States of Jersey

THE ZERO/TEN DESIGN PROPOSAL

0/10%
0/10%
0/10%

Treasury & Resources Department
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How to make your views known

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1 Executive summary

1.1 Summary of the Zero/Ten Design Proposal

1.1.1 The Island has undertaken to implement a 'zero/ten' tax system for companies from 2009 and it is proposed that this will be achieved by introducing a *standard rate of corporate income tax* of 0% and a *special rate of corporate income tax* of 10% into the Island's existing schedular tax system, as opposed to developing an independent corporation tax regime or creating any new schedules specifically for companies (section 14).

1.1.2 Utility companies will continue to be charged at the standard rate of income tax of 20% (section 18)

1.2 Look through

1.2.1 It is proposed that 'look through' be introduced for investment holding companies, but not for trading companies, owned by Island residents.

1.2.2 'Investment company' will be defined to prevent Island residents using companies with only ancillary or incidental trading activities (and potentially subject to the 0% rate of corporate income tax) to avoid tax on investment income (section 10.1).

1.2.3 It is also proposed that a new partnership trading vehicle, the 'limited trading partnership' ('LTP'), analogous to the UK LLP, the French SARL and the US LLC, be introduced into the Island's legislative framework for use by businesses trading in the Island. In common with the fiscal treatment applied to these analogous foreign vehicles, the LTP will be taxed on a look through basis whilst conferring limited liability on its member(s) (section 10.4). The LTP may have one or more individual or corporate members and would be available to residents and non-residents.

1.3 Application of the special rate of corporate income tax of 10%

1.3.1 A small proportion of companies can be subject to the 10% special rate of corporate income tax under the zero/ten system and it is proposed that the 10% rate will apply to 'specified financial services companies' (section 11.2).

1.3.2 Specified financial services companies will include *inter alia* banks, trust companies, collective investment fund functionaries (but not funds or fund managers), investment managers and brokers.

1.3.3 It is also proposed to introduce the concept of a 'specified financial services group' whose members will be taxed at the 10% rate (section 11.3). Financial services groups will be able to elect for this status.

1.4 Regulation of Undertakings and Development ('RUDL') charge

1.4.1 All businesses licensed under the Regulation of Undertakings and Development Law will be assessed annually to a RUDL charge based on their licensed headcount on 1 January each year (section 16).

1.4.2 The rate of charge will be determined by the RUDL sector and the median charge will be £500. The rate of charge for specified financial services companies will initially be set at zero.

1.4.3 The charge will be creditable against the income tax liabilities of sole traders, general partners and the partners of LTPs. The charge will not 'flow through' as a credit against the income tax liability on distributions to Island resident shareholders of companies subject to the standard rate of corporate income tax of 0%.

1.5 Extended basis of taxing rents and property development gains

1.5.1 Schedule A (the schedule under which rental income from Jersey property is currently taxed) will be extended to include all property development gains currently assessed as trading profits (section 17).

1.5.2 Rents, premiums and property development gains assessed under the extended Schedule A will be assessed on all taxpayers at a new Schedule A rate of 20%.

1.5.3 The exemption from income tax currently afforded to foreign charities and superannuation funds will be withdrawn (section 17.5). However, it will be open for

them to establish themselves in the Island as exempt charities or superannuation funds.

1.5.4 A form of non-resident landlord scheme will be introduced which will be backed up with a 20% withholding tax on rents paid to non-residents who fail to meet their compliance obligations (section 17.6).

1.6 Shareholder taxation measures

1.6.1 Shareholder taxation measures are proposed, designed to avoid trading profits being rolled up and extracted tax free by individuals resident in the Island, as follows:

- The definition of distribution will be extended to catch any withdrawal of trading profits whether by way of capital distribution, sale of shares or liquidation (section 26.3.8).
- A deferred distribution charge will be introduced which will effectively charge interest on the deferral of distributions (section 26).
- A deemed distribution charge will be introduced where trading profits have not been distributed within three years to avoid indefinite roll up (section 24).
- Article 134A will be extended to catch a 'series of transactions' rather than being limited to an isolated transaction (section 30).
- Anti-avoidance measures will be reviewed to cover situations where companies are owned by offshore trusts and/or companies (section 29).
- A five year re-entry charge will be introduced where distributions are received by temporary non-residents (section 27).
- The current 'benefits in kind' rules, appropriately modified, will be extended to shareholders (section 25).

1.7 Technical reforms

1.7.1 A number of technical reforms to the existing tax system will be made:

- Repeal of Article 123A i.e. the exempt company regime (section 13) together with the obligation of collective investment funds to withhold tax on dividends paid to Island residents;
- Withdrawal of Concession 60 relating to Foreign Incorporated Investment Companies (section 6.4);
- Repeal of Articles 86, 87 and 88 in respect of withholding tax on interest, annuities and dividends for companies other than insurance or superannuation companies (sections 7.8 and 7.9) ;
- Introduction of the concept of exempt income for non-residents in respect of interest (including bank interest), annuities, dividends and management fees (section 21);
- Introduction of statutory group relief for specified financial services groups (section 7.10);
- Extension of Schedule D Case VI to include dividends which currently are assessed as taxed at source income (section 7.2) ;
- Inclusion of the definition of permanent establishment found in Article 123A in the general income tax law (section 8.1).

2 Introduction

2.1 The EU Tax Package

2.1.1 The United Kingdom Government has requested the Crown Dependencies, including Jersey, to assist its endeavours to secure application within the European Union ('EU') of the components of the EU Tax Package.

2.1.2 The United Kingdom Government has stated its belief that these endeavours depend, inter alia, on the Crown Dependencies voluntarily co-operating with the requirements of the Tax Package, principally:

- The Council Directive on the Taxation of Savings Income (the 'Directive')
- The Code of Conduct on Business Taxation.

2.1.3 The Island of Jersey has agreed to play its part in a global approach to what are deemed to be harmful tax practices. In doing so, the Island is mindful of the following:

- The Island attaches overriding importance, in common with the position adopted by EU Member States and other jurisdictions in respect of their own fiscal affairs, to safeguarding its economic interests.
- The Island therefore attaches great importance to the implementation of the EU Tax Package initiatives on a level playing field basis covering, in particular, those countries with which the Island is materially in competition in the provision of cross-border financial services.
- The Island is not in the EU or the EU's fiscal territory and is not able to benefit directly in the Single Market, particularly in respect of the market for financial services.
- The Island is also in competition with Luxembourg and Ireland as EU Member States, Switzerland as a named third country, the dependent and associated territories of other Member States and other financial centres such as Hong Kong and Singapore in the provision of cross border financial services. Regard therefore needs to be had for the nature and timing of the action to be taken by these jurisdictions as well as by those Member States that have tax measures in place that compare with those in Jersey.

2.2 The Code of Conduct

2.2.1 It is generally recognised that the removal of the tax measures listed in the Code of Conduct Group ('the Group') report will have a far more significant effect on the Island's economy and tax revenues than would be the case with the removal of the measures in the EU Member States.

2.2.2 The Island has also concluded that in order to adopt the full removal of the tax measures listed in the Code a fundamental restructuring of the Island's tax system is necessary. This restructuring has been factored in to Jersey's ongoing fiscal review and has encompassed a radical shift from direct to indirect taxation, in the form of a Goods and Services Tax ("GST") to be introduced from 2008, in order to secure a substantial reduction in the rate of corporate tax as one way to satisfy the principles of the Code and at the same time safeguard the Island's future competitiveness.

2.2.3 The Island is aware that notwithstanding its fiscal reforms, the Island needs to be able to maintain the present level of expenditure on essential public services such as health and education.

2.2.4 The Island is aware of the experience of other jurisdictions which indicates that radical changes in the tax system cannot be planned and executed other than over a considerable time period. This also recognises that many businesses have set up in the Island on the basis of the Island's history of fiscal stability. These businesses have good reason for expecting adequate time to adjust to any material change to the tax system.

2.2.5 **In order to comply with the Code the Island has committed to introduce a zero rate of tax for all companies (other than companies in certain sectors), referred to in this Proposal as the 'zero/ten system'.**

2.3 Timetable for introduction of the zero/ten system

2.3.1 The proposed zero/ten system will be implemented with effect from the financial year 2009.

2.3.2 In order to achieve this implementation date the following provisional timetable is proposed:

Milestone	Target date	Responsibility
Finalise the Zero/Ten Design Proposal	May 2006	Treasury & Resources Minister
Begin consultation period with industry representative bodies and other parties	May 2006	Treasury & Resources Minister
Views of HM Treasury on proposals to be sought	31.05.06	Treasury & Resources Minister
End consultation period	30.06.06	Treasury & Resources Minister
Present to the States for approval	mid-August 2006	Treasury & Resources Minister/ States Assembly
Instruct law draftsman	mid-April 2006	Income Tax Department
Finalise law draft	30.09.06	States Law draftsman
Law approval by States of Jersey	December 2006	Treasury & Resources Minister/ States Assembly
Law approval by Privy Council	2007	Law Officers Department
Commence development of compliance systems for the Income Tax Department	2007	Income Tax Department
Finalise compliance systems for the Income Tax Department	2008	Income Tax Department
Publish explanatory booklet for the zero/ten system	2008	Income Tax Department

2.3.3 The rationale for this timetable is to end uncertainty for businesses operating in the Island and their clients as to the design of the zero/ten system and its impact on them and to enable the planning forward process to begin in 2007 for the introduction of the zero/ten system in 2009.

2.4 Statutory basis for the introduction of the zero/ten system

2.4.1 The Minister for Treasury and Resources will present his Budget at the beginning of December 2006.

2.4.2 The Assembly of the States of Jersey will be asked to pass a Finance (Jersey) Law 2006 and an Income Tax (Amendment No 2-)(Jersey) Law in December 2006 which will make amendments to and keep in force the Income Tax (Jersey) Law 1961 until subsequently amended. The States will also pass an Acte Operatoire to determine the commencement date of the parts of the Finance (Jersey) Law 2007 relating to the introduction of the zero/ten system as 1 January 2009.

3 The Code of Conduct on business taxation (the 'Code')

3.1 Background

3.1.1 The Code deals with, in the main, two concepts: rollback of harmful tax measures i.e. eliminating any harmful measure identified by the Group; and standstill i.e. commitment not to introduce new measures which are viewed to be harmful.

3.1.2 The Group, without prior consultation with the Island authorities, identified four harmful tax measures in the Island, which in its assessment required rollback:

- the exempt company;
- the international business company;
- international treasury branch operations that permit computational tax deductions; and
- captive insurance companies.

3.1.3 The Code also stipulates that the Member States must commit not to introduce new tax measures that are viewed to be harmful.

3.1.4 The Island has agreed to co-operate voluntarily with the Code process and this Proposal recommends ways to adapt the Island's income tax system in such a way as to deliver the political commitment given by the Island in 2003 in this regard.

3.1.5 When considering reform of the Island's tax system it is essential to adhere to good tax system design principles. Any reform of the tax system needs to acknowledge that the Island's public services are available primarily to its residents and should be funded primarily by them.

3.1.6 The States of Jersey recognises that, as outlined above, the Code, which covers business taxation, is concerned with measures (which include both laws or regulations and administrative practices) that affect, or may affect, in a significant way the location of business activity in the EU.

3.2 Code criteria

3.2.1 The Code outlines the various criteria that need to be taken into account when assessing whether a tax measure, which provides for a significantly lower effective level of taxation than those levels that generally apply in the EU, is harmful. These criteria are, *inter alia:*

- whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents;
- whether advantages are ring-fenced from the domestic market so they do not affect the national tax base;
- whether tax advantages are granted without any real economic activity and substantial economic presence within the Member State offering such advantages;
- whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD;
- whether the tax measures lack transparency, including where legal provisions are relaxed at the administrative level in a non-transparent way.

