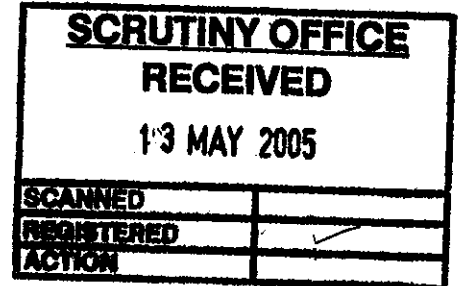




JERSEY FINANCE

Representing The International Finance Centre

Goods & Services Tax Scrutiny Office
States Building
St Helier
Jersey JE1 1BA



12th May 2005

Dear Sirs

GOODS AND SERVICES TAX – SHADOW SCRUTINY PANEL REVIEW

I am writing in response to the recent Shadow Scrutiny Panel Notice in the Jersey Evening Post inviting submissions from interested groups and individuals on the proposed Goods & Services Tax (GST).

Status of this Submission

Jersey Finance Limited ("Jersey Finance") is the representative body for the Financial Services Industry ('FSI' or 'the Industry') in Jersey. We have over 160 Members including all of the major financial services groups and the nine principal FSI trade associations operating in the Island. Since January 2004 (following a merger with the Jersey Finance Industry Association), Jersey Finance has been responsible for co-ordinating the Industry's response to legal and regulatory matters which affect it, including consultations issued by the States of Jersey and the Financial Services Commission.

Our position on the Goods & Services Tax proposals

Jersey Finance recently established and co-ordinated a pan-Industry Working Party specifically to respond to the consultation conducted by Crown Agents on behalf of the Finance & Economics Committee ('F&E'). A copy of the Working Party's original submission to the Crown Agents' consultation is enclosed. We would be happy for representatives of the Working Party to attend the public hearing and discuss our original submission, and the Crown Agents' final recommendations, with the Shadow Scrutiny Panel as required.



Other comments

We were somewhat surprised to learn that the proposed scope of the Shadow Scrutiny review appears to extend to the whole question of the "0/10" Fiscal Strategy, which of course was debated at length in June 2004 and approved in the States by a substantial majority. The original F&E proposition (P106/2004) setting out proposals for the "0/10" strategy covers in considerable detail the points set out at 1.i to 1.iv of the Panel's terms of reference. There is not much more that we would wish, or be able, to add by way of background, other than to endorse the conclusions drawn in the F&E proposition and respectfully remind the Panel that the proposition itself was based on extensive independent research conducted by States-appointed advisors including Oxera and PricewaterhouseCoopers. Copies of all such background reports, as well as F&E Fiscal Strategy consultation papers dating back to July 2001, are of course publicly available on the States' website (<http://www.gov.je/taxandspending/index.asp>).

I trust that the above comments are helpful and look forward to hearing from you in due course.

Yours faithfully

A handwritten signature in black ink, appearing to read "David Wild".

David Wild
Technical Director

Enc.



JERSEY FINANCE

Representing The International Finance Centre

Tax Proposals
Maritime House
St Helier
Jersey JE1 1JJ

3rd December 2004

Dear Sirs

A GOODS AND SERVICES TAX – THE RIGHT WAY FOR JERSEY?

I am writing in response to the above consultation paper, which was issued for public consultation by the Finance and Economics Committee ("F&E") on 28th October 2004.

A. STATUS OF THIS RESPONSE

In accordance with the agreed process for Finance Industry consultation, Jersey Finance notified all of its Members on 29th October 2004 that the above Consultation Paper had been issued by F&E. In addition to an e-mail communication to our Members, we included a link to the Consultation Paper on our website.

Jersey Finance Members were encouraged to provide responses either directly to you, through their respective Trade Associations or through Jersey Finance. Jersey Finance also established a Finance Industry Working Party to consider the proposals in further detail and to formulate this response. The members of the Working Party are detailed at appendix 1, and include representatives from eight of our nine Trade Association Members.

This response sets out the consensus view of the Working Party. We have also summarised at appendix 2 the alternative positions of two of our Trade Association Members who were represented on the Working Party. We are also aware that a number of our Members, including both individual Member Firms and Trade Association Members, have written to you directly on this important subject.

