STATES OF JERSEY

GOODS AND SERVICES TAX: PETITION (P.125/2007) – COMMENTS

Presented to the States on 17th October 2007
by the Minister for Treasury and Resources

STATES GREFFE

COMMENTS

1. Introduction

This proposition, and the petition on which it is based, asks the Treasury and Resources Minister to carry out two pieces of work prior to the introduction of a Goods and Services Tax (GST). Those two activities are –

1. to arrange an independent examination of public finances to identify potential savings, and
2. to investigate alternative methods of raising funds.

The reality of the situation is that both these issues have already been fully investigated and reported on, both to States Members and the public of the Island. This proposition offers no solutions of how to raise the £45m required to meet the shortfall caused by 0/10%. Nor can anyone truly believe that there is some better, popular and painless way of raising £45m which some further "independent review" will come up with. This is merely an attempt to put off a difficult, but necessary action which the States has already debated and decided upon on numerous occasions.

In the petition, the background given for deferring GST was that it "will lead to higher inflation, increased red tape and considerable extra cost to consumers and local businesses alike."

As these comments go on to show, GST will actually dampen inflationary pressures, and although any additional tax measures will increase administration and costs, the particular form of GST being introduced in Jersey has been designed to keep these additional burdens to an absolute minimum.

The underlying question which people were asked when presented with the petition lodged au Greffe was whether Islanders wanted to put off paying more tax, so it is fully understandable why people have signed the petition. No-one likes paying more in taxation, and everyone could happily agree to put off tax increases indefinitely, if one could ignore the consequences.

However, had it been explained to Island residents that by not having a Goods and Services Tax (GST), or some other tax which again would be paid by local residents, we would not be able to adequately support the most vulnerable members of our society, or maintain the standards everyone expects of our essential services, such as health, education, roads and sewers, and the police, prison and fire services, then people might have thought very differently about signing.

The fact of the matter is that, without GST Jersey will not be able to maintain the present level of public services that Islanders expect.

Two years ago, after looking at all the alternatives to GST, States Members had the courage to take a tough decision in the Island's best interest. Independent reviews, conducted by PricewaterhouseCoopers in 2004 and David Kern (for the Chamber of Commerce) in 2007, have also concluded that GST is the right choice for Jersey.

We should not even consider deferring GST. Now is the time to act to ensure certainty for Jersey's future. To prevaricate and delay the introduction of GST sends the message to the outside world that we are unable to take the difficult decisions necessary to guarantee Jersey's economic prosperity, and the confidence in Jersey, from which we are currently benefiting in terms of economic growth, would drain away.

2. A Reminder of the need to introduce a Goods and Services Tax (GST) and the need for a 0/10% tax structure - why was GST Chosen Instead of Other Taxes?

Why do we need GST?

For many years we have had a very successful economy, driven largely by the finance industry, which has generated enough tax to pay for the excellent public services we all enjoy, such as health and education, and given Islanders the opportunity for an excellent standard of living.

The finance industry is a vital part of the Island's economy providing taxation revenue and well paid jobs. Indeed, over 12,500 workers are currently employed in the finance sector, not to mention all those employees working in related businesses.

Increasing competition from other jurisdictions has meant that Jersey has had to reduce its corporate tax rate in order to remain an attractive location for the finance industry. Without these changes, it is very likely that Jersey would become considerably less prosperous and the standard of living which we all enjoy may be diminished.

The finance industry has an enormous amount of choice when deciding where to locate and Jersey is just one of many jurisdictions competing for its business. In order to protect our economy and compete effectively, Jersey has had to change the way it taxes businesses. This change is often referred to as "zero-ten". What this means is that all companies will be taxed at a rate of 0% on their profits, with the exception of companies operating in specific areas, like finance, which will be taxed at 10%.

The consequence of this means that about £100 million less in tax will be collected each year. However, if these changes to our tax structure are **not** made the result would be far worse. Thousands of jobs would be lost, businesses would leave the Island and the reduction in tax revenue would be far higher, potentially as much as £200m per year, which would require deep, indeed draconian, cuts to public services.

