of the EU review is known, then the Minister for Treasury and Resources will look at ways to seek additional revenues from certain foreign-owned companies.

The Deputy believes that the benefits of taxing foreign-owned companies would be great. She has not sought, however, to quantify this benefit. Of the approximately £80 – £100 million in tax revenues lost as a result of the introduction of 0/10, the overwhelming majority was due to revenue lost from financial services companies that had been paying tax at 20% and now pay at 10%.