STATES OF GUERNSEY

FUTURE ECONOMIC & TAXATION STRATEGY

SECOND CONSULTATION DOCUMENT

September 2005

FOREWORD

As a result of the first Consultation Document issued in March 2005, nearly 100 responses were received. The Group is extremely grateful to all those that responded. **However, the Group believes that it is essential that during this second consultation process the general public needs to be more engaged in the debate.**

Having considered very carefully all of the responses received during the first consultation process, this document sets out the Group's proposals.

The purpose of this second Consultation Document is therefore to further assist the States of Guernsey to establish a strategy to safeguard the future economic well being of the Island.

It is emphasised that any decisions on a revised taxation structure will require the approval of the States of Deliberation. However, in order to take those decisions the States must be presented with a well researched and argued case. This Consultation Document is an important part of that process.

Individuals, organisations or representative bodies should submit their views by no later than **14 November 2005** to:

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INTRODUCTION AND SUMMARY

Guernsey has over recent decades developed a prosperous and resilient business environment which has been able to respond quickly to changing local and international developments. It has created a business-friendly and competitive environment that attracts prosperous activity, entrepreneurship and diversification.

It is emphasised that the fundamental purpose of the Group's work is to maintain a vibrant and sustainable economy that generates corporate profits, offers well-paid job opportunities and makes a positive contribution to the prosperity of the Island.

The Island's future clearly lies in providing a business environment where its residents are in well-paid, secure and sustainable jobs which add value to the businesses in which they are employed. It is only through this economic activity that the States will be able to raise revenues to fund public services and infrastructure improvements. Unemployment, or employment in low paid jobs will simply not generate the necessary public sector revenues required to fund basic public services.

Therefore the key criteria used by the Group in putting together its proposals has been the maintenance of competitiveness for business and jobs.

Those options which would lead to the creation of a less competitive environment, and would therefore discourage new businesses locating in Guernsey, or existing ones moving away to competitor jurisdictions, have been discarded.

The purpose of this consultation process, of which this Consultation Document is the second part, is to assist the States of Guernsey in determining a strategy to enhance the Island's competitiveness, encourage more value added business coming to Guernsey, and thereby safeguard the future economic well being of our community.

As a result of the first Consultation Document, nearly one hundred separate responses were received (see Appendix XII) from a wide range of individuals, businesses, organisations and associations. The responses from a number of associations were a summary of the results of their own consultation exercise with their membership. The areas covered were also extremely varied, some were on single issues, others were more wide ranging.

In addition, important contributions to this debate were also made through a significant range of formal and informal discussions, and other channels of communication, not least through the local media. Representatives of the Group gave a number of presentations to various associations. A common theme emerging from these presentations was that they were the best-ever attended meetings of those associations. **However, the Group was disappointed with the level of involvement of the general public.**

A key part of the process going forward is ensuring that the general public becomes more aware of, and involved in this process. The proposals that the States ultimately adopt will have a direct impact on everyone's daily life.

Background

The European Union has developed a Code of Conduct on Business Taxation. Although, Guernsey is not within the EU's fiscal territory and is not within the EU single market for financial services, the countries of the EU (including of course the United Kingdom) are its major economic trading partners. Therefore, Guernsey continues to indicate its willingness to participate in a constructive dialogue with the EU.

The Code of Conduct listed a total of 66 measures which it considers harmful in EU Member States and their associated or dependent territories. Five regimes were identified in Guernsey as being considered harmful.

The main reason that the Code of Conduct listed these regimes as harmful is that the beneficial tax treatment that they provide is considered to be 'ring fenced' from the domestic economy. (Ring fencing is a term used to describe the situation when a preferential tax regime is available fully or in part only to non-residents rather than to residents in the country providing the regime.)

The existence of a zero or low tax regime is not deemed to be harmful in itself. A regime is deemed to be harmful if preferential rates are made available to non-residents but not to its own residents.

Hence, a corporate tax regime where the general rate of tax applied to resident and non-resident companies is zero is not deemed to be harmful. Furthermore, a regime that then charges a proportion of its companies at higher rates of tax (specified by sector) is also not deemed to be harmful provided that, as a proportion of the overall economy, these companies are a minority. **This is why the Zero-Ten option is compliant with the code of conduct.**

In December 2002, as part of the 2003 Budget a separate supplement (the "2002 Report") was published which set out the then Advisory and Finance Committee's views for the future direction of Guernsey's corporate taxation strategy. Essentially, this long-term strategy consisted of a general rate of income tax for companies of zero per cent in respect of tax year 2008 onwards. The profits of certain companies licensed by the Guernsey Financial Services Commission would be taxed at 10%. (The Zero-Ten option).

Since the 2002 Report there has been considerable activity across the world in response to the various international tax initiatives. Most competitor jurisdictions, including Jersey and the Isle of Man, have made announcements to the effect that they intend to adopt the approach set out in the December 2002 Report and introduce some variant of the Zero-Ten model.

A considerable amount of work has been carried out to investigate and model the effects of adopting a similar tax regime in Guernsey. Having carefully carried out various modelling exercises, using the best available data, it is estimated that the annual loss of revenue to the States of Guernsey from adopting the Zero-Ten option would be of the order of £48 million. This is now based on more up to date information and is slightly more than previously calculated.

In the 2002 Report the Advisory and Finance Committee was able to take a very positive approach to the adoption of a revised tax structure. One of the main reasons why it was originally possible to take such a view was that public finances had very high surpluses which had enabled substantial reserves to be built up. However, the States finances are no longer that strong. Therefore, this report also addresses some of the options that need to be taken in respect of the delivery of public services.

It is important to acknowledge that the need to change is not one that is only being faced by this Island. Other jurisdictions, many of which are direct competitors, are also faced with these issues and will, of course, continue to respond in their own best interests. These jurisdictions are competing with Guernsey for businesses and well-paid jobs.

The main drivers for change are therefore twofold, the need to meet our international obligations (in order to secure access to world markets) and the need to be competitive with other similar jurisdictions.

Summary and Conclusions

In order to maintain a vibrant and sustainable economy Guernsey needs, in its own best

interests, to change its taxation regime to comply with international standards and respond to competitive pressures.

Such fundamental change will be difficult and challenging. Not only is this change unprecedented in the Island's recent history, it is recognised that very few other jurisdictions in the world have ever faced such radical changes to their tax regimes.

Change of this magnitude presents risks and can create uncertainty but also presents opportunity. This opportunity must be grasped so that it can be the catalyst for future benefits and prosperity. In order to meet these challenges, it is essential that all parts of the community join together in a positive and constructive manner.

As has been stated on previous occasions, the Policy Council and the Treasury and Resources Department are determined to carry out this vital work in a methodical and measured manner and avoid the temptation to reach any premature conclusions without all options first being fully thought through, costed and consulted upon. The process thus far has demonstrated that this was, and remains, the correct approach.

This second Consultation Document is a further vital part of that process.

Having carefully considered the representations made to it during the past months, and bearing in mind the key criteria of maintaining business competitiveness and securing well-paid jobs the Group's proposals are that:

- Change is in the best long term economic, social and political interests of Guernsey.
- Public sector expenditure (revenue and capital) must be curtailed as a matter of urgency.
- It is in the long term best interests of Guernsey to maintain and enhance a vibrant and sustainable finance sector.
- Any changes must also protect and enhance the business environment and opportunities within the non-finance sector.
- The basic rate of income tax on company profits should be 0%.
- Captive insurance companies and collective investment schemes should continue to be subject to taxation at 0%.
- Guernsey resident shareholders should be taxed at 20% on the profits of the company in proportion to their ownership. (The attribution or "look through" basis). However, further consultation is required on an alternative whereby business profits should be taxed on a distribution only basis.
- Regulated finance institutions, other than captive insurance companies and collective investment schemes, should be subject to taxation at 10%.
- A payroll tax should **NOT** be introduced.
- Trading activities regulated by the Office of Utility Regulation should be subject to taxation at 20%.
- Resident individuals should continue to pay tax at 20% on assessable income.
- Significant individual taxpayers should be liable to the standard rate on their non-Guernsey

income only up to a defined income ceiling after which point their liability should be capped. Guernsey income to be taxed at the standard 20% rate.

