STATES OF JERSEY

INCOME TAX: ADDITIONAL LIABILITY (P.81/2005) – COMMENTS

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by the Finance and Economics Committee

STATES GREFFE

COMMENTS

Introduction

The sort of 'tax on a tax' proposed by Deputy Southern is virtually unheard of elsewhere in the world. It would certainly cause concern amongst business introducers and professionals at Jersey's unique and strange approach, largely on the basis that what is proposed is an unnecessary and burdensome complication to the Island's basic customer proposition, of which the present simplicity and clarity of the tax system forms an important part.

When this option was raised informally last December, at Budget time, what little professional feedback that the Committee received gave the impression that both tax experts and the financial services industry saw this so called ECOFIN surcharge as something of a wild flight of fancy rather than a serious measure. The general impression gained is that the proposal has neither been properly thought through in terms of its distributive impact, i.e. which members of the public pay it, nor its negative consequences for the economy.

Effect on individuals

The net effect of the Proposition, as contrasted with the 20% means 20% proposal, will be to reduce the tax bill of those with a high disposable income and increase the tax bills of lower and middle income earners.

Whereas 20% means 20% will only increase the tax bills of the top 16,000 taxpayers with the highest disposable incomes paying at the standard rate of 20%, this proposal will also increase the tax bills of those 23,600 on lower to middle income taxpayers who currently benefit from the marginal rate of 27%. In other words, the 23,600 taxpayers on lower to middle incomes who would pay no additional tax under 20% means 20% would pay additional tax under this proposal in order to fund a reduction in the tax bill of the 16,000 taxpayers on the highest disposable incomes.

The following examples illustrate the effect of these proposals, as contrasted with the 20% means 20% proposals –

A single person earning £100,000, with no children and a mortgage of £240,000 would pay an extra £3,744 in tax under the 20% means 20% proposals. Under this Proposition, that same individual would only pay extra tax of £431.

A married couple with the wife working, earning £140,000, with no children and no mortgage would pay an extra £2,620 under the 20% means 20% proposals. Under this Proposition, that same couple would only pay extra tax of £673.

Contrast this with households having lower incomes –

A married couple with the wife working, earning £60,000 with no children and a mortgage of £240,000 would pay no additional tax under the 20% means 20% proposals. Under this Proposition, they would pay extra tax of £180.

A single old age pensioner with an income of £20,000 would pay no additional tax under the 20% means 20% proposals. Under this Proposition, he would pay extra tax of £55.

Effect on companies

The effect of the surcharge would be to raise the 10% finance industry tax rate agreed by the States Assembly last year to 10.27%.

Although this increase is apparently small, it would provide a totally disproportionate marketing opportunity for competitor jurisdictions such as Guernsey, the Isle of Man and Singapore to point out that their corporate tax rates are lower than Jersey. This reason alone makes the potential damage done to the finance industry not worth the extra £2 – £3 million that might be raised from it. Allied to the additional complexity and inherent artificiality the

proposed approach creates, plus the concern that business decision makers will have regarding the potential for further tinkering with surcharge rates in the future when the alternative proposition would be a statutory 10% rate under the Committee's proposals, the same statutory rate expected in other jurisdictions, this is certainly not a winning proposition in the international market place.

This is an ill-thought out and counter-productive surcharge on the tax bills of corporates whose continuing contribution to Jersey could be put in doubt as a consequence. It will be seized upon by our competitors, most immediately by Singapore and the Isle of Man, who will no doubt seek to use the prospect of such a surcharge on corporate profits in Jersey to attract business already here – and business which may have been attracted here in the future – to them. On that basis the prospects for economic growth could be seriously dented.

Many of our international business companies and exempt companies will be unwilling to pay this surcharge. If only a small proportion of these international business companies and exempt companies relocate elsewhere for internationally competitive tax rate reasons, the surcharge would have to rise to compensate.

Yield

The estimated yield of £10 million appears to have been calculated on the simplistic basis of multiplying the total 2005 estimated income tax revenues of £370 million by 2.65% The Proposition fails to take into account the reduction in corporate tax revenues that will occur from 2010 onwards. After the introduction of 0/10% the yield from this tax would only be approximately £7.2 million and the surcharge would have to rise to 3.7% to yield £10 million.

Complexity

Although the proposal professes to simplify the tax system it does the opposite as it actually adds another tier of complexity to an already complex system.

The current two-tier system of (a) income less allowances with the balance of income charged at the standard rate of 20% and (b) income less exemptions with the balance of income charged at the marginal rate of 27% is confusing enough, but to calculate the tax due under that system and then make an additional calculation under this proposed surcharge system is likely to end up with even more confusion and complexity than now. For the taxpayer, checking his tax liability will become even more difficult.

The Committee is not aware of any other tax system anywhere in the world which has a similar "tax on a tax" surcharge and this is probably because it is without merit. If one wanted to increase the yield from income tax the rational way to do it would be to increase the standard or headline rate of income tax, not through this surcharge method.

Summary

The Committee does not support this Proposition for the following reasons –

- It hits the wrong people, increasing the tax paid by lower and middle earners in order to reduce the tax paid by higher earners when compared to 20% means 20%.

- It will do disproportionate reputational damage to the finance industry compared to the small amount raised.

- It will not yield £10 million after the introduction of 0/10 and the resulting fall in corporate tax revenue.

- It does not broaden or diversify the existing tax base.

- It will add a strange and unique element to Jersey's tax system and further complicate it.