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Dear Mr Morris

The Zero / Ten Design Proposal

We are writing to provide our comments on the "Zero / Ten" Design Proposal ("the Proposal") issued by the Treasury & Resources Department on 5 May 2006.

Consultation period

Whilst we welcome the opportunity to provide comments we would like to make clear at the outset that we do not believe that a consultation period running from 5 May 2006 to 30 June 2006 is sufficient for a document which is at the absolute heart of Jersey's economic future. We believe a much longer period, during which there could have been a much fuller debate and significantly deeper understanding of the proposal and any alternatives, would have been appropriate. Whilst we appreciate the need for certainty as soon as possible, there does seem to be a great rush to have the law approved by the end of this year, leaving (according to the document) two years for the Income Tax Department to develop and finalise "compliance systems" and (in 2008) to publish an explanatory booklet prior to the system going live on 1 January 2009. We would question whether or not in the short consultation period many sections of the community (including dare we say politicians) will really have had the opportunity to consider and understand the proposal in the detail it deserves. It is also worth pointing out that many of these very same people are also being asked to consider and comment on 3 separate sets of proposals relating to the proposed "Goods and Services Tax" over approximately the same period.

Context of our comments

We are quite sure that you will receive many detailed submissions on the technical aspects of the proposal from the various working groups formed for that purpose and we will therefore restrict the comments in this submission to those of a general nature, written from the perspective of the Island's general business community.

Complexity

As we have said publicly, although we fully appreciate the complexity of the topic, the proposal is not in our view particularly easy to follow and would have benefited greatly from some simple worked examples of how particular types of business would be affected. In addition, it is notable that the proposal does not set out many alternatives although clearly many exist, and we must therefore assume that

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alternatives must have been considered and rejected. It would assist readers' understanding of the proposal if that thought process could have been included in the document in more detail than it has been.

No "look through" for trading profits

Our principal concern at the design level is the decision to introduce a look through for investment holding companies, but not for trading companies. Much of the proposal then deals with provisions necessary to introduce a "hybrid" look through on those trading profits and also a means by which those provisions can be avoided.

We note at section 23.1.3 that you set out a number of ways in which a general look through would be open to challenge, but we fail to understand why you consider that these challenges can be met for investment profits but not for trading profits. Given that beyond the general concept of "zero / ten" this is effectively the starting point for many of the provisions in the document, we would like to see more debate on whether or not this is the right way to go.

At a simple level, if it could be achieved, what could be better than explaining to the local shareholder of a local incorporated business, that those business profits will still be subject to Jersey income tax, calculated in the same way as now, and at the same 20%, except that the person paying the tax would be the person owning the company rather than the company? However difficult, it must be worth pursuing this most simple of solutions until you are absolutely sure it will not work.

The 10% rate

We note the definition at 11.2.6 as to which companies will be subject to the 10% rate. Clearly, neither the FSJL or the BBJL were written with the intention of deciding the taxation treatment of the entity concerned and this will further add to the complexity of new businesses establishing in the Island who may be at the "edges" of the laws concerned.

Deemed and deferred distribution charges

The deemed distribution and deferred distribution charges are of course a direct result of the decision not to introduce a look through to trading profits and we would therefore prefer not to have to comment on them at all (there are of course others including the shareholder benefit in kind rules and the entry / exit charges). However, if they are to be introduced then they will certainly need much more detailed explanation to those local business who are unattracted by, or perhaps do not understand, the proposed "Limited Trading Partnership" (see below).

Paragraph 24.3.3 states that "companies subject to the standard rate of corporate income tax" will be subject to the "deemed distribution charge". This directly contradicts one of the examples in Appendix 1 where it is stated that financial services companies (i.e. companies subject to the special rate of corporate income tax) will also be subject to the charge. You have since explained to us that the intention is to apply the charge to financial services companies but it is surprising that such a fundamental point was left so unclear. Indeed it would be inequitable.

In relation to the deemed distribution charge we would very much agree with the comment that the three-year period is arbitrary and it will not suit the circumstances

of all businesses particularly those in periods of rapid growth and contributing to the economic growth envisaged by the Fiscal Strategy. We note the ability in exceptional circumstances to agree a longer period with the Comptroller – given this is one of the central planks of the proposal this opaqueness is unlikely to be welcomed by all.