3.3 Jersey positive evaluations under the Code

3.3.1 The Group considered a number of exempt and offshore companies including the Jersey exempt company and the Jersey international business company ('IBC'). In giving the Jersey exempt company and the Jersey IBC positive evaluations (i.e. they are contrary to the principles of the Code), the Group took particular account of whether some or all of the following features were present:

- the benefits are restricted to companies with non-resident shareholders;
- no business with local residents is permitted or no business undertaken with local residents qualifies for the exemption;
- the measure is targeted at mobile capital.

3.3.2 In addition, the Group suggested that IBCs have in the past been used to counter controlled foreign company rules in the country of the parent. (It must be recognised that a Jersey IBC can no longer be used to counter the UK controlled foreign legislation.)

3.3.3 The Group has agreed to leave out of account for the time being the assessment of collective investment funds (paragraph 28 of the Code).

3.3.4 The Code applies solely to business activities. However, business activities are given a wide definition and include, inter alia, trading and investment activities. It has been suggested that any activity of a company would be viewed as business and therefore caught by the Code.

3.3.5 The recommendations in this Proposal seek to lead to legislation to deliver the commitment given by Jersey in 2003 and which was accepted by the European Council of Ministers ('ECOFIN') on 3rd June 2003 consequent upon the recommendation of the Group.

4 Scope and objectives of the 0/10% proposal

4.1 Scope

4.1.1 The scope of this Proposal is to develop the means of implementing the zero/ten system committed to by the States of Jersey to comply with the requirements of the Code for consideration and, if approved, implementation by the States of Jersey.

4.1.2 The scope does not extend to

- Drafting legislation

  However, the Proposal should enable the Comptroller to requisition such legislation. It therefore includes a first principles review of the conceptual architecture of the existing tax system as it impacts companies and how it will require amendment to implement the zero/ten system.

- International loan business

  This regime is now unusual and relates, in the main, to historical business. It has now been abolished.

- Captive insurance companies

  There are relatively few captives in Jersey, and no further captives are allowed after 1 January 2006.

- Position of IBCs 2009 – 2011

  The position of IBCs in the transition years 2009 – 2011 is subject to agreement on a case by case basis with the Comptroller and is not impacted by the zero/ten system during this period. This Proposal does not therefore address the position of IBCs during the grandfathered period.

- IBC regime

  The IBC regime is grandfathered until 2011 for existing beneficiaries i.e. those with an IBC agreement in place at 31 December 2005. For those beneficiaries the regime will expire commensurate with the expiry of their individual agreements and will be ultimately abolished by the repeal of Article 123C in the 2012 Budget.

- Banks: maximum tax charge

  Banks may be subject to a maximum tax charge from 2012. The issues surrounding such capping are not addressed in this Proposal. However, it is considered that such capping would be Code compliant and could be subject to a variable upper limit capable of annual amendment by the States. Any such proposed ceiling would be of the order of £70 million.

4.2 Objectives

4.2.1 The objectives of this Proposal are to determine:

- the means to roll back the harmful tax measures identified by the Code, i.e. the exempt company regime, which will satisfy the Code's rollback criterion;
- the means of introducing the zero / ten system which will satisfy the Code's standstill criterion whilst maintaining the Island's competitive position in the provision of international financial services;
- the means of preventing tax avoidance by Jersey resident companies and individuals which arise from the introduction of the zero/ ten system;
- the compliance requirements for companies and individuals under the zero/ten system which satisfy the transparency criterion of the Code and enforce the anti-avoidance measures.

4.3 References

4.3.1 All references to "Article [ ]" or to "the Law" are references to the Income Tax (Jersey) Law 1961, as amended.

4.3.2 All references to "Concession [ ]" are references to the Comptroller's *Concession and Practice* booklet.

4.3.3 All references to "the Comptroller" are references to the Comptroller of Income Tax found in Article 6 of the Law.

4.4 The zero/ten system

4.4.1 The zero/ten system is a tax regime for corporate taxation where the general rate of tax for companies is 0% but a certain restricted sector is subject to a 10% special rate which, in the case of the zero/ten system introduced for the Island, would be companies referred to as 'specified financial services companies' (section 11).

4.4.2 It is proposed that utility companies continue to be charged at the standard rate of income tax of 20% (section 18).

5 The architecture of the Island's tax system

5.1 The legal basis

5.1.1 Tax is charged by the Law which is updated by amendment by the Assembly of the States of Jersey annually, normally in December to take effect the following 1 January.

5.1.2 There are very few decided tax cases either before the Commissioners, the Royal Court or the Privy Council. The Comptroller would generally refer to UK decided cases when considering matters of general principle with respect to making assessments.

5.1.3 The Comptroller has published a booklet of extra-statutory concessions and application of fiscal rules, *Concession and Practice*, which together with a number of other published concessions, includes all of the concessions currently available.

5.2 The schedular basis

5.2.1 Income is subject to a 'charge of income tax' under Article 1 if it falls within one of the Schedules A or D. The schedules subject all Island sources of income to tax regardless of the residence of the owner of the source. This approach is known as the 'source basis'.

5.2.2 There is no separate residence criterion for chargeability outside the Schedules.

5.2.3 There is no tax on capital gains, short term gains or land development gains unless these can be considered to form a trade.

5.2.4 Under Article 22 income to be charged to tax under Schedules A and D is assessed by the Comptroller.

5.2.5 There is no separate schedule to tax employment income which falls under Case II of Schedule D.

5.2.6 There is no separate tax to tax the income of companies. However, companies can elect to fall within the exempt company regime, which is discussed in section 13 below.

5.3 Schedule A

5.3.1 Article 51 introduces the charge under Schedule A which charges the annual profits or gains arising in respect of rents or receipts from interests in land in the Island. It does not include development profits which are currently assessed under Schedule D Case I.

5.3.2 The charge applies to residents and non-residents unless specifically exempted e.g. UK charities and superannuation funds under Article 115. There is no statutory mechanism for collecting tax on rents paid to non-residents and it has been estimated that a significant sum of tax is not being collected from non-resident landlords (see section 17 below).

5.4 Schedule D

5.4.1 Article 61 introduces the charge under Schedule D:

The Schedule referred to in this Law as Schedule D is as follows –

Tax under this Schedule shall be charged in respect of –

(a) the annual profits or gains arising or accruing –

(i) to any person residing in Jersey from any kind of property whatever, whether situate in Jersey or elsewhere,

(ii) to any person residing in Jersey from any trade, profession, employment, vocation or office, whether carried on in Jersey or elsewhere, or from any pension, whether arising in Jersey or elsewhere, and

(iii) to any person, whether a British subject or not, although not resident in Jersey, from any property whatever in Jersey, or from any trade, profession, employment, vocation or office exercised within Jersey, or from any pension arising in Jersey;

(b) all interest of money, annuities, and other annual profits or gains not charged under Schedule A, and not specially exempted from tax; and

(c) all sums paid to an individual or an individual's personal representative pursuant to Article 131D or 131E other than a sum applied in the purchase from an authorized insurance company which is unconnected with the individual of a lifetime annuity payable to the individual or, on the individual's death, to the individual's spouse or dependent,

in each case for every one pound of the annual amount of the profits or gains

5.4.2 Under Article 62, Schedule D charges ‘annual profits or gains’ under one of six cases based on the nature of the activity or property giving rise to the profits or gains:

- Case I - trades carried on in Jersey or elsewhere; however, if the trade is carried on entirely abroad it will be assessed under Case V (as in the United Kingdom);
- Case II - professions, employments, vocations or offices exercised within and pensions from the Island;
- Case III - interest, annuities and other annual payments; discounts; interest paid by savings banks; foreign pensions;
- Case IV - foreign securities;
- Case V - foreign possessions; trades carried on entirely abroad;
- Case VI - any other annual profits or gains; international activities of international business companies.

5.4.3 The schedular basis has been consistent with the tax system of the United Kingdom. Following the introduction of the Income Tax (Trading and Other Income) Act 2005 in the United Kingdom, as part of the tax law rewrite programme, the schedular basis has been superseded for individuals. Schedule D Case I, for instance, is replaced by the concept of ‘trade profits’. However, the schedular basis still provides the basis for United Kingdom corporation tax.

5.4.4 **It is proposed that the schedular basis be retained as the basis for the taxation of companies.**

6 Disclosure and returns

6.1 Income basis for individuals

6.1.1 Jersey resident individuals are only required to return their taxable income on their tax returns. There is no requirement to disclose the assets or activities which form the source of that income, other than trades, or the acquisition or disposal of such assets or activities.

6.2 Prevention of tax avoidance by individuals

6.2.1 There is no equivalent to the United Kingdom's 'tick the box' disclosure in respect of assets transferred abroad or interests in foreign companies or trusts.

6.2.2 There are no specific anti-avoidance charging or disclosure rules for individuals investing in 'roll up' investment vehicles such as insurance bonds or accumulation collective investment funds. When individuals disclose investment in such vehicles the Comptroller will agree a 'deemed distribution' rate and capital base which determines the assessment.

6.3 Corporate returns

6.3.1 All companies incorporated in the Island or becoming domiciled in the Island are issued with a Form 46A-1 by the Comptroller on which the company 'ticks the box' either to apply for exempt company or IBC status or to confirm that it is an income tax company.

6.3.2 Income tax companies and IBCs must annually thereafter file accounts, tax computations and a short form tax return. If the company has no gross income in a year it may file a nil return without submitting accounts and tax computations.

6.4 Foreign incorporated investment companies ('FIIC')

6.4.1 FIICs resident in the Island by virtue of being managed and controlled in the Island can, under Concession 60, file a one-off certificate whereupon they will be by concession exempt from income tax. At present no central register is maintained by the Comptroller for FIICs.

6.4.2 Under the zero/ten system FIICs will be subject to the 0% corporate income tax rate and therefore the exemption granted under Concession 60 will no longer be required.

6.4.3 **It is therefore proposed that Concession 60 be withdrawn.**

6.4.4 One of the prime drivers for FIICs being incorporated in jurisdictions such as the BVI or the Cayman Islands is the current requirement for disclosure of beneficial ownership of a Jersey company to the JFSC. With the proposed amendment to this requirement in Jersey from 2007 onwards (see note below) the Island intends to encourage the use of Jersey incorporated companies rather than FIICs.

6.4.5 **It is therefore proposed that JFSC licensed service providers administering FIICs should self assess an annual corporate residence fee of £150 as agent for the FIIC. A schedule of the names of the FIICs and the self assessed fees would be filed annually in January of each year with the Comptroller.**

6.4.6 It would be open to the regulated entity whether to pass the fee on to the FIIC or its beneficial owner(s).

6.4.7 Full 'know your client' procedures would be applied to the beneficial owners of FIICs by the licensed service providers but, in line with the current practice for FIICs seeking Concession 60 exemption, this information would not be disclosed to the Comptroller.

Note: Under the planned change of policy regarding disclosure of beneficial ownership for Jersey companies it will be mandatory to hold the identity of the beneficial owner at licensed service provider level and for it to be accessible by the JFSC on specific request. Failure to comply with the request or non-availability of the relevant details may give rise to regulatory sanction as yet to be fully specified in Companies Law amendment No. 9 which is currently out for consultation.

7 Taxation of companies and shareholders

7.1 Companies generally

7.1.1 There is currently no separate tax for companies.

7.1.2 Until 31 December 1988, companies incorporated in Jersey were liable either to income tax, if resident in Jersey by virtue of being managed and controlled in the Island, or a flat rate corporation tax of £500 per annum, if resident outside the Island. Non-resident companies were liable to income tax on Jersey source income under the Schedules with the exception, by concession, of bank interest.

