

CORPORATE SERVICES ZERO-TEN SUB-PANEL

THURSDAY, 13th JULY 2006

Review of Zero-Ten Design Proposals

EVIDENCE OF MR. JOHN RIVA OF KPMG

PANEL: **SENATOR JAMES PERCHARD (CHAIRMAN)**
SENATOR BEN SHENTON
DEPUTY PATRICK RYAN
DEPUTY GEOFF SOUTHERN
MR RICHARD TEATHER - ADVISOR TO THE PANEL

QUESTIONS

Senator J.L. Perchard:

Thank you. Well, formally welcome to the Corporate Services Scrutiny Sub Panel, which is undertaking a review of the Zero 10 design proposals. John, I am obliged to just read to you a standard witness statement, if you would just bear with me. It is important that you fully understand the conditions under which you are appearing at this hearing. You will find a printed copy in front of you of the statement I am about to read. Proceedings of the Panel are covered by Parliamentary privilege through Article 34 of the States of Jersey Law 2005 and the States of Jersey Powers, Privileges and Immunity Scrutiny Panels, PAC and PPC, Jersey Regulations 2006. And witnesses are protected from being sued or prosecuted for anything said during hearings, unless they say something that they know to be untrue. This protection is given to witnesses to ensure that they can speak freely and openly to the panel when giving evidence without fear of legal action though any immunity should obviously not be abused by making unsubstantiated statements about third parties who have no right of reply. The panel would like you to bear this in mind when answering questions. These proceedings are being recorded and transcriptions will be made available on the Scrutiny website. Are you happy with that?

Mr. J. Riva:

Certainly.

Senator J.L. Perchard:

Thank you for coming to see us. As you are well aware, the Zero 10 document is extremely complex and very technical and we have invited you as you were involved in the initial consultation with the Treasury over the aims and objectives of the document. Could you tell us, firstly, how much input did you have in the consultation leading up to the formation of the document?

Mr. J. Riva:

Well, we had a couple of meetings with a number of people. I think most of those are included in the back of the ..on page 57. We discussed a number of issues. I know Jonathan Crowther, the author, very well and we have had various discussions on various parts of it. I obviously had no editorial input in the document. I would have loved to have had some, but obviously I did not. So it is difficult to gauge exactly how much input any one of us had in the preparation of this document, but we did put forward our views.

Senator J.L. Perchard:

Do you think the industry, the finance industry as a whole, was sufficiently consulted at the early stages?

Mr. J. Riva:

I did read the submission by Le Rossignol, which said that only the big 4 accountancy firms were consulted and they felt that this was inappropriate, given that we do not deal with local trading companies. I think that is relatively unfair, because my firm personally deals with a great number of Jersey trading companies. Indeed we deal with the largest group of companies comprising 220 companies, so I do have a good understanding on how the middle man in Jersey deals with trading companies. But, yes, I am sure it would have been better to have more people, but you need to contain such a group and hopefully we represented the majority of people in the industry.

Senator J.L. Perchard:

Okay, thank you. Are you satisfied generally with the proposal in the document?

Mr. J. Riva:

I think I cautiously welcome the proposals and I think the Treasury and Resources Department need to be applauded for finally putting some flesh on the bones. There are aspects which I do not agree with and I think could be made better and I am sure we can explore those.

Senator J.L. Perchard:

What aspects particularly?

Mr. J. Riva:

Well, I suppose if you go to the objectives, which is page 13, one thing which did surprise me is when you are designing any tax system there ought to be various principles which one should adhere to, and these are not actually mentioned in the objectives. I think if you look at Adam Smith and the OECD when they looked at e-commerce type business. They articulated the various principles: simplicity and certainty, equality and neutrality, efficiency and international competitiveness. Now, perhaps these are

inherent in a number of these proposals, but one thing that does come out is that there is not much simplicity and certainty and that does concern me. I have been in Jersey tax for a good 20 years, and I think one thing that Jersey tax stands out from a lot of the other jurisdictions is not only do we have a very competent and commercially minded Comptroller but we do have a relatively simple and certain tax system and I am slightly concerned that a few aspects of this Zero 10 proposal does not actually adhere to it. I am not saying that we should scrap the whole lot. I think it can be tweaked here and there. But I think we do need to bring back the simplicity within the tax system.

Senator J.L. Perchard:

So you would like to see, as the document is out now for consultation, beef up on the objectives, bit more clarity?

Mr. J. Riva:

Exactly and I would like each proposal to be measured by those principles and to determine whether they do fulfil the basic good design principles of a tax system.

Senator J.L. Perchard:

Part of the proposals or the objectives will be simplicity.

Mr. J. Riva:

Very much so. Simplicity, certainty, equity and fairness, efficiency.

Senator J.L. Perchard:

You have mentioned the document was perhaps deficient there.