- The present level of personal income tax allowances and reliefs should be revised with interest relief restricted to principal private residences.

- "Wealth taxes" such as inheritance and capital gains taxes should **NOT** be introduced.

- The rates of existing indirect taxes should be increased, in particular duties on alcohol, tobacco and Tax on Rateable Values.

- The costs of the social security contributory scheme to be fully met from contributions. Employee and employer contributions should be increased to 7% each and the upper earnings limit increased to £60,000. The grants payable by general revenue (£35m per year) to social security to cease.

- General revenue would continue to fully fund the non-contributory elements of the present social security system (Family Allowances, Supplementary Benefit, etc) of around £22m per year.

- The Contingency Reserve (estimated to be £225m by 2008) to be used as a short-term measure to cover any initial shortfall in public sector funding.

The Group believes that increasing employer and employee social security contributions is a better alternative than introducing a general goods and services tax.

Guernsey, especially in the past decade or so, has seen unprecedented growth in the level of wages paid to islanders and the quantity and quality of public services provided. At the same time, taxes, in real terms, have reduced so that the level of disposable income for the vast majority of the population has become, by any standard, very high. There is no doubt that this has been made possible largely because of the finance sector.

The immediate impact of the Group's proposals will inevitably mean that individuals will have less disposable income. However, the overall package of proposals is designed to ensure that Guernsey remains a good place for business to operate and to provide well-paid jobs, hence enabling wages to remain high and, in many cases, to increase. **Even with the proposed tax increases, individuals in Guernsey will still be subject to tax at levels which are far less than the vast majority of other jurisdictions in the world, and disposable incomes of individuals will therefore continue to be very high.**

The Group also recognises that those on lower incomes must be protected from any changes and that taxation increases need to be targeted on those who can afford to pay, not those who are most vulnerable, including those on fixed incomes and pensions. The Corporate Anti-Poverty Programme will continue to be a key policy of the States and will need to continue to be funded.

The Group believes that by introducing this package of measures, including curtailing public sector expenditure, the challenges of the future can be met with confidence.

Within each of the proposed methods of raising income and cutting expenditure there is a range of detailed options which are explored in this document.

In order to take the necessary actions, the States of Guernsey needs to hear the views and opinions of the general public and the business community. Any individual, organisation or representative body who wishes to submit their views is asked to do so to the address shown in

the Foreword to this document.

This second period of consultation, which is as important as the first, will then enable specific proposals to be put before the States to discuss at the beginning of February 2006.

Competitive Business Environment

The finance sector is the dominant part of the Island's economy. This sector generates significant revenues which help to pay for public services (see Appendices VI & VII). Any taxation strategy therefore needs to address the competitive position of the finance sector as a priority. Failing to support this sector is not an option as it would lead to the Island's most important economic sector becoming uncompetitive and leading to an economic void which the other sectors could not hope to fill.

The finance sector is not one single type of business; it is made up of a number of inter-related and inter-dependent sectors. Professional support services (accountants, lawyers, actuaries etc.) are essential in order to provide very high standards of service. The inter-relationship between these various components is also complex. In addition, in order to remain competitive and help differentiate the Island in the marketplace, Guernsey needs this high level of expertise across all sectors of the economy.

It is worth emphasising that the success of the Island is based on a number of factors unrelated to the system of taxation. Most notably:

- Economic prosperity that relies on political and economic stability and fiscal autonomy.
- High quality institutions and professional service providers of international repute staffed by a highly skilled workforce.
- Independent professional supervisory and regulatory regimes with a pragmatic and responsive legislative framework.
- Accessible judicial system which is based on integrity and respect for the rule of law.
- Good local infrastructure and communications within a convenient time zone.
- Pleasant and safe place to live and do business.

However, it is indisputable that like any other finance centre, be it New York, London or Dublin, an important element of success is the existence of a competitive tax environment.

In view of the recent and growing competitive pressures facing the Island, it is clear that Guernsey needs to amend its taxation regime if the finance sector is to remain competitive and if the Island's overall economy is to be protected.

It is also recognised that any proposed package of measures for reform of corporate taxation has to take into account international standards in addition to competitive pressures.

Although the finance sector is presently the dominant part of the Island's economy, it is by no means the only sector. There are also a whole range of economic activities on the Island that includes light industry, retail services, tourism, horticulture and other local service and traditional businesses.

However, regardless of which sector is considered, the Island's future clearly lies in providing a business environment where its residents are in well-paid, secure and sustainable jobs which add value to the businesses in which they are employed. It is only through economic activity that the States will be able to raise revenues to fund public services and infrastructure improvements.

Any proposals that are implemented at the end of this process must protect the competitiveness of the finance sector and attract and retain non-finance sector businesses.

If Guernsey can attract and retain businesses that support well-paid jobs, public revenues can be raised to fund public services. If Guernsey fails to do this, unemployment, or employment in low paid jobs, will simply not generate sufficient public sector revenues to fund basic public services to support the community.

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Public Sector Expenditure

Annual revenue expenditure over the period 1999 to 2005 has increased by £105m, which represents 53% in cash terms, or 25% in real terms. In recent years it has consistently grown by over 3% in real terms each year.

General increases in revenue expenditure have been experienced in most areas, but in particular in health and education. However, a number of new services and initiatives, and associated increased expenditure, have been introduced or substantially increased during that period. Each of these projects were approved by the States, and in isolation were considered worthy of support, however, cumulatively they have increased the ongoing burden on the taxpayer.

In addition to the increase in revenue expenditure there has been an unprecedented increase in capital expenditure in the past few years. (It is estimated that for the years 2000 to 2005 inclusive, capital expenditure will total around £250m).

The overwhelming majority of the responses received as part of the first consultation period strongly endorsed the need for States expenditure to be curtailed.

It has to be accepted by all Departments, States Members and staff, and indeed the public, that the culture of increased public sector service provision and ever growing expenditure needs to be reversed. In the coming years the introduction of any new services can only be contemplated in very exceptional circumstances and then only if existing (lesser priority) services are reduced or withdrawn. It must also be seriously questioned whether "RPI plus" pay awards in addition to promotions and a final salary pension scheme are sustainable for public sector workers.

Although the level of States expenditure has risen in the past few years, the independent benchmarking exercise carried out in cooperation with Jersey and the Isle of Man, showed that, in general, Guernsey has a well deserved reputation for delivering public services at a cost which compares favourably with the other jurisdictions. **Nonetheless efficiencies and savings must be delivered.** Appendix IV sets out the major areas of expenditure for 2004 and 2005.

Of course, as a major employer and with a substantial property portfolio, any increases in the rates of employer social security contributions, TRV etc. will have the effect of increasing States expenditure. Such increases must be absorbed by increased efficiencies and productivities if real savings are to be delivered.

The Group is aware that there are already considerable existing pressures to increase public sector expenditure in a number of areas, (public sector employee pensions contributions, various social policy initiatives, medical inflation and healthcare workers pay to name but a few). Efforts must be made to contain these additional costs. However, while recognising that expenditure in some areas will inevitably need to grow, compensating reductions will need to be made elsewhere.