In our response, we have adopted terminology widely used in relation to VAT systems. This has been done for ease of reference but should not be taken to imply that we are recommending or endorsing a VAT-based GST model for Jersey.



B. IN SUMMARY

- **We believe that the three key objectives for the States' fiscal strategy should be to:**
 - **Create an environment which encourages and supports economic growth, which minimizes unnecessary cost and bureaucracy, and in which States' expenditure is properly controlled;**
 - **Address the inherent structural weakness within Jersey's current tax system by broadening the tax base and reducing the risk of future revenue volatility; and**
 - **Introduce a fairer, more progressive tax system, under which those individuals who can afford to pay more do so.**
- **We consider that the Fiscal Strategy 2005-2010 ("Fiscal Strategy") proposed by F&E broadly aims to achieve these objectives and is therefore in the best long-term economic interest of Jersey.**
- **However, we remain concerned at the States' ability to deliver key elements of the Fiscal Strategy, particularly in the areas of economic growth and control of States' expenditure. Further work is needed in this regard.**
- **We believe that it would be irresponsible of the States not to broaden the tax base in Jersey as part of the current general reform of taxation, and we therefore support in principle the introduction of a goods and services tax ("GST") in Jersey as part of the package of measures proposed under the Fiscal Strategy. If properly implemented, GST will become an important tool in reducing Jersey's current reliance upon direct taxation (and direct corporate taxation in particular) as the principal source of government funding.**
- **However, in line with the key strategic objectives outlined above, a GST should also be simple and cost-effective to administer for all businesses affected by it. A full compliance cost assessment should be included as part of the formal recommendations and this should then be one of the key criteria in deciding whether a GST system can be introduced at an acceptable cost.**



- **Moreover, in its proposition to the States in June 2004¹, the Finance and Economics Committee stated that:**

“The starting point for any long-term fiscal plan for Jersey must be the preservation and strengthening of the financial services industry. For Jersey to thrive, it is essential to ensure that it remains competitive internationally and is able to attract companies to invest, do business, employ people and pay tax on-Island”.

- ***We fully concur with this assessment, and would argue strongly that it is essential that any GST must not damage the competitiveness of the Financial Services Industry (“FSI”) in Jersey, as this would be detrimental to Jersey’s economy as a whole. To achieve this, it will be necessary for the provision of all financial services and transactions to FSI customers to be “zero rated” or outside the scope of GST. A great deal of care will need to be taken in designing a GST system which meets this objective.***
- ***GST is generally regarded as a regressive tax, in that it applies to all consumers of goods and services, and will have the greatest impact (in percentage terms at least) on individuals and households with lower income levels. Accordingly, appropriate safeguards will also need to be introduced to protect low income groups. In that regard we endorse F&E’s proposals to review and reform income support measures for such groups.***
- ***We would also favour some form of capping mechanism, whereby the States’ ability to raise the GST rate is limited and subject to statutory protection. Increases to GST should not become the ‘first port of call’ in the event that the States fails to deliver on other aspects of the Fiscal Strategy.***
- ***The final report and recommendations of Crown Agents should be made publicly available for comment before being presented to the States in February 2005.***

¹ “The Reform of Public Spending and Taxation”



C. THE ROLE OF THE FINANCIAL SERVICES INDUSTRY IN JERSEY

1. Over the past several decades, Jersey and its people have enjoyed one of the highest standards of living in the world. The Island has repeatedly demonstrated an ability to adapt and respond to change, and has successively prospered from agriculture, tourism, and most recently, from the provision of international financial services.
2. The Financial Services Industry is particularly important to Jersey from an economic perspective, and today makes the most significant contribution to economic activity in Jersey. In 2003, it contributed in excess of £1.05 billion to Jersey's Gross National Income (GNI), and generated approximately 70% of total corporate tax revenues and 50% of personal income tax revenues. The tax revenues derived from the Industry in turn fund the majority of annual States' expenditure on essential public services such as Health, Social Security and Education.
3. Nearly 12,000 Jersey residents (approximately 25% of the Island's work force) are employed directly in the Financial Services Industry. For many of these individuals and their families, the earnings derived from this employment represent their principal or only source of income.
4. Many thousands more work in other sectors of Jersey's economy which benefit indirectly from the demand created by the Financial Services Industry. These sectors include retail, construction and tourism & hospitality.
5. Jersey without a Financial Services Industry would be a very different place. There would be significant unemployment, rapid depopulation and negative equity in the housing market. Dramatic cuts would be required to States' expenditure on the core public services and benefits which many of us currently take for granted. The Fiscal Strategy Background Paper produced by Oxera on behalf of the States in February 2004 commented that:

"In the event that the financial services industry in Jersey were to go into a serious decline [...] the Jersey economy would be likely to experience a severe and prolonged depression. The economic decline, in the absence of some (hitherto undiscovered) alternative industry, would be likely to be permanent."



