JERSEY FINANCE

Representing The International Finance Centre

Senator Sarah Ferguson
Chairman of the Corporate Scrutiny Panel
Corporate Scrutiny Panel
Scrutiny Office
Morier House
Halkett Place
St Helier
JE4 8QT

11th February 2009

Dear Sarah,

Deemed Rental Scrutiny Review

Please find enclosed a copy of the letter previously sent to our Minister. This letter was drawn together based on the Fiscal Strategy Group at Jersey Finance Limited. A copy of the participants of the group is enclosed.

If you have any further queries please do not hesitate to contact me.

Kind regards

Yours sincerely

Robert Kirkby
Technical Director

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Appendix – Composition of Fiscal Strategy Group

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Chief Minister's Department
P.O. Box 140
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The Parade
St Helier
JERSEY
JE4 8QT

Wednesday, 17 December 2008

Dear Terry

Draft Income Tax (Amendment No. 32) (Jersey) Law 200- (Deemed Rental Charge)

Further to our meeting on 6 November 2008, we have met again to consider the draft Amendment in further detail. It is our considered opinion that the law in its current format contains a number of flaws which would render the law if enacted in its current state, ineffective.

Scope of the new tax – Article 123C(2B)
We consider that the definition of a "non-Jersey" company as set out in Article 4, amending Article 123C(2B)(a), would restrict the number of companies to which the new charge applies far more than was intended. The definition provides that a company will be considered to be a non-Jersey company, and hence within the scope of the deemed rental charge, only if it has an ultimate beneficial owner who together with his family or business partners controls 51% of the company's voting power at any general meeting. It seems likely that most if not all publically listed companies and potentially many private companies would not have one beneficial owner in such a position, and thus would escape the deemed rental charge entirely.

However, it is not clear whether the law would consider a company's ultimate parent company or its shareholders to be its ultimate beneficial owner in determining whether it fell within the definition of a non-Jersey company.

We note that the relevant factor in determining ownership for the deemed rental charge is the ability to exercise voting rights, which contrasts with the shareholder taxation provisions introduced in Amendment 29 in which shareholding is the key. It would be an easy matter for a company to amend the rights attaching to its shares in order to ensure that it was not considered a non-Jersey company and hence avoid the charge.

Availability of double tax relief
As noted in our letter dated 12 September 2008, one of the main objections to the introduction of the deemed rental charge was that because it was not computed by reference to a company's profits, it would not be creditable against the tax liability of a parent company on receipt of income from its Jersey subsidiary, thus increasing the cost of doing business in Jersey for most foreign-owned Jersey companies. On the basis of a brief analysis, we do not believe that the proposals as currently drafted will allow the charge to be creditable against UK Corporation Tax. However should you disagree we should be interested to see your analysis of the position.

Premises caught by the charge
Non-Jersey trading companies which occupy premises that are wholly or partly let out will be liable to the deemed rental charge, notwithstanding that they already pay Jersey tax under Schedule A.

We understood that the intention of this law was to collect tax from those businesses which would pay no tax in Jersey as a result of the Zero/Ten regime. Levying an additional tax on companies which will continue to pay tax in Jersey appears inequitable.

We suggest that the definition of "premises" should be defined more closely. At the moment it would appear to encompass any property owned by a company, including for example car parking spaces, domestic accommodation and mobile phone masts.

Costs of implementation
Article 123G(2) provides that the open market rental value of the properties affected will be assessed by an independent valuer. No guidance is given in the law as to how often this exercise should be carried out, but we note that the Comptroller of Income Tax has indicated his preference is for a three-yearly process. Presumably the process should be repeated where the premises in question is refurbished or extended. We note that this will add a significant additional level of cost for companies over and above the amount of the charge. *[Do people feel this should be included?]*

On that point, we suggest that it would be easy to manipulate the market value of a particular property by imposing onerous terms on the lease, and thus artificially depressing the value of the leasehold. While this may not be an issue for owner-occupiers of property, it will be relevant for tenants where they pay less than a market rental.

Because the amount of the deemed rental charge may also be contingent on the level of a company's tax-adjusted profits, companies which would not otherwise be required to prepare a tax calculation under Zero/Ten will still be forced to do so, thereby incurring additional time and expense. The Comptroller of Income Tax will also need to ensure that sufficient resources are allocated to the review of these computations. We would also question whether this aspect of the proposals is compliant with the European Union Code of Conduct on business taxation.

Financial services groups
It is common in large groups of companies that one company will hold a property while other companies carry on the trading activity of the group. For example, it will be common for a bank to have a separate group service company which will hold the freehold or leasehold over the property, employ the staff, incur the overhead costs, and any other necessary activities. We believe that in such a scenario the service company as a non-finance company would be subject to the deemed rental charge although the group's activities as a whole would be the provision of financial services, taxable at 10%.

