STATES OF JERSEY

GOODS AND SERVICES TAX: EXEMPT OR ZERO-RATED ITEMS

Lodged au Greffe on 4th July 2006
by Senator S. Syvret

STATES GREFFE

PROPOSITION

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

to refer to their Act dated 13th May 2005 in which they approved the introduction in 2008 of a broad-based Goods and Services Tax (GST) at a rate of 3% fixed for 3 years, and to agree to vary tha decision in order to exempt or zero-rate the following items –

(a) basic foodstuffs;

(b) medical services and products;

(c) education fees;

(d) child care costs;

(e) life insurance policies;

(f) books and newspapers;

(g) children's clothing.

SENATOR S. SYVRET

REPORT

Much has been written about the Goods and Services Tax (GST) and attempts to exclude certain items from the scope of the tax. I have produced 2 previous reports and propositions on the subject and the then Finance and Economics Committee produced 2 sets of comments on each of those proposals. Having re-read the comments of the then Finance and Economics Committee one is struck by 2 notable features of that Committee's arguments.

The first is the attempt to deny that GST is inescapably regressive. The Committee grudgingly had to state that the GST might be slightly regressive, but went on to cite ideologically extremist claims that sales taxes were not regressive at all. I will return to the issue of regressiveness later.

The second notable feature of the arguments put forward against zero-rating or exclusions within GST was the implicit notion that there was simply a single correct way to raise additional taxes and, more particularly, to structure this type of sales tax. Consequently, the Committee simply asserted that every alternative tax raising suggestion was, *ipso facto*, wrong.

If we are to have an honest debate about these questions we must recognise that any number of approaches to taxation would work. The States Assembly could agree with the GST as presently proposed. The resultant system would work. Alternatively, the States Assembly could agree with zero-rating items as I propose. The resultant system would also work.

In truth, the preference for one approach or the other is largely ideological. Politically I prefer a more progressive approach to taxation in which any increased tax burden is more proportionally directed at those in society who could afford to pay more. The previous Finance and Economics Committee had the opposite ideological view, instead believing that companies, the rich and the finance sector should be spared – as far as possible – any increased tax burden, so as to "not damage enterprise". There has also been a very clear view in certain political circles – though rarely, if ever, spoken publicly – that the tax burden should be more directed at the great majority of ordinary people and the less well-off, in order to teach them a lesson and punish them for expecting high standards of state provision in such areas as education and health care. It is not uncommon to see politicians in other jurisdictions using such mechanisms to seek to recruit ordinary people to the cause of cutting the quality and quantity of state sector provision thus reducing the need for taxation. Such an approach reached a nadir with the ill-fated U.K. 'Poll Tax', a tax mechanism that shared a key characteristic of GST in that the tax bore no relation whatsoever to a person's ability to pay it.

The impacts of GST:

This is not to suggest that only working-class people need protection from the full effect of GST. Many people who might be classified as middle-class because of their household income, will be hit by GST on unavoidable expenditure in addition to such measures as 20% means 20% (although this has been modified somewhat to reduce its impact) and the removal of allowances. To take an example, many families shoulder the cost of sending their children to private education establishments. Many such families can barely meet this cost. It is not uncommon for a couple to do 2 or 3 jobs between them to raise the money needed to pay schoo fees, but they do so in an attempt to give their children a good start in life. As presently proposed, the GST will be levied upon education fees – this additional burden at a time when massively increased costs for tertiary education are likely to arise in the next few years. Should we really be taxing education?

Child care costs are another area we really need to question. The Island economy depends upon a high mobilisation of its workforce. Far greater numbers of women, as a proportion of population, work in Jersey than in virtually any other jurisdiction. Yet we will all be familiar with the fact that child care costs incurred when parents work can easily wipe out the advantage of additional earnings. What is already a marginal decision for many parents will become even less attractive with the cost of GST placed on child care costs.