Following extensive research and consultation into the fiscal strategy over the past ten years, to make up the shortfall, the States have agreed a three pronged plan to –

- grow the economy
- control public spending
- increase taxes

recognising that the burden was moving away from corporate taxpayers and more towards individuals, The States agreed a package of tax measures aimed at everyone in society paying more in tax, but with higher earners paying most, and the least well off being protected through enhanced income support. This package was a combination of '20% means 20%', ITIS and GST.

Having considered the alternatives, GST is the only tax we can introduce which will make up the £45m we need to pay for public services without risking serious damage to the economy. Consequently, it is often referred to as the "least worst" option.

We need to bring in GST now, while the economy is doing well, in order to maintain the confidence in the Island. It would be difficult, if not impossible, to implement GST if that confidence was to ebb, the Island entered recession, and there was unemployment and falling incomes.

Of course no one wants to pay more in tax – but if we don't make these changes, we are risking making Jersey a less attractive place to live and work in, with fewer opportunities for Islanders. In this way, GST is a vital part of the plan, which the States have agreed, to keep Jersey moving forward.

GST: The alternatives we considered

The States decision to approve the package of tax measures and to introduce GST was not taken lightly.

The States decided to introduce GST after consideration of the extensive analysis and potential alternatives. These included:

Payroll Tax – A payroll tax can be applied to either the employer or employee, or to both, and it is calculated according to what the employee earns. A payroll tax paid by the employer would directly increase the cost of doing business, and make exports (including those in the financial services industry) less competitive. This could affect employment opportunities in Jersey in the future. If a payroll tax was introduced on employees, take-home pay for workers would be reduced. A payroll tax would not be paid by Islanders who do not work (including those with high incomes), nor would visitors to Jersey, who use our public services, contribute.

Increasing the Basic Rate of Income Tax - This would damage Jersey's low tax status. In order to raise the tax required the standard rate of income tax would have to rise from 20% to 25% **and** all personal allowances and exemptions would have to be reduced by 25%.

Just raising the rate of income tax for people on higher incomes wouldn't generate enough money. For example, if everyone earning more than £80,000 per year had to pay a 30% rate of income tax, we would only raise some £11 million.

Property taxes – A Property Tax was looked at briefly, which in reality would be effectively the same as the current All-Island Rate, but clearly at a much higher level (the present yield is about £10 million p.a.). Although simple to collect, it was considered not to be an entirely appropriate tax mechanism to raise this level of revenue, since it bore no connection to an ability to pay what could be quite significant sums.

Capital Gains Tax and Wealth Tax - a Capital Gains Tax is charged on the profit made on the sale of an asset (like stocks and property) that was bought at a lower price. A wealth tax is not based on income but on how much people own. This could include shares and property held by an individual. But some people are asset-rich, without necessarily having high incomes.

These taxes would not be consistent with Jersey's reputation as a location for international financial services, and could seriously harm Jersey's international reputation as a low tax jurisdiction. As can be seen from the chart in Annex A, Jersey has one of the lowest rates of taxation as a percentage of Gross Domestic Product (GDP) compared to other jurisdictions in the EU and OECD.

Development Gains Tax – This is a tax on profits made when land is sold for development. The disadvantages to this tax are –

- the money raised would be sporadic so it could not be a reliable and constant source of tax revenue;
- a high development tax may stop land owners from selling their land for building social housing;
- it is unlikely to raise significant amounts of tax revenue.

In deciding which tax, or combination of taxes, would be most suitable for Jersey the following general principles were taken into account –

- Fairness;
- Efficiency, simplicity, flexibility;
- Good for the economy;
- Broadening the tax base, stability and minimising avoidance.

No tax could precisely and fully meet all these principles but the package of fiscal measures agreed by the States scores well on all of them.

It also ensures that Jersey can look forward to a sound economic future which means that the Island's way of life with a pleasant environment, a generous level of public services and a good quality of life can be continued for generations to come.