Mr. J. Riva:

We can pick up on a couple of aspects but I think the obvious one is the taxation of shareholders. Now, that of itself is an extremely complicated matter, but I do believe the way we went through it is more complicated than it ought to be. And I am concerned with the deemed and deferred distribution, the benefits in kind for shareholders, the re-entry charge, the taxation of distributions under UK GAAP principles, the distinction between capital and income, the taxing the sale of shares, the taxation of the liquidation procedures. All of these will amount to substantial legislation and perhaps that could be put away with by having full look through for both trading and investment companies. We will have legislation for look through, but we also have all these other legislation merely to avoid look through for trading companies. I think that to simplify the system I would have liked more consideration being given to full look through.

Senator J.L. Perchard:

Deemed distribution, what is it about deemed distribution that you can agree with?

Mr. J. Riva:

Well, all of the provisions I have just mentioned are there to ensure that a Jersey resident individual who holds shares in a Jersey company pays tax on the profits of that Jersey company. So surely is that not look through but going round the houses?

Mr. R. Teather:

Isn't the reason they have gone round the houses that they felt that look through would still fall foul of the code of conduct?

Mr. J. Riva:

Well, it may very well be. I think the economic effect is the same though and I do not think anybody in this room can actually make an accurate assessment on the code until it is actually placed in front of a code group. Now, bearing in mind that caveat, if you were to ask my opinion, I would say on reflection I think look through for trading companies does seem to be code compliant. It is merely my view, but based upon I suppose the 2001 document issued by the EU on tax principles, they do specifically state and I quote here: "Personal income taxes fall in their entirety under the sole responsibility of the member state." I accept that the code looks at business taxation, not solely corporate, but back in November 1999 when they did look at the 250-odd measures, they did concentrate on corporate tax measures and not merely business. So they did give a narrower definition of business taxation, and I think the process was very similar when they looked at the 10 new entrants in the EU and their measures. They concentrated solely on corporate taxes. Now, I fully accept that the code is a political animal, and therefore interpretation really depends upon the political environment in the time when they look at the measures, but nevertheless there must be some consistency and there must be standard procedure in reviewing measures, and based upon previous experience my view is that look through would seem to be a code-compliant measure.

Deputy P.J.D. Ryan:

What about the question of the ability of shareholders to build up their balance sheet/capital strength because they may want to borrow against it and those kinds of issues?

Mr. J. Riva:

I do not believe that deemed distribution is anything different to look through in that the balance sheet will be made up. I think the question is how does an individual who has no money, merely a right to dividends through his shareholding, how does he pay the tax. I think that is an issue that concerns me with look through, but nevertheless it does concern me with deemed distribution, because as I read it, and please tell me if I am wrong, but deemed distribution is merely that, it is not a requirement for the

company to make a distribution, it is merely the imputation of profits to the individual. So therefore the ability to pay that tax is exactly as difficult as before look through. Now, I would personally like to explore 2 points on that. Firstly the Isle of Man method of the company acting as agent to the shareholder. Now, I fully appreciate the code issues in relation to that. It is getting closer and closer to that line, whether it steps over it I really cannot make an accurate assessment. It will be interesting to see whether the UK Privy Council approves, if that is the right term, the Isle of Man legislation. And if it does, then surely that must mean that the UK is of a view that it is code compliant. The other method of avoiding this inequity of the shareholder paying the companies tax -- actually can I just take a step back, I feel that is the wrong way of viewing it, I think the shareholder pays tax which is on an amount which is measured by reference to the company's profits. I think that is a more appropriate way of describing it. I think one point I would like to make is the right of reimbursement where the individual pays the tax and he has a statutory right of reimbursement against the company. Now, that is not dissimilar to some UK tax provisions although both of the rights of the reimbursement, as I understand it, are against trusts, but we still have similar legislation in the UK. And I would have liked that to have been explored.

Senator J.L. Perchard:

A bit of clarity, you cannot compel a company to pay a dividend.

Mr. J. Riva:

No, you cannot compel them to pay a dividend, but you can compel them to pay the tax once it has been paid by the shareholder. So it effectively becomes an expense of a company.

Senator J.L. Perchard:

Yes, I understand that, yes.

Mr. R. Teather:

Does that not get us back to it being the company's tax?

Mr. J. Riva:

Well, it is once removed, is it not? I do appreciate we are coming closer to that line. But other than letting the shareholder perhaps be bankrupt where he has no funds, it is a difficult issue and we have exactly the same issue in the UK where, if I can give you an example, an individual sets up an offshore settlement of which he has some form of interest, under the UK legislation any income arising to the trustees is deemed to be imputed to the UK individual. He pays the tax, even though he may not receive the income, but then he has a statutory right of reimbursement, which he can exercise against the trustees. Even more draconian, an individual sets up an offshore settlement of which he is specifically excluded, so is his wife, so are his children, but one grandchild perhaps is included. The trustees do not

need to consider the issues in relation to the settlor, they sell an asset. Any gain which arises will be imputed to that settlor and he will need to pay the tax and he has the statutory right of reimbursement even though he is specifically excluded from benefiting from that settlement. So you can see some parallels between the trust laws and a proposed UK company law.

Senator J.L. Perchard:

One of the reasons for deemed distribution is to stop companies rolling up profits and not paying tax. Is that a likely scenario? Would that be widespread on the Island?