The Group believes that public sector expenditure must be curtailed and, over the next five years, a maximum target figure of no more than the amount spent in 2005 in cash terms (i.e. £290m) for ongoing annual revenue expenditure and £15m for annual capital expenditure should be established.

As set out in the table in the next section, the £305m target above is before the removal of General Revenue grants to social security for contributory benefits. Total annual target expenditure on public services will be £268m.

In absorbing both the inevitable cost increases referred to above, and inflation (including wage inflation), the States public sector will be expected to cut around £15m (or 5%) compared to present expenditure levels.

Restraining public sector expenditure to this extent will be a challenging task and, as set out in the July 2005 Interim Financial Report, the Treasury and Resources Department, Policy Council and all other States Departments, undoubtedly have a more difficult task than has faced the States for many years. During this time of change every effort must be made to ensure that Budgets are, as far as possible, contained. Difficult decisions will have to be taken and a significant change of culture achieved. Where necessary, previous States approved spending plans will have to be revisited. Although this may well prove difficult to achieve, it is essential that States revenue expenditure is controlled, not least to enable money to be set aside for high priority capital expenditure.

Public Sector Revenues

In order to pay for public services (including capital infrastructure maintenance and improvements), taxes need to be raised from business, employment and consumption. The following table sets out in summary form how the Group proposes to raise the revenues to fund public sector expenditure.

	Post 2008 £m
Ongoing Expenditure	290
Capital Expenditure	15
Total Annual Expenditure Requirements	305
Less: reduction in grants to Social Security	35
Less: additional fees and charges retained by Departments	2
Target Annual Expenditure	268
	£m
ETI, self employed and investment income	145
Business profits	48
Indirect taxes	60
Miscellaneous income	3
Annual Company fees	5
Initial deficit funded from interest on the Contingency Reserve	7
Target Annual Income	268

In the later sections of this document (and in Appendix IX), more specific details are provided on the effect on individuals of the proposals and the impact on the overall pattern of States Revenues. The above table also assumes that the Capital Reserve is fully depleted.

In recent years there has been strong growth in ETI and self-employed tax receipts (of the order of 6% per year). If the Group's proposals are successful this should continue or even increase. However, given the difficulty in quantifying such growth, especially at a time of significant change, no attempt has been made to include increased revenue in the above figures. The effect of revenue growth will be to reduce the amount needed from the Contingency Reserve.

Other Income Streams

In addition to the direct and indirect taxes, (which are accounted for "centrally" and then allocated to individual Departments to fund their revenue and capital programmes), a wide variety of fees and charges are levied by individual Departments (and retained by them). Some of these charges raise several million pounds a year, others just a few thousand.

Examples of such fees and charges include admission charges to the Museums, property rents, various health service fees, refuse disposal fees, sewage tanker fees etc.

Although many of the fees and charges have been kept under careful review, others have been allowed to reduce in real terms, in particular in the last decade when Committees and Departments have been under less financial pressure.

The level of charges and fees was the subject of a comprehensive review by the National Audit Office on behalf of the Public Accounts Committee which identified a number of areas where charges and fees could be considered for increase**. It is proposed that a minimum of £2 million should be raised in this area.**

As has been stated on many occasions, the States of Guernsey has a large and varied portfolio of property. Some of this property is not being used to its full potential. The Treasury and Resources Department is already committed to reviewing the States property portfolio to ensure that it is rationalised. This process will identify any properties that can be released, either by sale, lease or used more effectively for another purpose, including by another Department.

Borrowing

The States of Guernsey has traditionally had a very prudent approach to borrowing and as a result the taxpayer has not had to bear the cost of interest charges. In recent decades the States has not borrowed to fund either ongoing revenue or individual capital projects.

The Corporate Agenda, as approved by the States in December 2004, includes the following statement on borrowing:

"Take a cautious approach to public sector borrowing, only doing so where the debt can be serviced by a secure, associated income stream".

The Group continues to believe that this remains a sensible and prudent approach.

Contingency Reserve

The purpose of the Contingency Reserve is to provide protection against major emergencies including significant economic downturns having a severe adverse effect on the Island.

Since 1998 the Contingency Reserve has increased from £71m to £190m at the end of 2004 and is expected to reach £225m by 2008.

The increase since 1998 has been the result of appropriations from General Revenue (£47m), the sale proceeds of Guernsey Telecoms (£23.8m) and net increase in investments (£48m).

Although the Contingency Reserve is expected to continue to increase in size as a result of investment growth (the Fund investments are mainly fixed interest and similar financial instruments), it is very unlikely that any further appropriations will be possible from General Revenue.

Although the Contingency Reserve cannot be used to make good any shortfall in revenue over an indefinite period, the Group believes it should be used in the short to medium term to help balance the books in order to smooth any transitional arrangements.

Case for the Zero-Ten Option

The European Union has developed a Code of Conduct on Business Taxation. Although, Guernsey is not within the EU's fiscal territory and is not within the EU single market for financial services, the countries of the EU are its major economic trading partners. Therefore, Guernsey continues to indicate its willingness to participate in a constructive dialogue with the EU.

The Code of Conduct listed a total of 66 measures which it considers harmful in EU Member States and their associated or dependent territories. The following five regimes in Guernsey are listed:

- Exempt Companies.
- International loan business.
- International bodies.
- Offshore Insurance companies.
- Insurance companies.

The main reason that the Code of Conduct listed the above regimes as harmful is that the beneficial tax treatment that they provide is considered to be 'ring fenced' from the domestic economy. (Ring fencing is a term used to describe the situation when a preferential tax regime is available fully or in part only to non-residents rather than to residents in the country providing the regime.)

The existence of a zero or low tax regime is not deemed to be harmful in itself. A regime is deemed to be harmful if preferential rates are made available to non-residents but not to its own residents.

Hence, a corporate tax regime where the general rate of tax applied to resident and non-resident companies is zero is not deemed to be harmful. Furthermore, a regime that then charges a proportion of its companies at higher rates of tax (specified by sector) is also not deemed to be harmful provided that, as a proportion of the overall economy, these companies are a minority. This is why the Zero-Ten option is compliant with the code of conduct.

The 2002 Report and subsequent States Reports have all acknowledged the need for change. Simply doing nothing is not a viable or realistic option. Not to respond to the competitive and international pressures would result in a very rapid, severe and irreversible decline in the Island's finance sector. This would have the most severe effect on the Island's economy, employment and ability to fund public services.

The first Consultation Document concentrated on two main options, Zero–Ten and Flat rate.

The Flat rate option was not favoured by the former Advisory and Finance Committee (in its 2002 Report) or by the Group. It also found little support within the consultation responses.

Most competitor jurisdictions, including Jersey and the Isle of Man, have made announcements to the effect that they intend to adopt the approach set out in the December 2002 Report and introduce some variant of the Zero-Ten model.

The main features of a Zero-Ten regime are:

- The basic rate of income tax on company profits (from business and investment activities)

would be 0%.

- Certain companies regulated by the Guernsey Financial Services Commission would be subject to tax at 10%.

If Guernsey was to adopt such a regime it would, in general outline, be consistent with the 2002 proposals and competitive with other jurisdictions.

In the previous Consultation Document mention was made that, “initial consultations with some of the regulated finance companies have revealed a preference for them continuing to pay tax at 20% if this would avoid the need for other charges which would impact adversely on their pre-tax profits.”

On the face of it a Zero-Twenty regime, (or one that has some regulated sectors taxed at 10% and others at 20%) has some attractions. Not least that, initially, it could potentially halve the size of the annual loss of revenue (see Appendix XI).

