STATES OF JERSEY

GOODS AND SERVICES TAX: EXEMPTION OR ZERO-RATING FOR FOODSTUFFS AND DOMESTIC ENERGY (P.103/2008) – AMENDMENTS (P.103/2008 Amd.) – COMMENTS

Presented to the States on 8th September 2008
by the Council of Ministers

STATES GREFFE

COMMENTS

This Proposition amendment seeks to extend the exclusions already proposed by the Deputy of Grouville under P.103/2008. It introduces 2 further categories of supply [Water; and Books, Magazines and Newspapers] for exclusion and extends the scope and coverage of the 2 categories [Energy and Fuel; and Food] already listed in P.103/2008.

When the public were originally consulted on GST as part of the fiscal strategy, their overwhelming response was that they wanted a simple system of GST, with a single low rate and few exemptions, which would be cheap to administer.

This amendment would do the exact opposite of what the public said they wanted, and also bring Jersey's GST very close to the UK VAT of supplies which is universally regarded as the worst and most complex VAT/GST scheme in the world.

However, as will be revealed during the debate on P.103/2008, the Council of Ministers is now prepared to accept the removal of GST on food only as part of a package of measures designed to mitigate unprecedented global price increases.

As this Proposition would further narrow the range of goods and services on which GST is charged, the 3% rate could no longer be guaranteed, and the rate of GST would almost certainly have to increase in the future.

Not only would the yield from GST fall, but the administrative complexity would increase, and hence the cost of administration as a proportion of the tax raised.

Implications of the Proposition to zero-rate the supply of Water; Energy and Fuel; Books, Magazines and Newspapers; and Food

Although the Proposition mentions zero-rating or exemption, it has been assumed that Senator Norman intends his proposed exclusions to provide the maximum benefit to consumers and therefore all comments and calculations are provided on the basis of zero-rating.

Loss of revenue

The table below provides an estimate of the revenue loss for each of the 4 categories in the amendment of Senator Norman [based on household consumption/expenditure]; and a sub-total.

Senator Norman Amendment to P.103		
Zero-rating household expenditure on water	475,405	
Zero-rating household transport-related expenditure on petrol, diesel and motor oil	947,885	
Zero-rating household expenditure on books, magazines, etc.,	575,346	
Zero-rating household expenditure on foods not included in UK basis	865,571	
		2,864,207

[Note: the above figures do not include the reduction in GST yield relating to visitor expenditure and some sticking tax effects that will also reduce the potential yield further.]

It must also be remembered that if this amendment and Proposition 103 are approved in full, the total revenue loss would be in the region of £8 million.

It is estimated that £610,000 total lost tax revenues from the proposed amendments would go to the bottom 2 income quintiles, whilst £1,607,000 would go to the top 2 income quintiles.

Tax technical complexity

Similar Propositions seeking exclusions from the tax base have been debated by the States previously (P.44/2005; P.165/2005; P.86/2006; and P.169/2007). The arguments/comments provided then by Treasury and Resources are relevant now and we still maintain there is no such thing as a simple exclusion.

In his report Senator Norman appears to endorse the Simple GST introduced in Jersey, but claims there should be no exemptions (exclusions) and that this principle has been breached. We can report that a VAT/GST system with absolutely no exemptions/ exclusions has never been introduced anywhere in the world. All exclusions approved by the States to date have followed international best practice and have mainly been provided by way of exemption for domestic services. The current Jersey GST system is still within the definition of a good/simple consumption tax.

Each of the 4 categories proposed by Senator Norman will need further policy consideration/clarification, legal definition, and then need to be reflected in basic interpretations/guidance.

The difficulties should not be underestimated and this is perhaps best illustrated by the proposal for food. The exclusion extends beyond even UK treatment and would be unique to Jersey – even regimes that zero-rate foodstuffs attempt to limit the exclusion to essential and/or basic types of food. The exclusion proposed would appear to include pet food, fizzy drinks, crisps, sweets/confectionary and perhaps even catering and the sale of alcohol (in which case there would be an even greater loss of revenue).

Impact on compliance and administration

"One overriding lesson about VAT/GST design is that adding tax preferences (exclusions by zero-rating/exemption) to the system may satisfy economic, distributional or other policy goals but at a cost. Tax preferences – in the form of zero-rates, exemptions or reduced rates – reduce revenue, add complexity and increase compliance risks. The end result is an increase in compliance burden for businesses and administrative costs for Government". [Concluding comment from a US Government Accounting Office report – "VAT lessons from other countries"; dated April 2008].

There still seems to be general misunderstanding on the part of many States Members as to the inter-relationship between the design of a tax system and the compliance risks; compliance costs and administration costs. In some ways this is understandable – it is a complex issue which was certainly not helped by the Corporate Services Scrutiny Panel's first interim report on GST (S.R.6/2006) – dated October 2006. Section 6 covers compliance and appears to rely on an Australian Senate Select Committee review dating back to April 1999, which in turn quotes from a UK National Audit Office (NAO) study into compliance costs in 1994. Although we have generally been impressed with the work of the Corporate Services Scrutiny Panel on GST (the conduct, methodology and outputs), we have never accepted these conclusions which are not evidence-based and in any case focus mainly on business compliance costs.

The Scrutiny Panel findings have repeatedly been misinterpreted by some States Members – Proposition P.103/2008 under Financial and Manpower includes "but as was demonstrated convincingly by Scrutiny, claims of excessive administration cost associated with exemptions or zero-rating were grossly over-stated". Scrutiny demonstrated no such thing and the panel members never had sight of the original NAO report. If they had, they would have seen an important footnote in the comparison of gross compliance costs – "The purpose of this comparison is to illustrate the similarity of the compliance cost: turnover curve. Comparison between individual countries figures [UK; Netherlands; New Zealand; Germany; Canada] are not valid because the tax regimes are different and the research has been carried out on a different basis".

Finally it must be emphasized that the NAO report was a study into the "Cost to Business of Complying with VAT requirements" and not the cost of administration of VAT by [at that time] H.M. Customs and Excise and other tax authorities.

If the States did approve the full range of exclusions covered by Senator Norman's amendment and P.103/2008, then the cost of administration is likely to double from the current estimate of £1 million to£2 million per annum.

Summary

In summary these amendments are without merit –

- They are a clear example of exclusion creep – if these really are considered to be essential to life and health – then what next?
- They are an ineffective mechanism for making GST more progressive.
- They leapfrog the UK’s extensive, complex and administratively expensive zero-ratings, previously regarded as the worst implementation of VAT/GST in the world.
- They propose zero-ratings for pet food, fizzy drinks, sweets and crisps.
- They significantly reduce the yield from GST, which will inevitably increase the risk of having to change the 3% rate.
- They will significantly increase the administrative costs of the revenue agencies (Income Tax Office and Customs and Immigration) and the compliance burden of business.

The Council of Ministers therefore opposes the amendments lodged by Senator Norman.