JERSEY FINANCE

Representing The International Finance Centre

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Dear Mr Morris

The Zero/Ten Design Proposal

I am writing in response to the above public consultation document issued by the Treasury and Resources Department on 5th May 2006.

1. Status of this response

This response reflects the views of the Fiscal Strategy Group ("FSG") established by Jersey Finance Limited for the purposes of responding to the States of Jersey's fiscal strategy proposals. FSG's terms of reference, which include details of its current membership, are enclosed at appendix 1.

In preparing this submission, FSG has consulted widely with the Trade Association Members of Jersey Finance Limited, as listed at appendix 2. A number of these Trade Associations, including the Jersey Taxation Society, the Jersey Society of Chartered and Certified Accountants, the Law Society of Jersey, the Jersey Bankers' Association and the Jersey Funds Association have specifically agreed to feed into the FSG consultation process, and only submit separate responses to the extent that they disagree with, or wish to add to, FSG's stated position.

In accordance with the agreed Finance Industry consultation process, Jersey Finance also notified all of its Members that the above consultation paper had been issued for public comment. In addition to an e-mail communication to our Members, we included a link to the consultation paper on the States of Jersey website, and invited our Members to provide responses either directly to you, through their respective Trade Associations or through FSG. We circulated a draft copy of our response to all Jersey Finance members and invited comments. We also held an open meeting to which all Jersey Finance Members were invited, and at which members of FSG presented the key 0/10 design proposals and the Group's proposed response. This submission takes into account the views expressed by individual Members in any such responses received by Jersey Finance or FSG.

2. Structure of this response

Our key observations and recommendations on the Zero/Ten ("0/10") design proposals are set out at section 3 below. Our detailed comments on the consultation paper are set out at section 4.

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3. Key Observations

3.1 Overriding design principles

In formulating our response, we have attempted to evaluate each of the 0/10 proposals against a set of overriding design principles which, in our view, are fundamental to the success of the States' fiscal strategy. These principles are that the 0/10 design proposals should:

- ***Comply with Jersey's International commitments***, and in particular with the political commitment given to the EU Code of Conduct Group in 2003;
- ***Protect the Island's economic prosperity***, by ensuring that Jersey remains internationally competitive as a location for Financial Services Industry ("FSI") business;
- Preserve, as far as possible, the ***simplicity*** of the Island's existing tax code for both residents and non-residents;
- Provide for an ***efficient*** taxation system, both in terms of the administrative burden placed upon the Income Tax Department and the compliance burden placed upon taxpayers;
- Provide ***certainty of treatment,*** particularly for businesses which may be geographically mobile;
- Be ***equitable*** in terms of how the tax burden is distributed across all sectors of society, as well as between businesses and individuals, and
- Be ***sustainable***, in terms of providing a framework for business taxation which can endure as part of the overall States' fiscal strategy.

We have not attempted to prioritise these principles, as clearly they are all important factors in terms of getting the overall package "right". That said, it is equally clear that whilst certain of the design principles may include an element of subjectivity (for example, the question of simplicity or fairness), the measurement of success for others, and in particular compliance with international standards, is likely to be a more objective evaluation.

Before commenting in detail on the 0/10 design proposals, we would make the following additional brief comments in relation to each of the above overriding design principles:

3.1.1 Compliance with international standards

It is not within the scope of our work to establish whether the 0/10 design proposals will satisfy Jersey's political commitment to comply with the requirements of the EU Code of Conduct Working Group on Business Taxation ("the Code"). This is a matter for the States of Jersey.

However, we did not identify any areas of obvious non-compliance during the course of our work, nor did we conclude that any of the specific proposals would create potential difficulty in terms of potential non-compliance.

Notwithstanding the above, it is also clear to us that the remit of the Code Working Group may not be purely technical, and that determination of whether or not a particular measure is 'Code compliant' may ultimately be coloured by a political dimension. In view of this, we note and endorse the proposal at paragraph 2.3.2 of the paper that the views of HM Treasury be sought at a relatively early stage in the detailed design process, as we understand that under

the Code process HM Treasury is responsible for representing Jersey's position to the Code of Conduct Group.

Our final position on a number of the key issues discussed hereafter (most notably the question of shareholder taxation) may also depend to an extent upon the final outcome of the Code evaluation process; for example in the context of mechanisms proposed by other jurisdictions which would allow for a limited company role in the tax collection process. We appreciate that the nature and timing of ongoing discussions with the EU already creates a tension with Jersey's need to formulate firm legislative proposals sooner rather than later, but notwithstanding this the earliest possible certainty for industry on any outstanding points of detail would obviously be of benefit to all.

3.1.2 Protecting the Island's economic prosperity

The arguments for preserving Jersey's competitiveness as an international finance centre, in order to protect its long-term economic prosperity, have been clearly and comprehensively articulated in a number of official States documents as well as in previous submissions made by Jersey Finance Limited and others in response to public consultations on tax-related matters. We do not, therefore, propose to rehearse the arguments again in detail here.

It is clear, however, that Jersey's international commitment to abolish certain 'harmful tax practices', most notably the Exempt Company and International Business Company (IBC) regimes, would, if delivered in isolation, severely impact upon the Island's financial services industry and the very considerable economic contribution it currently makes.

By restructuring the island's corporate tax regime under 0/10 at the same time as phasing out the Exempt and IBC regimes, Jersey is acting to protect the 'lion's share' of States' revenue currently generated from the financial services industry, whether in the form of direct corporate taxation from FSI businesses paying 10% corporate profits tax under the new regime, or indirectly through the social security contributions and income tax paid by the circa 12,000 individuals working directly in financial and related services.

