STATES OF JERSEY

DRAFT BUDGET STATEMENT 2018 (P.90/2017): FOURTH AMENDMENT (P.90/2017 Amd.(4)) – COMMENTS

Presented to the States on 27th November 2017
by the Council of Ministers

STATES GREFFE

COMMENTS

With the support of the Council of Ministers, the Minister for Treasury and Resources has lodged an amendment to this amendment proposing changes to the parts of the amendment relating to the duty-free tobacco allowance, the taxation of Class 1 bookmakers and the taxation of large liquor vendors. The comments supporting those proposed changes are included in the amendment to the amendment and are not reproduced here.

The Council of Ministers opposes parts (iv) and (v) of Senator P.F.C. Ozouf's amendment (P.90/2017 Amd.(4)) and relevant comments are provided below. The Council of Ministers encourages States Members to support the amendment of the Minister for Treasury and Resources which seeks to delete these parts of the underlying amendment.

Stamp duty changes on properties worth in excess of £10 million for newly-arrived HVRs

Senator Ozouf's amendment is specifically directed at the population of High Value Residents ("HVRs") who will arrive after the Budget debate and purchase property worth in excess of £10 million. It will create a separate stamp duty rate for this specific population, disadvantaging them compared to the non-HVR population and, more importantly, compared to those HVRs who have already arrived in the Island.

The Council of Ministers welcomes the opportunity to reiterate its commitment to the policy of encouraging HVRs to move to the Island. HVRs make a significant contribution to the Island, not just in terms of their direct tax contribution, but on a much broader basis such as charitable donations, business mentoring and sponsorship of sports teams.

The following paragraph is taken from the Withers LLP and Panopticon Policy review of 1(1)(k) regime undertaken in 2010[1], highlighting the economic benefit enjoyed by the Island through the HVR policy (original emphasis):

> "**The economic effects of 1(1)(k)s are large**. We have derived estimates from the income tax payments made by 1(1)(k)s in 2009 that **their economic impact is at a minimum of £50–70 million**, however, this estimate is both extremely conservative and subject to many uncertainties."

However, this Council of Ministers is alive to the need to ensure that HVRs are making an appropriate direct tax contribution, and the 2018 Budget proposes material changes to the tax regime applying to future HVRs (i.e. those granted 2(1)(e) status on or after 1st January 2018), which will result in them making an even greater direct financial contribution to the Island. These proposals implement recommendations that were identified in the review of the HVR tax regime published in December 2016[2].

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[1] See: https://www.gov.je/sitecollectiondocuments/tax%20and%20your%20money/r%20review%20of%201(1)(k)%20regime%20for%20the%20states%20of%20jersey%2020111011.pdf

[2] Post-Implementation Review of Jersey's High Value Residents Regime Applicable since July 2011 – A Report by the Tax Policy Unit for the Council of Ministers and the States Assembly (see: http://www.statesassembly.gov.je/assemblyreports/2016/r.130-2016.pdf)

The 2018 Budget proposals are to –

- increase the expected annual minimum income tax contribution to £145,000;
- ensure that income tax of £145,000 per annum is paid (through the introduction of a top-up mechanism); and
- periodically revalorise the £145,000 by not more than inflation.

These measures will both enhance and secure the direct tax contribution made by future HVRs. These measures represent significant changes to the regime, and were recommended after careful consideration of the "Jersey package" against that being offered in competing jurisdictions. There are other jurisdictions where the annual tax contribution expected from HVRs is much less than that expected in Jersey, but the "Jersey package" that is sold by Locate Jersey is broader than just the income tax proposition.

It must also be recognised that, from 1st January 2017, this Council of Ministers has already required those buying property at the higher end of the housing market to contribute more in stamp duty. The 2017 Budget included stamp duty increases on property worth in excess of £3 million, with an increased rate of stamp duty (8%) on consideration in excess of £3 million, and a new top rate of stamp duty (9%) on any consideration in excess of £6 million.