Many families have to face the consequences of caring for elderly or infirm relatives. The cost of such care can be very high. Residential care home rates can be significant. Although some charitable sector residential care homes may charge around £345.00 per week, these costs are rare and are levied upon clients who remain fairly independent with low levels of needs. The usual average range for care home costs is between £550.00 to £1,000.00 per week. Nursing home care, which of its nature has to be more intensive for high-need clients, can cost in a range of £1,000.00 to £1,200.00 per week. In some cases the cost of such care is met by the state. In others, the individual concerned will have to pay the cost themselves with savings or the realisation of equity in property. Or their families will pay the costs. It is quite bad enough putting a 3% tax on these services. How bad will it get when the States inevitably raises the GST rate?

Should we tax a person's disposable income – or all of their income?

As presently posited, the GST proposal raises no tax upon the sometimes large sums that wealthy families are able to save. If income exceeds your expenditure, you will save the surplus. As it is not being spent you will pay no GST on it. By way of contrast, lower income families who spend all of their income – because they have no choice – will pay GST upon their entire post-tax income, with the sole exception of rent, because they have to spend it all. This is regressive taxation and, it has to be said, a concept the Treasury appears to have great difficulty coming to grips with.

The former Finance and Economics Committee stated that GST is to be viewed as a 'proportional tax upon consumption'. As such, they claim that it is, at worst, only "slightly regressive". They are simply wrong in this claim.

1: Regressiveness is measured in relation to the proportion of *income* taken in tax, not consumption.

2: Consumption as a proportion of income always falls (when measured across populations as a whole) as income rises, because people with higher incomes save, when those on lower incomes tend not to save, or even spend in excess of their earnings.

3: It follows that consumption taxes are regressive. If you are spending all, or in excess of your income, as many of the poor have to do, you pay a significantly greater proportion of tax upon your income. GST must, by definition, be regressive.

Given the fact that poorer people will often have to spend all of their income – or indeed, in excess of their income, thus going into debt – the GST will be highly regressive upon this cohort. By contrast as income increases, the amount taken in GST as a proportion of income will decrease given the significant opportunities for saving enjoyed by those on higher incomes. Thus GST meets the classic test of regressiveness. The attempts by the Treasury to deny or play down this fact simply cannot be taken seriously. If States members are minded to support the approach favoured by the Treasury, they must openly acknowledge they are favouring a regressive tax structure that will be disproportionately burdensome upon the poor and less well off. To fail to make this acknowledgment would be simply dishonest.

Low income support to the rescue?

The GST as proposed will be an unavoidable tax upon essential purchases. The less well-off in our society will have no choice other than to pay this new tax – a tax not based upon the ability to pay – but yet levied upon food, medicines and education costs.

It is at this point in the argument that opponents of zero-rating items in GST wheel out that ubiquitous panacea for all social hardships – the Low Income Support scheme. This scheme, it is claimed, will protect the poor. Perhaps. It just might protect the very poorest. But let us at least be honest. Many people to whom the GST will be a burden will not be remotely close to qualifying for Low Income Support. The very reason GST is being introduced is for it to raise a very significant amount of tax. If this were not the case, we wouldn't be doing it. Therefore, even if we accept, for argument's sake, that the very poorest will be protected by Low Income Support, the new tax will be a new and additional burden upon the great majority of people in our society. Proportionately, its impact will be smaller upon the wealthy, as they save a far larger proportion of their income, yet the impact upon the great majority of ordinary working people in our society will be larger. Whilst we might successfully protect the very poorest, we must also recognise that people, who will not be even close to qualifying for benefits, often struggle financially in Jersey. It is not uncommon for couples to do 3 or 4 jobs between them in order to make ends meet. Even if we protect the poorest, let us not pretend that this tax will not add to the burden of the less well-off. It certainly will.