Considerable work has been carried out in this area, in particular detailed consultation has been held with the finance sector, including individual companies, various associations and professional advisors. **It is clear from the responses received that the majority of the finance sector strongly believe that a Zero-Twenty regime would be deeply damaging to the competitiveness and sustainability of the finance sector. It therefore fails the key criteria test that any proposals must support and encourage competitiveness.**

Although some business would, at least for a while, remain under such a regime, there would be an inevitable decline in existing business and a cessation of new business. Businesses, and therefore employment prospects, would simply relocate to those jurisdictions, such as the Isle of Man and Jersey where a 10% taxation rate would apply.

Having considered very carefully the arguments made in the responses received to the first Consultation Document, the Group believes that a Zero-Ten regime should be adopted.

EFFECT OF PROPOSALS ON STATES REVENUES AND INDIVIDUALS

The fundamental purpose of the Group's work is to maintain a vibrant and sustainable economy that generates corporate profits, offers well-paid job opportunities and makes a positive contribution to the life of the Island.

The Island's future clearly lies in providing a business environment where its residents are in well-paid, secure and sustainable jobs which add value to the businesses in which they are employed. It is only through this economic activity that the States will be able to raise revenues to fund public services and infrastructure improvements. Unemployment, or employment in low paid jobs will simply not generate the necessary public sector revenues to fund basic public services.

Therefore the key criteria used by the Group in putting together its proposals has been the maintenance of competitiveness for business and well-paid jobs.

How Will the Changes Affect States Revenues?

As well as impacting on individuals and businesses, the changes to the Zero-Ten tax regime, will also have a marked impact on where public sector revenues come from. In broad terms, States revenues come from three main sources:

- Taxation on the profits of business.
- Revenues arising as a result of employment (ETI, employee and employer social security contributions).
- Tax on consumption (duty on tobacco, alcohol, property taxes, etc.).

As set out in Appendix III, between 1999 and 2004 there has already been a move away from revenues raised from business profits to employment generated revenues. This is a trend that has also been experienced by other jurisdictions elsewhere in the world.

Under the Group's proposals, this trend will be more marked and the majority of revenue raised will come from employment and consumption sources.

It is emphasised that "revenues arising from employment" includes amounts payable by employers in respect of employing individuals, (i.e. employers social security contribution) and not solely that paid by individuals.

Revenue Source	1999 %	2004 %	2008 %
Business Profits	44	29	15
Employment	40	58	66
Consumption	16	13	19

Planning public sector expenditure based upon the predicted level of tax receipts from business profits is much harder to do than using predicted tax revenues from indirect taxes and taxes based on employment. Moving to a tax regime where the majority of taxes are no longer based on business profits, which can be unpredictable, will provide a much greater degree of certainty in planning public sector revenues and therefore expenditure.

How Will the Tax Changes Affect Individuals?

Appendix VIII sets out a comparison between Guernsey, Jersey and the Isle of Man of the amounts currently payable in respect of various individual scenarios for income tax and social security contributions.

From these figures it can be seen, especially for those on middle to high incomes, that taxes payable currently in Guernsey are less than Jersey and much less than in the Isle of Man.

Furthermore, as shown in the National Audit Office's report on Income Generation, the level of duties, fees and charges in Guernsey are also much less than most other jurisdictions and many of them have fallen in real terms over the past decade.

The Group does not advocate tax rises for their own sake. However, there is considerable scope for tax rises and for Guernsey still to remain competitive.

It is by remaining a competitive jurisdiction that businesses will continue to be attracted and flourish in the Island and therefore offer well-paid jobs to enable taxes to be paid.

Under the Group's proposals most individuals will be affected as follows:

- Social Security contributions to be increased to 7% for both employer and employee and the upper earnings threshold increased to £60,000. For an individual earning £40,000 per year this would be an increase of £740 per year or £14 per week. (An individual on £60,000 would pay £2,140 per year or £40 per week more). Self-employed and non-employed contribution rates will also be increased.

- The amount of tax on rateable value on domestic dwellings will increase threefold, which will increase the amount payable on a typical dwelling from £75 to £225 per year.

- Smokers and drinkers will be paying duties more in line with other jurisdictions and can expect them to increase at least in line with inflation thereafter. This could mean an extra 6p to 10p duty on a pint of beer and an extra 60p duty on a packet of twenty cigarettes.

- The duty on motor fuel and vehicle licence fees will increase up to the levels in other jurisdictions.

- Personal income tax allowances (2006: £8,250 for a single person) will increase, at best, in line with inflation.

- Income tax relief on interest paid for individuals will be limited to principal private residences of a modest value only, i.e. relief removed from general borrowings for boats, cars and second houses etc.

- Some **non-essential** services will be reduced or discontinued and some existing subsidies reduced. Other charges, for example on waste disposal to rise to more directly cover operating costs.

- Islanders will, under the Group's proposals, pay no general Goods and Services Tax.

As set out in Appendix IX, the immediate impact of the above proposals will inevitably mean that individuals will have less disposable income. However, the overall package of proposals is designed to ensure that Guernsey remains a good place for businesses to operate and to provide well-paid jobs, hence enabling wages to remain high and to increase.

The Group also recognises that those on lower incomes must be protected from any changes and that taxation increases need to be targeted on those who can afford to pay, not those who are already vulnerable, including those on fixed incomes and pensions. This is one of the main reasons why the Group does not favour the introduction of a general sales tax as it will have the greatest proportional impact on those on lower and fixed incomes. The Corporate Anti-Poverty Programme will need to be a key policy of the States and be funded.

The Group believes that even with the proposed tax increases, individuals in Guernsey will still be subject to tax levels which are far less than the vast majority of other jurisdictions in the world, and disposable income of individuals will also continue to be very high. Guernsey will continue to be a good place to live and bring up children because it is safe, attractive and forward-looking.

DETAILED PROPOSALS

Zero Tax

As set out in previous reports, in order to be an effective and competitive International Financial Centre, a zero tax product needs to be available. The existence of a zero tax product is already a fundamental principal element of the taxation strategies of the Island's competitors.

Collective Investment Schemes

Collective Investment Schemes, including closed ended investment vehicles, were **not** one of the regimes in Guernsey (or elsewhere) identified by the EU Code of Conduct Group as being considered harmful. **Therefore, in order to protect the Island's competitiveness it is proposed that Collective Investment Schemes, including closed ended investment vehicles, will continue to be subject to tax at 0%.**

Captive Insurance Companies

Guernsey is the leading captive insurance centre in Europe. It is a sector that is often cited as being a part of the finance sector which distinguishes Guernsey from its main competitor jurisdictions.

At present the majority of captive insurance companies are exempt from taxation (the captive **managers** are subject to 20% taxation).

In addition to making a substantial value added contribution to the island's economy (the contribution per employee in this sector is higher than in the banking and investment fund sectors), it also makes a major contribution to other sectors. Substantial sums are invested locally with banks and investment managers. The captive insurance sector also generates substantial fees in the accountancy and legal support professions and spends large sums of money in the hospitality, travel and service industries.

The Group recognised the importance of the captive insurance sector very early on in its deliberations and commissioned a separate targeted consultation exercise during October and November 2004. During that exercise a large proportion of interested parties in this sector were contacted directly and asked for their views.

The views of the captive insurance sector were very clear. If captive insurance companies were made subject to taxation, (of say 10%), there would be an immediate decline in the captive insurance sector in Guernsey. New business opportunities would cease and existing business would very soon relocate to other jurisdictions where a zero tax regime was available. A loss of critical mass for the sector would soon be reached and this part of the Island's finance sector would be lost with commensurate damage to the Island's international reputation and knock on effects on other sectors.

