STATES OF JERSEY

DRAFT MEDIUM TERM FINANCIAL PLAN ADDITION FOR 2017 – 2019 (P.68/2016) – NINTH AMENDMENT (P.68/2016 Amd.(9)) – COMMENTS

Presented to the States on 26th September 2016
by the Council of Ministers

STATES GREFFE

COMMENTS

Senator S.C. Ferguson proposes that –

- the net revenue expenditure of the Chief Minister's Department shall be increased by £30,000 in 2017 in order for that Department to commission an independent review of the tax system, including a quantification and explanation of changes in the profile of the taxpaying public since 2008 –

    1. reconciling and explaining the changes in the number of taxpayers in the main bands defined as non-taxpayers, marginal band taxpayers and 20% taxpayers;
    2. assessing the income generated from companies trading in Jersey or owned by residents of Jersey;
    3. assessing the overall effects on the economy resulting from high levels of immigration;
    4. including an economic impact assessment of how each income quintile would be affected by proposed 'user pays' charges, and from the changes already imposed since the implementation of zero/10, which will be financed from the Contingency Fund and from other funds and reserves including the Strategic Reserve, and to consider the appropriateness of routing income from the proposed health charge directly to the Consolidated Fund; and
    5. reviewing the change in accounting treatment of income tax to assess the robustness of the tax estimate process and reviewing the model used for estimating tax, precise terms of reference for the review to be agreed with the Corporate Services Scrutiny panel",

    precise terms of reference for the review to be agreed with the Corporate Services Scrutiny panel, and the revenue head of expenditure of the Department for Infrastructure shall be increased by £3,000,000 in 2018".

And –

- reductions to Contingency of –

    1. a reduction of £30,000 in 2017 in respect of the independent review of the tax system; and
    2. a reduction of £10.5 million in 2018 in respect of a delay to the implementation of the health charge and commercial waste charges during such time as the review of the tax system is completed, considered and implemented;

- defer the Health Charge of £7.5 million in 2018.

The Council of Ministers strongly opposes this Amendment, and the Amendment to the Amendment from Deputy G.P. Southern of St. Helier, and urges States Members to reject it.

Summary of Council of Ministers' Comments

- In essence, Senator Ferguson is proposing that the plan for sustainable public finances outlined in the MTFP Addition 2017 – 2019 is put at risk; deferring important decisions on future revenue-raising measures until some unidentified point in the future.

- This will delay the proposed transformation of health funding and the provision of waste services.

- The Council of Ministers understands what Senator Ferguson is seeking to achieve in proposing a review of the personal tax system. However, the Council does not consider the amendment is appropriate, not least because it fails to recognise the reviews and work undertaken in 2010, 2012 and 2014, or reviews that are already underway or in prospect.

- CoM have always recognised the need to keep the tax system under review in the light of changing international and domestic circumstances, but any such review process must be undertaken with the following very much in mind –

    1. **Jersey's economic success has owed much to the fiscal stability that has prevailed. Business decisions will be deferred or abandoned if there is no certainty that the tax arrangements upon which the decisions rest will be maintained for the foreseeable future.**

    2. **The Island is presently faced with the uncertainty arising from Brexit, and it would be damaging to the Economy and the present level of employment if that uncertainty was to be added to by a reaction to an announcement of a review of the tax system that gave rise to a fear of the prospect of significant and far reaching changes.**

    3. **Any process of review also should be undertaken by the Government and – in the first instance – without the glare of potentially international interest, so as not to damage Jersey's long-term economic and competitive position.**

    4. **This should be based upon a proper process of internal review, as is presently the case; and when appropriate, this should lead to measured findings that are then subject to informed consideration by those affected by any changes contemplated and by Scrutiny.**

- The Council of Ministers cannot support the removal of £10.5 million from Contingencies in 2018, or the associated delay in the introduction of the Commercial Waste Charges or the Health Charge. This would also be contrary to the recent advice of the Fiscal Policy Panel.

- Such significant reductions, which remove all general contingencies for 2018 and require further cuts to other allocations, significantly reduce vital flexibility and create considerable risk.

Detailed Comments

- The Council of Ministers understands the good intentions of the Senator in making this amendment, and has taken on board her comments made in meetings with the Chief Minister and Minister for Treasury and Resources in respect of the taxation system.

- The Chief Minister and Minister for Treasury and Resources have sought to work with Senator Ferguson to find a proposal that would be acceptable to her and the CoM, and have found the discussions to be constructive. They have allowed both parties to explore their shared aims and areas of concern, including Ministers' concerns as to the potentially open-ended and far-reaching nature of the amendment.