7.1.3 Companies registered in the Island avoided becoming resident in the Island either by appointing a majority of directors in a zero tax jurisdiction (such as Sark and so being resident in Sark) or by having peripatetic board meetings (and so avoiding being resident anywhere).

7.1.4 From 1 January 1989 (as the same time as the exempt company regime was introduced) under Article 123(1) companies registered in Jersey are resident in Jersey unless they elect to be treated as exempt companies:

> Except as provided in Article 123A of this Law, a company incorporated under the "Loi (1861) sur les Sociétés à Responsabilité Limitée" shall be regarded as resident in the Island, and a company incorporated outside the Island shall be regarded as resident in the Island if its business is managed and controlled in the Island.

7.1.5 There is no exit charge for companies becoming non-resident.

7.2 Dividends

7.2.1 Dividends paid by Jersey resident companies are franked at 20%, regardless of the income tax paid by the company, subject to a net effective rate adjustment if the company tax charge has been reduced by a double tax credit. The net effective rate limits any repayment claim to the Jersey tax actually paid but otherwise the dividend is treated as being franked at 20% for the purposes of satisfying the shareholder's liability to tax.

7.2.2 Article 88 is designed to protect the directors of a company paying a dividend by allowing them to deduct tax at the 20% rate from the dividend in order to have funds to meet the company's liability to income tax on the income from which the dividend is being paid. The tax is retained by the company to meet its normal income tax assessment rather than being paid over to the Comptroller at the time deducted.

7.2.3 Jersey companies therefore operate a full 'imputation system' of corporate taxation (as opposed to a classical system, see section 7.2.10) whereby if a company distributes 100% of its after tax income either no further tax is payable by the shareholder or a reclaim can be made e.g. by an exempt charity or an exempt superannuation plan.

7.2.4 Under an 'imputation corporate tax system', if a company fully distributes its after tax income, the company effectively pays no tax *per se* and its assessed liability amounts to a payment on account for its shareholders. If the shareholder is exempt or partially relieved from tax then the company's profits bear no tax proportionately.

7.2.5 There is no statutory machinery to ensure symmetry between the tax paid by a company and the tax credited to the shareholder either as to timing (e.g. a dividend paid on 31 December 2005 can be subject to a tax reclaim in January 2006 albeit that the profits for the year ended 31 December 2005 will form the basis for the 2006 assessment for which the tax will be paid in 2007) or amount (e.g. a receipt treated as income for accounting purposes may be treated as capital for tax purposes and distributed fully franked at 20% when in fact no tax has been paid in respect of that receipt by the company). However, other than in the small number of cases where a repayment claim is in point, this is currently fiscally neutral.

7.2.6 Under Article 114(4)(b) of the Companies (Jersey) Law 1991, as amended, "references to profits and losses of any description are to profits and losses of that description ascertained in accordance with generally accepted accounting principles". Under Article 114(2) distributions may be made out of

realised revenue or capital profits or unrealised revenue profits.

7.2.7 Distributions are assessable as income under the principle found in *Reid's Trustees v Commrs* (1929) 14 TC 512 even if the source of the distribution is capital in nature rather than income. The franking of distributions at 20% under the Island's imputation system as discussed in section 7.2.5 above means that capital profits arising in the company do not suffer tax in the hands of the shareholder(s). Under the zero/ten tax system tax will be payable (and a deferred distribution charge levied, see section 26 below) on distributions to shareholders rather than on the tax adjusted profits of the company and so tax potentially would become payable by shareholders on capital profits.

7.2.8 **It is therefore proposed that distribution vouchers should include a split between the revenue and capital elements of the distribution and that only the revenue element be subject to income tax at 20% in the hands of the shareholder.**

7.2.9 In order to calculate the deferred distribution charge distributions must be matched with 'profits'. The question therefore arises whether such profits should be the distributable profits of the company or its tax adjusted profits.

7.2.10 Under a 'classic corporate tax system' a company pays tax on its profits which is not imputed to its shareholders and in addition a withholding tax may be applied to dividends. The introduction of a dividend withholding tax into the Island's tax system would severely prejudice the tax neutrality of companies currently applying for exempt company status which will become companies subject to the 0% rate under the zero-ten system.

7.2.11 The repeal of Article 123A (see section 13) will eliminate the requirement for collective investment funds to withhold tax on dividends paid to Island residents under Article 123A(1)(6).

7.2.12 **It is therefore proposed that the current imputation system be retained and that no dividend withholding tax be introduced.**

7.2.13 There is no specific schedule or case for dividends (unlike the United Kingdom where UK dividends were assessed under Schedule F). Dividends paid to shareholders are assessed as 'income taxed at source' under general principles.

7.2.14 Under the zero/ten system dividends will not be taxed at source at the 20% rate and in the case of specified financial services companies will be taxed at source at the 10% rate.

7.2.15 **It is proposed that Schedule D Case VI be amended to include dividends paid by companies resident in the Island.**

7.2.16 Non-resident individual shareholders can make proportional allowance claims under Article 106 to recover all or part of the tax credit.

7.2.17 For corporate shareholders the tax credit represents a final tax and there is no mechanism for repayment unless the company is exempt from tax e.g. a personal pension plan (which must be in the form of a company which applies annually for exemption).

7.2.18 Dividends are not included in the UK / Jersey Double Tax Agreement. United Kingdom corporate shareholders would claim unilateral relief for Jersey tax suffered on dividends (UK Income and Corporation Taxes Act 1988 s.790) against their corporation tax liability on the dividend.

7.2.19 There would be no change to the principles of this process under the zero/ten system.

7.3 Jersey resident shareholders of non-resident companies

7.3.1 A Jersey resident shareholder of a non-resident company, whether closely held or open / public, would only be taxed on receipt of dividends from the company.

7.3.2 It is therefore open for a Jersey resident to conduct a foreign trade or hold foreign investments or property through a foreign company and avoid an assessment to Jersey

income tax. Furthermore it would be open for the individual to take loans from the company, sell shares in the company or to liquidate the company (any distribution by a liquidator is a capital distribution under general principles) without any charge to Jersey tax.

7.3.3 The Comptroller in practice may rule that a company with one or more Jersey directors and one or more Jersey resident shareholders was resident in the Island. Whilst this approach may be effective for family or closely owned companies it would prove more difficult in a consortium (albeit private) type ownership arrangement.

7.3.4 The Comptroller could invoke Article 134A against such an arrangement. However, if the company had been set up before the individual became resident in the Island, and was not set up in contemplation of so becoming, or there was genuine commercial and/or regulatory reason for doing so, the Comptroller would find it difficult to apply Article 134A.

7.3.5 The Comptroller has not historically made rulings in this area or applied Article 134A. There is no reliable estimate of the number of such companies and the tax avoided by their use.

7.3.6 If the company were paying tax in a foreign territory other than the UK or Guernsey the tax would be available for deduction but not credit offset (Jersey has no statutory unilateral relief) against any Jersey liability and so would suffer double taxation. For example if the profits were £100 and suffered foreign tax of 30%, its Jersey tax liability would be £100 less £30 @ 20% = £14 i.e. a total tax rate of 44%. The impact of such double taxation would be a considerable incentive not to disclose such interests and to implement a zero dividend policy.

7.3.7 **This situation is not impacted or exacerbated by the introduction of the zero/ten system and any measures which are deemed appropriate to prevent tax leakage in this respect are outside the scope of this Proposal. However it is suggested that a 'tick the box' approach be introduced with immediate effect to identify cases for enquiry by the Comptroller.**

7.3.8 Concession 23A provides for unilateral relief to be given under certain conditions at the discretion of the Comptroller. It is not proposed that any change be made to this concession.

7.4 Jersey resident individual shareholders - 'benefits in kind'

7.4.1 Article 65B and Schedule 3 introduced the taxation of 'benefits in kind' provided by companies to employees and directors from 1 January 2005. The taxable benefits are restricted to accommodation, motor vehicles and boats and aircraft (with exceptions).

7.4.2 Article 65B does not tax benefits provided to shareholders.

7.4.3 One prevalent method for providing funds to shareholders is by way of interest free or cheap loans followed by the release of the loan. Since the loans are funded by taxed income or tax free capital gains these methods do not represent tax leakage under the current tax system.

7.4.4 **However, under the zero/ten system the provision of benefits including loans to shareholders would represent a significant opportunity to avoid tax absent a full look through provision and anti-avoidance measures to prevent this are proposed (see section 25 below).**

7.5 Jersey resident individual shareholders - sale of shares and liquidation

7.5.1 The sale of a company by way of a sale of shares is a capital gain and is not chargeable to income tax. However, since all of its revenue reserves would have been subject to income tax a sale does not represent tax leakage under the current tax system.

7.5.2 The liquidation of a company is a capital gain and is not chargeable to income tax. However, since all of its revenue reserves would have been subject to income tax a sale does not represent tax leakage under the current tax system.

7.5.3 **Under the zero/ten system the above would represent a significant opportunity to avoid tax absent a full look through provision and anti-avoidance measures to prevent this are proposed in sections 22 to 26 below.**

7.6 Non-resident individual shareholders

7.6.1 Subject to a proportionate allowances claim being made to the Comptroller by the individual, the tax credit represents from a Jersey point of view a final tax.

7.6.2 The tax credit may be relieved by deduction or unilateral relief in the UK or elsewhere.

7.6.3 There would be no change in this position under the zero/ten system.

7.7 Non-resident corporate shareholders

7.7.1 The tax credit represents from a Jersey point of view a final tax for a corporate shareholder.

7.7.2 The tax credit may be relieved by deduction, tax credit or unilateral relief in the territory of residence of the shareholder.

7.7.3 The profits of the Jersey company may be subject to tax on the shareholder by way of apportionment under a territorie's controlled foreign company rules.

7.7.4 There would be no change in this position under the zero/ten system.

7.8 Interest

7.8.1 One of the fundamental elements of the Jersey taxation system is the procedure by which certain persons are obliged or entitled to deduct income tax on making certain payments to other persons and either retaining the tax (but then obtaining no further relief for the payment) or accounting for the tax to the Comptroller (and then claiming relief for the payment).

7.8.2 This procedure reflects the fact that it is administratively more convenient, where a payment by one person will become taxable income in the hands of another person, to collect the tax from the payer by deduction rather than the payee by assessment. It also gives relief for the payment to the payee, if the tax is retained, without the intervention of the Comptroller.

7.8.3 Article 86 governs relief by retention, where the taxable profits out of which the payment is made are greater than the payment, and Article 87 assessment by deduction to the extent the payment exceeds the taxable profits.

7.8.4 The payments impacted by Articles 86 and 87 include the yearly interest of money, an annuity or any other annual payment. Interest, other than on grandfathered loan agreements, was excluded from Article 86 from 1 January 2004. Relief is now given by deduction under Article 90. Short interest i.e. interest paid on loans not capable of exceeding twelve months and bank interest do not fall within this scheme.

7.8.5 The scheme applies to payments made by individuals and companies resident in the Island regardless of whether the payee is resident in the Island. The scheme therefore assesses non-residents on interest income arising in the Island analogous to the tax credit on dividends since the tax deducted, whether retained by the payer or paid to the Comptroller, represents a final tax for the payee subject to the same repayment conditions as for the dividend tax credit.

7.8.6 Paragraph 2 of Article 87 requires that the payer shall "forthwith" deliver an account to the Comptroller and the Comptroller shall raise an assessment on him. In reality the payer may not know until after the year end whether he has sufficient income in charge to cover the payment and in practice individuals deduct tax at the time of the payment but are unaware at that time as to whether they are making deductions under Article 86 or 87 and most taxpayers are probably unaware that there is a distinction. Any assessment under Article 87 (what is referred to as a retainable charge assessment) is usually made through the normal annual assessment process.