GST has been chosen because –

- it is competitively neutral for the Jersey economy – it keeps Jersey business competitive in both its export market and in relation to import substitution;
- it is paid by everyone consuming almost everything in Jersey – including the very wealthy, 1(1) Ks, those with investment income, the rich retired etc.;
- it minimises the risk of tax revenue flight or evasion;

- it broadens the tax base and reduces the volatility of tax receipts for the government;
- the required tax revenues can be generated in such a way that the most anyone could be worse off is by 3%, and in most cases, because of housing and other exclusions the figure is nearer 2%;
- provided the States keep it simple (i.e. no special rates, very few exemptions etc) GST is efficient to collect.

There is no perfect tax, but the combined package of GST, the revised Income Support Scheme, 20% Means 20% and up-rating of income tax entry levels protects those on low incomes, provides additional relief for those on middle incomes, and results in a disproportionately bigger contribution from those on higher incomes.

All of these issues have already been addressed, in much greater detail, in the previous papers and consultations. There is nothing that has changed since then that has altered the conclusions from that analysis.

3. Progress in Cutting States Spending

Contrary to the assertions with the Connétable’s Report the States has in recent years achieved substantial savings through both efficiencies and service reductions. The savings amount to over £35 million per annum in 2008 and well over £100 million in total and have been identified and agreed through the Change Programme and annual spending reviews since 2004.

Most of these savings have been recycled into maintaining standards of health care, funding pensions, eradicating poverty through the new income support scheme, increasing spending on the prison and overseas aid. It was an option not to spend the £35m on these services, but the States has debated these matters in the Annual Business Plan and decided to do so.

Undoubtedly there is scope for even more efficiency savings in the States, and the Council of Ministers is committed to working with the Public Accounts Committee and other States Members in identifying them. Equally there are pressures for additional spending that will not go away such as on the prison, health and residential care for an ageing population. No-one should be under the illusion that there is significant scope to actually cut States spending.

4. GST and inflation

The background to the Consumer Council petition says “the imposition of a Goods and Services Tax in Jersey will lead to higher inflation”.

The Goods and Services Tax will result in a one off increase in the Retail Prices Index of about 2%, which would drop out of the index a year later. It will not, however, add to inflationary pressures in the economy. Inflation is caused by the demand for goods and services exceeding the supply. The extra taxation of GST will take money out of the economy, and may actually <u>reduce</u> inflationary pressures. So it is incorrect to say that GST will lead to higher inflation. This is confirmed by an International Monetary Fund study of the price effects of introducing VAT in 35 Countries. The conclusion of the study was that there is “nothing inherently inflationary about the use of GST”.

5. The Administrative Costs of GST

The background to the Consumer Council petition refers to “increased red tape and considerable extra cost to consumers and local businesses alike”.

In the consultation on GST the overwhelming response from the public was to keep administrative costs of GST to the minimum. Accordingly, Jersey’s GST is based on a simple flat 3% tax rather than the U.K.’s much more complicated 17.5% VAT with a raft of exclusions.

There will, undoubtedly be some set up costs for businesses, primarily those with taxable turnovers in excess of the threshold of £300k p.a., but after that the cost of GST administration will be minimal.

The administrative implications for the States will be 10 additional staff, and a total administrative cost of less than £1m a year to collect £45m. This cost of collection of 2% is extraordinarily low because the States has wisely chosen a simple form of GST.

6. A Chronology of Research, Consultation and Independent Review

The Report that accompanies P.125/2007 suggests that –

- insufficient research has been undertaken;
- alternative tax raising measures have not be considered;
- there needs to be further time for consultation;
- there has not been an independent endorsement of the progressive package of fiscal measures already approved by the States.

Nothing could be further from the truth.

As the timeline in Annex B demonstrates, an extensive and thorough programme of research has been undertaken over the past ten years. Published detailed reports have been produced by independent, expert organisations such as Oxera, Crown Agents and PricewaterhouseCoopers. These publications have been, and still are, available to the public on the States website www.gov.je – an extract of these publications is shown in Annex C.

Never before in the Island's history has there been such an extensive and inclusive consultation exercise undertaken from 2001 to the present day on the agreed tax package.