Mr. J. Riva:

I would be very surprised if it is not. I mean, even if you look at the UK with their apportionment rules, many people say that in 1989 they got rid of the apportionment rules because they were too complex. I do not think that that was the case. I think they got rid of the apportionment rules because there was no need to because in 1988 they got rid of the 60 per cent bracket and therefore the taxation of companies was not dissimilar to the taxation of individuals and so there was a level playing field. I think as soon as you have an arbitrage between individuals being taxed at 20 per cent and companies being taxed at zero, you do not have to be a tax genius to know where you are going to keep the profits. I fully accept the argument on if you want to make it even simpler you go for distribution only and that will, in my view, spark off economic growth. It will be fantastic. Economic growth on taxation, companies will grow, balance sheet will be very strong. But at the end of the day we do not want economic growth; we want growth on the taxed economy. That is what we are trying to grow. We are not trying to grow just any economy because soon I could easily get enough businesses into Jersey to grow the economy but we need to grow the taxed economy, so we need to have some form of mechanism by which we can capture those profits for the good of the Island.

Senator J.L. Perchard:

Do we want to explore at all with John how the companies could be compelled to pay a dividend? It just seems so --

Mr. J. Riva:

I do not want the company to be compelled to pay a dividend.

Senator J.L. Perchard:

Well, a minority shareholder will be taxed on what they are deemed to receive from a company that has not paid a dividend. It seems to me there is a brick wall there.

Mr. J. Riva:

I agree and that is where I think there are only 2 possibilities, and this is the company acting as agent,

which has code issues but maybe the Isle of Man may resolve them for us, or alternatively the statutory right of reimbursement, which is not the same as compelling a company to make a dividend.

Senator J.L. Perchard:

Could you explain statutory right of reimbursement?

Mr. J. Riva:

Certainly. Let us assume we have a company with £100,000. It has 4 shareholders, each owning 25 per cent. So effectively each shareholder is in a minority. They cannot call as a company to pay dividend on their own. Three of these individuals are non-resident, one individual is Jersey resident. That means that £25,000 of the profits would be deemed to be his, either via the deemed distribution or by a look through. Now, he cannot force the directors to make a dividend because he is a minority interest. So under that situation he pays the tax, 20 per cent on the £25,000, and then under the law of Jersey he has a statutory right of reimbursement against the company. So he goes to the company and says: "In accordance with article [whatever], I have paid £5,000 of tax, I now want you to reimburse me" and the company would reimburse him on that amount of tax. So it will be an expense within the P&L. I think it ought to work from a company law point of view, because you can write that in company law, but it is a code issue as to whether that is appropriate or not and I cannot give a categorical answer as to whether that is code compliant or not.

Senator B.E. Shenton:

If they paid that money out the following year as distribution, would that be apportioned to his shareholding or would it be apportioned across the board?

Mr. J. Riva:

The beauty about having a full look through is that we can effectively ignore taxation on distributions as we currently do. At the moment if I am a shareholder of a company, my company pays tax at 20 per cent. If it subsequently pays a dividend to me, I do not pay any further on that dividend because it is deemed to have been paid out of taxed income. And economically, from a Jersey point of view, they do not mind because all you are doing is redoubling the profits. Profits are in that company, they are being taxed. Now, with a full distribution policy, the profits which are attributed to the Jersey resident have been taxed on that Jersey resident and so if he subsequently receives a dividend from that then he does not pay any further tax, because his tax, his element of the profit, has already been subject to Jersey income tax.

Senator B.E. Shenton:

That makes it quite complicated though doesn't it because you've got this three year thing – LIFO basis and all this sort of stuff.

Mr. J. Riva:

I totally agree with you, Ben, that the deferred and the deemed distribution is complicated. And what it is seeking to do is trying to replicate in some form or another the look through provisions. But when you do not have full look through then there are a number of places where the tax system will leak and so you try to plug it. You try to plug it there, you try to plug it here, you try to plug it there, and suddenly you have got a relatively complicated tax system which is merely trying to replicate look through, which we have already got, for investment companies.

Senator B.E. Shenton:

As a generalisation, would you say that the more complicated the tax system is, the more leaks there is likely to be?

Mr. J. Riva:

Undoubtedly, undoubtedly.

Mr. R. Teather:

I think the other half of Ben's question was, if you have got your statutory right of recovery, who effectively bears that? Is it the company as a whole, so that the non-Jersey shareholders bear a bit or can you allocate it?

Mr. J. Riva:

I do not know whether you can allocate it. I would expect that it would be the company as a whole, but if we look at the position at the moment, the company bears the tax at 20 per cent on all its profits, so the company is slightly better off. But I think it would be relatively complicated to try to allocate it solely to the Jersey resident.

Deputy P.J.D. Ryan:

If that were to be the case existing on the statute book, then it would never happen, because the company, knowing that it would be subject to that if it did not distribute sufficiently for the minority shareholder to pay his tax would actually swing in reverse and they would actually distribute.

Mr. J. Riva:

Well, I think if we are dealing with deemed distribution that is the case, but I would say that we do not need deemed distribution. We just have the allocation and then the statutory right of reimbursement. So therefore the tax system does not dictate the distribution policy of the company.