7.8.7 Under the zero/ten system corporate payees will be chargeable to tax at 0% or 10% in respect of interest receipts.

7.8.8 **It is therefore proposed that Article 87 be restricted to payments made by individuals resident in the Island in respect of interest and annuities and life assurance companies and trustees of superannuation funds resident in the Island in respect of annuities.**

7.9 Royalties

7.9.1 Articles 86 and 87 apply to patent royalties but not to copyright royalties.

7.9.2 The same comments made above in section 7.8 in respect of interest apply *pari pass*u to royalties.

7.9.3 **It is therefore proposed that Articles 86 and 87 be restricted to payments made by individuals resident in the Island in respect of royalties.**

7.10 Management fees and group relief

7.10.1 Management fees are used to extract profits from companies tax efficiently and to obtain group relief under Concession 23. There is no withholding regime or assessment mechanism for management fees which may therefore be paid by companies resident in the Island to non-residents tax free.

7.10.2 Under the zero/ten system different companies in the same group may be subject to 0% and 10% tax rates. It would therefore be possible to transfer taxable income from the 10% tax regime to the 0% tax regime by using Concession 23. The impact would be particularly acute in financial services groups where non-specified financial services activities are hived down to affiliates.

7.10.3 Whilst concessionary group relief may be appropriate and workable under the Island's current tax system it is not considered appropriate under the zero-ten system.

7.10.4 **It is therefore proposed that statutory group relief be introduced along the lines of Guernsey's Article 142A and that Concession 23 be withdrawn.**

7.10.5 Group relief would only be available between companies in the same group chargeable at the same rate of corporate income tax.

7.10.6 Groups are frequently structured with an investment holding company holding the share capital of a number of trading companies, both resident in and outside of the Island, where the funding for the acquisition of the companies, and therefore the interest charge, is at the holding company level. It is essential that this interest charge be relievable against the group's trading profits.

7.10.7 **It is therefore proposed that statutory group relief be available to investment holding companies that hold only investments in trading companies.**

8 Permanent establishments ('PE')

8.1 Definition of PE

8.1.1 There is no general definition of a PE in the Law.

8.1.2 Article 123A includes a definition of 'established place of business' with respect to exempt companies which is only applicable within that Article:

"established place of business" of a company includes a branch of the business, a factory, shop, workshop, quarry or a building site, and a place of management of the business, but the fact that the directors of a company regularly meet in the Island shall not of itself make their meeting-place an established place of business.

8.1.3 Article 5 of the OECD Model Convention defines a PE:

5(1) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

5(2) The term "permanent establishment" includes especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop, and

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

5(3) A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

5(4) Notwithstanding the preceding provisions of this Article, the term 'permanent establishment' shall be deemed not to include:

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

(f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5(5) Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

5(6) An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

5(7) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

8.1.4 The OECD definition is a highly developed concept that would sit uncomfortably within the Island's tax system. In practice the Comptroller has employed the Article 123A definition. Furthermore the introduction of the OECD definition into the Law would leave the Island with reduced flexibility when negotiating double tax agreements or tax information

exchange agreements. Furthermore, the exclusion of directors meetings is not found in the OECD definition.

8.1.5 **It is therefore proposed that the definition of PE given in Article 123A be reintroduced into the Law following the repeal of Article 123A.**

8.2 Liability to income tax

8.2.1 A non-resident trading in the Island through a permanent establishment, branch or agency is liable to income tax on its trading profits under Schedule D Case I.

8.2.2 The United Kingdom assesses a non-resident company trading *in*, as opposed to *with*, the United Kingdom to corporation tax. Non-trading income arising in the United Kingdom to a non-resident company is assessed to income tax at the basic rate.

8.2.3 Under the zero/ten system the Island is faced with the choice of charging a PE either at the corporate income tax rates or at the standard income tax rate. Since the general corporate income tax rate is 0% it would be inconsistent with good design principles to charge all PEs at the 10% rate which is targeted at specified financial services companies.

8.2.4 On the other hand, to charge PEs at the 20% income tax rate would seem to be in breach of the Code and the anti-discrimination clauses of double tax agreements. It would also mean that those banks which operate through branches in the Island would be charged at a 20% rather than 10% rate.

8.2.5 **It is therefore proposed that the PEs of non-resident companies be charged at the 0% or 10% rates depending upon whether they are carrying on specified financial services activities on the same basis as companies resident in the Island.**

8.2.6 However, the PEs of non-corporates will continue to be charged at the 20% income tax rate in line with Jersey resident non-corporates.

9 Determination of residence for companies

9.1 Worldwide basis versus territorial basis of taxation

9.1.1 Under a worldwide basis of taxation a person resident in a territory is liable to tax on their worldwide income. Under a territorial basis a person resident in a territory is liable to tax only on income arising in that territory. The Island employs a worldwide basis of taxation. Discussions with the United Kingdom Treasury have confirmed that a territorial basis however formulated would constitute rollback under the Code.

9.1.2 Under a territorial basis the determination of the location of the source of income is crucial and systems employed to enforce assessment are usually focused on the payer for goods and services and the application of a 'deemed profits' tax on all taxable payments to payees with no presence in the territory.

9.1.3 Under a worldwide basis the determination of residence and identification of residents are crucial. Historically a test of 'central management and control' has developed in the United Kingdom courts which seeks to determine (1) whether the board or directors manage and control the company and, if so, (2) where they do so.

9.1.4 In the United Kingdom this test has generally been applied to (1) companies registered in the United Kingdom but managed and controlled abroad, (2) foreign subsidiaries of UK companies, (3) foreign companies owned by United Kingdom resident individuals, (4) collective investment funds in the form of foreign companies and (5) foreign companies used by UK persons for tax planning, since in each of these cases there is an audit trail available for the United Kingdom tax authorities to identify foreign companies vulnerable to a residence attack. However, there is no mechanism to identify foreign registered companies which may be being centrally managed and controlled in the UK in cases other than these.

9.1.5 The Island introduced Concession 60 from 1996 whereby if a foreign incorporated investment company ('FIIC') managed and controlled in the Island submitted a certificate to that effect it would by concession be exempt from tax. Under the zero/ten system Concession 60 is no longer required since such companies will be subject to the 0% rate of corporate income tax.

9.1.6 The United Kingdom introduced a registration test for residence with effect from 14 March 1988. UK incorporated companies which were not UK resident on 14 March 1988 might clearly have been at a disadvantage if they had had no time to plan for their enforced change of residence and to revise their business and cash-flow forecasts etc. The discouragement of proper business planning was clearly not an aim of the United Kingdom Government and such companies were in general given a 'breathing space'. The extension of residence did not therefore apply to some companies until 15 March 1993.

9.2 The registration test for residence

9.2.1 The jurisdiction in which a company is incorporated or registered is its domicile. Companies can redomicile and the introduction of taxation for all companies in Ireland saw a large number of Irish exempt companies redomicile to jurisdictions such as the Cayman Islands.

9.2.2 The registration test in Article 123 was introduced by the Island from 1 January 1989, at the same time as the exempt company regime. Under this test all companies incorporated in the Island are resident in the Island

9.2.3 The registration test is unequivocal and non-judgemental and offers a clean audit trail for the Comptroller.

9.2.4 However, under this test a company may have no economic activity within the Island and not be managed and controlled in the Island but nevertheless be subject to income tax on its income in the Island. Foreign taxes paid on this income would not be relievable by credit in the Island since the Island has a very limited network of double tax treaties. The exempt company regime, which is discussed in section 13 below, avoided this consequence.

9.2.5 **The registration test is consistent with modern tax system design principles and it is proposed that the registration test be retained as a basis for determining the residence of a company.**

9.3 The three levels of management and control

9.3.1 For a company engaged in some real activity it would be possible to detect at least three levels of management. Working upwards there might be

(i) 'shop floor' or 'on the spot' management;

(ii) what might, in everyday language, be called the Head Office; the place where you would expect to find the executives and senior staff who actually make the business tick; the people directly giving the orders that govern the company's operations;

(iii) the central policy core of the whole enterprise. This may be indistinguishable from (ii) above or it may not. It may be a passive sort of body merely keeping its eye on things or it may be a very active body.

9.3.2 Central management and control is located at level (iii).

9.4 The central management and control test

9.4.1 The central management and control test is difficult to apply in practice as is witnessed by the long line of cases in the United Kingdom. *(Wood & Anor v Holden (HMIT)* [2006] EWCA Civ 26, handed down on 26 January 2006, is the most recent, decided for the taxpayer.) In particular the perceived weakness of using Sark directors (colloquially known as the 'Sark lark') was overturned in the case of *Untelrab Ltd & Ors v McGregor (HMIT)* Sp C 55 in 1995.

9.4.2 United Kingdom case law defines central management and control in essentially negative terms:

........a significant factor is whether the directors would have declined to do something improper or inadvisable; if they would then this would point towards the conclusion that there was no control by the parent. *(Esquire Nominees (as Trustee of Manolas Trust) v Federal Commissioner of Taxation* [1972])

9.5 The effective management and control test

9.5.1 The principal United Kingdom case on effective management and control is *Trustees of Wensleydale's Settlement v IR Commrs* (1996) Sp C 73, which concerns a trust rather than a company. This test is used by several EU countries and defines management and control as management at level two. The United Kingdom has considered introducing this test by statute but has retained the central management and control, or level three, test.

9.6 The shareholder control test

9.6.1 Guernsey employs a statutory shareholder control test and Concession 60 essentially mirrors the Guernsey position for FIICs.

9.6.2 As noted above, the Comptroller would be inclined to rule that a foreign incorporated company was resident in the Island if a majority of directors and the shareholders were resident in the Island which would not be strictly in accordance with United Kingdom case law where the residence of shareholders and directors may be indicative of management and control being exercised in the United Kingdom but is not determinative.

9.7 Summary

9.7.1 The statutory test of residence in Article 123(1) is "managed and controlled in the Island" and it is therefore open to the Comptroller to apply a wide definition which would include elements of all three tests.

9.7.2 **The management and control test is required for double tax agreement symmetry and as a generally recognised criterion for residence and it is therefore proposed that it should be retained.**

9.7.3 It is not considered that any change is required in respect of the Comptroller's practice in respect of his application of the management and control test as a result of the introduction of the zero/ten system.

10 Determination of profits

10.1 Trading companies versus investment companies

10.1.1 The Jersey tax system differentiates between *trading companies* and *investment companies*.

10.1.2 The differences in treatment between the two types of company are:

- Investment companies are assessed on an 'actual basis' (either pro-rated or on a concessionary accounts basis under Concession 56) and trading companies on a 'prior year basis'. However, it is anticipated that trading companies will be moving on to an actual basis from 2008.
- Interest expense is only allowed against current year investment income in an investment company whereas it is treated as a trading expense in a trading company and can be carried forward or back as a loss.
- Investment companies deduct management expenses against investment income. Surplus management expenses can be carried forward for offset. Trading companies can carry losses back (Article 107) and forward (Article 108) for offset.
- If a company converts between the types of company then either trading losses brought forward or surplus management expenses brought forward would be lost.

10.1.3 Under the zero/ten system there would be a significant tax planning opportunity for Jersey resident individuals who hold significant investment portfolios to transfer them into a company in which investment income could roll up tax free since they would be taxed at the 0% rate.

10.1.4 **It is therefore proposed that a 100% look through be introduced in respect of the gross investment income (without any deduction for interest expense or management expenses) where such companies are owned by Jersey resident individuals.**

10.1.5 **In addition, it is proposed that there would be no grandfathering provisions for existing companies and the provisions should be introduced as soon as practical.**

10.1.6 For the avoidance of doubt pension schemes for Jersey residents approved under Article 131B would not be subject to the look through provisions.