Furthermore, the tax proposals have undergone independent, external examination by the Pricewaterhouse Coopers Report published in May 2004 led by the internationally renowned expert Mr. John Whiting. The Report's 10 key points are summarised in Annex D.

An independent assessment of the package of tax measures by the eminent economist, Mr. David Kern, was also commissioned by the Jersey Chamber of Commerce earlier this year, which also supported the tax reform proposals as being the best for Jersey.

7. Retaining the 3% Rate of GST

Jersey's coherent economic and fiscal strategies have contributed to positive economic performance in 2006 and 2007. This has translated into additional tax revenues which have been factored into the latest financial forecasts.

Whilst these forecasts clearly demonstrate that GST is still needed they also reveal that provided the States keeps to its spending plans there is no need to increase the 3% rate of GST for the foreseeable future, and certainly not before 2015.

8. Conclusion

In summary, this Proposition (P.125/2007) is simply an attempt to defer necessary increases in taxes in order to court short term popularity, which will rebound in terms of longer term damage to the economy.

As is demonstrated in the Annexes to this report, the research and analysis of the alternatives to GST has been thorough and comprehensive. The public consultation on the options has been unparalleled. The States has debated GST and its alternatives on numerous occasions, and repeatedly confirmed its commitment to GST.

There are no easy, more palatable options to GST; it is the least worst option. Furthermore, whilst States efficiency has already been improved, and can be improved further, it is pure wishful thinking that this could be a substitute for the £45m generated by GST.

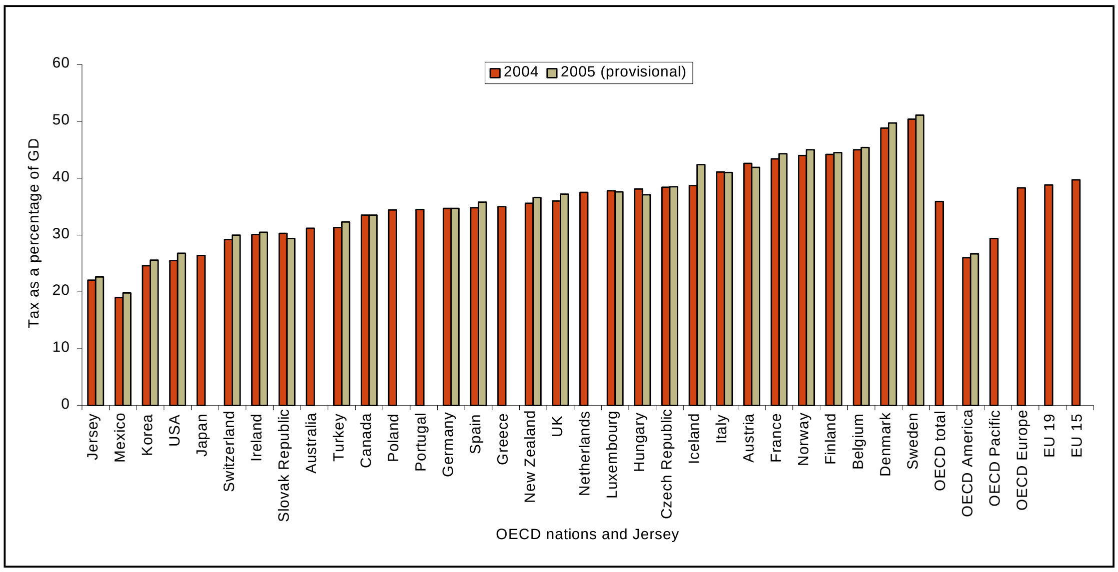
This Proposition is merely damaging prevarication and I urge the States to reject it.

EXTRACT FROM DRAFT 'STATES OF JERSEY ANNUAL PERFORMANCE REPORT' (yet to be published)

Tax as a percentage of GDP compared to other jurisdictions

Why it is important:
Low taxation improves the Island's competitiveness, encourages businesses to locate here and assists in promoting economic growth and prosperity.

