STATES OF JERSEY

GOODS AND SERVICES TAX: EXEMPTION OR ZERO-RATING FOR FOODSTUFFS AND DOMESTIC ENERGY (P.28/2009) – COMMENTS

Presented to the States on 30th March 2009
by the Council of Ministers

STATES GREFFE

COMMENTS

Summary

The Deputy of Grouville has put forward a proposal to exempt or zero-rate the supply of foodstuffs (in line with UK VAT treatment) and domestic energy under the Goods and Services Tax (GST). The Council of Ministers wishes to stress to Members that this is not the first time the States will have debated such a proposition. Similar propositions have been debated in this Assembly on 4 previous occasions – P.165/2005, P.86/2006, P.169/2007 and P.103/2008. On each occasion the democratic will of this Assembly has been to reject the proposition. All the reasons for the rejection of such exclusions from GST on previous occasions remain equally valid today, indeed even more so, and Members should reconfirm their previous decisions and reject this proposition. The Minister for Treasury and Resources has presented to Members a detailed response to the Deputy's proposition outlining the arguments why this proposal should be rejected. The Council of Ministers endorses the Minister's comments.

Members should be under no illusions about the consequences of accepting this proposition. The exclusions proposed by the Deputy of Grouville will, in the first instance, result in a direct reduction in tax revenues of some £6 million. Such a loss in States' tax revenue, especially in the current economic conditions, will need to be made up elsewhere. The options to make good this shortfall include increasing the rate of GST from 3% to 4%, increasing the rate of Income Tax from 20% to 21%, or removing significant elements of the package of support targeted at those households on low to middle incomes. The Council of Ministers believes that none of these alternative options would be palatable, or indeed acceptable, to the Island's taxpayers.

Economic circumstances have changed dramatically since the last debate on the GST exclusion issue. Deflation, rather than inflation, is now the major concern and there are no longer international pressures on oil and food prices. The States' revenues are forecast to decline and pressure on expenditure is increasing. Although it is difficult to predict what the impact will be from 2009, tax revenues are likely to decline, perhaps significantly. For this reason alone, if there was ever a time <u>NOT</u> to be reducing the tax base by adopting further GST exclusions – it is now.

The external advice received by the Council of Ministers and the Minister for Treasury and Resources supports the view that, in present circumstances, there should be no changes to Jersey's tax base for at least 2 years. The Fiscal Policy Panel (FPP) has advised that there should be no change in the rate and scope of GST, whilst increasing income support and tax allowances provides far greater benefit to those on low-to-middle incomes than blanket exclusions. To ignore the unambiguous advice of internationally renowned experts would be foolhardy. Similarly, the clear advice from H.M. Revenue and Customs, following their recent review of Jersey's system, is that GST should remain substantially as implemented and bedded in for at least a period of 2 years without <u>any</u> significant changes.

As the Minister for Treasury and Resources notes in his **Comments** paper (P.28/2009 Com.) in response to this proposition, in addition to the reduction of tax revenue of some £6 million, not only would there be additional costs to businesses (through additional compliance costs which may increase the general level of prices) and to the States of Jersey (by increasing the costs of tax collection and administration), the package of support targeted at those households on low-to-middle incomes would have to be reviewed.

Members will recall that the States last year approved a package of support which helped to insulate low-to-middle income households from the effects of a broad-based GST (which included the application of GST to foodstuffs and domestic heating). This package of support included the following measures –

- increased tax thresholds by an extra 3.5% from 3% to 6.5% for 2008 in the 2008 Budget at a cost of £4 million;

- protection from GST for those on the original income support at a cost of £1.75 million;

- an allowance for those households between the income support scheme and income tax system known as the GST bonus scheme at a cost of £0.4 million;

- Deputy Le Fondré's proposition (P.138/2008) to further increase income support by £3 million, double the GST Bonus Scheme at a cost of a further £0.4 million and provide an increase in income tax exemption thresholds from 3% to 5% in 2009 at a cost of £2.4 million.

This equates to a total financial benefit on those on low-to-middle incomes of £12 million, twice the benefit of removing GST from foodstuffs and domestic fuel.

It would not be unreasonable to suggest that if this proposition was approved, all of the above would firstly need to be reviewed. Those introduced directly as a result of food remaining taxed under GST could be withdrawn and other allowances reduced. Low-to-middle income households could potentially be worse off if this were to happen. That is surely not the outcome which Members would want.

This proposition assumes that by excluding foodstuffs and domestic heating from the application of GST, then the prices of these items would fall by 3%. There is no guarantee that this would happen. Retailers may simply argue that due to increased business compliance costs prices would need to be maintained at current levels, or even increased. Some retailers may choose not to pass on the reduction in prices to consumers at all, preferring instead to take the opportunity to maintain or improve profitability levels. If this were to happen, then whilst there would be a £6 million loss in tax revenue, there would be no benefit to consumers and those households on low-to-middle incomes.

The Council of Ministers therefore urges States Members, for the reasons given above, and those detailed in the Minister for Treasury and Resources' Comments paper (P.28/2009 Com.), to reject the proposal for further exclusions as outlined in P.28/2009.