10.2 Computation of trading profits

10.2.1 A company's computation of taxable profit is along the same lines as for a sole trader or partner in a partnership. The computation is based on the accounts profit for a period of account and adjusted for permanently disallowed expenses and for timing differences. Jersey then has a capital allowances code which substitutes a 'writing down' allowance for depreciation. There is no system of first year allowances.

10.3 'Force of attraction' principle

10.3.1 Where a trading company receives investment income or bank interest, other than Schedule A or Case V income, it is treated as part of its trading profits under the 'force of attraction' principle rather than separately assessed under the appropriate Schedule. However, under the zero/ten system the principle would enable shareholders to overcapitalise their trading companies by way of retained profits, share capital or shareholder loans and have their investment income roll up tax free in the company.

10.3.2 One anti-avoidance mechanism would be to introduce limited or 'Schedular' look through in respect of non-trading income. However, this is considered to be impractical.

10.3.3 As discussed above, the Jersey tax system distinguishes between trading companies and investment companies. Profits are retained in or capital introduced to a trading company to finance the working capital and capital expenditure requirements of the company to generate trading profits. Excessive investment income would therefore be indicative of overcapitalisation with the resulting avoidance of taxation.

10.3.4 **It is therefore proposed to introduce a definition of an investment company whereby a company whose trade is in fact ancillary to its investment activity is treated as an investment company and subject to 100% look through.**

10.3.5 The case law on the definition of 'investment company' is not helpful in developing this definition since it is directed at companies seeking to be classified as investment companies rather than companies seeking to avoid being classified as such.

10.3.6 The primary mischief is where companies are overcapitalised and used as zero tax 'moneyboxes' rather than where profits are retained and invested to fund trading activities in the form of working capital and capital expenditure. Therefore a company should only be treated as an investment company where its investment income exceeds the expected yield from the investment of its reserves since this form of retention will be assessed under the deferred distribution and deemed distribution charges (see sections 24 and 26 below).

10.3.7 **It is proposed that a company be treated as an investment company in any year of assessment where its investment income (which would include bank interest) is greater than a prescribed percentage applied to its capital and reserves, excluding loan capital, as measured by its annual accounts. This treatment would be in the year of assessment for which the accounts form the basis of assessment.**

10.3.8 Under this definition a trading company would not fall within the definition simply by virtue of retaining its profits on deposit and can in any case make its position secure by pursuing a full distribution policy. If the distributed funds are required to fund working capital and capital expenditure they can be loaned back to the company.

10.4 'Limited trading partnership' ('LTP')

10.4.1 Various alternative vehicles for conducting trading activities have been developed in countries such as the United Kingdom (the LLP – limited liability partnership), France (the SARL - société à responsabilité limitée) and the USA (the LLC - limited liability corporation).

10.4.2 In the USA, for instance, an LLC is not really a corporation and not really a partnership, but something different altogether. Most US states require there to be two people to form an LLC, but some states allow only one. An LLC has limited liability (hence the name), and unlimited life (i.e., the charter does not expire). An LLC allows for pass through taxation, which means that the income a company makes goes directly to the owners on their tax forms (even if the profits were not distributed). An LLC may have several different classes of stock.

10.4.3 **It is proposed that the concept of a limited trading partnership ('LTP') be introduced to enable local traders avoid the complications and charges associated with using companies as their trading vehicles under this Proposal.**

10.4.4 Businesses currently trading through companies would be able to convert into an LTP without incurring a regulatory establishment charge and with continuity of contract and trade.

10.4.5 It would be possible, as for the LLC, for there to be a single partner in the LTP.

10.4.6 Foreign persons trading in the Island through an LTP would be treated as trading in the Island through a PE.

10.5 Prior year basis of assessment of trading profits

10.5.1 A trading company's profits are assessed on a prior year basis under Schedule D Case I. The logic of this is that a trader's accounts take time to prepare and if, say, the accounts are drawn up to 31 March 2006 (the 'period of account'), then the assessment can be raised early in the year of assessment 2007 since the trader would have had nine months to prepare the accounts and tax computations.

10.5.2 The Island proposes to change to a current year basis of assessment, which will put trading companies on to the same basis as investment companies. It is expected that this basis will

apply from the year of assessment 2008. However, it is envisaged that an accounts basis will apply whereby the 2009 assessment, say, would be based on the accounts ending in that year.

10.5.3 Under the principle in *Duckering (HMIT) v Gollan* (1963 – 1966) 42 TC 333, a distinction must be drawn between the *measurement and assessment* of profits. For instance, if a company becomes resident in the Island in a year of assessment and has been trading for some time, its profits for the period of account ending in the year immediately prior to its becoming resident would form the basis for its first year of assessment despite the fact that those profits arose at a time when the company was not resident in the Island.

10.5.4 **It is proposed that any look through or other assessment of company profits on the shareholders should focus on the profits *assessed* in a year of assessment and not on the underlying profits which form the basis for the *measurement* of those profits.**

10.6 GAAP accounts basis of assessment

10.6.1 There is a worldwide trend towards accepting GAAP based accounts as the measure for taxable profits. However, the Comptroller, especially in the case of banks, rarely seeks to adjust the underlying basis of the measure of profits given in the GAAP accounts and it is not considered that the simple acceptance of GAAP profits without the flexibility to make computational adjustments would be to open the door for sophisticated tax planning.

10.6.2 **It is not proposed that any change be made to the current basis of computing taxable profits for specified financial services companies.**

10.6.3 In the case of 0% rate companies the concept of tax adjusted profits ceases to have any meaning other than as a basis for computing the deferred distribution charge and the deemed distribution charge. Year on year there may be a gap between the GAAP profits and the tax adjusted profits. However, in practice this gap will tend to equalise over the years other than for permanently disallowed expenses or income/capital discrepancies.

10.6.4 The United Kingdom's distributor status rules use a concept of 'UK equivalent (i.e. tax adjusted) profits' when determining acceptable levels of distribution and require a company to distribute 85% of the higher of its accounting profits and its UK equivalent profits subject to any local company law restriction on distribution e.g. until past losses have been fully covered by subsequent profits. In the past this caused problems which have largely disappeared once offshore funds adopted GAAP accounting e.g. in respect of bond accrued income.

10.6.5 In order for shareholders to complete their income tax returns companies issue dividend vouchers whenever a dividend is declared. Collective investment schemes which operate equalisation distinguish on the voucher between income and capital included in the dividend where the investor acquired the shares *cum div* and so the distribution represents in part a repayment of capital (which is generally not taxable). Similarly when an investor redeems his shares the redemption proceeds include an element of accrued income which is identified on the contract note.

10.6.6 Jersey companies currently compute the net effective rate of underlying Jersey tax on their dividend vouchers. The practice of analysing distributions is therefore not novel.

10.6.7 Under the zero/ten system it will be necessary for companies to (1) identify the income profits included in distributions, as opposed to capital profits, and (2) to identify the year to which that income relates.

10.6.8 **It is therefore proposed that the distribution vouchers of companies distinguish between the revenue profits and the capital profits included in the distribution based on GAAP and the year(s) in which the income arose (see also section 7.2.8).**

10.7 'Accounting period'

10.7.1 The UK system of corporation tax is based on the concept of an 'accounting period'. The Isle of Man is also proposing to introduce such a concept. United Kingdom statute also introduces the concept of 'account period' for the certification of offshore funds as distributing funds.

10.7.2 **However, since under the zero/ten system there does not appear to be any requirement for such a concept, it is not proposed that it be introduced into the Island's zero/ten system.**

10.8 Nil return

10.8.1 Many companies at present file a nil return. Corporate and shareholder compliance is discussed below.

10.8.2 **It is proposed that 0% rate companies file a simplified form of return along the lines of the current nil return (see section 31.1 below).**

11 Jersey regulatory and financial services regime

11.1 Focus of the regulatory regime for financial services

11.1.1 The Jersey regulatory regime for financial services is focused on

- corporate ownership
- corporate governance
- client assurance and know your client procedures
- employment of qualified staff and their continuing professional development
- maintenance of capital adequacy.

11.1.2 This can be represented as a silo:

Clients
Licensed Service Providers
Regulated Employees
Principal Persons: Directors
Capital Adequacy Requirements
Principal Persons: Shareholders

11.1.3 The 'walls' of the silo are non-porous in respect of licensed activities. Under the force of attraction principle all of the income arising in the company is assessed under Schedule D Case I.

11.1.4 The Jersey regulatory regime licences companies to provide financial services and grants initial licences based on a review that the business satisfies the criteria set out in the legislation and codes of practice in respect of the above foci and subjects the licensed company to an ongoing compliance regime.

11.1.5 Financial services businesses operating in the Island must also obtain a consent under the Regulation of Undertakings and Development (Jersey) Law, 1973, as amended. The principal foci of this regulation are (1) whether the type of business is acceptable for the Island, (2) the number of staff employed and (3) the economic contribution to the Island. The Department of Regulation and Undertakings will usually depend upon the JFSC in determining (1).

11.2 Focus of the 10% rate

11.2.1 Under the zero/ten system, the profits of a certain relatively small proportion of companies are subject to the 10% rate.

11.2.2 Under this Proposal 'specified financial services' companies would be subject to the 10% rate whilst other companies would be subject to the 0% rate with the exception of utility companies which would continue to be subject to the 20% standard income tax rate.

11.2.3 The question then arises as to whether the definition of 'specified financial services company' should be based at the Regulation of Undertakings and Development level or the JFSC licensing level. Furthermore the question also arises whether there should be income streaming within the Schedules or indeed extensions to or new Schedules specifically relating to specified financial services activities.

11.2.4 **Given the focus of the Island's regulatory regime on corporate activity, i.e. its ownership, its governance, its client contract and contact, its employees and its capital adequacy, it is natural (1) to identify specified financial services companies at the JFSC licensing level and (2) to apply the 10% rate at the corporate level rather than attempt to introduce income streaming at or below the Schedular level.**

11.2.5 It is not considered appropriate to strike the definition of specified financial services company at the Regulation of Undertakings level since this would not be sufficiently precise.

11.2.6 **It is therefore proposed that a specified financial services company be defined as any company licensed, registered or authorised under specified sections of the Financial Services (Jersey) Law 1998 ('FSJL') or the Banking Business (Jersey) Law 1991 ('BBJL').**

11.2.7 Under this definition it is proposed that neither fund managers (by exclusion) nor CIFs (since there is no reference to the Collective Investment Funds (Jersey) Law 1988 in the definition) would be treated as specified financial services companies. The position of fund managers is discussed further in section 12.1 below.

11.3 Support services

11.3.1 Specified financial services businesses, *inter alia* to minimise their regulatory compliance requirements, may set up separate companies within their groups to provide support services to their affiliates and third parties in respect of services such as:

- tax
- IT
- compliance
- property.

11.3.2 Such companies would not be classified as specified financial services companies and so would be subject to the 0% rate of tax. However, the provision of these services would be subject to GST, which it is envisaged would not be reclaimable by the specified financial services company since it is supplying exempt services to its third party clients.

11.3.3 At present the standard GST rate proposed is 3%. However, it is envisaged that financial services companies will not suffer tax on inputs at the full rate but be able to reclaim a proportion.

11.3.4 The GST proposal for businesses operating in the financial services industry is currently under development. It is understood that the proposal does not recommend GST grouping i.e. for inter-group goods and services to be zero rated. The alternative would be for charges made between affiliates to be subject to 3% GST but for such inputs to be subject to 100% recovery i.e. zero degree of 'stickiness'.