3.1.3 Preserving the simplicity of the Island's existing tax code

One of the fundamental principles underpinning Jersey's existing tax regime is *simplicity*. This is manifest in the existing income tax code and related Concession and Practice issued by the Comptroller of Income Tax, and is one of the key reasons why Jersey has developed successfully as an international finance centre over the past four decades.

Whilst we accept that the phasing out of the Exempt and IBC regimes, and the transition to the 0/10 corporate tax structure will inevitably lead to some additional complexity in the Island's tax code, we believe that every effort should be made to minimize this effect and to keep the overall regime as simple as possible both for residents and non-residents.

However, in our view, a number of proposals outlined in the 0/10 design document lose sight of this principle, such that the potential benefit arising from implementation is significantly outweighed by the 'cost' of additional complexity. We comment further on these areas below.

3.1.4 Providing for an efficient taxation system

Taxation systems should aim to be efficient. Taxes affect the economic efficiency and ultimately the living standards of a community. Efficiency can be assessed by the effort required by governments to raise the required revenue. The lower the cost of administration by the government (for all given revenue) the more efficient the system.

The lower the overall burden of taxation, the lower the distortions of taxation on economic activity. Higher rates of taxation (and associated tax compliance) levied on limited or narrow

tax base provide great incentives to make arrangements to minimise taxation, either through avoidance schemes or through the diversion of economic activity away from the sector of the economy thus reducing efficiency.

In implementing the 0/10 proposals it will therefore be important to preserve the existing compliance culture in Jersey which keeps collection costs to a minimum. However, in our view, a number of the proposals included within the 0/10 design proposal do not adequately satisfy the "efficiency" principle, as they would impose a significant administrative burden on the Income Tax Department and a considerable compliance burden on the tax paying community. These are discussed further below.

3.1.5 Providing certainty of treatment

The globalisation of financial services over the past 15-20 years has undoubtedly created far greater choice for consumers of such services (whether 'retail' or 'high net worth', private or corporate), and has dramatically increased the level of competition amongst established financial centres, such as Jersey, Switzerland and Luxembourg, as well as from emerging centres such as Dublin, Dubai and New Zealand.

Jersey has performed strongly during this period of tremendous global transition, by positioning itself as a well-regulated, respectable, and responsible finance centre committed (on a level playing field basis) to international standards. It has also undoubtedly benefited from its close proximity to London (the world's most important centre for international financial services) and from the benign and stable nature of its fiscal regime.

However, the fundamental reform of the Island's tax structure under the States' Fiscal Strategy will inevitably create uncertainty, particularly in the eyes of off-Island professional intermediaries who may not be close to the reform process. Given the wider choice and increasing geographic mobility of customers referred to above, it is important that this potential for uncertainty is managed as effectively as possible.

On the whole, we note and welcome the effort of Treasury and Resources to bring clarity to the situation by seeking to have the primary legislation and overall framework in place well in advance of the 2009 implementation deadline. However, in our view there remain a number of proposals in the document where the undue complexity is likely to extend the period of uncertainty considerably whilst the detail is finalised. In our view, the desire for simplicity and certainty of treatment should be the overriding priorities in these areas (as discussed further below).

3.1.6 Fairness

We recognise that the question of 'fairness' is always likely to be an emotive and subjective one, and that different people may have very different views on what constitutes a 'fair' distribution of the tax burden.

In general, however, taxation systems should aim to ensure that individuals and businesses in similar circumstances are taxed in similar ways (neutrality). The extent to which taxation systems should also be based upon the ability of a taxpayer to pay must be balanced against the need to provide incentives to retain and attract high value individuals and businesses. A good tax system will fairly distribute the tax burden while also minimising the disincentive effects such as discouraging people from working harder and investing available funds in a commercially focussed way.

Within the context of the 0/10 design proposals, it is clear that the new corporate tax structure will inevitably result in a shift of some of the existing tax burden from companies to individuals. In that regard, however, it should be remembered 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 and business. Whilst the required level of contribution towards such services from Jersey resident individuals will increase as a result

of 0/10, it does not seem unreasonable or inherently 'unfair' that consumers of public services should themselves make the greatest contribution to funding the public purse.

We would also note that the planned lowering of corporate tax rates in Jersey is reflective of a much wider international trend, and we note and endorse the advice received by the States that in order to remain internationally competitive as a finance centre, Jersey does need to lower its corporate tax rate for financial services businesses to 10%.

Finally, we also note that the 0/10 design proposals include a strengthening of Jersey's existing anti-avoidance measures to ensure that Jersey-resident individuals do not misuse corporate vehicles or other structures to avoid their Jersey income tax liabilities.

Overall, we concluded that the 0/10 design proposals, when viewed in the context of wider international developments as well as the other elements of the States' Fiscal Package, do not unduly offend the overriding design principle of 'fairness'.

3.1.7 Sustainability

The sustainability of the 0/10 design proposals will ultimately be determined by a range of factors, including future trends in international tax competition as well as future developments under supranational tax projects such as those initiated by the EU Code project and OECD.

It is hard to gauge the potential impact of such 'external' factors, although providing Jersey continues to engage internationally on a 'level playing field' basis, then it seems reasonable to presuppose that it will be no more disadvantaged than any other recognised international finance centre by the effects of global competition or attempted tax harmonisation / increased transparency.

From a domestic perspective, we also note that the proposed Fiscal Strategy should go some way to addressing the inherent structural weakness within Jersey's existing tax base (namely, over-reliance on direct corporate taxation), and therefore believe that, all other things being equal, the revised fiscal structure should be more sustainable than the existing one.

3.2 Regulation of undertakings and development ('RUDL') charge

In our assessment, the proposed RUDL charge (Section 16 of the Design Proposal) does not adequately satisfy the following overriding design principles:

- Simplicity
- Fairness
- Efficiency
- Sustainability

We do not therefore support the RUDL charge as currently proposed.

