STATES OF JERSEY

INCOME TAX: INTRODUCTION OF HIGHER RATE

Lodged au Greffe on 14th February 2011
by Deputy G.P. Southern of St. Helier

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

(a) to support the principle of progressive taxation through the introduction of higher rates of personal income tax for those individuals with higher incomes and, in order to achieve this objective, to request the Minister for Treasury and Resources to bring forward for approval the necessary legislation as part of the Budget 2012 proposals -

(i) to ensure that personal income tax assessments apply to individual earnings so that married couples are not discriminated against in the application of higher rates;

(ii) to introduce a higher rate of personal income tax on annual income in the band £70,000 to £99,999 and to set the rate for this band at 22.5% for the year of assessment 2012 with that rate being raised to 25% for the year of assessment 2013 and ensuing years;

(iii) to introduce a further rate of personal income tax on annual income over £100,000 and to set the rate for this band at 25% for the year of assessment 2012, with that rate being raised to 30% for the year of assessment 2013 and ensuing years;

(b) to request the Minister for Treasury and Resources to review the terms under which 1(1)(k) residents are granted consents and to bring forward for approval the necessary legislation as part of the Budget 2012 proposals to raise the tax liability of –

(i) those currently resident; and

(ii) future applicants,

by the application of the rates in paragraph (a)(iii) above.

DEPUTY G.P. SOUTHERN OF ST. HELIER

REPORT

I believe that we have to consider progressive taxation measures to solve our long-term problems in generating sufficient revenue to meet our needs. They will not be the only solution, but they must form part of the solution. In the short term, I believe we cannot continue to increase the burden on those who are less well-off at the expense of the better-off. We have been told repeatedly by the Minister for Treasury and Resources that we must all be prepared to shoulder the extra fiscal burden which is required if we are to emerge from the deficit we are in. And yet, at the time of writing, we have largely seen only regressive measures with little attempt to properly spread the burden to the real high-earners in our community.

This proposition is clearly an attempt to more fairly spread the tax burden to those in our community who are genuinely better-off, through the introduction of higher rates of tax for high-earners.

History

In outlining the case for the introduction of progressive tax rates, I anticipate that those opposed to such a move will drag out the prospect of the wealthy leaving the Island in droves. I refer them to the last real examination of wide-ranging options on taxation which was presented in an OXERA paper of June 2002. The overall argument for progressive taxes taken from this paper is highlighted here.

The report into the future of Jersey's tax and spending policies presented to the Finance and Economics Committee in May 2002 by the Committee's financial advisors OXERA, clearly identifies several means of generating additional income to meet our current and projected deficits in Chapter 7 'Addressing the problem on the income side'. In concluding this chapter, the authors are equally clear when they say –

> *"…there are many ways in which the additional tax burden could fall, both within the large structure (neutral, progressive or regressive, etc.) and relatively advantaging (or disadvantaging) particular groups. The limits at which tax avoidance would become a serious consideration do not seem to be approached, at least within the range of generating £50 million per annum of tax revenues. Thus, within quite large limits, the choice of large-scale structure of the tax burden seems to be largely political, not economic."*

The chapter starts by pointing out that a priority for tax policy is to raise an appropriate amount of revenue as efficiently and equitably as possible. The 2 equity principles that are commonly applied to tax policy are –

> the user pays (or benefit) principle;
> the ability-to-pay principle.

The authors point out that only under the latter principle can the social goal of helping those with less material wealth and fortune be met without the need for large-scale reform of the benefit system.

In discussing the distributional aspects of an increased tax burden, the report outlines the main dimension, as follows –

Progressive tax – raised largely from the relatively well-off
Neutral progressive – all taxpayers subject to the same percentage in their existing tax bill
Neutral regressive – all taxpayers subject to the same percentage point increase in their effective tax rate
Regressive – each earner is subject to the same actual increase

In addition they point out "in general, tax structures operate to increase the tax contributions in both the absolute amounts and as a proportion of income as income rises (i.e. tax rates increase as personal income rises)". This is the norm in most jurisdictions.

Jersey, on the other hand, has a single tax rate of 20% no matter how large one's personal income is. Its progressive nature is the result of the use of small income exemptions and the use of the 27% marginal (or entry) rate.

Back in 2002, according to OXERA, there were some 200 households with personal annual incomes over £250,000, and fewer than 100 with personal annual incomes over £500,000. In discussing the possibility that some of these households might simply leave the Island, the OXERA report admits that there is no precise data on the potential mobility of Jersey residents, but suggests that the relatively rich will be the most mobile.

They point out, however, that even under a scenario of a much larger tax rise (up to 39% on incomes over £100k), a household on £120,000 annual income would still be some £9,000 better off than in the UK. Under the proposals presented here, which entail higher rates, a household on £120,000 income would pay an additional £3,500 in income tax. The number of households earning the levels of income discussed in the OXERA paper will obviously have increased over the ensuing decade, but so have the rates in the UK. Those earning over £150,000 are now subject to a 50% rate.