We believe that the 8 short paragraphs devoted to the deferred distribution charge need much more careful explanation as much of section 26 is unclear to us and we suspect many others (e.g. 26.3.1. states "it is proposed that a deferred distribution charge be levied on distributions" - this presumably also includes deemed distributions and also 26.3.6. "if profits deemed to be distributed were to be actually distributed they would be distributed tax free" - as the deferred distribution charge is described as not being a tax we wonder what this paragraph is doing here at all.) Also we cannot understand the logic of the charge being measured on a LIFO basis. A FIFO basis would sit more comfortably with the logic of this section. It is rare that a business distributes all its profits each year, indeed for many it would be impossible.

Limited Trading Partnerships "LTPs"

This is of course recognition that most local individuals with local businesses would prefer to avoid the complexities of the deemed and deferred distribution charges etc and also obtain credit for the proposed Regulation of Undertakings and Development Charge (see below) and simply pay tax on the profits their business has earned as they currently do. However, to achieve this the LTP is of course an entirely new type of vehicle, which will require very detailed legal analysis to ensure that it provides the same protection to its owners as a company in all the jurisdictions that it may operate. Assuming this is the case, then local businesses will need very gentle handholding through the transition phase and we would hope could count on the assistance of Government in that respect at least in some degree. As a means to an end of achieving our desire of a general look through to trading profits it is therefore attractive, providing it is not impractical.

Regulation of Undertakings and Development Charge

We fully understand that the "Regulation of Undertakings and Development ("RUDL") Charge" is an attempt to recoup some revenue from those non-locally owned businesses which will benefit from the general zero rate of tax but this seems to us to be clearly a case of the medicine being worse than the illness. Given that the RUDL charge will almost certainly be non-creditable in the home jurisdiction of the business concerned, it will represent a cost of providing employment in the Island and must surely therefore act as a disincentive to inward investment, especially when viewed with the increased compliance costs brought about not only by this measure but for example the introduction of GST. Given that one of the components of the fiscal strategy is the encouragement of economic growth we question whether this is wise. We recognise that the alternatives (e.g. an increase in employer's social security contributions creditable in some way against locally owned businesses tax liabilities) are technically challenging and we do therefore wonder whether this loss of revenue should not be simply regarded as "collateral damage" of the introduction of a general zero rate of tax. There is any number of practical difficulties with the RUDL (e.g. how part-time or seasonal workers will be treated and the cashflow issues caused by the date of payment). We suspect that it will also cause businesses to review their licensed headcount much more regularly than they

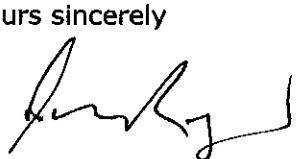
currently do. We also believe the proposed rates should be published before a decision is made given that the charge for financial sector workers will be £0

16.2.4 states that it may allow a tax holiday for foreign owned start-ups but there is no mention of such a holiday for locally owned start-ups. This is grossly inequitable and odd given that the RUDL is only being introduced to deal with an inequity. We would support strongly a system that encourages new local businesses. Indeed given the loss of revenue from foreign owned, non-financial services business, this surely must be encouraged rather than discouraged.
One benefit of the RUDL charge is that it may encourage foreign owned companies to trade through an LTP, which would benefit Jersey through increased tax revenue. However unless this is investigated more fully as a route that is likely to be taken up by such entities and the workings of the RUDL charge are simplified so as to be less burdensome on administration (both for business and Government), we do not support its introduction.

Article 134A

Perhaps oddly, the section on enhanced disclosure is to be found on page 55 of a 57 page document and is not referred to in the executive summary at all. We would like to understand the "mischief" that this is aimed at – if it is simply local individuals setting up local companies to benefit illicitly from the zero rate of tax, then cannot the Comptroller rely on local corporate service providers to police that, in the same way as they do at the moment for exempt companies. If it is perhaps though to ensure that local individuals are not establishing companies etc outside the Island, then this is of course an existing problem (to the extent it exists at all) and mechanisms to prevent that have little to do with "zero-ten". One should not lose sight of the additional compliance requirement that having to provide an annual statement of capital contributions will impose on all taxpayers, not just those who are evading tax. We would prefer a "tick the box" regime disclosing interests in companies etc and it would then be for the Comptroller to risk assess the tax return in the light of all other information he may have about the taxpayer.

Yours sincerely



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