D. THE STATES' FISCAL STRATEGY 2005-2010

6. Over the past six years, the Finance and Economics Committee ("F&E") of the States of Jersey has been developing a Fiscal Strategy designed to safeguard the future prosperity of Jersey and its people. This process resulted in the presentation to the States, in June 2004, of a proposition entitled "***The Reform of Public Spending and Taxation***".
7. In developing its Fiscal Strategy, F&E clearly recognised the position of the Financial Services Industry as Jersey's principal source of prosperity, and explained why it is therefore necessary to safeguard the Industry in order to preserve the Island's economic prosperity as a whole. In particular, in its proposition to the States, F&E commented that:

"It would be difficult to imagine an industry, other than financial services, which was better suited to a small island economy such as Jersey. It is one of the most profitable industries in the world and it uses relatively little land. Any alternative international industry that might be tempted to locate in Jersey would be very unlikely to be able to contribute so much to the economy and tax revenues. Therefore, losing the international financial services sector would reduce average wages and reduce the average profitability per worker on the Island. To continue to deliver the same public services would inevitably mean higher tax rates, for fewer people, on the significantly lower income and profits that would be left to tax.

The Committee has concluded that the future economic well being of the Island is dependent on ensuring that Jersey is, and remains, internationally competitive as a place to provide international financial services."

8. In order to preserve Jersey's competitive position, F&E has placed at the heart of its strategy the "0/10" proposals. Under 0/10, a general rate of corporate tax of 0% will be introduced by 2009, but certain sectors (primarily financial services) will pay a standard rate of 10%. This rate has largely been determined by market forces, and has been set at a rate which will keep Jersey internationally competitive (Singapore, Guernsey and the Isle of Man are moving to a rate of 10% and Dublin already has a rate of 12.5%). Above this level Jersey would rapidly become uncompetitive as a place to locate providers of international financial services. Jersey is operating on an international stage which is increasingly competitive and, like all countries and territories around the globe, cannot afford to stand still.
9. The proposed 0/10 structure will ensure that business continues to be attracted to Jersey, and that the Financial Services Industry continues to pay the vast majority of corporate tax revenues in support of Jersey's economy. However, the move to 0/10 is also expected to result in some loss of tax revenue. As has been well-documented, this is expected to be in the region of £80-100 million per annum.



10. A common misconception is that this loss of tax revenues for Jersey represents a 'windfall' for the Financial Services Industry, which will benefit from reduced corporate tax rates under the 0/10 regime. This is misleading, however, in that the expected revenue gap is caused by tax revenues being lost to other jurisdictions, especially the UK, with little benefit to locally owned businesses or the local economy.
11. In order to meet the expected deficit arising out of the move to 0/10, the Fiscal Strategy outlined five further objectives:
 - o *Eliminate waste and increase efficiency in the delivery of public services;*
 - o *Expand the economy through economic growth;*
 - o *Make the maximum rate of income tax of 20% mean 20% for well-off households by phasing out allowances;*
 - o *Introduce a goods and services tax of 5% in 2007; and*
 - o *Introduce an Income Tax Instalment System (ITIS) from 2006.*
12. The 0/10 proposals, together with four of the five objectives of the Fiscal Strategy were approved in the States by a substantial majority, and this provided clear evidence of the strength of the Island's political commitment to maintaining Jersey's competitive position as a leading international finance centre. We welcomed this decision, and believe that it was the right one for Jersey.
13. In respect of the goods and services tax proposals, however, it was agreed that further research and consultation should be undertaken, and we set out at Section E below the position of the Finance Industry Working Party in response to that process.
14. However, it is also important that the specific GST proposals should be considered within the context of the other measures proposed as part of the Fiscal Strategy, and in that regard we would make the following additional brief comments:
 - o A key element of the Fiscal Strategy relates to the States' plans to control and reduce public spending, through the elimination of waste and improved efficiency in the delivery of public services. We welcome this proposal in principle, but remain sceptical that States' expenditure has yet to be brought fully under control. We would welcome a thorough and transparent review of the States budget and expenditure plans, together with a clear and measurable action plan for achieving the proposed £20 million p.a. cost savings. We would also strongly encourage the States to aim for greater savings than the proposed £20 million per annum. We believe that there is significant scope for further savings to be achieved in many areas of States activity including in the provision of core public services.