GST and the labour market:

The hope has been expressed in political circles that the new cost burden of GST will not lead to corresponding wage and salary inflation. The words 'naivety' or 'wishful thinking' scarcely do justice to such a failure to grasp political realities. Employees will, of course, seek increases in their pay in order to compensate them for the additional tax. It may be asserted that employers need to ‘stand firm’ and not acquiesce to such workforce expectations – but is it not somewhat dangerous to base the success of a new taxation policy solely upon employers ability to withstand a new level of industrial dissatisfaction and unrest? We must be clear about this; for GST to achieve its objective it must not drive wage inflation. If it does, its gains are severely depleted. Demands for higher levels of pay will be far more difficult to resist if GST applies to food, medicines, health care and education. Expecting no wage inflation may be a forlorn hope in any event, but such inflation could only be minimised if we chose to exempt essential items from GST.

The minimum wage and failure in the labour market:

The cost of living in Jersey is extremely high, yet many businesses in Jersey depend upon comparatively cheap labour. Consequently, low wage employees will often not earn enough to cover the real market cost of living in Jersey. Taxpayers will often make up this shortfall in necessary income through a variety of mechanisms. Thus the ‘commodity’ of cheap labour in Jersey is subject to an artificial market intervention by the state. Taxpayers’ money is used to subsidise those businesses that cannot – or will not – pay their staff the real market cost of living in Jersey. There are 3 very significant examples of this phenomenon. Private sector rent rebate, public sector rent abatement and – most significantly – social security supplementation; this latter in the region of £50 million per annum. Certainly, to a limited extent, the ubiquitous Low Income Support wil step into the housing costs arena. Some accommodation cost relief will still be available to the poorest, but the likelihood is an increase in rental costs for much of the renting market as a result of benefits reform. Either way, the present market structure remains problematic. Subsidising rent is a continuing burden upon central taxation – and very probably inflationary. Yet some social groups who will be on low incomes will have subsidy removed during benefits reform. Whilst rent is to be exempt from GST, we are nevertheless facing increases in cost of living when GST is enacted. This fact, coupled with a possible loss of housing subsidy for certain groups of employees, will add to salary and wage demands.

It could be strongly argued already – without considering GST – that the market failure in the labour sector should be addressed with appropriate policies. The most obvious solution is to require employers to actually pay their employees the real market cost of their labour through the mechanism of the minimum wage – paid at a rate that reflected the true cost incurred by that labour in living in Jersey. If this market policy was employed, the current spend of tax payers money on subsidising labour could be dramatically reduced, probably to the tune of many millions of pounds a year.

The relevance of benefits versus minimum wage to the GST debate is this: if GST is applied across the board – on essentials such as food and medicines – market factors swing more and more towards a substantially higher minimum wage – one that reflects market reality – and away from Low Income Support which – unless its cost is to be vast – will be narrowly targeted at the very poorest. To stand any chance whatsoever of minimising the impact of GST on the labour market, essential purchases must be zero-rated or exempt.

3% – but for how long?

In defending the GST much store has been placed upon the promise that the rate will remain at 3% for 3 years. This may well be the case. But then what? Once the initial resistance to the introduction of a sales tax has been overcome and the population has had a few years to get used to it, the rate will certainly be raised. This fact is strenuously denied by proponents of the GST who claim the rate will remain low indefinitely. But you would have to think the public very stupid if you expected this claim to be taken seriously. Even comparative information produced by the former Finance and Economics Committee – in which they sought to demonstrate that non-exemption was the most common approach to sales taxes in 25 European jurisdictions – showed basic rates of sales tax ranging from 15% (the lowest!) to 25%. If, as the Treasury would have it, the Jersey GST follows a similar model to the European norm – with a minimal approach to exemptions or zero-rating – what chance of the rate remaining at 3% here? Virtually nil. The fact is that sales taxes are one of the very easiest taxes for governments to raise the rate of. Once the public are used to the idea, it is extremely easy to add a couple of percentage points to the rate each year. We must look at the medium and long term when considering the impact of GST. The reality is that once the 3 years have expired the States will begin to raise the rate. Where will it end up in 10 years' time? 5%, 8%, 10%, 12%? In case anyone regards these figures as unduly alarmist remember this – the dominant European model preferred by the Treasury has – as a minimum – a basic rate of 15%.