The President of F&E in 2002 committed himself to progressive taxation:

> "I repeat my commitment that our overall tax strategy should be mildly progressive. The better-off should shoulder a greater proportion of the tax burden than the less well-off."

At the time of writing, I have not seen any attempt to put these fine words and sentiments into action. When this proposal comes to the States, it will be because I still consider that insufficient movement on this front has been made.

In all the discussion of what we might do to clear the current and projected deficits generated by our tax and spending policies, the possibility of progressive measures has been largely ignored. Throughout the past decade the measures that have been brought forward for consideration, and introduced, have largely been regressive in their nature. User-pays charges, reductions in support for low-paid tenants, freezing income tax exemptions and the raising of impôt duties, the imposition of and increase in GST all have a disproportionate effect on those on low wages.

Recent Consultation

As a result of the recent Budget, the Assembly has accepted the way forward proposed by the Minister for Treasury and Resources for raising additional tax revenue.

In his consultation paper prior to the budget debate, he proposed 4 mechanisms to enable him to raise the sums he had targeted. The 4 possible options involved increases to –

- **Goods and Services Tax**
- **Social Security contributions**
- **Domestic property rates**
- **Income Tax.**

The options to raise £30 million as summarized by "Involve", the group employed to conduct the consultation, were as follows –

3.3 Goods and Services Tax

Current situation: GST is a sales tax of 3% on most goods and services supplied in the Island (one of the lowest GST/VAT rates in the world).

Option: Increase the rate of GST from 3% to 5%. This would raise £30 million a year.

3.4 Social Security contributions

Current situation: Social Security contributions are paid on wages and not on any other kind of income. Islanders who earn up to £43,752 (the ceiling) pay 6% of their wages and their employer pays another 6.5%, making a total contribution of 12.5%. They do not pay Social Security on anything above £43,752, which means that as income rises above this ceiling the proportion of income paid in contributions falls.

Most of this contribution (10.5%) pays for pensions and benefits, with the remaining 2% going into a Health Insurance Fund to subsidise doctors' fees and provide free prescriptions. Increasing the 2% contribution to the Health Insurance Fund is one option being considered to meet the costs of future investment in our health service.

Option: To raise the employee and employer social security ceilings to £115,000 (Guernsey is moving towards this in steps). This would raise about £30 million a year for the Social Security Fund. (A further £6 million would be raised for the Health Insurance Fund if the ceiling is applied to those contributions.)

3.5 Domestic Property rates

Current situation: The average rates paid (parish plus Island-wide) come to about £350 per household per year. In the UK, the average council tax per dwelling is about £1,100.

Option: Triple domestic property rates by increasing the Island-wide rate, which is collected by the parishes and passed onto the States. This would raise about £30 million per year.

3.6 Income Tax

Current situation: Jersey's finance industry attracts skilled, high earning individuals who generate business and employment, and contribute a significant amount in tax. Their financial contribution has enabled Jersey to provide high quality services while keeping the overall personal tax rates lower than many other places.

Option: To introduce a higher rate of income tax – 30% for income above £100,000. This would raise about £30 million a year.

The response to the option to raise income tax was summarized thus by Involve –

> "Income tax really divided those who took part in the consultation. More people felt this would be bad for business than those who felt it would be bad for Jersey as a place to live and work. This question elicited the highest number of positive views of all options from those who responded via the electronic questionnaire (note however that even so there were twice as many negative views than positive ones). Views were divided between those who were very concerned about undermining Jersey's international competitiveness and felt that the 20% tax rate was part of Jersey life, and those who felt that the wealthy are currently paying less than their fair share towards public services.
>
> This is a very mixed response. We were not presented with the actual proportions or the figures that correspond to the words "more" or "highest number" or "divided". This enabled the Treasury Minister to fall back to his previously stated position before the consultation of no rise in income tax rate under his time as minister."

Involve did however describe a clear distinction between group or organizational responses, as distinct from those from individuals, thus –

> *"It has been difficult to draw comparisons between different types of organisation because most of the more detailed responses came from finance-related groups and companies, and fewer from retailers and others".*

Despite his commitment to "fairness", as reflected here in the budget speech –

> *"In making these proposals I have listened to the views of more than 1,000 people, businesses and interest groups who responded to the consultation on personal tax. A whole range of valuable comments were received which highlighted the need to find a sustainable balance between fairness on the one hand and what is best for the economy on the other.".*

Involve, the organization who ran the consultation, had the following to say in their conclusions –

> *Overall the options of increased GST and Rates were seen to be relatively less damaging to businesses but more negative for residents and workers. The opposite was the case for the options of Income tax and Social Security, where more people and organisations identified negative impacts on Jersey as a place to do business than for Jersey as a place to work and live.*