- It should also be noted that the “20% means 20%” proposal will have a significant impact on middle and higher income households. Many individuals working at middle and senior management levels in all economic sectors will pay considerably more personal income tax as a result of these proposals, whereas it is not expected that the proposal will affect the 30% of the working population in Jersey who currently pay no income tax as a result of the generous allowances and exemptions available to those on lower incomes². We calculate that certain middle income households will experience 30% increases in the amount of personal income tax which they are paying as a result of this proposal. We believe that the impact of this proposal should not be underestimated when considering other ‘progressive’ tax measures.

E. A GOODS & SERVICES TAX – THE RIGHT WAY FOR JERSEY?

We support in principle the introduction of a goods and services tax in Jersey...

15. There is an inherent structural weakness in Jersey’s current taxation system, in that it is excessively reliant upon direct taxation (and in particular direct corporate taxation). It is estimated that direct corporate taxation currently accounts for approximately 43% of the Island’s annual total tax revenues, with a further 25% derived from personal income tax and just 7% from Impôts. In contrast, in the United Kingdom just 10% of annual tax revenues are derived from corporate tax, with a further 30% coming from personal income tax and 31% from VAT and Customs levies³.
16. Whilst this has meant that Jersey has historically been in the fortunate position of being able to fund most of its expenditure on public services effectively through the taxation of foreign corporations, such a high degree of reliance on direct taxation does make Jersey particularly vulnerable to changes in economic conditions both in the Island and elsewhere. A goods and services tax would reduce some of this exposure and help to ensure a more even distribution of the tax burden across the community. The concept that the consumers of public services should themselves make a contribution to funding the public purse is neither radical nor unreasonable.
17. As noted in the Consultation Paper, some form of GST is common in many countries, including the United Kingdom, Ireland, Luxembourg, Singapore and Switzerland. The general reform of taxation in Jersey currently being undertaken as part of the Fiscal Strategy represents a good opportunity to bring Jersey into line with international norms and to address the current imbalance in direct vs. indirect taxation in the Island.

² Source: Oxera Fiscal Strategy Background Paper – February 2004

³ Source: Oxera Fiscal Strategy Background Paper February 2004



...but any such tax must not damage the competitiveness of the Financial Services Industry in Jersey.

18. F&E's Fiscal Strategy is based upon preserving the international competitiveness of the Island's primary industry. Indeed, the Strategy also envisages significant economic growth – an increase to GNI of approximately £200 million per annum in real terms by 2010. In reality, it is likely that much of this expected growth will need to come from the Financial Services sector.
19. It is therefore essential that any planned GST is "tax neutral" to the Financial Services Industry and its customers. The only way to achieve this is by ensuring that financial services are "**zero rated**" or out of scope for GST purposes, and that the vehicles and structures we establish for our customers are entirely outside the scope of GST.
20. As noted in the consultation paper, under any GST system financial transactions and services are typically 'exempt' or 'zero rated'. However, for Jersey's Financial Services Industry, granting an exemption to a provider of services without a credit for the GST borne is quite simply not an option. Apart from the potential GST cost in terms of tax paid on inputs by service providers, exemption introduces additional complexities for affected businesses: verifying the location of counterparties/customers to determine the correct liability, classifying services to determine if they are exempt and not taxable and carrying out "partial exemption" calculations to ensure that recovery of GST on costs is maximized. We need a system which is easy to understand and operate (and therefore does not impede new business) and which bears no significant cost either in the form of a tax on inputs or undue administration. It is our strong view that zero rating is the best way to achieve this. It is also worth noting that there is an increasing international trend towards zero rating financial services (for example, New Zealand, a developing international finance centre, has most recently gone down this route in order to stimulate growth of its financial services industry).
21. Zero rating will ensure that not only are customers of financial services in Jersey outside the scope of the GST regime, but also that local financial services businesses will be able to recover input tax suffered on the purchase of domestic supplies and services. Similarly, where services are purchased from overseas, zero rating would ensure that the potential imposition of a "reverse charge" would have no cash impact on the business as it would be fully recoverable. Should such input taxes not be recoverable, then this would effectively represent an additional tax on financial services businesses in the Island. This would damage the Industry's competitiveness and is contrary to the 0/10 policy, which is designed to preserve and indeed stimulate further growth in the Island's key economic sectors. Any additional costs arising in this way would ultimately have to be passed on to customers (which would reduce Jersey's ability to retain existing and attract new customers) or borne by the financial services businesses themselves. It is widely acknowledged that the imposition of VAT in the Isle of Man on fund management services had an adverse impact on the growth of that industry



