STATES OF JERSEY

DRAFT INCOME TAX (AMENDMENT No. 32) (JERSEY) LAW 200- (P.161/2008): COMMENTS

Presented to the States on 25th November 2008
by the Corporate Services Scrutiny Panel

STATES GREFFE

COMMENTS

1. Summary

The Treasury has proposed a tax on "deemed rents" of certain companies.

This is an attempt to collect tax from foreign-owned companies that are trading in Jersey (such as the main High Street chains). Under 0/10 they no longer pay any Jersey tax on their profits, which currently gives rise to 2 problems –

- they make no direct contribution to the States, despite operating here; and
- Jersey-owned companies will still be taxed, so may become less competitive.

The Corporate Services Sub-Panel reviewing the 0/10 proposals asked the Treasury to examine a "deemed rent" tax to see if it would be a suitable way to collect tax from these foreign-owned companies[1]; this proposed Law is the result.

The Treasury estimated that under 0/10 it would lose £10–12 million of tax revenues from foreign-owned non-finance companies, but that it will recover about half of that (£4–6 million) through this deemed rent tax.

As part of this reform, the Treasury also proposed removing the exemption from Jersey tax currently enjoyed by UK superannuation funds and charities. Under this draft Law, they would pay Jersey tax on their Jersey rents, like any other landlord.

The Corporate Services Scrutiny Panel supports the Treasury's attempt to tax these companies, but various issues need to be resolved before the tax can be introduced (see part 5).

2. The draft Law – who is taxed?

The tax is designed to tax companies that are actually doing business in Jersey, but whose profits will escape tax under 0/10. Therefore the following will not be affected –

- Residential property.
- Sole traders and partnerships (they still pay 20% tax on their profits).
- Jersey-owned companies (i.e. more than 50% owned by Jersey residents), because the Jersey shareholders are taxed on the company's profits.
- Property rental and utilities companies (they still pay 20% tax on profits).
- Finance companies that pay the new 10% tax on their profits.

There is an anti-avoidance provision that allows the Comptroller to charge the tax even if companies make artificial arrangements to try to avoid it. Also, when deciding whether shareholders are Jersey residents, companies and trusts will be "looked though" to see where the "ultimate" shareholders are.

Where 1% to 50% of a company's shares are owned by Jersey residents, the company will have to pay the tax, but can apply for it to be reduced in proportion to the shares owned by Jersey residents.

Companies that were "exempt" under the pre-0/10 regime are unlikely to pay the deemed rent tax, because they are unlikely to own or lease any property in Jersey.

There is also a related proposal to remove the current exemption from Jersey tax enjoyed by UK superannuation funds and UK charities when they receive Jersey rents (which could otherwise be used to avoid the deemed rent tax).

3. The draft Law – what is taxed?

Companies subject to the tax will be taxed at 20% on their "deemed rent", i.e. the rental value of their Jersey premises minus any rent that they actually pay. Therefore –

- Where a company owns its own premises, it is taxed on the market rent that it would otherwise have to pay to occupy them.

- Where a company rents or leases its premises, it is taxed on the difference between the rent it actually pays and the full market rent. In the case of a normal commercial lease from an independent landlord, the taxable amount should generally be zero.

The deemed rent is to be certified by an independent, qualified valuer.

3.1 Deductions

Companies will be able to deduct interest and maintenance from the deemed rent.

This will reduce the tax yield, and so reduce the effectiveness of the tax. However it will increase fairness, because owner-occupiers and landlords will be taxed in the same way.

3.2 Maximum tax

The taxable deemed rent cannot be more than the company's taxable business profits would have been if it were not a 0% company.

This may reduce the tax yield in some cases, but it will ensure that the company's tax bill under deemed rent will not be more than it would have been before 0/10. However there will be an administrative cost in calculating and agreeing the maximum.

4. Effect on the Jersey economy

Under the pre-0/10 system, a UK company with a branch in Jersey could usually offset the tax that it paid in Jersey against its UK tax – so the Jersey tax did not increase its overall tax bill.

If the deemed rental charge cannot be offset in this way, then it will add to the costs of doing business in Jersey, and therefore could lead to increased prices and reduced competition (if companies pull out of Jersey), and so add to the cost of living.

The Corporate Services Scrutiny Sub-Panel commissioned the UK accountants BDO to examine whether the deemed rent tax could be offset against UK tax. Their opinion was –

- Under general rules the tax probably could not be offset (because there was not a match – the Jersey tax was a tax on deemed rents, whereas the UK tax was a tax on trading profits).

- However, it would be relatively easy for a group to restructure itself so that the tax could be offset (by transferring the property to a separate group company, which would rent it at a full market rent to the trading company).

It would cost companies to reorganise in this way, but it seems that many UK groups already adopt this arrangement, to consolidate their property management.

The Sub-Panel's initial view therefore was that this would not be a significant issue; companies would either absorb the tax or reorganise so that they could offset it.

5. Issues

The Treasury has carried out a public consultation, and shared the replies with the Corporate Services Scrutiny Panel. The draft Law seems to deal with many of the concerns raised, but some do not seem to have been addressed. The Corporate Services Scrutiny Panel also has some concerns of its own.

As a result of these concerns, the Panel recommends that the Minister for Treasury and Resources should withdraw the draft legislation, in order for the next Corporate Services Panel to review the legislation in more detail, and fully consider the following concerns.

5.1 Property Industry

The property industry is very concerned about the proposal to remove the tax exemption for rents received by UK superannuation funds. These funds are tax-free in the UK, so any Jersey tax would be an additional cost.

The industry claims that without investment from these funds it would be impossible to raise the money needed to finance new developments. If true, this would be a major barrier to Jersey's future economic development. Discouraging pension funds would also reduce liquidity in the Jersey market, making it difficult for sellers to find a buyer, particularly for larger properties that are beyond the resources of local investors.

5.2 Hotels

Two hotels were very concerned about the deemed rent tax, fearing that they would pay much more tax than they did before 0/10 (when they were taxed on their profits).

The draft Law now provides that companies cannot be taxed on more than their profits (see 3.2 above), which may allay these fears. However, these concerns, and those of other industries, should be investigated to see if they have been settled.

5.3 Fairness

Several issues about fairness were raised –

- Companies with the same level of profits would pay different amounts of tax, because tax would be based on their property value rather than their profits.

- Jersey shareholders will be taxed on their companies' profits, but foreign-owned companies will be taxed on their property values. This could lead to unfairness.

- Finance companies will pay 10% tax on their profits and just a flat-sum for GST. Some companies thought that this was a more favourable treatment than GST plus a deemed rent tax.

5.4 Other issues

- Is it possible, or practical, to keep track of Jersey shareholdings? Would a "pay and reclaim" system be better?

- Companies with up to 49% non-Jersey ownership are still exempt. Are there any significant companies in this position, and does it risk distortions?

- Will the valuation method be robust, and how will disputes be settled? Will it be too costly for companies? Why are Rates valuations not being used?

- Should group relief be available, so that companies are not taxed where the Jersey-based group as a whole is unprofitable?

- What expenses (if any) should be deductible from deemed rents? Allowing deductions could increase fairness, but will reduce the tax yield.

- The definition of which companies are subject to the tax seems unusual and may be difficult to operate.

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[1] S.R.14/2007