We envisage that in future, groups in this position will reorder their affairs in such a way that the property is held by a financial services company and as a result no tax will arise to the Island. This in itself involves additional cost to the group, but in the meantime we feel that it is unfair to levy more tax on these groups.

Offset of expenses
The draft law indicates that a deduction may be made from the deemed rental charge for amounts "necessarily expended... on or for those premises for the purposes of the non-Jersey company's business" (Article 123H(10))

The same article also provides that no relief may be claimed in respect of sums of a capital nature. Are we to take it that this prevents companies from claiming capital allowances on sums which were expended on the building and in respect of which capital allowances would be available to reduce the company's profits under Schedules A or D, such as sanitary fittings and certain fire equipment?

We note that relief is explicitly given for interest incurred in connection with loans taken out to purchase the premises, but would the same relief be available for loans taken out to expand or improve the same property?

Further clarity needs to be given generally on what types of expenses may be offset against the deemed rental charge. In particular, may the company deduct an item of expense more than once, firstly in calculating its assessable profits under Schedule D, and then again when calculating its assessable deemed rental charge?

Ability to minimise the deemed rental charge
We note that sections 8 and 9 of Article 123H limit a company's liability to the deemed rental charge to the level of its profits assessable under Schedule D. We believe that this should be limited to the company's profits earned from those premises and in respect of its Jersey business only. This will protect those companies which have branches in other jurisdictions. Otherwise, we would anticipate that companies which wished to carry on business in more than one jurisdiction would relocate to a territory which did not penalise them in this way, such as perhaps Guernsey.

While we welcome the ability to limit the deemed rental charge to a company's profits in a particular year of assessment, we believe that a company should be in a position to carry any excess losses forwards to minimise its future or past liability.

Article 123H(6)
Article 123H(6) provides that where a company that falls within the scope of the deemed rental charge has Jersey resident shareholders, the deemed rental charge will be reduced to reflect an amount that "in the opinion of the Comptroller" reflects the proportion of shares held by Jersey residents. We believe that this is not an area where it is appropriate for the Comptroller to have discretion, as the question of voting powers is not arbitrary but is a question of fact.

Avoidance
In our recent meeting, we identified several opportunities for structuring a Group's affairs in such a way as to avoid the deemed rental charge. To give one example, under Article 123G(7)(b) a company will be considered to own premises where it leases the property at less than a market rate, or where it is entitled to occupy the property because it holds shares in the company which does own it. Where two companies are in common control but there is no direct shareholding, and the property owned by one is enjoyed by the other but there is no formal lease or tenancy agreement in place, then no deemed rental charge would apply.

Effectiveness at achieving the stated goals
You have stated that the aim of these provisions is to ensure that companies which do business in Jersey pay some tax in Jersey. Recognising that the rent which is paid by companies in the Island is taxed at 20%, you have confined the deemed rental charge to those companies which own their premises and hence do not rent them out.

We would note that it is possible for a landlord to order its affairs in such a way that the rental income received is substantially or completely extinguished by costs incurred in connection with the rental activity such as interest payments on loans incurred in order to acquire the property in question. We would therefore query how large the contribution to the Island's revenues made by rental businesses is.

The 2008 Budget statement stated that the deemed rental charge would raise £4 million of revenue per annum. We would query whether this will be achieved, and should be interested to understand the basis for your calculations.

Other
We regret not having had the opportunity to comment on the draft law before its presentation before the States.

We would request that you consider deferring the implementation date of this and other broad tax changes such as Land Transfer Tax and Probate Duty until the appointment of a Tax Strategy Officer. We believe that in the light of the many recent changes to Jersey's tax regime and recent market uncertainty the proposal should be reconsidered to ensure that it fits with Jersey's overall strategic aims.

We should be interested to see the economic analysis prepared when the deemed rental charge was proposed, in particular the extent to which you envisage that businesses will pass the additional tax on to their customers in the form of price rises.

Finally, as noted above we are also concerned that by discriminating between Jersey and non-Jersey companies in this way, the new law would breach the terms of Jersey's commitment to the EU Code of Conduct.

Conclusion
In conclusion, we believe that the law as currently drafted will not achieve your aims by capturing every non-Jersey owned company. In addition, there are several areas which require clarification and the law is easy to avoid. Finally, we are concerned that the provisions will increase the cost of doing business in Jersey, including but not limited to, our concerns that no UK tax relief will be given in respect of the charge.

We therefore believe that the law in its current format is unworkable and recommend that action is taken to address our concerns before its enactment.

We trust that you will give due consideration to the arguments set out in this letter and we look forward to hearing from you in due course. Should you wish to discuss any of the above in greater detail, please contact me.

Yours sincerely

Robert Kirkby
Technical director
Jersey Finance Ltd

Cc. Senator Philip Ozouf