and measures have since been introduced to move to zero rating. For a jurisdiction such as Jersey where the overall cost of doing business is already high relative to many of our competitors, a significant GST cost would almost certainly ultimately drive financial services providers themselves from the Island.

22. In this regard, a further factor of fundamental importance to the design of the tax is that the financial services sector is clearly but broadly defined. It is not enough to assume that businesses will accept an everyday interpretation of the phrase. The final report on GST should not only set out the types of services which would fall to be treated as "financial services" and thus benefit from the zero rating but also provide clear guidelines on the business types which are covered. Failure to do this could lead to "grey" areas and confusion and the loss of business to other offshore jurisdictions.
23. For example, we consider that the zero rating should apply to all businesses within the following sectors:
- Banking – retail, private, commercial
 - Trust and companies administration
 - Investment management
 - Fund management and administration
 - Service providers to administered vehicles and structures

Furthermore, zero-rating should apply to supplies made by these businesses regardless of whether the services are provided locally or to international customers.

24. It is also essential that those vehicles which are at the heart of Jersey's Financial Services Industry (such as exempt companies, trusts and funds) are not touched in any way by the imposition of GST. These are effectively the products that we provide to customers of Jersey's Financial Services Industry. They rely significantly on tax neutrality. Currently, such vehicles are not required to file tax returns and are for the most part exempt from the scope of any form of taxation in Jersey. However, the Island's principal competitor jurisdictions provide similar products and there is intense competition between the jurisdictions for the provision of these vehicles. The choice of jurisdiction available to our customers is broad and often one jurisdiction may simply be chosen ahead of another because of force of habit. It is fundamental that these vehicles are not affected in any way by the introduction of GST, as this would undoubtedly lead to a rapid and substantial migration of business. For example, even the hint of a GST complexity affecting securitisation vehicles or investment fund vehicles would lead customers to establish such vehicles in other jurisdictions.
25. The activities of these vehicles are broad and often complex. It is common place for such vehicles to transact with each other, many provide services themselves and for many it is increasingly important for the activities to be undertaken from within the Island. Such vehicles must be afforded a special treatment to ensure that they are not touched by GST and importantly that it is not necessary to undertake a detailed analysis of their activities in order to



determine the impact GST may have on them. It may be possible to achieve this by a provision which deems them to be established outside Jersey for GST purposes. Alternatively, an exemption certification method could ensure that they fall outside the entire scope of GST. However, it would be crucial to ensure that such a provision did not jeopardise the efficacy of current/proposed structures from a direct tax perspective.

26. In summary, the effect of not adopting a GST which zero rates financial services and which protects the vehicles and structures we provide to our customers would be severely detrimental to the planned strategy for economic growth, and it would not be unreasonable to envisage a rapid and significant outflow of business to competitor jurisdictions.

A goods and services tax will affect all Jersey residents...

27. The argument for zero rating financial services will not directly benefit individuals working in the Financial Services Industry. As individuals, we will all have to share the burden of GST, whether we work in financial services, retail, tourism or agriculture. This is a simple fact of life and a necessity if we are to broaden the tax base in Jersey and reduce the volatility risk for future generations.
28. So if individuals working in the financial services sector do not stand to benefit personally from zero rating financial services, why are we advocating this approach? Quite simply, because zero rating is necessary to preserve the overall competitiveness of Jersey as an international finance centre, and Jersey's future economic prosperity is dependent upon the success of its Financial Services Industry.