The Group continues to support a 0% tax rate for captive insurance companies in order to maintain the Island's competitiveness.

Regulated Finance Sector

As set out in the 2002 Report, under the Zero-Ten regime, the profits of certain companies licensed by the Guernsey Financial Services Commission would be subject to taxation at 10%.

The types of regulated entities to be taxed at 10% include:

- Banks
- Fiduciaries

- Money Brokers
- Stockbrokers
- Insurance & Captive Insurance Managers
- Fund Managers

Types of regulated activities which would be taxed at 0% include:

- Domestic and off-shore insurers (including Captives)
- Collective Investment Schemes
- Treasury or Referred business

As emphasised throughout this and previous Reports, the Finance Sector in Guernsey must remain internationally competitive. The adoption of a Zero-Ten regime recognises this and is a measured response to that competitive pressure.

Non-Finance Sector

Although the finance sector is presently the dominant part of the Island's economy, it is by no means the only sector. There are also a whole range of economic activities on the Island including light industry, retail services, tourism, horticulture and other local service and traditional businesses.

Under the Zero-Ten option, the general rate of income tax paid by companies would be 0% from 2008 onwards. This would apply to former exempt companies (including general partners of limited partnerships).

In order to prevent avoidance of personal tax liabilities and to protect the Island's tax revenues, it was originally proposed that Guernsey resident individual shareholders would be taxed (at 20%) on the profits of the company in proportion to their ownership.

The tax charged would be on an assumed 100% distribution of profits basis, not on an actual distribution paid basis (i.e. shareholders would not be able to avoid taxation simply by not paying out dividends). **In the context of this Consultation Document, this process is termed "attribution".**

For a company that is wholly owned by Guernsey residents the effective tax liability would be the same under the new regime as the present time. However, tax would be charged on the shareholders.

For non-Guernsey resident shareholders, no tax would be due to the Guernsey authorities. Profits accruing to a UK based shareholder from a Guernsey business would be liable to taxation in the UK, not in Guernsey.

In the first Consultation Document, and as set out in the 2002 Report and in line with the proposals agreed in Jersey, in order to protect States revenues, it was proposed that Guernsey resident individuals should be taxed at 20% on the profits of the company in proportion to their ownership. This is the so-called "look through" or attribution basis.

Although this basis has many advantages, not least the protection of States revenues, a number of drawbacks exist. For example, complex rules on how to deal with minority shareholders, timings of dividend payment and anti-avoidance legislation etc. would need to be developed, implemented and enforced.

A major concern (which was confirmed by the responses received during the first consultation process) was the widely held perception of the creation of an unfair regime that would lead to shareholders selling up or leaving the Island. This would almost inevitably result in less vitality and investment in local businesses, a decline in job opportunities and a fall in local owner-operated businesses.

A distribution-only policy on business profits would encourage inward investment and re-investment, and provide an incentive to local ownership. Investment income would be treated on an attribution basis. Adopting a distribution-only policy and taxing resident shareholders at 20% on the distributions that they actually receive would enhance the Island's competitiveness.

The actual impact on States revenues of adopting a distribution-only policy on business profits is very difficult to quantify with any degree of certainty due to assumptions and judgements that need to be made on predicting future business behaviour. However, it is estimated that this policy could, at least in the short term, reduce States income anywhere in the range between £7m and £17m.

The Group therefore believes that further consultation on this issue is required.

Annual Company Filing Fees

At present all Guernsey companies pay an annual filing fee of £100. In addition exempt companies pay an annual fee of £600, which raises around £4.7m per annum. Under the new tax regime, exempt companies, and therefore the associated fees will cease. In order to compensate for the loss of exempt company fees, it is proposed that the annual filing fee will increase up to £1,000 per annum, subject to the level of comparable fees established in other jurisdictions. Different types of companies, for example smaller trading companies, might be subject to lower fees.

The Group therefore believes that annual filing fees for all companies should be increased to compensate for the fall in exempt company fees.

Utilities and States Trading Entities

Having considered the main alternatives:

- Treat the incorporated utilities in the same way as all other companies (i.e. zero tax).
- Treat all regulated incorporated utilities as a special category subject to taxation on their profits.
- Treat utilities and States Trading Entities as a special category subject to taxation.

The Group's conclusion is that any entity subject to regulation by the OUR should continue to be subject to taxation at 20% as this was a key principle of the commercialisation process.

Payroll Tax

The first Consultation Document put forward the concept of introducing a payroll tax which would be creditable against resident shareholders tax liabilities.

In summary, the regime proposed that companies would be liable to a payroll tax and the amount payable would be limited to 20% of the profits of the company. The payroll tax would be the liability of the company. For any company, payroll tax would be payable to the States and therefore would be a contribution to public sector revenues in Guernsey which can then be used to fund public sector expenditure.

Initial calculations suggested that such a regime would generate about £8m annually in tax revenues (£3m from the finance sector and £5m elsewhere).

The payroll tax would then be available as a credit or deduction against the Guernsey tax liability of the shareholder on their part of the profits of the business.

In terms of the actual payment of payroll tax it was envisaged that this would be done as part of the annual tax return process rather than as an extension of the present ETI system (i.e. cash flows for local businesses would not be adversely affected).

For Guernsey companies subject to the payroll tax but owned by non-residents, there would be no Guernsey tax against which to credit the payroll tax.

It was highly unlikely that any overseas parent company of such a Guernsey company would be able to credit the Guernsey payroll tax against any corporation tax liability that the parent might have in its home jurisdiction. In such a case, the Guernsey payroll tax would increase the overall cost of doing business in Guernsey. It would therefore act as a disincentive to investment by non-residents in the non-finance sector industries of Guernsey and would therefore run contrary to the need to sustain and grow the economy.

The Group is therefore recommending that a payroll tax is NOT introduced.

Personal Income Tax Rates, Allowances and Reliefs

As set out in the original 2002 Report, the principle of a basic 20% rate of income tax in Guernsey for individuals is very well established, competitive, equitable (in that those who earn more contribute more) and administratively simple. The Group believes that the 20% basic rate of income tax for individuals continues to be appropriate but that the present system of reliefs and allowances needs to be revised. The Group also believes that the absence of "wealth taxes" such as inheritance and capital gains taxes remains appropriate.

In common with other jurisdictions, deductions are given against an individual's income when calculating their tax liability. The main deductions, in terms of financial effect, are personal allowances and relief for interest payments.

In recent years personal allowances have been increased above the general rate of inflation. The single persons allowance for 2006 will be £8,250.

Increasing the personal allowances in such a blanket manner is a relatively expensive measure. For example, increasing the personal allowances by 3% increases the weekly take home pay of a single person by just £4, but "costs" the Treasury around £2m in reduced income tax receipts. This, of course, means that there is less money to spend on health, education and other public services. It is more appropriate, over a period of time, to introduce much more targeted allowances to benefit those who need it most rather than adopt a blanket approach.

The system of giving interest payments tax relief is very simple and, compared to some other jurisdictions, generous. At present interest payments are allowable as a deduction against assessable income without limit.

Tax relief on interest paid is, in effect, a subsidy to borrowers from the general taxpayer. Whilst it could be argued that there may be valid reasons for such subsidies in limited circumstances (for example, to encourage an expansion of home ownership although even this could be regarded as preferential treatment for homeowners compared to the rental sector) it is difficult to support the case for subsidising holiday homes, cars, boats, aircraft, holidays and other personal borrowings without limit.