Deputy P.J.D. Ryan:

What I am trying to say is, if you had the statutory right of reimbursement, would it actually act in such a way, as such a disincentive to companies not to -- would it never actually be used because it would be far better for the company in actual fact to do it the other way and let the minority shareholders have sufficient funds to pay their tax?

Mr. J. Riva:

I think that would be a decision for the shareholder and the company to make, but at least it is not government making that decision.

Senator B.E. Shenton:

Under your proposals, surely you would have to have a form of personal taxation level as opposed to a business taxation level. What I mean is you would have to bring in lookthrough as a personal taxation.

Mr. J. Riva:

Very much so.

Senator B.E. Shenton:

So, it would not actually be part of 0/10. Because if it was at the business level then it is illegal isn't it?

Mr. J. Riva:

Yes, I know where you are coming from, I think. Zero 10 is merely a part of the overall model and I think the look through or the deferred business or whatever is another part. It kind of goes hand in hand, you start at the zero then you have 10 per cent, and you know that individuals are taxed at 20 per cent, so to ensure that there is no tax arbitrage you kind of need this look through. So I think it is not specifically designed for companies and I fully appreciate that, but I think it is an intrinsic part of the Zero 10 model. But, no, you could have it in a totally separate section within the tax law which has nothing to do with companies.

Deputy G.P. Southern:

I would just like to explore the RUDL charge. We have had it described this morning earlier as a political move. It certainly seems from this politician's view to be something that is thrown in at the last minute because of some sort of equity principal. Any company here should be paying something here towards our economy and you've certainly... What do you think of the RUDL charge itself?

Mr. J. Riva:

I applaud Treasury and Resources for including it in this proposal. I have always said that if you have a company in Jersey and it is using Jersey resources then it ought to be paying Jersey tax. I think that is a fundamental principle. However, Zero 10 is a difficult animal. It is a one-size-fits-all animal. We are

not very good at that in Jersey. We like to have flexibility and obviously some flexibility unfortunately brings a bit of non-transparency but as a whole we work on the principle that if you are using Jersey resources then you should be paying Jersey tax. If you are not using Jersey resources then since that company, that individual, is not using our roads, not using our hospitals, not using our schools, so why should it pay tax. Now, with the Zero 10 model we do have a gap. We can tax your finance companies 10 per cent, we can tax your Jersey-owned companies in a look through type way, but we have got a hole. And the question is how do we fill that hole. And I know Treasury and Resources has looked at a number of issues. Most of those have been rejected under code principles. And this is, it seems to me, a last resort to try to tax it. I think that is good, because I think it is important for them to try to get it. My view is that the RUDL charge does not work. I do not particularly like it. As a member of the community, I think that is my decision now. I can say to Treasury and Resources: "I don't like it." And I think all of the Jersey community now needs to consider the RUDL charge and if they do not like it then they have got to accept that certain companies in Jersey, which will be using Jersey resources, will not be paying Jersey tax. But it cannot be a decision solely left to the politicians. I think it has to be brought in by the whole community; the whole community has got to be satisfied that if we do get rid of the RUDL charge, which is certainly my preference, then there are going to be certain companies out there which the Zero 10 model will not apply to and it will be an advantage to them.

Deputy G.P. Southern:

And your objection to the RUDL charge?

Mr. J. Riva:

My objection to the RUDL charge, I suppose all you need to do is look at the fiscal strategy paper where they rejected payroll tax. Yes, the RUDL charge is not quite a payroll tax, more of a poll tax to be honest, but I think it is a very blunt instrument and I do not like the administration of it. I do not like the idea -- okay, it is called a charge but nevertheless it is still a tax and it is being operated by a department which has never been set up to take funds from businesses and I think it is a disincentive to economic growth and I think any tax on employment needs to be carefully considered.

Senator J.L. Perchard:

One of the requirements, if the RUDL charge is to achieve its target, its aim, would be for local businesses to convert to limited trading partnerships. Could you give us your thoughts on that and the whole process of that?

Mr. J. Riva:

I think there are 2 reasons why a company would wish to move to a limited trading partnership. One is to achieve a tax credit for the RUDL charge. And (2), to make it simple, so they have full look through, which, if you bring in my proposal, look through, that takes away a large reason for going to an LTP. I

do find it problematic that government are forcing companies to move down a specific route. There are many reasons why one would not want to do that. Personally, if I was UK-domiciled, say, even though resident in Jersey, if I had shares in an unquoted company, if I held those shares for 2 years then what is known as business property relief would be available, which means effectively 100 per cent relief to inheritance tax if I were to die. If I were to convert I would expect that the business property relief clock would start again. So if I were to die within 2 years, then instead of getting 100 per cent relief against inheritance tax I would be paying 40 per cent inheritance tax on the value of my interest in the limited trading partnership. That needs to be carefully considered. Also I think some companies just will not be able to convert to a limited trading partnership, I think perhaps ones where they have a minority interest and the majority interest is held by non-Jersey residents and suddenly they will have a double hit. They will have not only the deferred and deemed distribution, but they will also have this RUDL charge where suddenly their tax has increased. Quoted companies, I am not convinced that they will be able to change to a limited trading partnership, so there will be a number of companies that will be unable or even unwilling to move to a limited trading partnership, and therefore they have got the RUDL charge as well as effectively the income tax charge.