In essence, the proposed RUDL charge is an attempt to address the fact that under 0/10 all foreign-owned non-FSI companies trading in the Island will pay no tax locally (such businesses currently paying tax on corporate profits at the standard rate of 20%).

In our view, the proposed charge appears to be an attempt to 'claw back' some of this lost corporate tax revenue, by imposing an additional 'headcount charge' for foreign-owned companies operating in the Island. Conversely, with the push for local companies to convert to LTP status, it is intended that the RUDL charge should not increase the cost of doing business for Jersey-owned businesses, on the basis that any charge suffered would be fully creditable against a Jersey-owned entity's tax liability (if any) and repayable in full if greater than the assessed tax liability. We understand, however, that the RUDL charge will also represent an absolute cost of doing business for any 0% trading company which is unwilling or unable to convert to LTP status, as any such company will not be able to recover the RUDL charge directly, nor would the charge be creditable against the shareholders' liability to income tax under the deemed distribution charge.

We have the following specific reservations concerning the practical effects of the RUDL charge:

- as noted in the proposals, it will represent an absolute cost on doing business in the Island for foreign-owned companies (i.e. the charge payable in Jersey will not be creditable or recoverable against such companies' "home" tax liability), as well as any local 0% trading company that is unable or unwilling to convert to an LTP. Hence it will act as a disincentive to such companies from making inward investment into the Island;

- whilst we note and acknowledge the intention that the charge should only apply to a clearly defined, limited sector of the Jersey economy, it is effectively a tax on employment for such companies (albeit not in the sense of a classic "payroll tax"). In that regard, we would draw your attention to the potential adverse effect of any "tax on employees" to the economy, as detailed in the States' own fiscal strategy documents;

- it is likely to have the most significant impact on labour-intensive industries, such as tourism and agriculture, which also typically report the lowest profitability per capita;

- it may be administratively burdensome for locally-owned businesses, if they have to go through the process of paying and reclaiming the annual charge;

- it will also have a negative cash flow impact for many small businesses, and may adversely impact their working capital arrangements.

We note that the Authorities in Jersey and also the Isle of Man have been looking for a possible solution to this issue for a number of years now, and that neither has managed to date to come up with a satisfactory solution. Regrettably, we are not convinced that the proposed RUDL charge is a viable solution to what is essentially a 'political' problem, and believe that on balance, the unintended consequences for locally-owned businesses of introducing the RUDL charge would probably outweigh the perceived political capital of managing to claw back at least a proportion of the corporate tax revenue that will be lost under the move to 0/10.

Our recommendation is therefore that the proposals for the RUDL charge be put on hold. We can, however, see one particular set of circumstances where the introduction of a form of RUDL charge may be appropriate, and this is where 0% companies would have the option to elect to be taxed at the 10% rate. This is discussed further below (see 3.6 below).

We do, however, acknowledge that in abandoning this proposal, there will be inequity within the overall proposals in that, whilst foreign-owned, non-finance companies will continue to provide employment and other economic benefit to Jersey, they will not in future pay any direct tax in the Island.

3.3 Deemed Distribution and Deferred Distribution charges vs "Look through"

In our view, this is the most difficult and contentious area of the 0/10 Design Proposals. It is also an area where EU Code compliance factors may need to be taken into account in determining the desirability of the most practical alternative solution to distribution only taxation (see below).

At this stage, the Fiscal Strategy Group was able to reach agreement on a number of specific points, but in other areas no clear consensus was achieved. The following section therefore:

- sets out, in summary, those points upon which there was general agreement within FSG;

- rehearses, in detail, the Fiscal Strategy Group's specific concerns with the current proposals, and identifies the minimum required action to address those concerns; and finally

- describes two broad possible, and in our view preferable, alternative approaches to deemed distribution, and discusses some of the key advantages and disadvantages of each of these approaches.

As the Group was unable to reach a consensus position on this issue, we understand that individual members of FSG may respond to you separately on this issue, outlining their respective positions.

3.3.1 Points where general agreement was reached

- We support the proposed "look through" treatment for "investment companies", as this represents a key anti-avoidance measure designed to discourage the use of corporate structures by Jersey resident individuals in order to avoid taxation on investment income. However, we suggest an alternative definition / means of distinguishing between "investment companies" and "trading companies" (see detailed response to 10.3.7 under Section 4 of this submission);

- As regards trading companies, we believe that the proposals for a deferred distribution charge are unduly complex, unnecessary, and that they should be scrapped;

- Whilst we understand, and accept, the principle behind the deemed distribution charge, we consider that the desire to achieve some form of compromise between pure "look through" and an "actual distribution" approach to taxation of shareholders has resulted in a "half way house" that is unattractive to supporters of either of the alternative approaches referred to above. On balance, we therefore believe that the proposed deemed distribution charge should not be introduced, but rather that one of the alternative approaches discussed in more detail below should be taken forward as the preferred option. .

- We agree that the 0/10 framework should include measures to ensure that Jersey resident shareholders of Jersey and foreign trading companies are subject to fair but effective taxation of the income arising from their participation in such companies. Moreover, a majority of FSG members believe that, as far as possible, the anti-avoidance and enforcement provisions to meet this objective should be consistent for shareholders of both Jersey and foreign companies, and should be based upon Jersey's existing general anti-avoidance rules (A134A) rather than through the creation of a complex regime which has the specific objective of seeking to preserve the 'status quo ante' in terms of the tax yield currently derived from Jersey income tax paying companies under the existing regime. In that regard, the Group notes and endorses the proposed approach in respect of Jersey resident shareholders of non-resident companies, as set out at section 7.3 of the Design Proposal. The position in respect of shareholders of Jersey resident companies is discussed in more detail below.