In the present tighter financial climate, it is not unreasonable to expect that the existing wide ranging interest relief system, which costs around £12m per year, should be reduced. Therefore, the amount of interest relief should only continue to be provided on principal private residences of a modest value with an upper limit on mortgage relief.

The Group believes that a basic 20% income tax rate for individuals remains appropriate as it is well established, competitive, equitable (in that those who earn more contribute more) and administratively simple.

The Group believes that "wealth taxes" such as inheritance and capital gains taxes should NOT be introduced.

The Group proposes that, through restricting interest relief to just principal private residences, and restricting various personal income tax allowances and reliefs, £5m of extra income tax revenue should be raised.

Significant Individual Taxpayers

Guernsey, like many small economies, has a number of individuals who because of their exceptionally high business profits or personal wealth can potentially pay income tax of an amount far in excess of any possible drain on public services.

In Guernsey such high taxpayers have typically kept a low profile. Nonetheless many of them have made significant contributions to the Island's economic and social well being by paying tax, supporting local industries and (in some cases to a large degree) supporting social and charitable activities.

Such individuals are therefore extremely important to the Island and potentially the target of other jurisdictions. It is therefore very important that the Island remains attractive to such individuals especially those who, through their own expertise and future business activities, would generate new economic activity and well-paid employment opportunities.

The Group therefore believes that it may be desirable to introduce a system whereby significant individual taxpayers pay taxation on their non-Guernsey income at the standard 20% rate up to a certain ceiling only. Other income would be subject to tax at the standard 20% rate. **The Group believes consideration should be given to introducing a total tax payable threshold on non-Guernsey income of around £1m to £1.25m (i.e. tax payable of £200,000 to £250,000).** Any threshold would need to be further evaluated, and if adopted, revised from time to time in the light of experience and competitor jurisdictions and in view of ongoing considerations on population and economic policy.

Although the introduction of such an arrangement would lead to a small initial drop in tax receipts, the attractiveness of this measure will produce substantial direct and indirect long-term benefits.

Social Security Contributions

The States of Guernsey has a long established and well administered Social Security Benefits system, which due to consistent and prudent management over a long period, is well funded.

There is a long standing principle that contributions (from employees, employers and the self-employed) are not a tax, but an insurance premium.

The current contribution rates (for an employed person) are 5.5% for the employer and 6% from the employee (a total of 11.5%). The contribution rate for self-employed persons is 10.5%.

Another long standing principle of the funding is that those individuals who are on incomes less than the upper earning limits (2005: £34,320 per year) have the difference paid by the States by means of an annual grant from general revenue. At present only 25% pay the full amount of contribution, the remaining 75% being subsidised by general revenue.

The grant from general revenue is set following periodic review by the UK Government Actuary's Department. With effect from 1 January 2004 the grant was reduced to 50% (from 57%) of contribution receipts. As a result of this change, the grant paid by general revenue was reduced by £3.6m per year.

From a general revenue point of view, the mechanics of the contribution matching process means that as more people are employed and pay more contributions (because of a buoyant economy) there is an increased drain on general revenue resources.

Despite the above change, the amount of grant paid by general revenue has increased steadily in recent years. In 2004 the grant from general revenue was £35m (see Appendix V) which represents 13% of total States revenue expenditure (in 1999 the grant from general revenue was £25m which also represented 13% of total States expenditure).

The present social security arrangements mean that if an individual has income in excess of the upper earnings limit (2005: £34,320 per year) then the amount paid by the employer and the employee is the same whether that individual earns £35,000, £75,000 or even more than £100,000.

Compared to Jersey and the Isle of Man (which has replicated the UK social security legislation) the amounts raised annually by social security in Guernsey are much less. Appendix VIII includes a comparison between Guernsey, Jersey and the Isle of Man of the present amounts payable for income tax and employer and employee social security contributions for various scenarios.

Although the rates of contribution and earnings limits are designed to finance different ranges and levels of benefit, if Guernsey adopted the Jersey scheme, an extra £11.5m would be raised or £59.6m for the Isle of Man.

The effect of changing the various percentages and thresholds is as follows:

Increase of 1% in employer contribution: £6.85m

Increase of 1% in employee contribution: £6.71m

Increase of 1% in self-employed contribution: £0.66m

Increasing the employee and employer contribution levels by 1% and 1.5% respectively (so that both are 7%) and raising the threshold up to £60,000 would generate an extra £35m, (i.e. the amount payable by general revenue to fund the contributory social security payments). The Contributory Scheme would therefore be entirely funded from contributions without general revenue subsidy.

General revenue would continue to fully fund the non-contributory elements of the present social security system (Family Allowances, Supplementary Benefit, etc) of around £22m per year (see Appendix V).

The Group believes that revising the present system and removing the grant payable from general revenue is a better alternative to introducing a General Sales Tax.

In order to achieve this and to raise the necessary £35m, the Group proposes that employee and employer contributions should increase by 1% and 1.5% respectively so that both are 7%, and the upper earnings threshold be increased to £60,000.

Contribution rates for the self-employed will increase from 10.5% to 13% (i.e. still 1% less than combined employee and employer rates) and non-employed contribution rate will rise from 9.9% to 10.9%.

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Indirect taxes

In common with most developed economies, Guernsey has a long established tradition of levying indirect taxes. The major indirect taxes (and their projected income levels for 2005) are set out below:

	£'000
Alcohol duties	6,425
Tobacco duties	7,850
Duty on foreign goods	500
Document duty: other	4,900
Document duty: property	11,650
Tax on Rateable Values	4,050
Motor Vehicle Tax	6,000
Motor Spirit duty	2,040
	43,415

In recent years the rates of indirect taxation (with the exception of tobacco) have not been increased in line with inflation. Nonetheless, the actual amounts collected in indirect taxes have increased since 1999 mainly due to increased document duty as a result of increased property prices.

The duty on tobacco has been increased, as a deliberate States policy, in excess of the increase in Guernsey RPI, as a measure to discourage smoking.

Indirect taxation rates in Guernsey have traditionally been low compared to other neighbouring jurisdictions (Jersey, United Kingdom, France etc.) and in recent years have been further eroded in real terms.

Increasing indirect tax levels, using existing legislative and administrative processes, would therefore be an efficient method of increasing States Revenues. It is estimated that if the rates of existing indirect taxation were raised to the equivalent levels elsewhere, then between £10m and £15m per year extra would be raised. Appendix X sets out the potential impact on the Guernsey Retail Price Index of increasing duties etc.

By way of illustration, increasing duties in line with Jersey rates in the following areas would raise an extra:

Tobacco	£2.7m
Alcohol	£2.0m
Petrol and Motor Vehicle duties	£3.3m

The Tax on Rateable Value system has already been identified as requiring fundamental review. The Treasury and Resources Department is committed to bringing forward outline proposals for a simplified system during 2006. This is seen as a preliminary step to raising significantly the amount currently raised from this source.

TRV has no direct comparison in other jurisdictions, however, as a broad principle, property taxes are generally considerably higher elsewhere.

Except for an 18% increase in TRV in 2001 (as part of a compensating adjustment for a reduction in document duty) the rate of TRV has remained unchanged since 1994. The increase in the total amount of TRV received has been marginal and caused by new buildings and extensions to existing ones (domestic and business).

The total amount of TRV collected in 2004 was £4.1m from the following sources:

	£'000
Domestic: Local Market	1,553
Domestic: Open Market	250
Tourism	178
Horticulture & Agriculture	167
Utilities and Public Buildings	822
Business Premises	1,152
Total	4,122

Although there are, of course, individual variances the TRV on an individual domestic property represents a very small percentage of its value. For example, a mid-sized property whose value may be around £300,000 would pay TRV of around £60 per year (0.02%).