Following these changes, the stamp duty payable on the purchase of a £10 million property is currently £727,000, an increase of £110,000 over the amount of stamp duty that would have been payable on such a property purchase in 2016.

The Council of Ministers considers that the changes proposed to the taxation of HVRs in Budget 2018, and the changes to stamp duty already made strike the right balance between welcoming future HVRs to the Island and asking them to make an appropriate contribution. Increasing the stamp duty rate on a size of transaction that, based on historical trends, may only occur once a year, risks damaging that balance for very little additional revenue.

Tax rate applied to large corporate retailers

In the 2017 Budget, Senator S.C. Ferguson lodged an amendment seeking the introduction of a large corporate retailers tax that mirrored the equivalent tax introduced in Guernsey in 2016. Following the adoption of an amendment to prevent the Minister for Treasury and Resources being required to simply copy the Guernsey legislation directly into Jersey's Income Tax Law, the amendment was overwhelming supported by the Assembly; with a number of Members welcoming the fact that steps were now being taken to require non-locally owned companies trading in the Island to make a direct contribution to income tax revenues.

The only conditionality associated with the amendment was that it should not be introduced if to do so would pose a risk to the zero-ten regime. During 2017, the Treasury reviewed whether making the change would pose a risk to the zero-ten regime. The Treasury's findings were that it was considered safe to extend a positive rate of tax to large corporate retailers in the manner proposed, as the proposal will not have a material impact on either –

(a) the amount of profits taxable at 0% vs profits taxable at a positive tax rate; or

(b) the number of companies taxable at 0% vs the number of companies taxable at a positive tax rate.

Correspondingly, the Minister for Treasury and Resources was obliged to bring forward appropriate legislation to the States Assembly for consideration in the 2018 Budget.

Senator Ozouf's amendment does not seek to strike out the large corporate retailers tax completely, rather it seeks to reduce the applicable tax rate on profits in excess of £750,000 from 20% to 10% – effectively halving the estimated revenue that the States will receive from the tax. There appear to be 3 reasons supporting Senator Ozouf's position: (a) impact on prices; (b) economic impact; and (c) the existence of the 10% tax rate applied to financial services companies.

Impact on prices

Although not required by the States' decision, in developing the legislative proposals, the Council of Ministers requested that the Economics Unit produce both an economic and distributional impact analysis to inform their considerations. This analysis has been published in full as Appendix 11 to the Draft Budget Statement 2018. In completing their analysis, the Economics Unit also considered the experience of the Isle of Man, Northern Ireland, Scotland and Guernsey from the introduction of taxes that apply to large retailers.

For the benefit of States Members, the section of the analysis relating to the likely impact on prices from the introduction of the large corporate retailers tax has been reproduced in the **Appendix A** to these comments. The conclusions reached on the likely impact on prices in the Island are summarised in the analysis as follows –

"The impact on prices could be limited for a number of reasons:

- The retailers subject to the tax will often be competing against smaller retailers and against off-island retailers, neither of whom will face the tax.
- Some of the retailers affected are likely to be branches of large UK corporate retailers with national pricing structures.
- Locally-owned large retailers will have less incentive to increase prices as local shareholders will be able to offset the corporate tax against any personal tax they would otherwise have paid on the distribution/dividend of those profits.
- Profits are generally a small part of the price of retail goods."

After reviewing the experience in the other jurisdictions noted above, the analysis states –

> "There is limited evidence of any significant price impact in other jurisdictions. Discussions with Northern Ireland indicate that there was no evidence that retailers deviated from prices set at a UK-wide level, however this risk may have been partially mitigated by the temporary nature of the scheme there (which was a three year increase in rates for large individual premises, rather

than Corporation Tax). Similarly, no increase in prices was attributed to the introduction of a retail tax in Guernsey or the Isle of Man."

Having taken this analysis into account, the Council of Ministers was content that the likely increase in prices from the introduction of the large corporate retailers tax at 20% was limited.