- Ministers are grateful for the discussion with Senator Ferguson, and many of her concerns are either the subject of work in progress, or will be undertaken once data collection is completed.

- The Council of Ministers has significant reservations over the blurring of the accountabilities and responsibilities between Ministers and Scrutiny proposed by the Senator, and regards this as being wholly inappropriate. If Scrutiny became so implicated in policy formulation, then our structure of governance would lose a key check and balance on the Executive: put simply, who then would be responsible for scrutinising that policy? Our current system is built to provide the checks and balances essential to Jersey's good governance: its removal is not something to be undertaken without careful consideration.

- The Council of Ministers welcomes policy formulation being scrutinised and Scrutiny Panels are of course free to undertake their own enquiries into any aspect of the tax system.

- The Council is also concerned at the prospect of essentially transferring the development of policy to one individual third party as proposed, particularly on something so important to the prosperity of our community. Given the critical nature of such work, the CoM warns against conducting a root-and-branch review of the tax system in the full glare of publicity. This would generate significant uncertainty.

- Stability and certainty are critically important in these times of generally heightened uncertainty, particularly following the U.K. decision to leave the E.U. They have always been part of the attractive package that Jersey presents to investors. Creating further uncertainty would place Jersey at a competitive disadvantage, damaging the prospects for the economy, jobs and standards of living.

- The Council of Ministers believes that at this time the commitment to 0/10 for corporate tax, and the broad structure of our income tax system, work in the best interests of the people of Jersey and its future.

- The Council of Ministers supports the principle that no systems and policies should be beyond review, and recognises the advantages of continuously improving systems practices and policies. It would be wrong to draw the conclusion that no review work is being undertaken or that the Treasury, the Taxes Office and the Department for Financial Services are not keeping both under review, to identify opportunities within the broad principles of each system to improve equity, increase yield and minimise tax avoidance.

- This can be demonstrated by transformation of the assessment and collection systems currently being undertaken by the Taxes Office. This will involve root-and-branch changes to our tax legislation and a wide-ranging review of many aspects of our tax law.

- A further example, much rehearsed in the Assembly, is the review of the personal income tax system to investigate a move to independent taxation. This will involve carefully examining every aspect of the income tax system over the coming couple of years to ensure an equitable system that minimises unintended tax planning opportunities and maintains yield without creating hardship. Consideration of the interaction between tax and benefits will be included within this work.

- In addition, the Council of Ministers is determined to eliminate any abuse of the tax system, and will ensure that anti-evasion and avoidance measures are kept under review to ensure they meet the required standards.

- Recognising the aims of Senator Ferguson's amendment, but concerned at the approach proposed and the open-ended and potentially far-reaching wording of the proposition and the associated threat to economic stability, the Council of Ministers proposes the following pieces of work be undertaken: set out below in more detail is the work currently being undertaken, further work already planned, and work the Council is committing to following the comments it has received and the debate taking place in the community. Reports arising from all such pieces of work will be made available to the Corporate Services Scrutiny Panel.

Work already in progress

- **Post-Implementation Review of the current High Net Worth Taxation system which will identify any substantive issues and make appropriate recommendations for change.**

  This work is currently being undertaken by the Taxes Office and early findings will be presented alongside the Budget this year.

- **Review in preparation for independent taxation**

  A model of the personal income tax system is being developed with the Statistics Unit to inform options for Independent Taxation. This review will entail a root-and-branch review of the tax system and include consideration of the interaction with the benefit system. We will report in time to inform the Council of Ministers' next Strategic Plan.

- **Reconciliation of population figures with population of taxpayers**

  Work is already being undertaken by the Statistics Unit/Taxes Office to produce a reconciliation between the population figure and the number of "taxpayers" per the Taxes Office's records. This will address the apparent changes in the taxpayer population and address the concerns of some that "10,000 taxpayers have been lost".

- **Collection of company profit data**

  2015 tax returns (2015 YOA) have been amended to collate the data on locally owned companies liable to tax at 0% (data will be available in early 2017). It is proposed to change 2016 tax returns (2016 YOA) to gather data from more companies.

Work already announced and committed to

- **Impact analysis of immigration**

As set out in the recent written answers to States' question 1240/5(9569) and 1240/5(9570), research and analysis is being planned by the Economics Unit to examine the economic and fiscal implications of different levels and types of inward migration, collating and aggregating, as required, the range of existing information which departments use to plan public finances and services; for example, the absolute and marginal costs of health care by age-band, the average weighted pupil costs at primary and secondary school, and other information covering social security contributions and benefits.

This work will be expanded to include advice on the process for estimating the impact upon public finances of the net inward migration identified by the Statistics Unit since 2007.