By carrying out calculations based upon a GST rate of 3%, attempts are made to demonstrate the resultant tax burden to be slight and negligible. There are 2 failings with this approach. Firstly some States members and political commentators suggest that £200 or £300 a year – here or there – is really no big problem and nothing to get alarmed about. This attitude displays a serious ignorance of the high costs of living in Jersey for people on comparatively low incomes. It is not an exaggeration to say that some individuals and families experience real financial hardship. To some States members such sums may appear to be no more than would be spent on a good meal at a high quality restaurant in St. Helier. To some families the additional labour or cost-cutting needed to find these sums will genuinely lower their quality of life. Secondly, it would clearly be imprudent, unwise and wholly unrealistic to base our decisions in respect of GST upon wildly optimistic assumptions concerning the rate of 3%. The States Assembly must learn to be more long-term in its thinking; we need to proceed on the assumption that the rate will be raised – perhaps significantly if we consider the European comparisons favoured by the Treasury.

Pensioners: the most vulnerable group?

Given the reality that the GST will rise 3 years after its introduction, we must consider the impact on pensioners, many of whom will be on fixed incomes, struggling already to deal with a cost of living higher than central London. It will be bad enough to put 3% on their unavoidable expenditure, let alone the inevitable increases in GST that will be added to essential purchases in the future. In fairness, the very poorest will receive some support in the form of Low Income Support, but many pensioners will remain in a poverty trap, whereby they may have worked hard and have some savings. Their circumstances will prevent them from qualifying for Low Income Support.

How do we compensate for income lost by zero-rating?

If the zero-rating of the proposed items is agreed there will be a loss of revenue from the GST and some additional administrative cost. It is reasonable to assume that this loss of tax revenue will need to be recovered in some way if present States budgeting is to be maintained. It is worth repeating that there are many different approaches to taxation that would work, and the approach that individuals prefer will largely depend upon their political predisposition. Of course some extreme approaches to taxation bring with them profound difficulties. For example, 'old' Labour style tax and spend policies of the 1970s brought the country's economy to breaking point. One could be forgiven when considering comments from bodies such as the Institute of Directors, and the Chamber of Commerce that Jersey's taxation policies are similarly extreme. The reality is almost the complete opposite. Tax take as a percentage of GDP in Jersey is extremely low; if anything it could be argued that we have an under taxed economy leading to excessive inflation. Consider the following figures –

Country	*Taxation as % of GDP*
EU 15 average	40.6%
OECD average	36.3%
UK	35.8%
USA	26.4%
Guernsey	26.8%
IOM	40.7%
Jersey (pre-tax changes)	21.8%
Jersey (post-tax changes)	20.9%

(2002 figures supplied by the Economic Adviser to the States)

Of course the way in which these taxes are raised and the distribution burden will differ from jurisdiction to jurisdiction. But what the figures demonstrate is that the total tax burden in Jersey is the lowest of these jurisdictions. This means we can consider other tax raising mechanisms of modest proportions, to raise any revenue lost through zero-rating. What might that mechanism be? If essential items were zero-rated, a suggestion is that the rate of GST on remaining items would need to be raised. This is not my favoured option, but it is an approach that would certainly be a workable solution. It would make the GST less regressive as the higher rate would be on far less essential items. Thus those who may be struggling financially could spend on unavoidable items such as health care, basic food stuffs and child care costs, without being taxed on that expenditure. With a higher rate on non-essential items, those with disposable income will be taxed more on non-essential goods and services of the kind that people on higher incomes purchase. Nobody likes taxes, but this approach would be fairer. Raising the rate of GST in this way is of course the Treasury's preferred option in the event of zero-rating being agreed. However, it is not the only option for raising additional revenue and many other mechanisms could be used. Some of these mechanisms are not liked by some States members whose ideological beliefs have led them to reject such proposals in the past. Such Political rejection does not though mean such taxation options are unworkable or unworthy of further consideration.