...but safeguards should be introduced to protect low income groups.

29. The consultation paper briefly discusses the impact of a GST upon low income groups. As noted in the paper, such groups can be sheltered from the impact of the tax by excluding from the tax base essential goods and services (e.g. food and children's clothing), or by adjusting income support measures to compensate for the effect of the tax.
30. We agree that those people on genuinely low incomes should not be unduly prejudiced by the introduction of a GST, and that the States will need to introduce appropriate safeguards to achieve this aim.

A goods and services tax should be simple and cost-effective to administer.

31. As discussed at our recent meeting with Crown Agents representatives, the final report on GST proposals should include a compliance cost assessment.
32. The final report and recommendations should also be made publicly available for comment before being presented the States.



Thank you for giving us the opportunity to comment on these important proposals.
We would be pleased to meet with you to discuss our position in further detail.

Yours faithfully

A handwritten signature in black ink, appearing to read 'David Wild', written in a cursive style.

David Wild
Technical Director



Appendix 1 – Composition of GST Working Party

Name	Representing
Mark Dufty	Association of Private Client Investment Managers & Stockbrokers
Daniel Henbest	Barclays
Jo Huxtable	Deloitte
John Shenton	Ernst & Young
Sara Durnford-Lloyd	Jersey Association of Trust Companies
Hans Baerlocher	Jersey Bankers' Association
David Wild	Jersey Finance
Jonathan Crowther	Jersey Funds Association
Alex Ohlsson	Jersey Law Society
Paul Sanderson	Jersey Pensions & Financial Services Association
Wendy Dorman	Jersey Society of Chartered & Certified Accountants
Chris Lowndes	Jersey Society of Chartered & Certified Accountants
John Riva	Jersey Tax Society
Jane Stubbs	PricewaterhouseCoopers
Lynn Cleary	Royal Bank of Scotland International



Appendix 2 – Position of Jersey Funds Association and Jersey Association of Trust Companies

Jersey Funds Association

The Jersey Funds Association (JFA) wrote to the President of F&E on 24th November 2004 outlining its views on GST. The full letter is not repeated here, but in summary, JFA recognises the need for Jersey to reduce its dependency on direct taxes, but has strong reservations concerning the cost and administration implications of implementing a GST system, and the impact this would have on the planned economic growth strategy.

Because of these concerns, JFA is not convinced that a GST is the most appropriate solution to meet the expected budget deficit. The JFA letter of 24th November 2004 outlines a number of alternative proposals, which we understand have been or are also being considered by F&E.

JFA conclude that:

“GST is bad for the Fund Industry and the Island and should only be implemented as a very last resort and after further consideration of alternative taxes, which have existing mechanisms for collection [...].

If it is brought in then it is absolutely essential that the Fund Industry does not charge GST and also that we do not suffer it on legal, audit, accountancy, IT, data and telecommunications services.

This does mean that we reluctantly accept that if GST is introduced that we may have to pick up some GST on the costs of other types of goods and services.

We expect the States to demonstrate that it is genuinely putting its own house in order first by conducting a credible review of its own spending. We would also want a proper economic assessment of the impact of any increased costs on other industries, especially tourism. To make our already expensive Island even more expensive to its international clients and in particular the users of its services in the FSI will have a negative impact on the willingness of businesses to invest and operate from the Island, making it harder to achieve economic growth. GST has the potential to be at least partly self-defeating.”



Appendix 2 – Position of Jersey Funds Association and Jersey Association of Trust Companies (continued)

Jersey Association of Trust Companies

The Jersey Association of Trust Companies (JATCO) has expressed similar reservations to those of the JFA, particularly with regard to the potentially high administration and compliance costs associated with introducing a new GST system.

JATCO has argued that, for a small Island population, it may be preferable to modify and rely on existing tax collection systems rather than have the risk and expense associated with the implementation of a new system. At this stage, JATCO does not believe sufficient data has been made available in order to assess the full impact of a GST system or the alternative proposals.

However, should the States decide to proceed with GST, then JATCO broadly shares the views and concerns of the rest of the Industry Working Party, as expressed in this submission.