Completing the work in this rigorous fashion will deliver rounded and expert information to support the development of the long-term plan, inclusive of population policies, and clear aspirations for our economy, community, and environment. Once the scope of this research work is complete, this will be reported, inclusive of expected timing.

- **CoM proposes to establish a ministerial sub-group led by the Minister for Treasury and Resources to oversee a review of the personal tax system as described below. It will be supported, as necessary, by external expert advisers. Such review to commence in October 2016, to report by March 2017:**

Background

1. Since the early 2000s, Jersey's personal income tax system has undergone a number of significant changes, including –

   - the introduction of ITIS;
   - the adoption of the "20-means-20" policy that withdrew income tax allowances from higher earners;
   - increases in exemption thresholds; and
   - the reduction in the marginal rate to 26%.

Each of these changes was given careful consideration, including an analysis of the distributional impact of the change. However, to date, the overall distributional impact has not been drawn together in one document covering the whole period.

Scope

2. The scope of the review will be as follows:

(a) To identify the significant changes (i.e. those changes that apply to a broad section of the Island's population) made to the Island's personal income tax system, Social Security and Long-Term Care contributions, as well as GST (to include the effects of associated benefit changes) since 2007. To demonstrate the distributional impact (by quintile) of those changes and the cumulative distributional impact by reference to a representative sample of household types and the results of the most recent income distribution survey, wherever possible drawing on the work already undertaken by the Treasury/Chief Minister's Department.

(b) To demonstrate the distributional impact of the proposed health charge and the proposed waste charges by reference to a representative sample of household types and the results of the most recent income distribution survey, drawing on the work already undertaken for the purposes of the MTFP Addition 2017 – 2019.

(c) To identify the reasons for – and to explain – the evident change in the number and type (i.e. exempt, marginal rate and standard rate) of personal income taxpayers per the Taxes Office's records for all years since 2007. Work is already being undertaken by the Statistics Unit/Taxes Office to produce a reconciliation between the population figure and the number of "taxpayers" per the Taxes Office's records, and hence this is explicitly excluded from the scope of this review.

(d) To assess, to the extent possible from the information available, the amount of income remaining undistributed since the termination of the deemed dividend/full attribution regimes in companies subject to tax at 0% and owned by Jersey resident individual shareholders, and to identify what information should be collected in the future.

(e) Regarding matters raised in paragraph (d) above and more generally to comment upon measures to counter tax evasion and avoidance contained within Jersey's personal income tax legislation.

Other work being undertaken separately from this review.

Tax Gap Analysis

As previously explained in written answers, the Taxes Office is also proposing to commence work in 2017 on identifying Jersey's tax gap – that is the difference between what ought to be taxed and what is collected. Work is likely to commence in summer 2017 and take around 2 years to complete.

Review of the model used to forecast personal income tax

The Economics Unit will work with the Income Forecasting Group, including its 2 independent external members, to establish what additional external advice will be sought on how the model used to forecast personal income tax revenue can be improved.

The advice will build on work already underway by the Statistics Unit and Taxes Office to use the taxpayer data base to calculate the revenue implications of tax policy changes and the work being undertaken by the Economics Unit on longer-term fiscal trends and migration. This advice should examine how the model forecasts both taxable income and likely yield, and consider any recommendations on how the model might be improved in the future, in a cost-effective way, and taking into account the information available locally.

The economic assumptions used in the model are specifically outside the scope of this review, on the basis that these assumptions are endorsed by the independent Fiscal Policy Panel. The assumptions made on bad debts are also specifically outside the scope of this review.

The Accounting treatment for taxation recognition and associated estimates are already the subject of extensive internal scrutiny from an expert Audit Committee and external examination by the States Auditors PwC, whose work is also reviewed by the independent Comptroller and Auditor General.

Proposed use of Contingency

- Senator Ferguson proposes to reduce the Contingency expenditure allocations by £10.53 million in 2018. This would remove ALL the annual Contingency expenditure of £2 million for AME Contingency and £5 million for DEL Contingency.

- The Amendment would mean that all associated flexibility for expenditure in 2018 is removed.

- The balance of the proposed reduction of £3.53 million is unlikely to be available from the pay, PECRS and workforce modernisation provision, as it is likely by this time that much of this will have been committed.

- The remaining £3.53 million would therefore have to be found by not progressing important initiatives for restructuring, public sector reform, economic and productivity initiatives and the initiatives to support vulnerable children.

- The Senator’s proposals to reduce Contingency do not fit with the agreed principles of Contingencies and would cause all department expenditure, and in particular social security benefit expenditure, to be at risk.

<u>Contingency Provisions</u>

- As with other such Amendments, it is important to emphasize that, although the provision for Contingency spending may appear significant, it is very clear from the MTFP Addition Report (Section 8) that this includes a number of specific allocations.