In Senator Ozouf's report accompanying his amendment he notes that: "The research that I have undertaken that the prices of goods sold by the companies affected if the 20% rate would be adopted would be in the region of 3%. That is equivalent to an additional 3% GST for those customers who would continue to shop at those establishments.".

That statement is inconsistent with the findings outlined in the Economics Unit's analysis, which states –

> "In 2016 the Guernsey government introduced a 20 per cent tax on retailers with profits above £500k. This scheme raises around £1.5m per annum and impacts on around twelve businesses across a range of retail subsectors, with most of the businesses concentrated in the food/drink, garage and clothing sectors.
>
> There is no information to suggest the cost is being reflected in retail prices or staff numbers/wages at this stage. While inflation has accelerated from mid-2016, this is generally understood to be the result of the depreciation in sterling following the UK referendum vote to leave the European Union."

In considering the impact of Guernsey's large corporate retailers tax on prices in Guernsey, States Members will need to consider whether to rely on the analysis prepared by the Economics Unit or Senator Ozouf's research.

Furthermore, although the Economics Unit's analysis cautions against placing excessive reliance on comparing inflation rates between jurisdictions, it is worthwhile highlighting some key inflation statistics reported in Jersey and Guernsey since the introduction of the large corporate retail tax in Guernsey in 2016. The reports prepared by the respective Statistics Units show the following inflation rates overall and in key retail sectors for the year ended 31st December 2016 –

	Jersey – annual % change[3]			**Guernsey – annual % change[4]**		
	RPIX	Food	Clothing and footwear	RPIX	Food	Clothing and footwear
Dec. 2016	1.9	-1.2	1.8	1.6	-2.5	-2.5

[3] See: https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/R%20RPI%20Dec%202016%2020170120%20SU.pdf

[4] See: https://www.gov.gg/CHttpHandler.ashx?id=105604&p=0

With *lower* inflation rates in Guernsey across RPIX, the food sector and the clothing and footwear sector, this data indicates no support for the contention that the introduction of large corporate retailers will result in price increases of around 3%.

Economic impact

Senator Ozouf's accompanying report states (original emphasis): "Continued investment in retail is absolutely vital. To impose a tax at 20% will restrict the ability of major retailers to invest. In fact, the 20% may result not only in **higher prices** but investment in retail **falling**.".

The Economics Unit's analysis of the impact on firms/economic output has been reproduced in **Appendix B** to these comments for the benefit of States Members. However the analysis is summarised as follows –

> "If firms are unable to pass the tax on in prices or by reducing other costs, they may need to absorb the tax increase through reduced profits. At the margin, this may affect investment decisions – but given the size of the tax as a percentage of the overall cost base it is unlikely in itself to lead to firms downsizing, closing down or relocating."

In the body of the analysis it is noted that this may lead to some opportunities for smaller businesses because: "if there is some reduction in market share by large retailers who decide to scale back activity/employment, this will often be picked up by smaller retailers who are unaffected by the tax."

Availability of the 10% tax rate

On the move to zero/ten it was identified that requiring financial services companies, which predominantly provide services to customers located outside the Island, and which operate highly mobile business models, to pay tax at 20% would make Jersey uncompetitive in this sector and might result in key businesses/employers relocating outside the Island. Having undertaken appropriate competitive analysis, it was determined that applying a 10% corporate income tax rate specifically to financial services companies struck the balance between delivering the sector an internationally competitive tax rate and the need to raise revenue from the sector.

The conclusions reached in the context of financial services companies do not automatically apply in the context of large corporate retailers who are based in the Island and predominantly sell to local consumers. These businesses are not highly mobile – it is not straightforward for them to move their businesses wholly outside of Jersey and continue to sell goods to consumers in Jersey. Large corporate retailers arguably have more in common with utility companies/companies supplying hydrocarbon oils which are currently subject to the 20% tax rate.