11.3.5 **It is proposed that 100% recovery should not be automatic but subject to the companies electing to be in a specified financial services group in which all group companies would be subject to the 10% rate of corporate income tax. The specified financial services group would be identical for GST and corporate income tax purposes. Otherwise these services would be subject to the standard level of stickiness.**

11.3.6 GST suffered on inter-group charges would not be creditable for either resident or non-resident shareholders against their tax liabilities in respect of distributions and therefore specified financial services groups seeking to arbitrage their tax liabilities by hiving activities down to affiliates subject to the 0% rate would incur an absolute tax charge.

12 Companies subject to the 0% rate: special cases

12.1 Fund managers

12.1.1 There are a significant number of regulated fund managers whose activities are 100% delegated which employ no staff in the Island. These fund managers, since they have no established place of business in the Island, currently qualify for exempt company status.

12.1.2 It is common for fund managers to outsource many of their functions both within and without the Island. Such delegated functions include share registrar services, valuations, fund accounting, investment management and custodian services.

12.1.3 **In order to maintain the competitive position of the Island it is proposed that fund managers, but not their functionaries, should *not* be classified as specified financial services companies (as discussed in section 11.2.7 above).**

12.1.4 Where a fund manager does not delegate any functions to a specified financial services company and carries out these functions itself it will be subject to the 0% corporate income tax rate.

12.1.5 Delegated functions are caught since typically these are carried out by specified financial services companies and there is no concept of income streaming under the zero/ten system i.e. a company pays either 0% or 10% corporate income tax on the whole of its income (subject only to the 20% Schedule A rate on its Schedule A income).

12.2 Hived down subsidiaries of specified financial services companies

12.2.1 Specified financial services companies will be in the position of being able to hive down assets (e.g. associated with their reserves over and above the minimum Tier One capital requirement) into a 0% rate subsidiary.

12.2.2 Such a company owned by Jersey residents would fall to be classified as an investment company.

12.2.3 Where the company was owned by non-residents the income arising in the company would be unlikely to benefit from participation exemptions in its home country since there would be no substance in the subsidiary. In any case it is open for such planning to be employed under the current system using a non-resident subsidiary since the Island currently has no controlled foreign company legislation.

12.2.4 **It is not proposed therefore that any specific anti-avoidance measures be introduced to counter this planning.**

13 The exempt company regime

13.1 Rationale

13.1.1 The exempt company regime was introduced in 1989 in part to end the perceived abuse of using Sark directors and to enable companies incorporated in the Island to avoid Jersey income tax on their international activities as a result of becoming resident under the registration test discussed in section 9.2 above.

13.1.2 Both Jersey incorporated and foreign incorporated companies can apply annually for exempt company status which treats the company as not resident, albeit registered and/or managed and controlled in the Island, with the proviso that any Jersey source income, other than bank interest, or profits arising from an established place of business in the Island will be subject to a tax charge.

13.2 Collective investment funds ('CIF')

13.2.1 The introduction of redeemable preference shares saw a shift in the use of the unauthorised unit trust as the vehicle of choice for CIFs, discussed in section 28 below, to the open ended investment company ('OEIC').

13.2.2 Prior to the introduction of the exempt company regime, the boards of OEICs held peripatetic board meeting to avoid becoming resident in any territory which made them vulnerable to residence attacks by onshore tax authorities. Post the exempt company regime board meetings were regularly held in Jersey with some benefit for the Island's economy generally.

13.2.3 As noted above, in section 3.3.3, CIFs are excluded from the Code. It would therefore be possible for the exempt company regime to remain in place with respect to CIFs i.e. rather than repeal Article 123A in its entirety only 123A(1)(b) would be repealed:

(b) no person resident in the Island has, at any time during the year of assessment, any beneficial interest in the company other than as a shareholder in or debenture holder of a body corporate which

(i) has a beneficial interest in such a company, and

(ii) is listed on a recognized Stock Exchange,

and disclosure has been made to the satisfaction of the Jersey Financial Services Commission established by the Financial Services Commission (Jersey) Law 1998, of either the full name and address of the ultimate beneficial owners of the shares of the company or, where the shares of the company are held on trust, the full name of the trustees, the name of the trust, the names and addresses of the persons who provided the trust property and the name and address of the instigator of the trust, if different, together with, upon request, the names of all persons having a beneficial interest in the company.

and Article 123A(1)(a) would remain in place

(1) A company shall, on an application in that behalf made in such manner, within such time (not being later than the thirty-first day of March in the year of assessment or three months after the date on which the company is regarded as having become resident in the Island, as the case may be) and accompanied by such information as the Comptroller may require and on payment of the sum of six hundred pounds, be treated for all the purposes of this Law for any year of assessment as not resident in the Island (and referred to in this Article as an "exempt company") if –

(a) the company is a collective investment fund.

13.2.4 Whilst in theory therefore the exempt company regime i.e. Article 123A(1)(a) could be left in place for CIFs it may be considered that the sensitivity of the term 'exempt company' is such that Article 123A should be repealed *in toto*. In that case the classification of CIFs proposed in section 11.2 would be required.

13.2.5 **It is therefore proposed that Article 123A be repealed in toto.**

14 A 'corporate rate of income tax'

14.1 United Kingdom approach

14.1.1 The United Kingdom introduced a corporation tax, and capital gains tax, in 1965. Prior to that time the United Kingdom's tax system was similar to the Island's.

14.1.2 Corporation tax is introduced into the United Kingdom's tax system by ICTA 1988 s.6:

6(1) Corporation tax shall be charged on profits of companies, and the Corporation Tax Acts shall apply, for any financial year for which Parliament so determines, and where an Act charges corporation tax for any financial year the Corporation Tax Acts apply, without any express provision, for that year accordingly.

6(2) The provisions of the Income Tax Acts relating to the charge of income tax shall not apply to income of a company (not arising to it in a fiduciary or representative capacity) if–

(a) the company is resident in the United Kingdom, or

(b) the income is, in the case of a company not so resident, within the chargeable profits of the company as defined for the purposes of corporation tax by section 11(2).

6(3) A company shall not be chargeable to capital gains tax in respect of gains accruing to it so that it is chargeable in respect of them to corporation tax or would be so chargeable but for an exemption from corporation tax.

6(4) In this section and sections …… except in so far as the context otherwise requires–

(a) "profits" means income and chargeable gains; and

(b) "trade" includes "vocation" , and also includes an office or employment.

14.2 Amendment of Article 123

14.2.1 **It is proposed (1) that Article 123 of the Law be amended along the lines of s.6 to introduce a 'standard rate of corporate income tax' of 0% and (2) a new article 123C be inserted to introduce the concept of a 'specified financial services company' together with a 'special rate of corporate income tax' of 10% applicable to specified financial services companies.**

14.2.2 Since there is no proposal to introduce a separate set of rules relating solely to companies other than two new rates applicable solely to companies there is no requirement for a separate corporation tax code (as, say, in the United Kingdom).

15 Income derived by banks from their Tier One capital

15.1 Banks' Tier One capital

15.1.1 A bank's Tier One capital consists in general terms of its capital and reserves and banks operating in the Island are required by the JFSC to maintain certain levels of Tier One capital in relation to their risk weighted assets.

15.1.2 The assets representing Tier One capital must be held in relatively liquid and secure form, typically government bonds, from which the bank derives investment i.e. non-trading income. However, under the force of attraction principle this income is treated as Schedule D Case I income in the bank's tax computation for Jersey income tax purposes.

15.2 Impact of the zero/ten system

15.2.1 Under the zero/ten system banks could hive down these assets to a Jersey subsidiary subject to the 0% rate or to a foreign subsidiary and so avoid a charge to the 10% rate of corporate income tax.

15.3 Rate for income derived from Tier One capital

15.3.1 **It is therefore proposed that income derived by banks from their Tier One capital when held in a specified financial services company be charged at either one of the two rates of corporate income tax under the zero/ten system of 0% or 10%. It is further proposed that the rate initially be set at 0%.**

16 Regulation of undertakings & development ('RUDL')charge

16.1 Rationale for charge

16.1.1 All businesses operating in the Island are controlled by the Regulation of Undertakings and Development (Jersey) Law, 1973, as amended ('RUDL').

16.1.2 The focus of the law is the control of the types of business allowed to operate in the Island and their manpower requirements. At the end of 2005 permitted staffing numbered in excess of 35,000 employees.

16.1.3 At present no levy is made by the Island in respect of businesses operating in the Island either on establishment or annually other than through the income tax system or through the payment of various JFSC license fees.

16.1.4 **It is therefore proposed to levy a 'RUDL charge' annually in January each year on all businesses which are registered under the RUDL which would be creditable against income tax and corporate income tax, and repayable if greater than the assessed income tax liability, but which would not flow through to frank distributions.**

16.2 Economic impact

16.2.1 A RUDL charge would not be a creditable tax for foreign owners in their home territory and is therefore for them an absolute cost of doing business in the Island. Like any other cost it would need to be factored into the business case for operating in the Island.

16.2.2 The RUDL charge would not impact utility companies since it would be creditable against their 20% income tax charge or construction companies since it would be creditable against their 20% Schedule A rate income tax charge.

16.2.3 The charge would avoid unfair competition between local and foreign owned businesses and any tendency for locally owned businesses to sell out to foreign investors.

16.2.4 However, in order to encourage foreign owned start ups in the Island, it may be that government would introduce a tax holiday period in respect of the charge.

16.3 Basis and collection of charge

16.3.1 The charge could be based on headcount or payroll and be an absolute amount or a percentage amount based on payroll, both variable with respect to the RUDL sector.

16.3.2 If the charge were to be based on payroll then it would need to be assessed and collected by the Comptroller since he has access to company payrolls.

16.3.3 The concept of a payroll based tax is economically unattractive and would also be considerably more complex to administer than a simple fixed charge based on headcount.

16.3.4 **It is therefore proposed that the RUDL charge be an absolute amount based on headcount levied and collected by the Department of Regulation of Undertakings and Development (the 'Department').**

16.4 Rate of the charge

16.4.1 Whilst being a headcount based charge, different RUDL sectors will have different salary profiles and contribute different levels of economic benefit to the Island. A single level of charge would therefore be inequitable.

16.4.2 **It is therefore proposed that differential rates be charged based on the average earnings within the RUDL sector and that the median rate be initially set at £500 per capita.**

16.4.3 **It is also proposed that the rate for specified financial services companies initially be set at zero as any such charge would be creditable against their corporate income tax liability.**

16.5 Headcount basis: actual or licensed capacity

16.5.1 The Department employs a concept of three year joint licenses whereby businesses operating in the Island have a headcount capacity and only need apply for new licenses when the actual headcount exceeds capacity.

16.5.2 These licenses represent a valuable asset for a business and frequently enter into price negotiations when businesses are being acquired, especially by foreign companies.

Basing the RUDL charge on the license count rather than actual numbers would be administratively simpler and would represent an annual charge on a valuable asset of the business.

16.5.3 A charge based on licensed headcount would also act to deter businesses from building up licensed capacity over and above their actual requirements.

16.5.4 **It is therefore proposed that the RUDL charge be based on the licensed headcount.**

17 Schedule A

17.1 Current position

17.1.1 The current position is that rents and lease premiums are charged under Schedule A.

17.1.2 Effectively non-resident landlords are taxed on a voluntary disclosure basis and may escape assessment, unless the Comptroller becomes aware of the income and raises assessments accordingly, since there is no Schedule A withholding tax on rents paid abroad.

17.1.3 Furthermore under Article 115 United Kingdom charities and superannuation funds are exempt from Jersey income tax on rental income received from property in the Island.

17.1.4 Land and property development profits are presently assessed under Schedule D Case I. Capital gains on property are not subject to tax. The difference between trading in land and making a capital gain is dependent upon an analysis of the transaction using the 'badges of trade' which have been well developed in the United Kingdom case law.