Deputy P.J.D. Ryan:

It has been said that a lot of those existing limited companies would simply from an outside perspective point of view not want to become partnerships because it will not hold the same clout with their customers or people they want to borrow money from.

Mr. J. Riva:

That is right. I think that is fairly likely. To me, as a partner in a partnership, I view totally the opposite. Ever since I started in an accountancy firm I always wanted to be a partner in a partnership. We incorporated and now I am an executive director in a partnership. The whole standing, if you are company director and you like that position, then to change to a principal of an entity may have various intangible issues attached to it. Also I think if we were to pursue this then government would have to give not perhaps a cast iron guarantee, but not something dissimilar, that the rights of a creditor of an LTP are exactly the same as the rights of a creditor of a company. I am not convinced that you will be willing to give that guarantee. But if you are forcing someone to move to a fiscal vehicle, then you have got to give consideration to that.

Deputy P.J.D. Ryan:

Overall nice try but ...

Mr. J. Riva:

I do believe that the Island needs to have some form of LLP which works, but not for this.

Deputy P.J.D. Ryan:

What about the £5 million, because it is driven by £5 million, where does that come from?

Mr. J. Riva:

I think the problem with Zero 10 is that there will be winners and there will be winners. I struggle to see the losers at the moment other than the taxman, and so I think we have just got to accept that we have lost that £5 million.

Senator J.L. Perchard:

So abandon RUDL.

Mr J. Riva:

I believe so.

Deputy G.P. Southern:

That was never envisaged that we were going to get the £5 million, this is a late addition in terms of filling the black hole. We are talking VAT, we are talking --

Mr. J. Riva:

I think that is right, Geoff, yes.

Senator B.E. Shenton:

Going back to the figures, the £5 million and so on and so forth, how much detail were you given by the Treasury when you were in the consultation process?

Mr. J. Riva:

None at all, £5 million came afterwards.

Senator B.E. Shenton:

So where did all the figures, the £60 million, the £5 million the £45 million, everything, come from?

Mr. J. Riva:

I do not know, I cannot answer that, Ben. But I thought it was quite amusing, because the average is 500, finance sector are zero, so that is 25 per cent of the work population. I would be amazed if the tourist industry or agriculture would be higher than 500, so I started to get very concerned, because I think the only people left are the accountants and the lawyers. I was not too keen on paying £10,000 per person on the RUDL charge so perhaps I need to declare an interest in this one. **[Laughter]**

Deputy P.J.D. Ryan:

One of the interesting things that came a little bit earlier - sorry to spring this on you but it was sprung on us earlier today - which is quite interesting, and a certain amount of cross-fertilisation to the other review that we are doing, which is the GST review, was whether it would be code compliant to discriminate against foreign owned and non-Jersey owned trading companies through a partial exemption through GST.

Mr. J. Riva:

That sounds like a Mr John Shenton idea. **[Laughter]**

Deputy P.J.D. Ryan:

Have you a view on this instantly? Have you thought about it at all?

Mr. J. Riva:

I have not, but I make the comment that I do not believe that the code on business taxation extends to VAT or GST. I think if you look at the EU they are more interested in harmonisation of VAT rather than co-operation and co-ordination approach of the code of conduct. So although it is not explicit in the code I think it is inferred that it does not apply to the code. And that is similar to any form of payroll tax. I believe that we can be as discriminate as we so choose subject to human rights on payroll tax as well as VAT. I do not know whether that is your view as well.

Mr. R, Teather:

Do you not think at some point the EU would say, "Hang on, this is just back door back to IBC position"?

Mr. J. Riva:

Well, yes, it is a difficult one, is it not, because as I said, will it actually be on their radar, when it comes to VAT they want harmonisation and we are not part of that and they accept that we are not part of that. Also we are not having full compliance of the code in relation to GST and I believe that is the main reason, because it is just not on their radar for the code. This is merely my interpretation of what I see. So I think, yes, it could be something to explore.

Deputy P.J.D. Ryan:

Would it have the effect -- whatever you do there is not going to be double tax creditable.

Mr. J. Riva:

No, no.

Deputy P.J.D. Ryan:

There is an added -- I mean, as RUDL would have been --

Mr. J. Riva:

It becomes an absolute cost --

Deputy P.J.D. Ryan:

Is there any danger from a competition perspective that these companies say "Oh well, sorry"?

Mr. J. Riva:

We are moving into areas where I am certainly not all that competent to comment, but I was always led to believe that these companies are the market makers in relation to pricing and if their cost base increase then prices are going to increase. If they increase prices so will most places, most competitors.

Deputy P.J.D. Ryan

They have the market power.

Mr. J. Riva:

Yes.

Senator B.E. Shenton:

You could argue the same with the RUDL charge?