Furthermore the Council of Ministers notes that in respect of any locally owned companies subject to the large corporate retailers tax, the proposals represent simply an acceleration of the personal income tax that would be paid by the local shareholder(s) when they receive a distribution of the profits (i.e. the proposals do not result in any additional tax being paid, just an acceleration of the time at which that tax would be paid). This is because the local shareholder(s) will be entitled to a credit for the tax paid by the company when calculating their personal tax liability. The proposals effectively

return large corporate retailers to the tax position that applied before the introduction of zero/ten.

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

These comments were submitted to the States Greffe later than the noon deadline on Thursday 23rd November, specified in Standing Order 37A, as final internal review processes had not been completed in the time available from the lodging of all the amendments to the 2018 Budget.

APPENDIX A

IMPACT ON PRICES: EXTRACT FROM:
"APPENDIX 11 – ECONOMIC AND DISTRIBUTIONAL ANALYSIS OF THE PROPOSED EXTENSION OF CORPORATE TAX"

Impact on prices

It is difficult to accurately quantify the likely firm response. While firms are likely to want to pass on the increased cost through prices, their ability to do so in this circumstance may be limited for the following four reasons:

1. The retailers subject to the tax will often be competing against smaller retailers and against off-island retailers (for example online retailers), neither of which will face the increased taxes. Therefore any increase in prices would be likely to result in a loss of market share.

2. Some of the retailers affected are likely to be branches of large UK corporate retailers. These firms will often have national pricing structures. This makes it less likely that prices can be increased in a simple or cost-free way and it may be harder to justify any increases above UK levels to customers – given that corporate tax is already levied on this sector in the UK.

3. Locally-owned large retailers will have less incentive to increase prices as local shareholders will be able to offset the corporate tax against any personal tax they would otherwise have paid on the distribution/dividend of those profits. This is in the form of a credit, equal to the amount of corporate tax paid, so the net position for local shareholders will be unchanged in respect of their total personal income after tax. Further, this may mean that non-locally-owned large retailers find it more difficult to increase prices if they are competing with locally-owned large retailers in addition to smaller retailers and off-island retailers as per point 1.

4. Profits are generally a small part of the price of retail goods. In Jersey, gross operating surplus (a measure of profit used in national accounts) is thought to be around 6-7 per cent of total turnover for the wholesale and retail sector. Therefore even if fully passed on in prices, a 20 per cent tax on profits would add only around 1-2 per cent to the cost of goods sold by the retailers affected.

As a result of these factors, there are likely to be limited increases in prices at the retailers affected. However, this will depend on the specific circumstances of the retail subsectors affected. For example, if a specific sector was dominated by large UK-owned retailers with limited off-island competition and was selling products for which profit represented a large proportion of cost then there might be more of a price increase expected as the four points above may not necessarily hold for all retail subsectors. It is not clear that any of the retail subsectors affected meet all these conditions, but some sectors may meet some of the conditions.

If there is an increase in prices, this will impact on the general rate of inflation in Jersey (as measured by changes in the Retail Prices Index - RPI). The companies affected make up around 50 per cent of sales by GST-registered businesses, and the subsectors involved impact less than half of the RPI calculation (the combined weighting of food,