17.1.5 Under the Island's housing law certain individuals own their dwelling house through a company, typically 'J' Category employees and individuals owning through share transfer arrangements.

17.2 Impact of the zero/ten system

17.2.1 Under the zero ten system both Schedule A rental income and Schedule D Case I development profits earned in a company would be subject to the 0% corporate income tax rate if received by a zero rate company.

17.2.2 In theory, there is a case for subjecting all land and property gains to tax whilst making provision for exemption for principal private residences. The gain on the sale of a second home, say a flat in town, would be subject to tax. This would require complicated rules to determine an individual's principal private residence and some form of pro-rating for periods of letting or non-occupation.

17.2.3 **It is not proposed to adopt such an approach but rather that (1) the definition of Schedule A income be extended to include development profits for all taxpayers and (2) a new Schedule A rate be introduced.**

17.3 Schedule A rate

17.3.1 The introduction of a Schedule A rate is not considered to offend the rollback criterion of the Code.

17.3.2 **The Schedule A rate proposed for all taxpayers including companies is 20%.**

17.4 Income and gains assessable under Schedule A

17.4.1 In scope income would include rental income and premiums and land and property development profits (formerly assessed under Schedule D Case I) which would be assessed under Schedule D Case I principles.

17.5 Foreign charities and superannuation funds

17.5.1 In order to prevent distortions in the market and to protect the tax base it is proposed that Article 115 be repealed in respect of United Kingdom charities and superannuation funds.

17.5.2 It would be open to any United Kingdom charity or superannuation fund to establish itself in the Island and so avoid the charge thereby bringing new business to the Island.

17.6 Non-resident landlord scheme

17.6.1 The United Kingdom operates a non-resident landlord scheme under which a tenant or letting agent is required to deduct and account for tax at the basic rate from rents paid to a non-resident unless HMRC confirms that the rents can be paid gross. This is on the basis that the foreign landlord undertakes to HMRC to submit returns and pay any tax due.

17.6.2 It is proposed that a form of non-resident landlord scheme be introduced in order to ensure that non-resident landlords meet their compliance and payment of tax obligations.

17.6.3 The scheme may include a backup withholding tax to be deducted by tenants or letting agents which may be subject to a de minimis rental level.

18 Utility companies

18.1 Position under the Code

18.1.1 It has been confirmed that utility companies do not readily fit within the scope or the purpose of the Code, being non-mobile activities. It is therefore open to the Island to charge the Island's utility companies to tax at a rate other than 0%.

18.1.2 So long as the States of Jersey owns the whole or a substantial proportion of the utility companies, there will be an element of 'pocket accounting' in charging the utility companies at a rate other than 0%. However, so doing will secure the tax base against future privatisations or the introduction of privately owned competitors into the Island.

18.2 Utility company rate

18.2.1 **It is proposed that utility companies continue to be assessed to income tax at the income tax rate of 20%.**

18.3 Utility services

18.3.1 The following services are potentially classifiable as being provided by utility companies:

- electricity
- water
- gas
- oil and petroluem
- telecoms
- postal
- harbours
- airport.

19 Public companies

19.1 Position under the Code

19.1.1 The position discussed with HM Treasury seems to suggest that publicly owned companies operating in the Channel Islands could be considered as falling outside the scope of the Code. It might therefore be possible for to the Island to consider charging the Island's publicly owned companies which are not specified financial services companies to tax at a rate other than the 0% rate i.e. at the 10% rate or another rate.

19.2 Definition and treatment of public companies

19.2.1 Under Jersey law a public company is defined as a company with more than thirty shareholders or which has issued a prospectus.

19.2.2 There are in the Island a significant number of SPV companies owned by charitable trusts which have issued a prospectus and are therefore classified as public companies. These SPVs are typically involved in the issuance of debt to the public to finance major asset acquisitions.

19.2.3 Furthermore, a company with group headquarters functions listed on the Channel Island Stock Exchange ('CISX') would fall within the definition of public company.

19.2.4 **It proposed that public companies be charged at the 0% corporate income tax rate, if they are not specified financial services companies, or the 10% corporate income tax rate, if they are specified financial services companies.**

19.3 Deferred distribution charge

19.3.1 The shareholders of public companies incorporated in Jersey will consist of both residents and non-residents of the Island together with Island and foreign companies and employee benefit trusts and pension funds. Public companies typically attempt to maximise their dividend yield and their distribution policy is governed by a board which will include independent non-executive directors.

19.3.2 **It is proposed that shareholders of public companies be exempted from the deferred distribution charge and the deemed distribution charge (discussed in section 24 and 26 below) in respect of shareholdings less than 1%.**

19.3.3 Public companies would be required to include on their dividend vouchers the average level of shareholding during the year the dividend relates to and which year(s) the profits from which the dividend is being paid arose in respect of shareholders with interests greater than 1%.

19.4 Stock dividends

19.4.1 If a public company is taxed at the 0% rate then it can eliminate the income tax liability of its shareholders by paying stock dividends. Since by definition a public company's shares can be easily traded shareholders could sell the stock and realise a tax free dividend.

19.4.2 It is proposed that stock dividends be taxed as income in the hands of Island resident shareholders of public companies.

20 Capital allowances

20.1 Current scheme

20.1.1 The current scheme of capital allowances substitutes for the depreciation charge in the accounts a writing down allowance of 25% per annum applied to the net balance brought forward on capital expenditure on machinery or plant. There is also the concept of a balancing allowance or charge when machinery or plant is disposed of.

20.1.2 There is no industrial buildings allowance or any allowance for capital expenditure on hotels other than on what can be identified as machinery or plant.

20.2 Writing down allowances

20.2.1 Consideration has been given to not allowing capital allowances to specified financial services companies. However, this would have to be in respect of future capital expenditure since otherwise it would amount to retrospective taxation.

20.2.2 Furthermore allowing no deduction for capital expenditure would have a detrimental effect on investment in the Island's infrastructure such as IT and telecommunications.

20.2.3 **It is proposed that the system of writing down allowances be continued under the zero/ten system for specified financial services companies and utility companies.**

21 Exempt income for non-residents

21.1 Exempt income for non-residents

21.1.1 In order to encourage the use of its financial services industry by non-residents the United Kingdom introduced its exempt income rules in FA95 s.128. Prior to this exemption had been by concession.

21.1.2 Strictly, under the source basis of taxation which is inherent in the Island's Schedular system, any payment by a company to a non-resident is chargeable to tax.

21.1.3 **For the avoidance of doubt and to avoid this technical liability to tax on non-residents it is proposed that an article be introduced in the Law equivalent to FA95 s.128.**

21.1.4 This article would not extend to Schedule A income which is in line with the United Kingdom's treatment of Schedule A Business Profits under FA95 s.128.

22 Maintaining the tax base: Principles

22.1 Imputation versus classic system of corporate tax

22.1.1 As discussed in section 7.2 above the current Jersey tax system is a full imputation system in that if companies pursue a full distribution policy they effectively suffer no tax at the corporate level since the Jersey income tax they pay is fully imputed to their shareholders. If those shareholders are exempt from income tax then the profits earned by the company are completely free of tax.

22.1.2 A classic system of corporate taxation leaves the tax paid by the corporate as a final tax. Dividends may then be paid gross or net of a dividend withholding tax. The dividend withholding tax is a payment on account of the tax liability of the shareholder and may be credited or repaid accordingly. Double tax treaties may eliminate or reduce this withholding and the relief may be 'front ended' or by way of a repayment claim.

22.1.3 **Given that dividends are not included in the Jersey/United Kingdom double tax arrangement and that Jersey does not have an extended double tax treaty network it is not considered that a dividend withholding tax is appropriate and that the present imputation system in respect of the extended definition of corporate distribution be maintained with franking rates of 0%, 10% or 20% as appropriate.**

22.2 The corporate ownership vehicle

22.2.1 The legal person of the limited liability company has been pivotal in the development of modern capitalist economies both as a vehicle to conduct business activities and to own property. Its principal features are limited liability, sometimes referred to as the 'corporate veil', and the conduct of its affairs by a board of directors.

22.2.2 The 'veil of incorporation' has been pierced historically by revenue authorities seeking to tax a company's profits on its shareholders on a 'look through' basis and by creditors, such as banks, seeking personal guarantees from its shareholders and/or directors. However, this piercing generally has been limited to 'closely held' companies, where the shareholders are limited in number and/or are the directors, or to offshore companies used for tax avoidance. The United Kingdom's look through provision for capital gains, TCGA 1992 s.13, for instance, only applies where the company is a 'close company'. It would not apply therefore to retail corporate CIFs with United Kingdom resident investors.

22.2.3 Differential tax rates between companies and their shareholders and between capital gains and income result in companies being used to minimise tax liabilities. The introduction of a zero/ten system in the Island when the general corporate income tax rate will be 0% and the personal tax rate 20% will provide a great incentive to incorporate.

22.2.4 Companies are also used by Island residents to avoid foreign tax liabilities e.g. holding an investment portfolio or UK property through a Jersey company avoids United Kingdom inheritance tax and income tax at the higher rate.

22.2.5 If companies were to pursue a full distribution policy then theoretically there would be no difference between the Island's present imputation system and the zero/ten system. Indeed, the tax take cash flow would be accelerated.

22.2.6 However, under the zero/ten system Island resident shareholders who could influence their company's distribution policy would be capable of achieving tax free roll up of profits in their company and then of extracting those profits tax free using a variety of strategies as follows:

- sale of shares in the company
- liquidation of the company
- provision of benefits by the company
- provision of cheap or interest free loans followed by loan release by the company.

22.2.7 In addition the following life events of a shareholder can result in the tax free extraction of profits:

- gifting of the shares
- becoming non-resident and disposing of the shares
- death.

22.3 Anti-avoidance responses

22.3.1 The proposal for 100% look through for investment companies owned by Island residents is set out in section 10.1 above. The discussion here relates solely to trading companies (which may own investments).

22.3.2 There are a number of generic anti-avoidance responses available to the Island in respect of avoidance strategies pursued by Island residents as follows:

A: a percentage (which may vary between 0% and 100%) look through on trading profits and other income i.e. the company's income is deemed to be that of its shareholders in whole or in part as it arises;

B: a deemed distribution charge i.e. after taking into account working capital and investment requirements and any actual distributions the company is deemed to have made a distribution of its retained income to its shareholders;

C: a charge in respect of benefits and/or loans provided to shareholders i.e. the existing employee benefits in kind legislation, as appropriately modified, is extended to shareholders;

D: a deferred distribution charge i.e. a percentage 'interest' charge on shareholders on distributions made in a year out of profits earned in previous years; an extended definition of distributions would be required to include profits realised by way of sale or liquidation.

22.3.3 Tax charged at the company level enables reasonably accurate forecasts to be made of the tax likely to be assessed for budgetary purposes and the Comptroller conducts an annual exercise of obtaining estimates of tax from companies resident in the Island in this respect.

22.3.4 Furthermore, where tax is charged on a shareholder under responses A and B their position vis-à-vis a statutory reclaim of the tax from the company may need to be considered since otherwise the shareholder may not have the funds to settle the tax liability which has fallen upon him in respect of the company's income. Such a right of reclaim by settlors against trustees exists in the United Kingdom where settlors are assessed on a trust's income or capital gains.

22.3.5 Each of these responses needs to be measured proportionately against the following criteria:

- yield
- compliance with the Code
- impact on investment and economic activity
- attraction of the Jersey company for the financial services industry
- administration cost for the Comptroller
- compliance cost for the shareholder
- compliance cost for the company
- anti-avoidance efficiency
- complexity
- effectiveness for budgetary forecasting
- legal basis.

