STATES OF JERSEY

INCOME TAX: INTRODUCTION OF HIGHER RATE (P.23/2011) – COMMENTS

Presented to the States on 4th April 2011
by the Council of Ministers

STATES GREFFE

COMMENTS

The Council of Ministers opposes all parts of this proposition.

Comment

In December 2010, the States approved the 2011 Budget which clearly sets out a cogent strategy to deal with the long term effects of the global economic downturn on our finances. This strategy was developed following a thorough process of research and consultation, a process which independently collated and considered the views of more than 1,000 islanders and local organisations.

The option of increasing income tax rates was carefully considered during the Fiscal Strategy Review process. Based on all the information collected during this process it was decided that a higher rate of tax was not appropriate for Jersey. Imposing a higher tax burden would damage Jersey's economy by undermining its competitiveness, reducing employment opportunities for local people and ultimately reducing tax revenues for the Treasury. The Council of Ministers believes that this is as true now as it was 4 months ago when the Budget was thoroughly debated and approved by States members.

Jersey's standard rate of income tax of 20% is one of the key pillars of its economic success. It is essential that as many people are involved in the workforce as possible, in order to sustain economic growth. Lower personal tax rates are linked with higher take-up of employment, because the incentives to work, and the rewards from work, are higher.

Jersey also competes with other financial centres in order to attract the key skills that create jobs, businesses and tax revenue in the Island. We need to ensure our rates of personal tax enable us to continue to do this.

Finally, constantly debating the option of increasing personal tax rates is damaging Jersey's reputation for stability both locally and internationally. We saw this very clearly last year when the UK mainstream media seized on the inclusion of increased personal tax rates in the Fiscal Strategy Review green paper. Actually increasing tax rates would be even more damaging to the international perception of Jersey as a stable jurisdiction. This stability is one of our key selling points when it comes to attracting the international business that drives our economy.

(a)(i): Independent taxation

The first part of the proposition proposes that a system of independent taxation should be introduced, so that married couples are taxed separately on their individual income.

The Treasury Department is currently conducting a review of the income tax system with the aim of modernising it and making it more efficient to administer. It is possible that this review will recommend the introduction of independent taxation as part of a wider reform, and that many of the issues that currently prevent it will be resolved. However, redesigning the Jersey income tax regime must be done with care to ensure that a modernised regime continues to meet Jersey's needs. It will take time to properly consider all aspects of our personal tax regime to ensure that it is fit for purpose. A root and branch review of the whole income tax system cannot and should

not be rushed, and could not be completed before the 2012 Budget is lodged in 5 months' time, as this proposition would require.

There are some key flaws in the way in which the system as proposed in this proposition would operate, in the absence of any other changes –

- Rather than making the tax system fairer as the proposition suggests, this would instead increase the tax liabilities of couples with lower to middle incomes. Currently, for these couples, if one spouse either does not work or earns a low salary the couple can take advantage of the full married couple's exemption threshold of £20,510. If one spouse has no or a low income, the other spouse can effectively "use" the remaining exemption threshold.

  In the system proposed here, each spouse would be entitled to the single person's exemption limit of £12,790. If the spouse on the lower income did not use all of this exemption limit, they could not transfer the balance to the higher earning spouse as effectively happens under the current regime. The unused exemption limit would be effectively lost and the spouse with the higher income could have a higher tax liability than under the system of joint taxation currently applied.

- Couples with a higher combined income would be relatively unaffected and in some cases would be better off. Married couples with one main earner earning over £85,000 and where the other spouse earned between £15,000 and £25,000 would see a fall in their net tax liability. This is because the spouse on the lower income could benefit from their single person exemption threshold if they were assessed independently. In the present system, these married couples do not benefit from any exemptions because between them, they earn enough to pay tax at the 20% standard rate under 20 Means 20.

- Under the current structure, the Taxes Office would have to administer an additional 20,000 assessments each year, along with the additional paperwork and taxpayer enquiries, which could cost in the region of an extra £700,000 year. It is far from clear that the benefits of introducing independent taxation in the way proposed in this proposition would outweigh the considerable increase in the cost and complexity of administering the income tax system (further details of the cost and additional manpower that would be required are given below).

<u>(a)(ii) and (iii): Higher rates of income tax</u>

Higher rates of income tax would damage the island's economy by affecting the location decisions of businesses and individuals. The report accompanying the proposition refers to the fact that the highest rates of tax in the UK are higher than in Jersey. However, comparison with other international finance centres, especially the other Crown Dependencies is more relevant.

A comparison of the income tax rates in Guernsey (20%) and the Isle of Man (20%) shows that if higher rates of tax were introduced in Jersey, our highest tax rates would be significantly higher than the other Crown Dependencies. Jersey already levies more income tax on the highest earners than either Guernsey or the Isle of Man because

Jersey does not limit the amount of tax payable in any one year as the other two islands do.

Our ability to compete with Guernsey and the Isle of Man would be damaged by the introduction of higher rates of tax. Such a change would also make it harder to attract and retain high earners, and would increase the cost of employing staff.

This would ultimately affect everyone in the island – leading to fewer jobs, lower salaries and lost tax revenue. Individuals would either have to pay more tax to compensate for the drop in corporate and personal taxation or the standard of public services provided by the States would have to be reduced. Other local businesses outside the finance industry would lose valuable business.