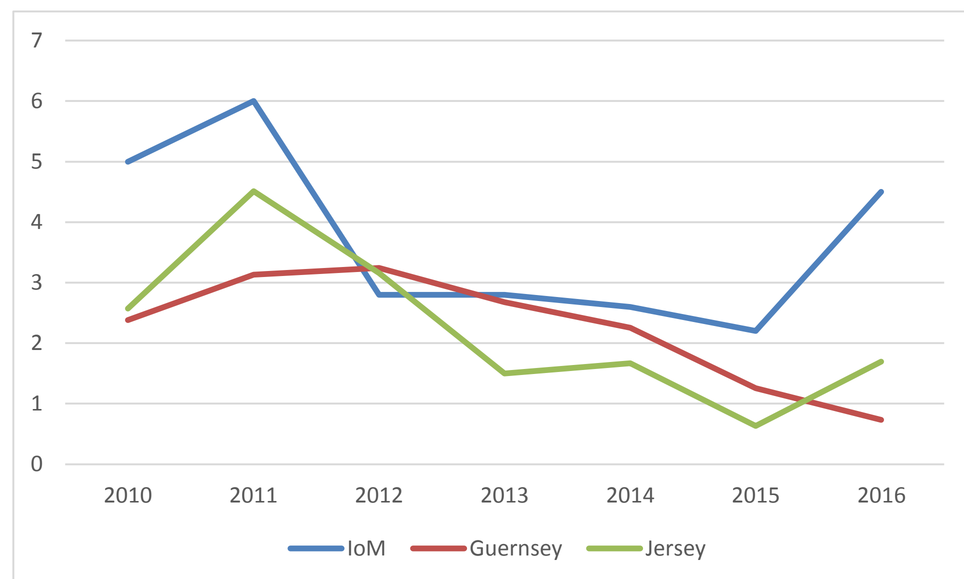
tobacco, household goods, clothing, motoring, and leisure goods). Therefore even if the tax resulted in a 1 per cent increase in prices in the retailers affected, this would likely translate into less than a ½ per cent increase in the overall price level. However, the actual impact may be much lower as affected retailers will have limited ability to pass on as much as a 1 per cent increase in prices, due to the reasons above.

Any increase in the price level is likely to be a one-off increase unless it leads to higher wage demands. The potential small scale of any change in the overall price level may make this less likely.

There is limited evidence of any significant price impact in other jurisdictions. Discussions with Northern Ireland indicate that there was no evidence that retailers deviated from prices set at a UK-wide level, however this risk may have been partially mitigated by the temporary nature of the scheme there (which was a three year increase in rates for large individual premises, rather than Corporation Tax). Similarly, no increase in prices was attributed to the introduction of a retail tax in Guernsey or the Isle of Man.

Inflation tends to follow broadly similar trends in Guernsey, Jersey and the Isle of Man; but can differ somewhat in individual years. No clear upward trend can be seen in Figure 74 for the year in which the retail tax was introduced in either the Isle of Man (2013) or Guernsey (2016). It is, however, difficult to draw any conclusions from this data as there are different trends which might be impacting on inflation at different times in each of the Crown Dependencies, and there will be methodological differences in the way RPI is calculated – including differences in the 'basket' of goods and services for which prices are measured.

Figure 74 – RPI inflation in the Crown Dependencies (annual average % change in the RPI)



Source: Jersey Statistics Unit, Isle of Man Cabinet Office, States of Guernsey Data and Analysis

APPENDIX B

IMPACT ON FIRMS/ECONOMIC OUTPUT: EXTRACT FROM:
"APPENDIX 11 – ECONOMIC AND DISTRIBUTIONAL ANALYSIS OF THE PROPOSED EXTENSION OF CORPORATE TAX"

Impact on firms/economic output

If firms are unable to pass the tax on in prices or by reducing other costs, they may need to absorb the tax increase through reduced profits. At the margin, this may affect investment decisions – but given the size of the tax as a percentage of the overall cost base it is unlikely to be the sole reason for firms closing down or relocating. For a firm with a 7 per cent profit margin (average for the sector), the tax would make up a maximum of 1½ per cent of total costs.

No tax will be collected on firms with taxable profits below £500k so any firm paying the tax will still be profitable, even after paying the tax, meaning that the tax itself will not make any existing operation untenable. A similar scheme in Northern Ireland (based on increasing rates for large retailers, rather than corporate tax which is based on profits) is not thought to have led to any store closures over and above those which were already planned, as part of UK-wide restructuring – though this risk have been partly mitigated in this case by the temporary nature of the increase.