Such alternative ways of raising tax revenue could include –

- • An income tax surcharge;
- • Adjusting the Social Security system to be more self-sustaining, to reduce or even phase out the £50 million per annum of central tax revenue the States spends on supplementation;
- • Development taxes;
- • Windfall tax on commercial property speculation;
- • Land Value Tax (The Treasury has yet to produce its paper on LVT);
- • Closing of tax loopholes and avoidance mechanism.

These are just a few of the possible approaches to raising additional tax revenue. There will be others. The key point to remember is that the total tax take in Jersey as a percentage of GDP is very low by European standards and lower than both Guernsey and then Isle of Man. Claims that we have no choices available to us when needing to raise taxes simply just don't wash. If the States of Jersey was so minded it could make its tax proposals less regressive – less targeted at the poor – and more progressive – better targeted at those actually able to pay slightly more tax. If the Island's government continues to take a regressive approach to GST – it is because it *wants* to – not because it *has* to.

The zero-rated items:

The proposition asks that we agree to zero-rate the following goods and services:

(a) basic foodstuffs;

(b) medical services and products;

(c) education fees;

(c) child care costs;

(d) life insurance policies;

(e) books and newspapers;

(f) children's clothing.

Food

The cost of basic foodstuffs in Jersey is already very high. This is one of the reasons why comparisons to tax on foods in other jurisdictions are simply not credible when considered in the context of Jersey. Western society has a growing range of health problems related to diet and poor lifestyle. Generally, people are not eating enough fruit and vegetables. We should be encouraging healthy diets, not taxing them. People simply have no choice other than to buy essentials, for example, bread, meat, dairy products, fruit and vegetables. GST on these products is an unavoidable tax on the very foodstuffs people need to eat in a healthy diet. Tax junk food by all means – but don't tax a healthy diet.

Health

It is interesting to note that the comparative information produced by the then Finance and Economics Committee showed that sales taxes upon medical services and dental care was extremely rare, and of the 27 jurisdictions cited by the Committee only 5 had sales tax upon such services. 22 of the jurisdictions exempted medical and dental care entirely. In respect of pharmaceutical products only 7 of the 27 jurisdictions cited charged a sales tax at the full rate upon such products. Nearly ¾ of the jurisdictions applied a reduced rate upon pharmaceutical products – in some cases zero. It has to be remembered that many of these jurisdictions have an extensive range of social benefits in excess of that available in Jersey – there is a better safety net; and the cost of living in Jersey is higher than in any of the 27 jurisdiction cited. The Treasury has repeatedly asserted that "complexity" is to be avoided. If that is the case, it is extremely difficult to see any merit in having different rates of GST for different items. For example a full rate of 3% (or 5%, 10% or 15% in the long term) and a rate of, say 1.5% (or 4%, 7% or 9%) on pharmaceutical products. If we wish to reduce the impact of the GST upon the less well off, we may just as well exempt or zero-rate such items entirely. This would be far less complex than a multitude of differing rates upon a multitude of differing products.

In medical services and products, for the avoidance of doubt, I include such items as residential and nursing home fees, aids to mobility, such as wheelchairs etc, and products and services specific to helping people with disabilities. I make this point now to avoid future argument, as many disabilities may not be regarded as "medical" issues by some. Nevertheless, living with a disability can be extremely expensive. Have things really got to such a point in the extremely rich community of Jersey that we have to start taxing wheelchairs, bed hoists and hearing aids?