3.3.2 Specific concerns with the current proposals

The proposals for a "Deemed distribution charge" and "Deferred distribution charge" are set out at sections 24 and 26 of the consultation paper respectively. Consideration of "Look through" (under which the company's shareholders are assessed each year on its taxable profits) is set out at section 23.

It has been suggested at paragraph 23.1.3 that "look through" may be open to challenge on some fronts. Whilst we would agree with a number (but not all) of the points made in the paper, we are far from convinced that the proposed alternative solutions (namely, deemed and deferred distribution charges) necessarily resolve the position, as discussed below.

Under the proposals, we understand that both the deemed and deferred distribution charges would operate on a "Last in First Out" ("LIFO") basis; i.e. any actual distribution would be matched against the latest year's profits. However, we recommend that, *as an absolute minimum*, the basis for the these charges should be changed from a LIFO to a "First in First out" ("FIFO") basis, as the LIFO basis could result in a company being deemed not to have made a distribution of profits for particular year (and therefore subject to an 'interest charge' on such profits), when all such profits have in fact been previously distributed.

It is also not clear from the paper whether the deferred and deemed distribution charges are intended to apply to special rate / 10% companies as well as 0% companies? Our belief is that in respect of Jersey resident shareholders the taxation rate at the personal / dividend level should be the same for all.

3.3.2.1 <u>Deemed distribution charge</u>

In our view the deemed distribution charge does not adequately satisfy the following overriding design principles:

- Protecting the Island's economic prosperity
- Simplicity
- Fairness
- Efficiency

Specifically, a majority of the FSG members expressed concern that the introduction of a deemed distribution charge for Jersey-resident shareholders (but not for non-resident shareholders) would fundamentally conflict with established company law principles which provide for parity of treatment between ordinary equity shareholders in a company.

It was also suggested that the deemed distribution charge would be likely in many cases to impact upon companies' actual distribution policies and could moreover have a significant detrimental impact on inward investment into the Island. For example, it was suggested that investors resident in or moving to the Island would be more likely to structure their operations through a foreign company managed and controlled outside of Jersey in order to suffer taxation only upon receipt of dividends from the company.

It should also be noted that the ultimate effect of the deemed distribution charge, combined with the proposed three year "guillotine period", would simply be to introduce straight forward "look through" but with an initial three year deferral. After this initial 'grace period', the company would be subject to an annual deemed distribution charge (albeit the charge would be based on the profits arising three years earlier rather than in the current year). The 'cost' of this deferral, however, would be the added complexity for the shareholders of having to perform potentially complex deferred and deemed distribution calculations (or indeed more likely having to engage tax advisors to perform such calculations), and in our view this cost would significantly outweigh the deferral advantage.

The calculation of the deemed distribution appears to rely on GAAP profits as opposed to taxable profits which potentially could result in taxable profits being greater than the profits that are actually able to be distributed under GAAP / company law. This could lead to the unacceptable situation of a company never being able to fulfil the 100% distribution effectively required under the proposals. This, together with the ability of Jersey companies to choose their relevant recognised GAAP, is likely to serve only to further complicate this situation.

From a shareholder perspective, it also seems inequitable to us that a minority shareholder in a company should suffer the tax burden arising under a deemed distribution when he/she may not be in a position to control or exercise significant influence over the company's distribution policy.

For the reasons outlined above we do not favour the introduction of a deemed distribution charge. However, if deemed distribution is pursued as the States' preferred option, then as an absolute minimum we would suggest that, rather than exempting shareholders with <1% holdings in public companies from the deferred and deemed distribution charges [paragraph 19.3.2], the exemption threshold should be set at 10%. We would moreover suggest that serious consideration be given to exempting all public companies from the deferred and deemed distribution provisions altogether (to the extent that such provisions are indeed retained in the final 0/10 model).

3.3.2.2 Deferred distribution charge

The deferred distribution charge is intended to act as an interest charge on the tax that would have been paid if the profits of the company were distributed in the year in which they arose. With a proposed rate of 20% of the shareholder's marginal income tax liability on the distribution, this will approximate to an annual 'interest' rate of 4%. Whilst not explicitly stated in the paper, we presume that this charge would be calculated annually but only become payable by the Jersey resident shareholder in the year that the distribution is received or deemed to have been received?

In our view the deferred distribution charge does not adequately meet the following overriding design principles:

- Simplicity
- Efficiency

We would therefore strongly recommend that the deferred distribution charge be scrapped altogether, on the basis that we would not expect the charge to be a significant revenue raising tool, and that the compliance and administration costs would therefore substantially outweigh the benefits of implementing it. We believe this to be particularly so give the fact that, under the deemed distribution charge, shareholders would in any event be subject to a form of full annual "look through" charge with effect from year 4 onwards.

3.3.3 Possible alternative approaches

3.3.3.1 Move to actual distribution basis

It is difficult for us, in the absence of access to the detailed underlying fiscal and economic data upon which the 0/10 proposals have been modelled, to understand the likely economic impact of *any* variation in the proposed package (i.e. the impact this would have on the overall tax yield). Leaving such considerations to one side for one moment, it is clear, however, that the 0/10 design proposals could be dramatically simplified if the following broad model were adopted:

- Maintain annual "look through" for "investment companies" (albeit with revised approach to identifying / categorising "investment companies");

- Scrap the deferred and deemed distribution charges in relation to trading companies, with Jersey resident shareholders of such companies instead being taxed on a straight forward actual distribution basis (as for participations in foreign companies);

- Introduce the proposed shareholder anti-avoidance provisions (as described at Sections 25, 26.4 and 27 of the 0/10 Design Proposals), in order to prevent shareholders from benefiting from shareholder loans and/or excessive capital gains arising from the roll up of undistributed profits in a company prior to sale or part-disposal.