While the scope to shut down operations may be limited – the tax could however give some incentives to firms to reduce their operations (or reduce margins) in order to reduce their profits or turnover below the threshold. This is particularly likely for those firms who are very close to the threshold. However, it is understood that none of the retailers identified have a turnover below £2.5m, so these firms may have limited opportunity/incentive to avoid the tax plus as the tax would only levied at the full 20 per cent rate on profits above £750k then this risk is further mitigated.

In the absence of information on how firms are likely to respond, it is not possible to estimate the overall impact on economic output (gross value added – GVA) or productivity. The wholesale and retail sector makes up around 7 per cent of the economy (£288m of GVA in 2015). However, given that only a proportion of the retail part of the sector is affected (and none of the primarily wholesale firms in the sector), there is not likely to be a significant impact on an economy-wide basis.

If there is some reduction in market share by large retailers who decide to scale back activity/employment, this will often be picked up by smaller retailers who are unaffected by the tax. This may have marginal impacts on productivity at the sector/economy-wide level but there is insufficient data to indicate whether the impact would be positive or negative. Evidence from the UK shows that in the broader 'services: distribution, hotels and restaurants' sector, medium-sized businesses (50–249 employees) are the most productive, with micro-businesses (1 to 9 employees) being least productive:

Figure 75 – Output per worker in UK Distribution, Hotels and Restaurants Sector, average 2008-2014

Business size	Labour productivity (£)
Micro (1-9 employees)	25,700
Small (10-49 employees)	29,600
Medium (50-249 employees)	38,100
Large (250+ employees)	28,700

Source: UK Office of National Statistics

https://www.ons.gov.uk/businessindustryandtrade/internationaltrade/adhocs/005325additionalanalysisofthedistributionofproductivitybyfirmsizeandindustry

If similar trends exist in Jersey, therefore, there may be a reduction in productivity if micro firms were to increase their market share and their level of employment, at the expense of small or medium firms. The majority of larger corporate retailers appear to be headquartered in the UK. Whether the tax on large corporate retailer is an absolute cost for these businesses will depend on the UK tax position of the direct parent company. The tax analysis applicable in the UK is complex and uncertain, as it depends on factors such as the size of the relevant UK company/group and whether it has made certain elections.

Normally the profits of Jersey permanent establishments of UK companies are taxable in the UK, with double tax relief available in the UK for any Jersey tax suffered to prevent the double taxation of profits. In this situation any additional Jersey tax payable as consequence of the proposed measure should not be a material overall cost to the business.

However UK tax law allows UK tax resident companies to elect for the profits of their non-UK permanent establishments to be exempt from corporation tax. This election is not available to all UK companies and some companies may simply choose not to make the election. To the extent that the profits of a Jersey permanent establishment are the subject of such an exemption election in the UK, any additional Jersey tax payable would be an additional absolute cost to the business.

Distributions paid from Jersey subsidiaries to their parent company in the UK will be exempt from UK corporation tax. This exemption does not apply in all cases and companies can elect for the exemption not to apply. To the extent that distributions from Jersey subsidiaries are exempt from tax in the UK, any additional Jersey tax payable would be an additional absolute cost to the business.

To the extent that the distribution from Jersey subsidiaries is taxable in the UK, the UK should give unilateral tax relief for the underlying corporate income tax paid by the subsidiary in Jersey. In this situation any additional Jersey tax payable should not be a material overall cost to the business.

For a Jersey-resident individual who owns shares in a large retailer which is subjected to tax, the effect will largely be an acceleration of tax (i.e. the tax will be collected from the company's profits but this will be given as a credit when calculating the individual's personal tax liability) such that the distribution is not also taxed. This could however impact on cash flow within businesses, e.g. where shareholders are not distributing profits as they are being retained within the business to fund growth. In this case, the company may not be able to invest as much in growth, unless external funding could be raised. This may have some economic impacts, though of course shareholders will have an incentive to invest additional cash to maintain cash flow and fund growth.