What was achieved:
Taxation as a percentage of GDP has increased slowly from 21.8% to 22.6% between 2002 and 2005. Despite this, with the exception of Mexico, Jersey has one of the lowest rates of taxation as a percentage of GDP compared to other jurisdictions in the EU and OECD. (NB 2003 and 2006 data is not available).



ANNEX B

TAX REFORM TIMELINE

	Fiscal Review Working Group established – recommends that Jersey reforms its tax structure to become less reliant on direct taxation	1998
	First public consultation paper on tax reform – outlining the future problems and tax deficit forecasts	July 2001
	Publication of Oxera Report on the future of Jersey's Tax and Spending policies	May 2002
	Second public consultation paper – outlining possible options to fill the tax deficits	May 2002
	Third public consultation paper – outlining ways of addressing the tax funding challenges over the next 3 years	August 2003
	Tax modelling workshops for States Members, businesses and other stakeholder groups – to assess the tax raising sums generated by alternative taxes	January 2004
	Publication of Oxera Report into the options for changes to Jersey's economy	February 2004
	Fourth public consultation paper – 'Facing up to the Future' – outline of the proposed tax reform package	February 2004
	Independent PricewaterhouseCooper Report The Report supports tax reform package proposed by Finance and Economics Committee	May 2004
	States reject a Proposition from Senator Syvret asking for further consideration of all tax options (P.41/2004)	6th July 2004
	States agree tax reform package – including move to 0/10%, ITIS and 20% means 20% and further research into GST, payroll tax, environmental taxes, Capital Gains and Wealth Tax, and Development Gains Tax (P.106/2004)	6th & 7th July 2004
	Consultation on GST	Autumn 2004
	Crown Agents Report on the Design of a prototype GST	February 2005
	States reject a proposal from Deputy Southern to increase Social Security contributions (a 'Payroll tax') rather than introduce GST (P.82/2005)	10th & 11th May 2005
	States reject proposal from Deputy Southern to introduce an additional income tax liability for higher earners (P.81/2005)	11th May 2005
	States agree to introduce GST and implement a revised Income Support system together with amendments to income tax and research into new taxes (eg environmental taxes) (P.44/2005)	11th, 12th &13th May 2005
	Publication of Crown Agents Report on how GST would be operated in Jersey	July 2005
	States reaffirm principle of keeping GST as simple as possible, and reject proposal from Senator Syvret to exclude items such as food, children's clothing, heating etc from scope of GST (P.165/2005)	28th September 2005

	Consultation on GST Primary Law	Spring 2006
	States reject for second time proposal from Senator Syvret to exclude basic items from GST (P.86/2006)	25th October 2006
	States agree GST Primary Law (P.37/2007)	17th & 18th April 2007
	States agree proposals relating to ‘20 means 20’ (P.58/2006)	18th July 2006
	Independent adviser to Chamber of Commerce (David Kern) supports tax reform proposals	July 2007
	GST Law receives Royal Assent	July 2007
	Further consultation on GST Regulations	August 2007

Planned future activities

	States Debate GST Regulations	October 2007
	States Debate Price Marking issue and GST Appointed Day Act	November 2007
	0/10% Shareholder Provisions legislation	November 2007
	States Debate 2008 Budget	December 2007
	GST Registration begins	January 2008
	GST begins	May 2008
	Price marking legislation implemented	May/June 2009