Whilst such a simplified approach would clearly be far more commercially attractive than the complexities of the proposed deferred and deemed distribution charges, the key "unknown" (from our perspective) is the potential negative impact on yield that a move to simple taxation of distributed profits would have. In that regard, however, we would assume that in the case of many small and medium sized owner-managed businesses, owner/managers will typically seek regularly to extract any surplus profits from the business either in the form of remuneration and emoluments and/or by way of an annual profits distribution. All such methods of extracting value from the company would result in a shareholder income tax

liability. Moreover, as noted above, a range of measures could be introduced (and indeed are proposed) to discourage shareholders from rolling up profits and/or to prevent owner/managers from extracting the surplus profits in a way that avoids their personal income tax liability.

We also note with interest proposals in the Isle of Man to introduce an "Acceptable Distribution Policy" (ADP) for companies, such that any company which distributes at least 55% of its available profits annually is taxed on a distribution-only basis. With the proviso that such a policy can be implemented in a flexible and pragmatic way (for example, to take into account the needs of high growth companies that may need to retain profits for capital investment purposes), then we can see some attraction in adopting a similar approach in Jersey, possibly coupled with enhanced anti-avoidance provisions and/or the retention of the "deemed distribution charge" rules only for those companies which do not satisfy the ADP (and which are not able to agree a position with the Comptroller).

It is therefore the current view of the majority of FSG members that a simple approach to taxing shareholders of trading companies on a straight forward distribution basis would be preferable, and those members remain to be convinced that such an approach would in practice have a significant adverse impact on the overall tax yield (other than perhaps an initial cash flow impact)? We would welcome the publication of further detailed economic analysis by Treasury and Resources in this regard.

We would also note that, should actual experience under an "actual distribution" approach ultimately result in a significant shortfall in the tax yield, then it would be far easier for the States to resurrect the deemed distribution and/or look through provisions if needed, whilst at the same time reserving the right to 'test' the most straightforward solution during one or two years' trial period. Conversely, we believe it highly unlikely that the States would 'roll back' from either the deemed distribution or 'look through' approaches once implemented. By first testing the effect of an "actual distribution" basis, the States would therefore essentially be adopting an 'incremental' approach to plugging the gap, starting with the administratively simplest approach, and in the view of the majority of FSG members this is seen as the most sensible way forward.

As noted above, those members of FSG that do not agree with this approach will be writing to you directly on this point.

3.3.3.2 "Look through"

As noted above, the concept of a straight forward "look through" is considered and rejected at Section 23 of the discussion paper. However, in our view look through does require further consideration, not least because of the fact that many of the suggested arguments against look through (paragraph 23.1.3) would apply equally to the deemed and deferred distribution charges, which moreover would introduce the additional complexities described above.

We would also note that annual "look through" is accepted for "investment companies", and that none of the potential objections raised at 23.1.3 are applied in this context.

In terms of assessing the desirability of "look through", there are still some key considerations:

- first of all, at what point, if any, does "look through" and related mechanisms create any potential compliance problems relative to the EU Code of Conduct requirements?; and

- secondly, does the "look through" concept offend the fairness / equity principle, insofar as it could result in [minority] shareholders suffering tax in respect of the income of an independent third party over which it has no effective control?

As regards EU Code compliance, it is not within the remit of our response to determine how all potential "look through" mechanisms interrelate with the Code. However, on the basis that the proposed deemed distribution charge is simply look through with a three year deferral, then we would not expect one measure to be Code compliant but not the other. We also understand that "look-through" is generally defensible on anti-avoidance and equity grounds, as well as being in the realm of personal / dividend taxation which is in any event outside the EU Code Group remit.

On the second point (the equity principle) it again seems to us that, leaving aside the deferral / cashflow advantage for shareholders under the guillotine period, the same issue arises under both deemed distribution and the straight forward "look through" – namely, shareholders will be assessed and charged on the income of the company without necessarily having received any distribution of profits. This could potentially force the company to adopt a distribution policy which may not be in its (or its shareholders') best interests, simply to ensure that shareholders have sufficient funds available to meet their tax liability.

However, a number of FSG members believe there are three possible solutions to the above, and that these should be explored in preference to pursuing an "actual distribution" basis.

- ***firstly, further investigation should be conducted into whether it is acceptable for the company to act as agent for the shareholder (i.e. apportionment of profits, after adjustment for working capital and capital expenditure requirements). In such case, the company would pay the annual agreed tax liability directly on behalf of its shareholders;***

- ***secondly, a possible right of reimbursement, which would provide a statutory entitlement for shareholders to reclaim from the company any tax suffered in respect of their participation in the company; or***

- ***thirdly, a statutory provision that would allow the Comptroller to recover the tax from the company in cases where the Jersey resident shareholder is 'unable or unwilling' to pay tax due.***

We note that the Isle of Man has adopted the first of the above solutions – namely it has deemed that the company can act as 'agent' for its shareholders. We understand, however, that this position is still subject to formal agreement with the UK and EU Code group. Subject to the satisfactory outcome of those discussions, this would also be our preferred position for Jersey (assuming that the straight forward taxation of distributed profits approach outlined above is not economically viable and/or politically acceptable).