Of these options, only one, the possibility of raising the rate at which income tax is charged for higher earners, is truly progressive. It came as no surprise that throughout the so-called consultation, the minister restated his personal commitment to retaining the single 20% rate of income tax. Again this is reflected in the budget speech –

> *"After consultation and very careful consideration the Council of Ministers supported my conclusion that a higher rate of income tax would have negative consequences. This budget, I hope, will send out a strong and powerful message that we support maintaining the foundation of our economic success, our 20 per cent tax rate."*

Furthermore, during the consultation it became clear that the option to introduce a higher rate of income tax for higher earners was impractical. In terms of individual responses, some respondents had spotted the defect in the proposal on income tax. As Involve notes thus –

> *"One aspect of the option that was considered unfair was the possible inclusion of joint incomes.*
>
> *If this is not done on individuals but on household income you are going to cause hardship. Many hardworking couples have stretched themselves to afford the vastly inflated accommodation costs... (individual online response)."*

Under the current Income Tax Law, the treatment of married and unmarried couples is different. The introduction of higher rates for higher income bands would, in effect, discriminate against married couples. This made the proposal which was the subject of the consultation a non-starter. At no time during the consultation or since has the Minister or his deputies attempted to address this fundamental flaw. This alone rendered the consultation process, in my opinion, largely invalid.

As a result of this basic flaw in the option presented, it became clear to those who were interested that progressive changes to income tax were not possible in the short term (to start in year of assessment 2011) to help deal with the taxation revenue "black hole" resulting from the recession and zero/ten. However, looking to the medium to long term, there can be no doubt that we must properly examine all options for raising tax, and not dismiss some as sacrosanct because of the political prejudice of the Minister for Treasury and Resources.

What we have seen in the budget process over the past year is a series of regressive measures combining service cuts with tax changes largely aimed at low- and middle-earners.

Thus we have –

- Spending reductions to the tune of £65 million by 2013. Despite the protestations of the Minister for Treasury and Resources, this will result in some public service cuts, which are most damaging to the welfare of the poorest and the vulnerable.

- Increase in GST to 5%, with no exemptions, raising £15 million in 2011 and £27 million in 2012. A more regressive tax than in the UK, with twice the impact on the lowest income quintile than on the highest.

- Increase in impôts (£3.3 million), again a revenue-raiser with regressive impact.

- Increase in Social Security contributions for those earning over £45,000 to 2%, whilst appearing to be progressive still leaves this element of the tax system regressive overall.

The measures outlined in this proposal bring a long awaited balance to the tax debate.

Application of the current Income Tax Law, under which a higher rate on the joint incomes of married couples would see them unfairly treated in comparison with unmarried couples (that is without part (a) of the proposition) the sums which could be generated by the introduction of the higher rates outlined in this proposition and based on 2008 figures are as follows –

Higher rates of tax:

	Year	*%*	*Taxable income band*	*Net estimated increase*
(b)	2012	22.5%	£70K – £99.99K	£2.9 million
	2013	25.0%	£70K – £99.99K	£5.9 million
(c)	2012	25.0%	£100K +	£13.4 million
	2013	30.0%	£100K +	£26.9 million

If the higher rates were to be applied to the incomes of all 1(1)(k)s as outlined in (d)(i) then the maximum return from this group would be in direct proportion to the increase in the rate. Thus the current £13.6 million would be increased as follows. Not all 1(1)(k)s will have incomes over £100,000, however, so returns would be less –

(d)	2012	25%	1(1)(k)	< £3.4 million
	2013	30%	1(1)(k)	< £6.8 million

Members will note that allowing for a rise in line with the Average Earnings Index the amount raised in (c) – a 30% rate on incomes above £100k – yields the approximate £30 million estimated in the consultation paper.

However, since this option (as proposed in the consultation paper) is discriminatory, as I have noted above, part (a) – a move to individual tax bills for all households is required. This reduces the overall revenue produced. Once part (a) is introduced the sums produced, based on 2008 returns, are estimated to be as follows –

	Year	*%*	*Taxable income band*	*Net estimated increase*
(b)	2012	22.5%	£70K – £99.99K	£1.9 (-1.0m) million
	2013	25.0%	£70K – £99.99K	£3.7 (- 2.2m) million
(c)	2012	25.0%	£100K +	£10.3 (-3.1m) million
	2013	30.0%	£100K +	£20.6 (-6.3m) million

The maximum return from 1(1)(k)s would be unchanged –

(d)	2012	25%	1(1)(k)	< £3.4 million
	2013	30%	1(1)(k)	< £6.8 million

The addition of a higher rate of tax to the options available to the Treasury might be used in several ways. My own favoured option would be to use the £30 million additional revenue produced to remove the increase in GST to 5%.

Financial and manpower implications

This measure will increase income tax revenue by around £30 million in a full financial year as detailed above. The introduction of a higher rate of tax will require some law drafting time and some time to rewrite the income tax computer program, but makes no long-term demands on additional manpower.