Mr. J. Riva:

Undoubtedly, yes, undoubtedly. The problem is, we are not saying that, well: "You should be better off because you are 20 per cent -- not paying any Jersey tax", because a number of these institutions are structured as branches of UK companies, so whether they pay 20 per cent in Jersey, 10 per cent in the UK or zero per cent in Jersey and 30 per cent in the UK is neither here nor there. So I do not think --

Deputy P.J.D. Ryan:

So again your view is the same, which is this notion that companies have a trading advantage over Jersey companies, similar companies, is in fact not really based on any logic.

Mr. J. Riva:

Yes, exactly, exactly. But there will be some companies -- if you are a company in Jersey and you are owned by a UK company, there are various anti-avoidance rules in the UK which try to deem those profits to be that of a company under the CFC provision, but most of those pass because they are true Jersey companies, they are trading in Jersey. No, I can see there being advantage in them not paying

any Jersey tax, because year one they do not pay a dividend, year 2 they do not pay a dividend, year 3 they do not pay a dividend, year 4 they want to repatriate the funds so they cease trading, liquidate, move their profits out, move their company out, liquidate the company and therefore you can repatriate your funds tax free. So, yes, there is an advantage but we have got to go back. We have decided to go to zero corporation tax, so because of that decision it does not mean that we can replicate what we had previously. There are going to be winners on this and I think it is just something we need to accept.

Senator J.L. Perchard:

Staying on the RUDL, why do you think in the Zero Ten design proposal document it was proposed to exempt the financial service industries from a RUDL charge?

Mr. J. Riva:

I would expect that... Financial services companies pay 10 per cent and it is important that that 10 per cent is a credible tax. Now, a possibility could have been that financial service companies pay the RUDL charge and then through a complicated process they could offset that RUDL charge against their corporation tax. Economically to that company it ought to be the same. So instead of £1 million of solely corporation tax they pay £900,000 and £100,000 RUDL charge. Economically they have continued to paying £1 million. But they have suddenly only got credible tax of £900,000 because that RUDL is not credible. So to ensure that there is credible your primary tax must be corporation tax, but corporation tax is after the event, so it is after you have earned your profits you pay your corporation tax. The RUDL charge is before the event and so it will be very difficult to have a credit against your RUDL charge for your corporation tax and for that reason it was felt that as the companies are paying 10 per cent then they ought to be zero rated.

Senator J.L. Perchard:

I must admit to being confused by that because it obviously would come off their bottom line, so they would not actually be paying a charge, assuming they were making profits. What did cross my mind was the fact that they may not be paying 10 per cent. The implication of them not being liable to a RUDL charge is that there may be an opportunity for them to avoid paying this 10 per cent.

Mr. R. Teather:

Are you saying that actually it's not a Jersey problem, it is a UK problem?

Senator J.L. Perchard:

I believe so, yes.

Mr. R. Teather:

That if they have £1 million Jersey corporation income tax, but they actually then offset £800,000

RUDL charge and only pay £200,000, the UK might only give them £200,000 credit against the UK corporation tax.

Senator J.L. Perchard:

Exactly.

Mr. J. Riva:

Which I think is the case if we had one. I would be surprised --

Deputy P.J.D. Ryan:

Because it can't be a tax – it's not counted as a tax?

Mr. J. Riva:

I do not think it is. It is a charge.

Deputy P.J.D. Ryan:

But we can do anything in our own domestic tax system and give them something to be offsetable, at a personal level.

Mr. J. Riva:

Well we can, yes. And that is why the LTP was born. If it is a look through, the profits of the LTP will be taxed on the individual and he will be able to offset the RUDL charge from his personal tax liability and so economically the RUDL charge falls away.

Deputy G.P. Southern:

Can I take us on to a slightly wider scope, looking at the objectives, why we are doing Zero 10, we are talking about we are competitive with Isle of Man, Guernsey, for example. How do you see these measures in terms of competition?

Mr. J. Riva:

I suppose if you go into detail one could say that we are not quite as competitive as the Isle of Man and Guernsey in so far as my understanding of the Isle of Man and Guernsey proposals, always bearing in mind that the Guernsey proposals have not gone into as much detail as we have, despite the fact that they will be moving to a Zero 10 one year earlier than us, my understanding is that they intend to tax at 10 per cent only banking activity other than the third banking activity so that means that trust companies will be taxed at zero per cent while trust companies in Jersey will be taxed at 10 per cent. So there is obviously a competitive issue there. The question, I think, once again you as politicians need to consider and us, as the industry, need to pass on to you is whether that would mean that our trust

industry would start to gravitate towards Guernsey. My view, and this is my personal view, is that for existing trust companies which do not have a presence in Guernsey I very much doubt that the extra 10 per cent will mean that they will sack all their staff in Jersey, they will get rid of their leases in Jersey and set up business in Guernsey merely for the extra 10 per cent if the cost of relocating is far greater. My concern, if there is a concern, is that where you have an international company with operations both in Jersey and Guernsey whether the business would gravitate towards Guernsey - the new business this is - and not Jersey. And I think that this comes to a suck it and see type of approach. It is easier to move from 10 to zero rather than zero to 10. What I mean by that is I think it is appropriate for Jersey to set the level at 10 per cent and see what happens. If we do find that businesses are going to move to Guernsey then we can reduce that tax rate to stop it if we so choose. I find it rather difficult if we were to settle at zero per cent now and then note that no business has moved and then we try to move it up to 10 per cent, so I think the approach is right, is my view.