3.4 Determination of special rate / 10% taxation companies

We note the intention to determine the application of the 10% special rate by reference to a company's regulatory status. Thus, in broad terms, the 10% rate will apply to:

- Deposit-taking institutions regulated under the Banking Business (Jersey) Law 1991 ("BB(J)L");
- Most Investment and Trust Company Businesses licensed under the Financial Services (Jersey) Law 1998 ("FS(J)L"); and
- Most functionaries to collective investment funds holding a permit under the Collective Investment Funds (Jersey) Law 1988 ("CIFL") and/or a "funds services business" license under the Financial Services (Jersey) Law 1988[1]

Whilst we agree in principle with this broad approach to determining a company's corporate tax status, we would note that in practice there are likely to be many 'grey areas' and potential complexities if the test is solely a 'regulatory' one. This is because, particularly in the context of exemptions from FS(J)L, there is currently a great deal of complexity in relation to whether or not certain types of structure fall to be regulated.

In our view, the intention of the proposals is to capture only those regulated financial services businesses which have a physical presence (permanent establishment) in the Island. Clients creating new structures not intended to have a permanent establishment in Jersey will need to have confidence that their structure could not inadvertently fall within the 10% rate by virtue of the 'regulatory test' alone. We therefore believe, in broad terms, that the test for identifying 10% companies will need to be a dual one, i.e.:

- is the company carrying on a prescribed regulated financial business that, all other things being equal, would bring it within the scope of the 10% regime; *and*
- if so, does that company trade through an "established place of business" in the Island?

We would note, however, that this is likely to be a complex area and hence a pragmatic approach will be needed both in terms of developing and applying the relevant criteria. This is particularly likely to be the case in respect of certain types of managed financial services providers – for example a 'managed manager' to a collective investment fund.

3.5 Limited Trading Partnership ('LTP')

We support in principle the introduction of a tax transparent trading vehicle, such as the proposed Limited Trading Partnership ("LTP"), which would then be available to local residents as an alternative trading vehicle to the limited company.

However, the fact that the 0/10 design proposals recognise the need for an LTP in order to allow local businesses to elect for straight "look through" and avoid the deemed and deferred distribution charges in our view only serves to emphasise the potential complexity of those proposals.

Whilst we support the LTP concept in principle, we believe further clarification is needed on the relationship between LTPs and the existing Limited Liability Partnership (LLP) vehicle. We also believe that further consideration should be given as to whether it would be simpler

[1] Excluding the funds themselves and certain classes of fund functionary – notably managers

to reform the existing LLP legislation rather than creating the additional complexity of a new LTP law.

A further key concern is the potential legal and administrative complexity involved for any existing company which elects to covert to LTP status. Statutory provision will be needed to make this transition as simple, certain and cheap as possible, otherwise it is probable that many businesses will chose to remain as limited companies (and be subject to the additional complexities and costs described above).

3.6 Elective regime for 10% companies

Whilst the 0/10 design document does not specifically raise the question of a possible elective regime which would allow 0% companies to elect to be taxed at 10%, we understand that this proposal is under active consideration in a number of other jurisdictions.

We further understand the key 'question mark' to be one of Code compliance. However, in the event that experience in other jurisdictions confirms the availability of an elective regime to be Code compliant, we would favour the introduction of similar provisions under the Jersey 0/10 design proposals.

Some members of FSG believe that this could be particularly attractive in the event that the RUDL charge were to be kept, as it would allow certain foreign owned 0% companies to elect to be taxed at 10% and offset the RUDL cost against their local tax liability, whilst receiving further tax credit at a group level in respect of any net Jersey tax paid. This would have the effect of turning the RUDL charge from an absolute cost of doing business in the Island to a recoverable one.

3.7 Practical considerations

Our final "high level" comment relates to the practical implications of delivering the 0/10 design proposals.

As noted above, the consultation paper sets out a complex regime which is likely to take a good deal of time and effort from, and impose a requirement for additional resource on, the Income Tax Department. In terms of presentation of these changes to clients and what happens in practice, both for businesses operating in the Island and cross-border finance business conducted here, the practical implementation will be crucial. Given the other additional resource pressures arising from the implementation of the ITIS and GST taxation systems, it will be essential to ensure that the Comptroller has sufficient resource available to implement all elements of the fiscal package effectively within the prescribed timeframe. Failure to do so will create jurisdictional risk for the industry.

We would recommend that the primary legislation to introduce the basic 0/10 model is brought forward as quickly as possible, preferably in the 2006 budget, with any other required legislation and/or regulation to be introduced in 2007 after further consultation.

4. Specific / detailed comments on 0/10 design proposals consultation document

Ref	*Comment*
4.1.2	**Third bullet point – captive insurance companies** The paper suggests that "no further captives are allowed after 1 January 2006". We believe this is incorrect, and that captives will still be able to be established in the Island under the 0/10 regime. We believe that captives (Category B permit holders under the Insurance Business (Jersey) Law 1996, should specifically be taxed a the standard rate of 0%.
4.1.2	**Final bullet point – banks: maximum tax charge** Re the proposal to introduce a ceiling "of the order of £70 million" – it should be made clear that this ceiling relates to a bank's taxable profits and not its tax liability.
6.4	**Foreign Incorporated Investment Companies** We believe that the annual corporate residence fee for foreign companies should apply not just to foreign incorporated investment companies (FIICs) which currently benefit from Concession 60, but rather to any foreign incorporated company that is resident in Jersey.
7.10	**Group relief** We note that paragraph 7.10.7 is inconsistent with paragraph 7.10.5 – you could have a mixed group of investment / trading companies and 7.10.5 already provides that group relief would only be available between companies in the same group chargeable at the same rate of corporation tax. We also note that the paper does not deal with the group relief position where at the point of "grouping" the relevant entity is a partnership. This will apply to several local trading organisations. What they will seek to achieve is that they pay tax on the net consolidated profits of the group. There will need to be further clarity in this area if sophisticated tax arbitrage structures are to be avoided.
9.2.5	**Registration test to determine residence** We note that it is concluded that the registration test for residence be retained. This matter has in the past caused issues for exempt companies incorporated in Jersey but managed and controlled from outside of the Island and tax resident in the place where they are managed and controlled. The matter will be further exasperated following the abolition of the exempt company regime. Accordingly, we would wish further research to take place into the possibility of having management and control as the single test for residence with a presumption that those companies incorporated in Jersey are managed and controlled in Jersey. Only where a company seeks to challenge this presumption and on satisfying the Comptroller that the company is indeed managed and controlled in a place outside of the Island, would the company be viewed to be non-Jersey resident. It is believed that this change may be beneficial in a number of instances where Jersey companies are used in corporate structures but where there is no intention to establish Jersey tax residency.