- The provision for the actual annual contingency is only £7 million. This is made up of –

    - £5 million or 1% for total States general department expenditure, and
    - £2 million or 2% for Social Security benefits.

- The rest of the money set aside for Contingency expenditure includes provision for –
    - pay, workforce modernisation and pensions proposals,
    - restructuring projects and redundancy funding to support Public Sector Reform and to deliver the planned savings in this MTFP period and beyond,
    - economic and productivity growth initiatives,
    - important initiatives to support vulnerable children.

- Any amounts above the £7 million annual contingency are actually earmarked for restructuring and redundancy, economic and productivity growth and supporting vulnerable children. These amounts are only included in the Contingency Expenditure Allocation to provide appropriate governance over their allocation.

Principles of Contingencies

- The £7 million annual Contingencies provide an important part of the flexibility within the MTFP.

- They are to enable departments to respond to unforeseen and unexpected one-off events.

- A fundamental principle of Contingencies is that they should not be used to fund recurring spending, but only to provide temporary funding until a permanent re-allocation of funding is agreed.

- The annual Contingencies also provide an important buffer for more volatile areas of spending such as social security benefits. These areas, termed annually managed expenditure (AME), are extremely difficult for departments to forecast so central contingencies are provided in addition to those held in departments.

- Allocation of all contingency funding is closely managed through approval of the Council of Ministers and Minister for Treasury and Resources. All allocations follow tight governance processes.

- Adequate annual contingency provisions are an important part of the overall flexibility in the MTFP to –
    - help deal with the scale of change and reform that is needed,
    - react to the uncertainties and changes in economic and financial outlook and associated expenditure pressures.

- The Fiscal Policy Panel has emphasized in its Annual Report the importance of flexibility in the MTFP Addition to deal with uncertainties in the economic and financial outlook. These expert economists have encouraged the States to maintain that flexibility.

Financial implications

Unless Senator Ferguson is solely seeking the collation of data, a figure of £30,000 significantly underestimates the cost of an independent report.

The deferment of charges of £10.5 million in 2018, and associated reductions in Contingency, delay the development of sustainable funding-streams and sustainable public finances, and remove the ability to respond promptly to unforeseen events.

The scale of reduction would also mean cuts in other central provision, leading to savings and reform programmes being delayed, economic and productivity growth initiatives either delayed or removed, reducing the opportunities to generate additional revenues for the Island.

Statement under Standing Order 37A [Presentation of comment relating to a proposition]

These comments were received by the States Greffe after the deadline set out in Standing Order 37A because the Council of Ministers wanted to ascertain the views of members and to ensure proper consideration was given to the Amendments and the later Amendments to Amendments, to provide the latest information ahead of the debate.

APPENDIX

Definition of terms used by the Taxes Office
(taken from answer to Written Question 9586)[1]

A Personal Taxpayer is defined as an individual/married couple/civil partnership that pays tax, based on their own liability, in Jersey, for the year. Personal Taxpayers whose liability was less than £50 are counted as Personal Non-Taxpayers. This is consistent with the Taxes Office historical position on gathering tax data.

A Personal Non-Taxpayer is defined by the Taxes Office as an individual/married couple/civil partnership who has completed an income tax return and does not have a positive income tax liability for the tax year, based on the income, allowances, reliefs and deductions for the year. The data above does not therefore include individuals/married couples/civil partnerships that do not receive a tax return (such as students that register for holiday job purposes only and therefore have annual income well below the exemption threshold and other members of the population where their income has consistently been below the exemption threshold and their specific circumstances dictate that it is unlikely they will pay tax in the future).

The number of "non-taxpayers" (in accordance with the current Taxes Office definition set out above) will vary for a number of reasons which include:

- Annual changes to the income tax thresholds approved by the States in the annual Budget process.
- Targeted use of resources by the Taxes Office to reduce the number of taxpayers that receive a tax return each year. When resource is available the Taxes Office will review cases where the taxpayer's income has been consistently below the tax exemption thresholds and is likely to remain that way. The last such review will have impacted on the 2014 figure shown above.

Personal Taxpayers and Personal Non Taxpayers include:

- Single individuals.
- Married couples/civil partnerships that have not opted for separate assessments (counted as one Personal Taxpayer or one Personal Non-Taxpayer).
- Married couples/civil partners that have opted for separate assessments (counted as two Personal Taxpayers or two Personal Non-Taxpayers).

[1] See: http://www.statesassembly.gov.je/AssemblyQuestions/2016/(9586)%20Dep%20Higgins%20to%20TR%20re%20income%20tax%20information.pdf