Since 1994 average house prices in Guernsey have increased threefold. A similar increase in TRV, if applied to all sectors, would increase TRV receipts by £8m.

The individual rates of TRV could be increased by different amounts for each sector, for example different rates could apply to large open market properties compared to small local market dwellings. Different sectors of the economy could also be charged different rates.

It is proposed that TRV on domestic properties should be increased in line with house price inflation (threefold) and TRV on business premises increased fourfold to increase TRV receipts by a total of £10 million.

The Group proposes that the duty on alcohol & tobacco (£5m), motor vehicle & fuel duties (£3m) and TRV (£10m) should be increased to raise an extra £18m of revenue.

General Sales Tax

In addition to raising revenues from duties on certain goods (alcohol, tobacco, motor spirit etc.) many jurisdictions have a general sales tax (for example VAT in the UK and the Isle of Man).

The advantages of a broad based sales tax regime are that it can be seen as fair in that it is widely applied to the majority of citizens (who benefit from public services), gives relatively stable income flows, once established can be efficient, and is capable of raising substantial sums of money for the public purse.

There are a variety of ways in which a general sales tax could be implemented. However, all of them, to a greater or lesser extent, result in increased administrative burden and expense on businesses and the public sector administration. Furthermore, in order to raise substantial sums of money they need to be levied on a very wide range of goods and services.

As a result, those on lower incomes would experience a relatively significant increase in their cost of living.

If the States wishes to hold true to the principles of the Corporate Anti-Poverty Programme, those on lower incomes would need to be protected from the impact of the introduction of a general sales tax (i.e. benefits would need to increase).

A general sales tax regime would increase the cost of visiting and doing business in the Island and therefore acts as a disincentive for businesses to locate in the Island and for tourists to visit.

In its Report entitled "Income Generation in Guernsey" the National Audit Office estimates that if

Value Added Tax at the rates applied in the UK (and the Isle of Man) were to be introduced, £110 million per year could be raised.

As part of its strategy the States of Jersey, in order to make good its £80m to £100m shortfall in tax receipts, have announced that it will introduce a general goods and services tax of 3% to raise £40m.

If such an approach was adopted in Guernsey approximately £30m per year would be raised. Alternatively, introducing a 5% Goods and Services Tax, with exemptions for food, drink, medicines and services could raise £10m net of collection charges. However, such a system would have administration, enforcement and collections costs.

The Group believes that increasing social security contributions is a better alternative to introducing a General Sales Tax.

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Appendix I

SUMMARY OF PROPOSED REVENUE RAISING MEASURES

The Group's proposals are that the following revenue raising measures be introduced:

	Annual £m
Increasing Tobacco & Alcohol Duty	5
Increasing Motor Vehicle and Fuel	3
Increasing Tax on Rateable Values	10
Increasing Other Fees & Charges	2
Revising Personal Allowances, Interest Relief etc.	5
Increases in employers, self employed, non-employed and employees social security contributions	35
Total	60

In addition to raising revenues as set out above, the Group is recommending that public sector revenue expenditure is curtailed to a maximum of £290m (i.e. at 2005 levels). Capital expenditure should be £15m per year. In addition to the above, the Contingency Reserve would be used to fund any short to medium term deficit.

Appendix II

PUBLIC SECTOR REVENUES: DETAILED 2004 FIGURES

		2004 Actual £m	2004 Actual £m
Income Tax	ETI	109.0	
	Companies	96.0	
	Self-employed, investment income etc.	30.9	
			235.9
Excise Duties			
	Alcohol	6.1	
	Tobacco	7.2	
	Others	0.6	
	Motor Spirit	1.9	
			15.8
Motor Vehicle Tax			5.5
Document Duty	Property	11.4	
	Other	5.1	
			16.5
Exempt Company fees			4.7
Tax on Rateable Values			4.1
Miscellaneous			2.5
			285

For ease of comparison with the figures on page 10 the above figures can be reanalysed as follows:

	2004 £m
ETI, self employed and investment income	140
Business profits	96
Indirect taxes	42
Miscellaneous income	2
Exempt Company fees	5
	285

Appendix III

CHANGES TO PUBLIC SECTOR REVENUE SOURCES 1999 TO 2008

	1999	2004	2008

SOURCE	Actual £m	Actual £m	Projected £m
Business Profits	105	96	48
Employment (ETI, employer & employee contributions)	95	191	215
Consumption taxes (Alcohol, Petrol, property, etc.)	37	42	60

The above table is an analysis of where public sector revenues (including contributions from insured persons and employers) originate.

The table shows the existing trend of more States revenue coming from the employment of individuals (both by employee, self employed and employer) compared to taxing business profits and consumption taxes.

The third column shows the effect of the change to the tax regime, i.e. increased rates of indirect taxation and increased employer and employee social security contributions to compensate for the decline in direct taxation of business profits.

Appendix IV

PUBLIC SECTOR EXPENDITURE

Revenue Expenditure	2004 Actual £m	2005 Budget £m
Policy Council	8.1	8.5
Treasury & Resources	19.5	19.9
Commerce & Employment	11.8	12.3
Culture & Leisure	2.8	3.2
Education	59.0	62.2
Environment	7.9	8.7
Health and Social Services	73.6	79.8
Home	22.7	24.9
Housing	2.7	1.6
Public Services	10.5	9.2
Social Security	57.1	59.2
	275.7	289.5

Capital Expenditure		
Major Construction Projects	29.7	28.5
Miscellaneous Capital Works	8.2	12.4
Equipment, Machinery and Vehicles	3.0	3.0
ICT Projects	3.5	3.0
	44.4	46.9

FUNDS CONTROLLED AND MANAGED BY SOCIAL SECURITY DEPARTMENT

	Guernsey Insurance 2004 £m	Health Service 2004 £m	Long-Term Care 2004 £m	Total 2004 £m
Contributions	50.7	20.9	11.1	82.7
Grants from General Revenue	25.3	8.3	1.3	34.9
Total	76.0	29.2	12.4	117.6
Reserves & Fund Assets	405.5	27.2	10.9	443.6

Contributions are the amounts payable by employers, employees, self-employed and non-employed.

In addition to the above, in 2004 General Revenue financed the Non-Contributory Services of £22m to pay for Supplementary Benefit payments (£9.8m), Family Allowances (£7.4m), Attendance and Invalid Allowances (£1.9m) etc.

Appendix VI

ANALYSIS OF CORPORATE TAX PAID IN 2004

Sector		Tax paid in 2004 £m
Finance		
	Banking	37.8
	Investment Companies	9.6
	Captive Managers & Captives	6.1
	Insurance	3.4
	Investment Managers	8.0
	Fiduciary	2.3
	Others	6.6
		73.8
Non-Finance		
	Primary	0.5
	Manufacturing	1.2
	Construction	3.7
	Hostelry	2.0
	Wholesale & Retail	8.3
	Information Handling	1.1
	Miscellaneous	5.4
		22.2
Total		96.0

ANALYSIS OF ETI PAID IN 2004

Sector		ETI 2004 £m
Finance		
	Banking	14
	Captive Managers	1
	Investment Managers	2
	Accounting, Legal and Stockbrokers	7
	Fiduciary	6
	Others	7
		37
Non-Finance		
	Primary	2
	Manufacturing	4
	Construction	9
	Hostelry	4
	Wholesale & Retail	9
	Information Handling	4
	Miscellaneous	13
	Transport	3
	Utilities	2
	Public Sector	22
		72
Total		109

Appendix VIII

COMPARISON OF PRESENT INCOME TAX AND SOCIAL SECURITY RATES

Social Security Rates for Employed Persons

	Employer rate	Employee rate	Total	Upper Earnings Threshold
Guernsey	5.5%	6%	11.5%	£34,320
Jersey	6.5%	6%	12.5%	£35,760
Isle of Man	12.8%	10%	22.8%	£30,940

Note: For the Isle of Man there is no upper earnings threshold for employers contribution.