Ref	*Comment*
10.1.2	We note the intention to move trading companies to an actual basis of assessment with effect from 2008. We believe that the precise transitional arrangements should be clarified, agreed and made public as soon as possible, in order to provide for certainty of treatment.
10.1.4	It is proposed that: *"100% look through be introduced in respect of gross investment income (without any deduction for interest expense or management expenses) where such [investment] companies are owned by Jersey resident individuals."* Whilst we agree in principle with this approach, we believe that bona fide (i.e. arm's length) management expenses should be allowable for deduction.
10.3.7	**Definition of "investment company"** It is proposed that: *"a company be treated as an investment company in any year of assessment where its investment income (which would include bank interest) is greater than a prescribed percentage applied to its capital and reserves, excluding loan capital, as measured by its annual accounts."* Whilst we agree in principle with the overall proposed treatment of investment companies, we find the proposed definition of "investment company" unsatisfactory and do not believe it will be appropriate to have a single prescribed rate as individual trading companies may have different funding requirements. We believe that a more sensible approach (on the basis that "investment companies" are more likely to attempt to obtain "trading company" status than the other way round), would be to define a "trading company" as: *"a company whose business consists wholly or mainly of carrying on a trade or trades".* This definition is well understood and supported by relevant case law, such that it would be clear in all but the most marginal of cases as to which category a company falls under. The onus would be left on the company to demonstrate that it is "wholly or mainly carrying on a trade or trades" and not therefore subject to the annual "look through" provisions applicable to investment companies.
12.1	**Companies subject to the 0% rate: special cases** Will there be a voluntary election feature of these arrangements for fund managers? Certain fund managers may wish to retain the same tax treatment as they currently enjoy.

Ref	*Comment*
13.2	**Collective Investment Funds** As noted at paragraph 3.3.3, the assessment of collective investment funds (CIF) is not currently within the scope of the EU Code of Conduct Group. It is therefore permissible to leave the exempt company regime in place in respect of CIFs and we believe that this is the approach that should be adopted.
17.5	**Foreign charities and superannuation funds** It is anticipated that the proposed repeal of Article 115 (Miscellaneous exemptions) in respect of United Kingdom charities and superannuation funds may have an impact on commercial property values in Jersey as such property may be held and valued by UK charities and superannuation funds using discounted cash flow forecasts based on gross rental receipts. It is suggested that the repeal of this exemption will need to be managed on a phased basis, with possible grandfathering provisions for existing structures.
19.4.1	**Stock dividends** Could you please clarify whether it is intended that this provision should apply to bonus shares issued? Please also clarify the treatment of dividends payable to charitable trusts. Will the current exemption mechanism provided for under Article 115(A) of the 1961 Law continue to apply? It will be essential not to bring SPV structures used in cross-border finance activity within the complexities of the deemed distribution provisions.
25.2.2	**Benefits in kind rules** It is proposed to extend the benefits in kind rules to shareholders and to widen their scope to cover the situation where shareholder takes a loan from the company (rather than receiving a profits distribution). Under the proposed provisions, any such loan would be treated as a distribution and taxed in full on the shareholder. The intention of this provision is to accelerate the timetable for the shareholder's payment of tax on the profits of the company in the event of a loan. For example, under the deemed distribution charge, a shareholder would be taxed in year 4 on profits realised in year 1 but not distributed. However, if the profits are made available to the shareholder by way of loan in year 2, then he/she will pay tax in year 2. However, the design proposals do not cover the situation where the loan is subsequently repaid. In such circumstances, would the company's distributable taxable profits be reduced by the loan element to the extent that tax has already been suffered?
27.2	**Re-entry charge** 27.2 discusses a proposed 're-entry charge' under which any individual who becomes non-resident would be liable to tax arising during the period of non-residence in the event that they return to Jersey within five years of leaving the Island. However, further clarification is needed as to whether such individuals would be entitled to tax relief on any tax suffered in their temporary country of residence on the distributions received?

Ref	*Comment*
30.2	**Proposals for enhanced 'balance sheet' disclosure** We believe that the proposed level of disclosure in respect of an individual taxpayer's potential sources of income ('balance sheet') is intrusive and unduly onerous. We believe that any such disclosure should be limited to a 'tick the box' approach as suggested at paragraph 30.2.4 of the paper.
31.1.6	**Reporting and compliance** It is stated in (b) that a company must state whether it has "Island resident shareholders". However, a significant number of companies incorporated in Jersey have island resident shareholders as an administrative convenience with the beneficial ownership of the shares being held on bare trust. This therefore needs clarification.
	Unit trusts / Concession 2 Concession 2 issued by the Comptroller currently provides that unit trusts may obtain full exemption from tax on foreign income even where they have Jersey resident beneficiaries (unit holders) provided that: - formal application for exemption is made; - the trustees undertake to deduct and account for income tax in respect of any distributions to Jersey residents; - potential investors resident in Jersey are made aware, by means of a warning in the prospectus, that Article 134A (anti-avoidance) may be invoked in the case of an investment in an accumulation fund. This concession will need to be amended.