ANNEX C

EXTRACT FROM THE STATES OF JERSEY WEBSITE

The 'Zero/Ten' Design Proposal	217kb
Proposals for Introducing 20% means 20%	Web Page
Tax Facts briefing for FE	153kb
P44 Fiscal Strategy Report and Proposition	615kb
Supporting Papers	
'Which Tax is best suited to Jersey's objectives? An evaluation of alternative tax options' (OXERA, February 2005)	534kb
'Economic consequences of the application of a selective tax' (OXERA, February 2005)	210kb
'Crown Agent's Final Report' (February 2005)	1.46MB
'General Guide to GST - Frequently Asked Questions' Crown Agents (February 2005)	220kb
States of Jersey information supplement summarising the Fiscal Strategy proposals	492kb
Past Documents	
Reforming Jersey's Taxation Structure: A Goods and Services Tax - The right way for Jersey? Proposal for the Design of a Prototype Goods & Services Tax Summary GST Consultation Document Full GST Consultation Document Financial Services Consultation Tourism Sector Consultation	1.46mb 743kb 213kb 106kb 176kb
Fiscal Strategy	931kb
Report by PricewaterhouseCoopers to the States of Jersey on taxation matters.	341kb
Tax and Spending Frequently Asked Questions	Web Page
Facing up to the Future - Presentation	166kb
Facing up to the Future: reforming public spending and taxation to sustain a prosperous and competitive economy	501kb
OXERA (Oxford Economic Research Associates) Fiscal Strategy: Background Paper February 2004	563kb
Interest Tax Relief - Press Release	103kb
A guide to the third Consultation paper on the future of our Tax and Public Spending Policies - August 2002	98kb
Third Consultation Paper on the future of our Tax and Public Spending Policies - August 2002	436kb
A guide to the Second Consultation paper on the future of our Tax and Public Spending Policies - May 2002	93kb
Second Consultation Paper on the future of our Tax and Public	

Spending Policies - May 2002	414kb
OXERA Report on The Future of Jersey's Tax and Spending Policies - May 2002	611kb
A guide to the First Consultation paper on the future of our Tax and Public Spending Policies - July 2001	72kb
First Consultation Paper on the future of our Tax and Public Spending Policies - July 2001	77kb

ANNEX D

EXTRACT FROM THE EXECUTIVE SUMMARY OF THE REPORT BY PRICEWATERHOUSECOOPERS PUBLISHED IN MAY 2004

Ten key points

Our report covers a lot of ground. Trying to summarise it briefly is difficult and we hope that most readers will wish to study it in full. To help the reader, we can perhaps put our findings in terms of ten key points.

(1) Jersey needs to take action on its tax system; it has been left with no choice because of EU/OECD pressures. We think there is a need to take decisions on the main direction of reform quickly, to give business certainty.

(2) There needs to be a clear setting and understanding of the aims of the reform, which we see primarily as ensuring a good climate for the retention and development of the Financial Services Industry. More can be done to explain the aims; more needs to be done on planning and developing diversity strategies.

(3) The 0/10 company tax proposals are sensible and are acceptable to the relevant authorities. They are generally acceptable to the Financial Services Industry. But the 0/10 system cannot be expected to endure forever and Jersey will need to keep its tax system under review.

(4) The changes to company tax will leave a significant gap in Jersey tax revenues. Only income tax or VAT/GST/Sales Tax seems likely to fill the gap.

(5) We think that Jersey needs to keep its 20% income tax as a core component of its tax system. We are not in favour of raising this rate or introducing higher rates. The idea of clawing back personal allowances for those on higher incomes, although perhaps administratively involved, does contribute to spreading the tax burden to the better off.

(6) VAT is our preferred route for raising significant tax funds. Whilst there will be a need for considerable detailed design work on the tax, there is a wealth of experience from the U.K. and around the world that Jersey will be able to draw on. It spreads the Jersey tax burden away from income tax in a way that means all will contribute.

(7) We do not think Jersey should introduce a capital gains tax. Maintaining the existing probate duty is preferable to introducing a wider form of death duties; we are not in favour of a wealth tax.

(8) We think there is some limited scope for further tax revenues to be raised from what Senator Syvret terms the “accommodation industry”. Our preference would be for some form of development levy. We think the rates system needs reappraisal, though we are aware that the parish system makes this a longer-term prospect.

(9) There is some scope for further environmental taxes – perhaps some form of waste disposal levy and higher petrol/diesel duties.

(10) Anti-avoidance will always be an issue. There may be a need to look at tax enforcement, the General Anti Avoidance Rule (Article 134A) and information powers. The proposals for apportionment of company income are reasonable but we have concerns about the administrative burden. Other rules on the income/capital divide may be needed.