Education

Education fees and child care costs are extremely important to many Islanders from all walks of life. Many families make great sacrifices to send their children to the many fee-paying educational establishments in Jersey. It has been argued to me that the state sector in Jersey is extremely good. Yes, this is the case; nevertheless many people for differing reasons prefer to send their children to fee-paying institutions. It needs to be remembered that if hundreds of such parents could no longer afford the fee-paying sector because of rising rates of GST on school fees, a far greater cost burden would fall onto the States education system. It should also be recognised that many parents, whose children will be at either fee-paying or state sector schools, will feel that their children may need some additional educational assistance and development in certain subjects, perhaps those the child may be struggling with at school. A number of individuals offer such additional tuition professionally. I do not believe it acceptable to place GST on such services.

Child Care

The States has a specific strategic aim to increase the working population. This objective has been re-iterated in the recent proposal to expand the retail sector in Jersey. In both cases it is claimed that the great majority of this labour will be found within the local population as opposed to massed inward migration. If this objective is to be met, we need to make it easier – not harder – for parents to work. Child care costs for working parents can already be so prohibitive as to make it not worthwhile to bother working. How wise can it be to start taxing such a service?

Life insurance

Life insurance policies represent a wise and sound investment for people to make. I do not believe taking up such policies should be discouraged by the application of GST.

Knowledge

The vast majority of books and newspapers sold in Jersey come from the United Kingdom, where no VAT is applied to them. Of the 27 jurisdictions cited by the former Finance and Economics Committee, only 4 applied sales tax to books at the full rate. The remaining 23 jurisdictions apply *significantly* reduced rates on books – in some cases zero. This reflects the importance that civilised countries have long attached to knowledge, learning and self-betterment. Similar arguments apply in this case as in the proposed tax on pharmaceuticals: In Jersey's circumstances, it is easier and less complex to simply zero-rate such items rather than initiate a system of complex different rates.

Children

Children's clothing is an example of goods which simply have to be brought; parents have no choice other than to clothe their children. Some have suggested that of all the goods and services we might zero-rate, this is the least important. That is not a view I agree with. Indeed it is likely that a tax on children's clothing will be one of the most regressive aspects of GST as many wealthier families – those who may travel to the U.K. often – will simply buy their children's clothes there where no VAT is applied. Poorer parents in Jersey will not have this luxury of avoiding GST. It is, of course, imaginable that the States of Jersey plan to employ an army of Customs officers to stop and question every family returning to Jersey to demand that they pay the GST on their children's clothes or confiscate them. Such an approach would be highly intrusive and extremely expensive. It is also very difficult to imagine this state of affairs being remotely acceptable to the people of Jersey. Indeed, similar, though perhaps less intrusive, customs and excise issues arise with other goods. It will be very interesting to see the full costs of port enforcement of GST.

Is GST a disproportionate tax upon the immigrant community?

As a general point on the regressiveness of GST, it has to be noted that many of the poorest working people in Jersey are first- or second-generation migrants. We therefore need to be conscious of any potential racist impact of regressive tax burdens placed upon the poor. As explained previously, a GST without exemptions is regressive because the poor have to spend all of their income, whereas the wealthy can save. Given that working migrants already run the risk of being exploited through accommodation costs and poor quality employment opportunities, in addition to being exposed to a cost of living greater than central London, the States should be very conscious of the risk that pursuing the present highly regressive approach to GST could be seen as an unfair – even calculated – targeting of a tax burden upon the immigrant community.

Financial and manpower statement

There will certainly be a cost in zero-rating the items suggested in this proposition. There will also be some additional administrative cost involved in the zero-rating process, though I am deeply sceptical of the cost of this latter factor cited by the Treasury and their consultants. Jersey already has purchase taxes upon some goods and not others, for example duty on motor fuel, alcohol and tobacco products. This approach to taxing some goods and not others appears to have worked perfectly acceptably for many decades without the need for a massive and expensive bureaucracy.

In respect of the GST revenue which would be lost in the event of zero-ratings, any number of options exists for recovering this amount. Other approaches to taxation could be adopted as described above. What is a plain and immutable fact is that the States could zero-rate items if they chose to. If the States Assembly refuses to zero-rate these items it will be because it *wants* to – not because it *has* to.