Deputy G.P. Southern:

In terms of competition, it is argued that the Isle of Man is in a completely different economic position to us and can afford to do what it likes with its business tax and that in fact in joining the competition it is the race downward, the downward spiral. We are going to end up being the loser.

Mr. J. Riva:

I agree that the Isle of Man is a totally different economic model. I think with VAT at 17½ per cent I think people look at them and say: "If only." I think: "Thank God we don't have that."

Deputy G.P. Southern:

And a good deal with customs and excise...

Mr. J. Riva:

Exactly, exactly, there is that, because I think one of the reasons why the Isle of Man does not have a fund industry is because of VAT. The reason why Jersey and Guernsey have a fund industry is because we do not charge VAT so we do have a totally different economic model. We have headquarters in Jersey and that is so, so important because with headquarters we have the capital. With the capital effectively it is free interest which we are taxing. We need to safeguard that. The battle is not fought in the States; it is actually fought in the boardrooms of trying to decide where to locate their head offices, and we have done extremely well on that and I think we need to maintain that. I think 10 per cent is a good figure. I am not that convinced that a company would try to reallocate a headquarters merely because of 10 per cent. I think once you go below 10 per cent then it is not all that material. The 10 per cent seems to hit a chord and at the moment I would be disappointed if we did try to move to zero per cent for a number of the other finance companies.

Deputy G.P. Southern:

Is there a possibility in the future - are we heading towards zero zero?

Mr. J. Riva:

I cannot answer that. I think our approach of seeing how things move is the right approach. Once again, to move back to what I said previously, I think we do need to grow the economy but I do think it has got to be a targeted growth and it has to be growing the taxed economy. And for that to happen we have got to have some taxes.

Senator B.E. Shenton:

Can I just ask about IBCs, because there is a big gap on IBCs. There is no solution for them as yet is there?

Mr. J. Riva:

Well, there are some solutions. They are not totally adequate, but there are solutions. If it comes to KPMG there are. [Laughter]

Senator B.E. Shenton:

They talked about having a cap which is one idea, I think the industry would prefer to have a two tier system.

Mr. J. Riva:

This is a problem with -- perhaps we went a step too far in 1998 where we introduced Article 123(b)(3)(a) where a company could actually choose its tax rate. But we need to take a step back. We had a fantastically flexible regime. We could have a company which pays zero. We could have a company which pays 1 per cent, 2 per cent, 3 per cent all the way up to 100 per cent, we had an amazingly flexible machine. Now we have 2. We have zero and we have 10 per cent. Having said that, if you have zero and 10 per cent then you still have some form of flexibility. And I would expect that as long as it is done sensibly, as long as the Comptroller continues to administer the tax law on a sensible and commercial basis, that we can still attract the big players who will bring business and will therefore bring taxes to the Island. I am still quite ...

Senator B.E. Shenton:

What you're saying is within an entity they'll have a chance it will be 0 a chance it will be 10 and the result will be two?

Mr. J. Riva:

Exactly.

Deputy G.P. Southern:

Are we then in danger of being accused of returning to the old situation and we are bang up against compliance?

Mr. J. Riva:

You need to look at why the Zero 10 model works in accordance with the code, and once again this is my personal view, is that our general rate is zero. Now, one clever thing which has not really been picked up in this proposal is the definition of resident includes not only Jersey incorporated companies, which is 30,000-odd companies, but also those companies that are managed and controlled in Jersey. And that will include a great number of BVI companies and foreign incorporated companies, which we have never really monitored. And they could be as much as -- for every Jersey company there could be 5, there could be 10. So suddenly our population of companies which are subject to that general rate of zero is not 30,000. It could be as much as 150,000-200,000. I really do not know what the figures are but there is a great amount of companies and suddenly only those companies who are subject to 10 per cent will be very, very much in the minority. We are only talking about 1,000-2,000 and compared to the 150,000 it is a very, very small amount of companies that are subject to 10 per cent. So I think that is why the Zero 10 model actually works, because the general rate is clearly zero per cent and it is only a small proportion of companies that are 10, so it is very difficult for someone to say: "Well, the actual rate is 10 per cent and we are giving an advantage to other companies at zero." So I think it will be quite difficult for the code, in accordance with their current principles of evaluating the measures, to say that our Zero 10 is not in compliance with the code. If you share the same views.

Senator J.L. Perchard:

Are you aware of how much the Treasury is trying to raise through the Zero 10?

Mr. J. Riva:

I am not. I do not really have the figures to hand.

Senator J.L. Perchard:

Not sure if they are.

Mr. J. Riva:

It is a difficult position. We have operated in an environment where data has not been collected because we did not really need it. Also the data which is collectible for control of income tax is always out of date data because of the way we tax companies. On a prior year basis, at best we are going to have data 2 years old.

Deputy G.P. Southern:

You did refer to suck it and see previously. Is that what we are doing now? We are told that we have a black hole a certain size and we're going to raise so much but infact that's very much finger in the air.