(b): Higher rates of income tax for 1(1)(k)s

This part of the proposal would effectively abolish the 1(1)(k) tax regime. The Council of Ministers considers that it is inappropriate to propose a change of this nature without clearly explaining what is proposed to States members.

Abolishing the regime for 1(1)(k) residents will not increase tax revenues; it may well lead to a reduction because it is likely that some existing 1(1)(k)s will leave and we will be unable to attract new 1(1)(k)s.

The very wealthy have the greatest opportunity for mobility; they are courted by a large number of countries which try to attract them and the benefits of their wealth. These individuals rarely have ties to Jersey before coming here. Increasing the tax rates for these high net worth individuals will deter many from relocating to Jersey and will inevitably lead to some leaving the Island. They would be difficult to replace when our competitors are already offering more attractive tax regimes.

The approximately 130 1(1)(k) residents currently in Jersey pay £13.5 million in income tax annually, almost equivalent to the amount of tax raised by every 1% of GST. Without the contribution from the 1(1)(k)s, the rest of Jersey's population would have to shoulder an increased tax burden. By way of illustration, the average household in Jersey pays £7,000 of income tax every year, compared with an average of more than £100,000 paid by 1(1)(k) residents.

Independent research recently commissioned into the value brought to Jersey by these residents suggests that the tiny number of 1(1)(k) residents contribute some £50 – £70 million to the local economy (based on OECD estimates for economies with similar characteristics to Jersey's). This comes in the form of direct and indirect taxes paid, spending in local shops and restaurants and employment of local people. It would be unwise to damage Jersey's ability to attract these high spending, high net worth individuals at this time.

Apart from the financial contribution these wealthy individuals bring, they contribute to Jersey society, and are part of the local community.

A review of the 1(1)(k) regime is currently underway and proposals are due to be presented to the States later in this year. States members will have the opportunity for a properly informed debate on the 1(1)(k) regime at that time. To make ad hoc changes before all the information is available and all the options have been considered, would be detrimental to the island's economic security.

Impartial, independent advice commissioned into the factors that influence wealthy individuals' choice of where to live suggests that the amount of tax charged is an important issue. The minimum tax contribution required in Jersey makes us one of the most expensive places for high net worth individuals. There are other reasons why wealthy individuals choose Jersey over other jurisdictions like Switzerland, Monaco and Guernsey, but it is clear that the comparatively high level of tax charged here does deter some potential applicants for 1(1)(k) status.

That advice did however suggest that some wealthy individuals might be prepared to pay an increased amount of tax to acquire 1(1)(k) status in Jersey. It was estimated that the additional tax collected as a result of increasing the minimum tax contribution required from £100,000 to £125,000, would be greater than the tax lost from those individuals deterred from coming to Jersey by the increase. The Minister for Housing has therefore increased the minimum tax contribution required from applicants for 1(1)(k) status with effect from 30th December 2010.

That change was made on the basis of careful consideration and having sought impartial advice. By contrast, this proposition would sweep away the 1(1)(k) tax regime with no regard for the economic consequences for Jersey.

Other changes which are due to be brought before the States shortly are designed to encourage 1(1)(k)s to increase their investment in the Island. Currently, the tax system tacitly encourages them to invest their money outside the Island. By removing the barrier to investing in Jersey, the Island will see an even greater economic advantage from the presence of these wealthy individuals. However, this advantage will be lost if the special tax regime for 1(1)(k)s is abolished.

Financial and manpower implications

The financial and manpower figures included in the report accompanying the proposition are not reliable estimates of the impact of this proposal. The report ignores the additional financial and manpower resources required to implement and administer an independent system of taxation, and the 20,000 additional tax returns and assessments required. The Taxes Office estimates that this aspect of the proposition alone would require up to 14 additional staff and cost an extra £700,000 per annum. This calculation has been prepared on the basis that 11 additional accounts officers would be required to review an average of 1,800 returns each and that the equivalent of three more staff would be required to deal with the additional filing, scanning, helpdesk assistance, tax collection and IT infrastructure requirements arising. The cost of printing and posting all the additional paperwork required alone is estimated at £50,000.

The proposition also assumes that the introduction of higher rates of tax would not affect the behaviour of individuals and businesses. However, it is likely that the effective abolishment of the special tax regime for 1(1)(k) residents would lead to a loss of some of the £13.5 million of tax revenues contributed by these individuals, rather than an increase. This is because some of our current 1(1)(k) residents would leave Jersey and it would be extremely difficult to replace them if Jersey could no longer compete with the many other territories which offer special tax regimes to the highly wealthy.

The proposition also assumes that employers would continue to employ the same number of staff in Jersey as at present, and at the same rates of pay. Increasing the cost of employing staff in Jersey and reducing Jersey's attractiveness to highly paid employees is likely to lead to jobs being transferred away from the Island. The impact of this is difficult to quantify and would be unlikely to be experienced immediately, but Jersey must be careful to ensure that it does not indirectly encourage businesses to relocate to one of our competitor jurisdictions.

Clarification – comments regarding Involve

The Council of Ministers would advise Members that the comment attributed to Involve in the fourth paragraph of Page 6 of the proposition (starting "This is a very mixed response…") was not made by Involve but seems to be a comment by Deputy Southern.