STATES OF JERSEY

DRAFT BUDGET STATEMENT 2014 (P.122/2013): AMENDMENT (P.122/2013 Amd.) – COMMENTS

Presented to the States on 2nd December 2013
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

Draft Budget Statement 2014 (P.122/2013): amendment
After the words "as set out in the Budget Statement" insert the words – "except that – (i) income tax exemptions for the year of assessment 2014 shall not be increased by 1.5% as proposed in the draft Budget Statement; (ii) the marginal rate for the year of assessment 2014 shall not be decreased from 27% to 26% as proposed in the draft Budget Statement; (iii) the estimate of income from taxation during 2014 shall be decreased by £5 million by zero-rating or exempting from Goods and Services Tax foodstuffs in line with United Kingdom Value Added Tax arrangements and domestic fuel and energy with effect from 1st July 2014."

Recommendation	**Summary of Key Points**
Strongly opposed	1. UK VAT exemptions would complicate GST legislation which is broad-based, simple and low. 2. UK VAT exemptions have been debated on many previous occasions and each time they have been rejected. 3. The benefit of the marginal rate tax cut is guaranteed. Alternatively, there is no guarantee of permanent price reductions being passed on to the consumer if there is a reduction in GST. 4. The reduction in the marginal rate is targeted to lower and middle income earners.

Cost Implications

<u>Part Year from 1st July 2014 to 31st December 2014</u>

	£
Foodstuffs	**3.9 million**
Domestic fuel and energy	**<u>1.2 million</u>**
Total:	**5.1 million**

Full Year from 2015

	£
Foodstuffs	**7.8 million**
Domestic fuel and energy	**2.4 million**
Total:	**10.2 million**

Introduction

1. If this proposition were adopted, there is a strong possibility that the States would lose significant revenue, businesses would incur increased compliance costs, and the States would incur additional administrative costs, with Islanders seeing little or no real benefit.

2. Jersey's policy towards GST is one of a Broad-Based Low Rate – "BBLR", where the absence of numerous reliefs enables us to retain what is a relatively simple system and the lowest standard rate of GST in the world.

3. Because of our broad-based low GST rate, the creation of reliefs has a small economic effect, but a disproportionate legislative and administrative cost when compared to other countries, where the average worldwide GST rate is between 16 – 25%.

4. A system of exclusions (whether by zero-rate or exemption) requires detailed legislation, and the added complexity greatly increases the scope for avoidance, evasion and error.

5. The UK VAT system is a poor model on which to base any GST relief changes and is recognised as being excessively complex and outdated. This point was amply illustrated in the Coalition Government's 2012 attempt to make changes to zero-rate reliefs on foodstuffs which culminated with the "pasty tax" fiasco. In contrast, Jersey should seek to follow the best examples of international tax practice, not adopt a regime which, 40 years after implementation, is still subject to constant challenge and change.

6. International studies (Mirrlees, OECD Global Forum on GST/VAT) and global experience illustrate that a reduction of consumption tax on goods does not lead to a reduction in price, and in many cases only serves to increase margins through the supply chain. GST/VAT taxation is a very inefficient way to target financial assistance, as there is no guarantee that GST reduction would be passed on to the public through lower prices.

7. Introducing GST exemptions is a less efficient way to support those on lower incomes than the current system of income support and GST bonuses. This proposition fails to recognise that those in receipt of income support and the GST bonus would lose the element of those payments that relate to food and fuel, this contrasts with the better-off who would benefit considerably more since they spend and pay more GST on the food and fuel they buy.

8. Of the over £10+ million (foodstuffs £7.8 million, fuel £2.4 million) annual revenue that would be lost from excluding food and domestic energy, research conducted in 2011 suggests less than £1.3 million would go to the 20% of the

population on the lowest income, but more than £3.3 million would go to the top 20%. This again illustrates the ineffectiveness of using a GST relief to address income redistribution. In contrast, the marginal relief reduction proposed would benefit 84% of taxpayers.

Supporting analysis (updated from response to P.36/2011)

9. The proposition to introduce exclusions for food and domestic energy is not new and the concept has been debated before in the States. The arguments for and against have not changed significantly – they are the same now as they were when this issue was last discussed in May 2011 and on many other occasions over the past years.

10. One difference at the time of this debate is that we have had nearly 6 years of live tax experience since GST was implemented, and we can make informed judgements as to how well the tax system has performed. We also have international comparisons and the experience across over 150 other countries with a similar GST/VAT tax. The November 2012 Global VAT/GST Forum held by the OECD illustrated clearly that there is a movement away from technically challenging zero rates and exemptions across the world, and a growing acceptance that broad-based simpler consumption taxes support government and business aims.

11. The internationally recognised measure of efficiency in GST/VAT taxation systems, "the C – efficiency ratio", compares the yield from the tax with the theoretical yield if all goods and services were standard rate, A high ratio indicates limited or no reliefs, whereas a low ratio indicates numerous reliefs. The UK ratio at 42% indicates an inefficient system with many exceptions to tax, and no longer compares favourably with nations such as New Zealand, Switzerland, Canada and Japan, who seek to seriously limit reliefs and have factors between 60 to 85%. Jersey's GST taxation would be more effective by retaining a broad-based tax with high level of efficiency in common with the approach taken by those countries named above.

The UK VAT system is not the best model to follow

12. The UK VAT system was introduced in 1973, 40 years ago, and is now beginning to show its age – as such it is considered very much to be a first generation system. Internationally, a fundamental review of the UK VAT system is considered long overdue.

13. As an EU Member State, the UK should comply with the EU common VAT rules which determine, amongst other things, the rates of tax charged and what exclusions are permitted (whether by zero-rating or exemption). Food and domestic energy are both taxable under EU rules, but the UK, Ireland and Malta have been allowed to retain their different treatment as a transitional measure. This matter is kept under regular review; at some point the UK may be required to fall into line with the rest of the EU regarding its treatment of food for VAT purposes.

Impact of exclusions on the complexity of GST/VAT systems

14. The range, type and number of exclusions under any GST/VAT have a direct impact on the complexity of the system. The overall impact assessment of mirroring the UK VAT treatment of food is very high, while the impact of following the UK treatment of fuel would be lower.

Benefits of decreasing the marginal rate of tax

15. Personal income tax in Jersey is based around a standard 20% rate of tax with limited deductions and allowances but, in order to protect the lower to middle-income earners, a separate calculation called 'marginal relief' with a 27% rate is also made. These two calculations are carried out at the same time.

16. Taxpayers pay whichever calculation gives them the lowest tax bill according to their circumstances, so no-one pays more than 20% of their total income in tax.

17. This works because more deductions are available to those who are marginal rate taxpayers. So, for marginal rate taxpayers, the calculation starts with their income; exemptions for child care and mortgage interest relief are deducted, and then the tax due is calculated at 27% on the reduced amount.

18. Because these exemption thresholds are used to calculate tax, people on high incomes do not benefit from them.

19. If someone's income increases, the percentage of tax they pay also increases, as the marginal relief gradually tapers away until they are paying the maximum 20%.

20. A cut in the marginal rate of tax will benefit all marginal rate taxpayers. In addition a number of standard rate taxpayers will be brought into the marginal rate.

21. The proposal to reduce the marginal rate of tax will reduce the tax liability of approximately 84% of the taxpaying population (around 40,000 households).

22. The cost of decreasing the marginal rate by 1% is approximately £7.8 million.

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

The Minister apologises to the Assembly for the lateness of these comments, which was due to extra work being done to make sure that these were as useful as possible to all States Members.