The following are some worked examples comparing the amounts payable in income tax and employee and employer social security contributions. These are for illustrative purposes only based on 2005 figures.

Scenario One

Single Person earning £20,000 and paying no mortgage interest

	Guernsey £	Jersey £	Isle of Man £
Income Tax	2,400	2,425	1,246
Employee contribution	1,200	1,200	1,510
Employer contribution	1,100	1,300	1,932
Total	4,700	4,925	4,688

Scenario Two

Married Person earning £40,000 and paying £9,000 mortgage interest

	Guernsey £	Jersey £	Isle of Man £
Income Tax	3,000	3,596	1,400
Employee contribution	2,059	2,145	2,786
Employer contribution	1,888	2,324	4,493
Total	6,947	8,065	8,679

Scenario Three

Married Person earning £60,000 and paying £12,000 mortgage interest

	Guernsey £	Jersey £	Isle of Man £
Income Tax	6,400	7,880	3,932

Employee contribution	2,059	2,145	2,786
Employer contribution	1,888	2,324	7,053
Total	10,347	12,349	13,771

Scenario Four

Married Person earning £100,000 and paying £18,000 mortgage interest

	Guernsey	Jersey	Isle of Man
	£	£	£
Income Tax	13,200	14,680	10,052
Employee contribution	2,059	2,145	2,786
Employer contribution	1,888	2,324	12,173
Total	17,147	19,149	25,011

In addition to the above taxes, individuals in the Isle of Man are subject to VAT on a range of goods and services at 17.5%. As patterns of expenditure will vary considerably between individuals, is it very difficult to give anything but a very rough estimate of the amount of VAT payable by individuals. In 2004/5 the Isle of Man estimates that it will collect over £260m from VAT, an average of approximately £3,000 per person per year.

Appendix IX

COMPARISON OF PRESENT AND PROPOSED SOCIAL SECURITY CONTRIBUTIONS

Social Security Rates for Employed Persons

	Employer rate	Employee rate	Upper Earnings Threshold
Guernsey			
Present	5.5%	6.0%	£34,320
Proposed	7.0%	7.0%	£60,000

The following are some worked examples comparing the amounts payable in employee and employer social security contributions. These are for illustrative purposes only.

Scenario One: Person earning £20,000

	Present £	Proposed £
Employee contribution	1,200	1,400
Employer contribution	1,100	1,400
Total	2,300	2,800

Scenario Two: Person earning £40,000

	Present £	Proposed £
Employee contribution	2,059	2,800
Employer contribution	1,888	2,800
Total	3,947	5,600

Scenario Three: Person earning £60,000

	Present £	Proposed £
Employee contribution	2,059	4,200
Employer contribution	1,888	4,200
Total	3,947	8,400

Scenario Four: Person earning £100,000

	Present £	Proposed £
Employee contribution	2,059	4,200

Employer contribution	1,888	4,200
Total	3,947	8,400

Appendix X

IMPACT ON GUERNSEY RPI

Unfortunately increasing taxes will have an impact on the Guernsey Retail Price Index. However, this impact will be a one-off at the time of introduction and then after a year its impact will be lost.

The effect of the Group's proposals on RPI (all other things being equal) will be:

	Effect on Guernsey RPI
Increase TRV threefold	0.6%
Increase Motor Vehicle licences and petrol duties by 50%	0.2%
Increase tobacco duty by 30%	0.3%
Increase alcohol duties by 30%	0.3%

Note:

Increase employee and employer contributions	No direct impact
The introduction of a 3% tax on all goods and services	One off 3%

Appendix XI

CORPORATE TAX MODELS: COMPARISON OF REGIMES

	Zero-Ten £m	Zero-Twenty £m
Tax payable (2004)	96.0	96.0
Tax payable (2008)	(25.3)	(50.7)
Beneficial Ownership Receipts	(23.2)	(20.1)
Shortfall of Revenues	47.5	25.2

It is important to note that the above figures take no account of corporate behaviour and assume that all existing business stays on the Island and no new business is attracted.

The Group strongly believes that under a Flat ten regime there would be a very rapid demise of the finance sector. Under a Zero-Twenty regime this decline would be slower, but irreversible, and little or no new business attracted.

The beneficial ownership receipts are based on a full attribution or “look through policy” with £13m deriving from business profits and £10m from investment income. Under a distribution-only policy on business profits, depending on business behaviour, receipts could decrease by up to £13m.

Appendix XII

LIST OF RESPONSES TO FIRST CONSULTATION DOCUMENT

Deputy Roffey
Deputy Jones
Deputy Guille
Deputy Le Pelley
Deputy De Jersey
Deputy Le Moignan
Deputy De Lisle
Deputy Sirett
Deputy Gabriel
Deputy Brouard
Deputy Parkinson
Deputy McNulty Bauer
Deputy Gollop
Deputy Brehaut
Deputy Matthews
Alderney Rep. Richard Cox

Culture & Leisure Department
Health & Social Services Department
Education Department
Commerce & Employment Department
Social Security Department
Housing Department
Environment Department

Guernsey Training Agency
Guernsey Trustees Association
Chamber of Commerce
Transport & General Workers Union
Guernsey International Business Association
Guernsey Investment Fund Association
Guernsey Insurance Company Management Association
International Bankers Association
Institute of Directors
Assoc. Guernsey Civil Servants
Guernsey Building Trades Employers Association
Institute of Financial Services
Confederation of Guernsey Industry
Guernsey Public Employees' Consultative Committee
Guernsey Assoc. of Pension Funds
Assoc. Guernsey Insurers
Friends of the Earth
Guernsey Bar Council
Guernsey Society of Chartered and Certified Accountants
Acumen International
Active Management Services
Specsavers Optical Group
Healthspan Limited
Ozannes
McKean & Roberts

St Peters Trust
W Le R Robilliard
Constables of the Forest
Le Lacheur & Co
R Northley
P Hame
HSBC
J Hazzan
C Bowker
M Wadsworth
N Crocker
Cheshire Home
H Lancaster
S Perry
C J Thornburn
Guernsey Financial Services Commission
Constables of St Sampson
Guernsey Post Limited
Guernsey Electricity
Cable & Wireless
Generali Insurance Ltd
P Gillson
N G Wilkinson
St Saviours Douzaine
International Private Equity Services Limited
J F Peters
Island Coachways
Nordben Insurance
NRG Limited
A J O Field
M J Sandle
R A Laurent
Cleland & Co
Heritage Group Limited
R Bisson
K J Tydeman
PricewaterhouseCoopers
Ernst & Young
Deloitte & Touche
PKF
BDO

Appendix XIII

SOURCES OF OTHER INFORMATION

In June 2005 the United Kingdom National Audit Office published a report for the States Of Guernsey Public Accounts Committee entitled “Income Generation in Guernsey”. This Report contains an analysis of various income streams and comparisons with other jurisdiction, mainly Jersey and the United Kingdom.

The 2005 Guernsey facts and figures booklet issued by the Policy Council in July 2005 includes a wide variety of information on the Island, including economic, environmental and social data.

The Commerce & Employment Department’s “Building Confidence” Consultation Documents are also very useful background information.

These reports are available on line on the States of Guernsey website: www.gov.gg