Mr. J. Riva:

All I can say is, thank God we are not in Guernsey. I think our provisions at least are -- there is some scientific way of saying that we are going to get most of it. I think the GST is an extremely important part of that Zero 10 model, I have spoken previously. I think it is the other section towards it and it is the safeguard for the suck it and see approach.

Deputy G.P. Southern:

You mentioned earlier there are winners and winners, there are in fact losers in the sense that Jersey residents are actually going to be paying refunding through GST and the other measures the drop in income tax. Is GST the way to do that?

Mr. J. Riva:

That was a facetious comment, for which I apologise. I think it is. I sat on a few of the working parties in 1999 chaired by Colin Powell, and it is quite extraordinary but the first meeting we had Colin pointed out the inequity between direct tax and indirect tax and said it needed to be addressed. And he later said that he had actually stated this back when he first started in the 1960s and 1970s and everybody ignored him. But I do feel we need to address that balance between indirect and direct and GST seems an method.

Deputy G.P. Southern:

Previously I believe you said we have a fund industry because we have no VAT.

Mr. J. Riva:

Well, the Isle of Man are in sync with the UK and so prior to a certain date which was within 6 or 7 years ago management fees were VATable and so the Isle of Man did not have that fund industry because they had to charge VAT at 17½ per cent or whatever the rate was at that time on the management fees. We have the ability to design our GST in accordance with our industry, not accordance with the UK industry, and so we are in a unique position where we can mould the GST to where we want it to fall.

Deputy G.P. Southern:

In terms of flexibility GST/VAT is the flexible tax instrument isn't it?

Mr. J. Riva:

Exactly, yes, very much so.

Senator J.L. Perchard:

Going back to Patrick's earlier question about the ability to mould GST and how it overlaps with an opportunity to perhaps extract some tax from non-locally-owned trading businesses on the Island, would you give some thought to the opportunity and perhaps consider over the next week or 2 if there is possibly an opportunity here to develop the GST system or proposals that could do that. If you could come up with anything we would be very grateful to receive it. It has just been thrown up in the air this morning, as you rightly suggested, and it has sort of caught us all on the hop a bit. It is an area I certainly am interested in and will be asking Richard if he could give that some thought, because the target is right, it is just achieving what we are trying to do without too much complication.

Mr. J. Riva:

I will but I would say that I think you need to bring in some economic modeller who would actually look at the economic impact of placing an extra cost on these businesses.

Senator J.L. Perchard:

Yes I understand the Treasury is undertaking that at the moment of course but they probably will go straight on to the price of goods.

Deputy P.J.D. Ryan:

In the same way as RUDL.

Senator J.L. Perchard:

That is fairly true.

Deputy G.P. Southern:

You talked about IBCs balancing their activities so that they ended up paying a lower rate than 10 per cent tax, to what extent do you see all of those businesses that are supposed to be paying 10 per cent rebalancing, splitting, using transferred pricing, forming subsidiaries so that they minimise their turnover?

Mr. J. Riva:

I think if you are just looking at Jersey in isolation, the majority of international companies can radically reduce their Jersey tax bill, but they do not, mainly because in doing so they would find that they would have UK issues and I go back to what I said before about controlled foreign companies legislation, a lot of these banks do not have, their profits are not imputed to their shareholder, their corporate shareholder, because they are a truly banking operation. If they were to operate a subsidiary and drop down the

profits into that subsidiary, then that subsidiary would, I would expect, be subject to the CFC provisions and the profits would be imputed up to their parent and taxed at 30 per cent. So, yes, they would lose their Jersey tax bill but they suddenly have a larger amount of UK tax. I think I am right in saying, as I say I do not deal with all of the non-UK banks, but a number of the ones I deal with do pay tax at less than 10 per cent. And most of those of the ones I deal with have been grandfathered to 2011 and this is because tax to them is an absolute cost. There is various participation exemption in their home jurisdiction and so as long as they pay some level of taxation at the moment then there is no imputation to the UK or the dividends are not taxed when they do make dividends to the home jurisdiction. So tax is a cost for them and 2011 there will be a substantial increase in their taxation bill. Now, I expect that they would want to have some form of planning to reduce that and what we spoke of may assist them. But I think overall corporates do understand there is a balance to have. They do use Jersey resources, they do need to ask the Jersey government to employ staff, they do appreciate that if they are not a good corporate taxpayer then perhaps those requests may not be honoured. So there is a balance and I think and I hope that the majority of the banks and trust companies and fund managers do honour that balance.

Senator J.L. Perchard:

I think we are probably going to wrap it up unless there is anything that we have missed, John, that you would like to ...

Mr. J. Riva:

No, no. I just reiterate that although we concentrated on the points where I feel may need to change, overall I would like to applaud the Treasury and Resources for actually at last giving us some details.

Senator J.L. Perchard:

That's right. Thank you. It has been very helpful and if you do get some ideas on the aforementioned replacement to RUDL to help us with £5 million worth of revenue it would be welcomed, I am sure. Thank you very much and I declare the session closed.