Thank you for giving us the opportunity to comment on the 0/10 design proposals. ***We would welcome the opportunity for representatives from the Fiscal Strategy Group to meet with the 0/10 design team and/or Treasury and Resources representatives directly to discuss the above submission.***

Yours sincerely

David Wild
Technical Director
Secretary, Fiscal Strategy Group

C.C.:

Fiscal Strategy Group Members
Jersey Finance Board
All Jersey Finance Members
Chairman, Corporate Services Scrutiny Panel

Appendix 1 – FSG Terms of Reference (adopted 7 May 2006)

Status

The Fiscal Strategy Group (FSG) is a Sub-Committee of Jersey Finance Limited and has been established to represent and promote the interests of the Finance Industry on fiscal strategy matters. Whilst the FSG is made up of representatives from across the Industry, it is not an elected body and, therefore, in formulating its views and recommendations, it will need to consult extensively with the Member firms of Jersey Finance and the Trade Associations.

Membership and quorum

The Chairman and members of the FSG will be appointed at the discretion of the Jersey Finance Board. Participation in the Group is voluntary and on an unremunerated basis. A minimum of any five members is required at a meeting for the Group to be quorate. The use of alternates is permitted.

In determining the composition of the Group, the Jersey Finance Board will be mindful of the need to reflect a broad cross-section of the Industry, and will seek to ensure that all key Industry sectors are at all times represented. However, it is also recognised that the Group will need to include tax professionals with sufficient expertise to deal with complex fiscal matters.

In identifying appropriate members, the Board may take into consideration the views of the Trade Association Members of Jersey Finance. However, it should be noted that all members of the working party are acting in a personal capacity and do not represent the views of their respective firms or of any body of which they may be a member.

Whilst the FSG will at all times seek to achieve a consensus position on matters under consideration, it is recognised that this may not always be possible and that individual members of the Group may have dissenting views.

Purpose

The primary purpose of the FSG is to consider and report upon the technical and commercial implications for Jersey's Finance Industry arising out of the States' fiscal policies.

In determining its position on key fiscal strategy issues, the FSG will consult widely with Jersey Finance Member firms and the Trade Associations. It will also work closely with the States and other relevant stakeholders as required.

Confidentiality

Given the focus of the FSG's remit, it may be asked to consider information of a confidential nature. All members of the Group will be expected to apply the highest professional standards and judgement in the handling of such information.

Key Objectives

- To study all key fiscal policy issues and assess / report on their potential impact on Jersey's Financial Services Industry.

- To consider any significant tax developments in selected key competitor jurisdictions (whether identified by members of the Group or others) and inform the Finance Industry and/or the States of any important changes – especially where tax changes in a competitor jurisdiction may affect Jersey's market position2.

- To support the Market Access Group (MAG) in formulating its proposals/recommendations in relation to the States' international tax negotiations (e.g. Tax Information Exchange Agreements).

Operating parameters

The FSG will operate on the following basis:-

- The FSG is a technical group with no decision-making capability. However, it may be used as a mechanism for consultation and technical discussion with other parties, including the States of Jersey, and it is intended that the FSG should be recognised by all interested parties as the primary Industry forum for dealing with fiscal strategy issues.

- The purpose of the FSG, as a technical group, is to study and report on fiscal matters affecting the Finance Industry in Jersey, with a view to preserving and enhancing the long-term competitiveness of the Industry in the provision of international financial services.

- The FSG is mindful that its work and any recommendations it puts forward should take place in the context of what it understands to be in the best economic interests of the Island.

However, it is not within the remit of the FSG to:-

- Support or advise the States (or its appointed representatives) on matters of fiscal policy development. This remains entirely the responsibility of the States of Jersey.

- Determine whether the States' fiscal policies (or any findings of the FSG if adopted by the States) would satisfy Jersey's international commitments on taxation.

- Model the economic impact of its findings and/or recommendations. This will need to be subject to a supplementary process led by the States.

- Engage in any PR or publicity initiative designed to gain acceptance of the States' fiscal policies.

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[2] In fulfilling this objective it should be noted that neither the Group, nor its individual members, have responsibility for proactively monitoring and reporting on international fiscal developments.

Meetings

It is envisaged that the the FSG will meet at least bi-monthly and meetings will be chaired by the appointed Chairman.

Formal minutes will not be prepared unless agreed on a meeting-by-meeting basis. However, the Secretary will note and control any specific action points arising from each meeting.

Duration

The FSG will be established in January 2006 and will continue in existence until such time as it is disbanded by the Board of Jersey Finance.

Reporting Line and deliverables

The FSG will report to the Board of Jersey Finance through its Secretary. From time to time, the FSG Chairman, or other representatives, may be asked to attend Jersey Finance Board meetings for more comprehensive feedback and discussion.

Jersey Finance Limited will provide its Members with periodic updates on the activities of the FSG through its regular communications channels. However, given that the work undertaken by the FSG may be commercially sensitive, such updates may be general in nature as required.

From time to time the FSG may produce formal deliverables – for example, responses to public consultation documents or other reports. It is envisaged that such documents, once agreed by the Group and the Board of Jersey Finance as a formal deliverable, will be made available to all Jersey Finance Members, as well as to other relevant bodies including the consultation sponsor and (where applicable) relevant Scrutiny Panel.

Appendix – Composition of Fiscal Strategy Group as at May 2006

Member	***Contact***
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Appendix 2 – Trade Association Members of Jersey Finance Limited

ASSOCIATION
Association of Private Client Investment Managers & Stockbrokers – Jersey branch
Association of English Solicitors in Jersey
Jersey Association of Trust Companies
Jersey Bankers Association
Jersey Funds Association
Jersey Society of Chartered and Certified Accountants
Jersey Taxation Society
Law Society of Jersey
Personal Finance Society – Jersey branch