22.3.6 **It is not considered that an all or nothing approach should be taken with respect to these responses but that each can be employed as part of a simple but effective suite of anti-avoidance measures available to the Comptroller to maintain the Island's tax base.**

23 A: Look through

23.1 Anti-avoidance mechanism

23.1.1 Looking through a company to assess a company's shareholders on its income is an anti-avoidance mechanism. In the United Kingdom the look through provision for income, ICTA 1988 s.739, looks through any offshore arrangement to which a UK resident individual has made a 'transfer of assets' (which would include a trade). However, the application of this mechanism is subject to a motive test i.e. the ICTA 1988 s.741 defence: avoidance of tax must be the main reason or one of the main reasons for the transfer.

23.1.2 Under the zero/ten system a resident company taxed at the 0% rate is on all fours with an offshore company and so it may be considered natural for the zero/ten system to apply look through as a default, with or without a motive override.

23.1.3 However this may be open to challenge on a number of fronts as follows:

- The funding considerations for shareholders who are being taxed on the income of a third party which may lead to a distribution policy which results in unwanted tax liabilities for non-Island resident shareholders in their territory of residence
- it is potentially inequitable
- it is difficult to manage *de minimis* considerations
- there are Jersey company law implications if the company is treated as being an agent for the shareholder and implications for the veil of incorporation since, if the company is acting as an agent for the shareholder, the shareholder may become responsible as principal for the company's actions
- there are human rights implications of taxing a minority shareholder on the income of an independent third party over whom he has no effective control
- the high level of disclosure required and the computational complications coupled with timing issues for companies whose period of account is not simultaneous with the Island's tax year
- the identification of interests where shareholdings are held through other companies or trusts or by connected persons
- the treatment of losses between different companies
- the differential treatment of dividends between those paid by look through companies and those taxed at the 10% rate
- the Code implications.

23.2 Look through for trading companies

23.2.1 Whilst look through for trading companies on an arising basis may appear to provide an effective solution to the zero tax problem, in practice and in equity it would extremely problematic.

23.2.2 **It is not therefore considered that a whole or partial look through to tax shareholders on trading profits in non-public or close companies is appropriate under the zero/ten system.**

24 B: Deemed distribution charge

24.1 Apportionment charge

24.1.1 The basis of an apportionment charge is to charge the company rather than the shareholder on a proportion of its trading profits either adjusted formulaically for working capital and capital expenditure requirements or at a fixed rate (such as 60%) with adjustments for actual distributions.

24.1.2 The problems with apportionment are similar to look through with the added complication of computational adjustments (e.g. for working capital requirements and capital expenditure) for the company to determine the apportionment charge and the Code implications of taxing the company.

24.2 United Kingdom close company profits apportionment rules

24.2.1 The United Kingdom applied apportionment rules from the 1920's to 31 March 1989. The rules only applied to 'close companies' i.e. companies under the control of five or fewer participators. The rules were viewed as being largely unworkable and ineffective in terms of anti-avoidance tax yield.

24.2.2 The United introduced the concept of the close investment company from 1989 which is taxed at the 40% higher rate of tax. Benefits and loans by close trading companies are also subject to a tax charge.

24.2.3 The close company apportionment rules are chiefly remembered for their complexity: the statute ran to twenty pages supplemented by more than two hundred pages of Revenue Manual guidance.

24.2.4 100% look through for investment companies coupled with a charge on shareholder benefits is considered to be most closely aligned to the current United Kingdom rules.

24.2.5 **For these reasons it is not proposed that the Island should introduce an apportionment charge.**

24.3 Deemed distribution charge

24.3.1 However, whilst trading companies' profits are normally used, along with overdrafts and loan and share capital, to fund working capital and capital expenditure requirements, they are also normally used over a trading cycle to fund dividends. Retention of trading profits within a company over the long term or indeed indefinitely should be viewed as simply 'fattening up' the company for eventual tax free extraction of the profits.

24.3.2 Collective investment funds that require certification as distributing funds under the United Kingdom's distributor status rules make distributions that the investor elects to have immediately re-invested in the fund and the investor is therefore in the position of being liable to income tax on distributions that are not actually received.

24.3.3 **Given that the regular payment of dividends is part of the normal economic cycle of a trading company, it is proposed to introduce a deemed distribution charge for the Island resident shareholders of companies subject to the standard rate of corporate income tax.**

24.4 Guillotine period in respect of the deferred distribution charge

24.4.1 However, in order to recognise companies' working capital requirements, the charge should not be applied annually but periodically.

24.4.2 **It is therefore proposed that a 'guillotine' period of three years be applied and that the profits of Year 1 be deemed to be distributed on the first of January in Year 4.**

24.4.3 Deemed distributions would be subject to the deferred distribution charge (see section 26 below).

24.4.4 As discussed in section 10.6 above the measure of the deemed distribution should be the revenue profits of the company as measured by GAAP.

24.5 Deemed distribution versus look through and apportionment

24.5.1 The deemed distribution charge avoids many of the problems and issues identified with look through and apportionment:

- The shareholder has effectively five years to provide for the income tax liability on the deemed distribution i.e. the profits of Year 1 will be included in his Year 4 taxable income the tax on which will be payable during Year 5.
- The three year deferral period should allow companies ample time to make normal distributions without compromising their working capital or capital expenditure requirements and so avoid the charge for their shareholders. Nevertheless the company is not put into the position of having to make a distribution.
- The shareholder has no statutory right of reclaim against the company in respect of his tax liability on the deemed distribution and so the company is not acting as agent for the shareholder.

24.5.2 **However, it is recognised that the three year period is to a degree arbitrary and therefore it is proposed that shareholders may agree a longer deferral period with the Comptroller in exceptional circumstances.**

25 C: Shareholder ‘benefits in kind’

25.1 Position if no look through or apportionment

25.1.1 As discussed in section 22.2 above if there is no look through shareholders can employ a number of strategies for extracting benefit from the company without triggering a tax charge.

25.1.2 **It is therefore proposed that the benefits in kind rules for employees be extended, as appropriately amended, to shareholders. The rules should not be restricted to closely held companies.**

25.2 Extension of employee ‘benefits in kind’ rules to shareholders

25.2.1 The charge should be absolute rather than by reference to income, as is the case for the employee benefits in kind rules, and be measured by the economic benefit.

25.2.2 The charge in respect of loans should be for the full amount of loan i.e. the loan proceeds rather than the interest benefit should be treated as a distribution

25.2.3 The benefits should be included in the company’s ITIS reporting and self assessed in the case of benefits provided by foreign companies.

26 D: Deferred distribution charge

26.1 Effect of zero / ten system

26.1.1 Essentially under the zero/ten system there is no ‘payment on account’ by the company of the shareholders’ 20% income tax liability and therefore the company’s distribution policy determines the tax point of company profits.

26.1.2 Profit retention gives the company an interest free loan from the shareholder who is thereby not achieving an economic return from his investment.

26.2 Profit distribution is tax point

26.2.1 The profit distribution point becomes the tax point under the zero/ten system. Under the current system a company pays 20% on its profits regardless of its distribution policy.

26.3 Deferred distribution charge

26.3.1 **It is proposed that a deferred distribution charge be levied on distributions at a rate of 20% of the shareholder’s marginal income tax liability on the distribution.**

26.3.2 A rate of 20% would approximate to an annual interest rate of 4%.

26.3.3 The distributable profits subject to the charge would be the company’s trading profits measured on a LIFO basis i.e. any actual distribution would be matched against the latest years’ profits. However, because of the application of the deemed distribution guillotine the chargeable period would be limited to three years.

26.3.4 The charge would not be a capital gains tax, which effectively taxes the NPV of future dividends on a disposal of the right to receive those dividends, nor a tax, since it is in the form of an interest charge. As a charge it fits with the Island’s policy of levying charges for late filing of tax returns and late payment of tax.

26.3.5 If a company needs funds they can be loaned back interest free by the shareholder, which puts the company effectively in exactly the same position as at present if it does not distribute.

26.3.6 If profits deemed to be distributed were to be actually distributed they would be distributed tax free.

26.3.7 The following table illustrates how this charge and the deemed distribution charge would work:

Year	Profit	Actual distribution	Deemed distribution	Attribution of actual and deemed distributions:			
				1	2	3	4
1	100	60		60			
2	100	120		20	100		
3	100	50				50	
4	100	110	20	20		10	100
Balance of undistributed profit end Year 4				0	0	40	0

26.3.8 The balance of undistributed profit of Year 3 at the end of Year 4 would be deemed to be distributed in Year 5 unless actually distributed in that year.

26.4 Extended definition of distribution

26.4.1 The definition of distributions would include:

- cash dividends
- capital dividends
- profits paid by way of liquidation
- profits realised by way of disposal of shares.

26.4.2 The general rule would be a tracing rule such as that found in *Harmel v Wright (HMIT)* (1965-1975) 49 TC 149:

> [Counsel] submits that it is impossible to come to any other conclusion unless one strips aside the corporate veil and looks behind [the company] to study the shareholders and looks at the reality of the situation behind the corporate veil. To my mind this case does not depend on stripping aside the corporate veil at all. This case depends on keeping one’s eye on the emoluments, on the original sum of £25,000, and seeing what happens to it. It is true that it is paid over at one stage as the purchase price for shares, and it is true that

one cannot normally identify money, but in the present case you can; you do not need to get behind the corporate veil to perceive and know that the £25,000 which goes in as the purchase price for shares comes out on the instant in the form of the loan to [another company]. In my judgment, on the wording of s. 156 one does not need to strip aside the corporate veil if you find that emoluments, which mean money, come in at one end of a conduit pipe and pass through certain traceable pipes until they come out at the other end to the taxpayer.

26.4.3 The test for a distribution on this basis is 'did money traceable to the trading profits of the company start off in the bank account of the company and end up in the bank account of the shareholder?'.

26.5 Special situations

26.5.1 Special situations include:

- death;
- gifting of shares to connected parties, other than trusts;
- emigration and liquidation or sale whilst non-resident.

26.5.2 There should not be any charge levied at the time of death since no distribution is necessarily made to the deceased's estate. However, it is proposed that the undistributed profits clock be 'inherited' by the deceased shareholder's heirs.

26.5.3 In the same way there should not be any charge on the gifting of shares to connected parties. However, it is proposed that the undistributed trading profits clock be 'inherited' by the donee(s) in the same way as on death.

26.5.4 **It is proposed that a re-entry charge be introduced in the case of post-emigration sale or liquidation, which is discussed in section 27 below.**

27 Re-entry charge for temporary non-residents

27.1 Export charge versus re-entry charge

27.1.1 The main problem with respect to an exit charge is similar to that on death or gift: the shareholder receives no cash at the time of the trigger event. In addition there is a series of cases in the EU to rule that exit charges offend the free movement of capital and may well in the future be introduced into the Code.

27.2 Re-entry charge

27.2.1 A re-entry charge is only levied if the shareholder has received a distribution from the company whilst non-resident and therefore avoids the funding problem of an exit charge.

27.2.2 It is considered that a period of non-residence of five clear tax years, after which the charge would fall away, would be sufficient to deter all but the most determined of taxpayers from becoming temporarily non-resident to avoid a tax charge.

28 Trusts: Unit trusts

28.1 Collective investment funds

28.1.1 Collective investment funds can be constituted as unit trusts issuing units or as open ended investment companies ('OEIC') issuing redeemable preference shares both of which are valued on a net asset value basis.

28.2 Unit trusts

28.2.1 Unit trusts established in Jersey are referred to as unauthorised unit trusts ('UUT') as opposed to unit trusts established in the United Kingdom, referred to as authorised unit trusts ('AUT').

28.2.2 UUTs have been widely used to invest in property because of their SDLT advantages and because of the absence of a REIT regime in the United Kingdom. They are usually referred to as Jersey property unit trusts ('JPUT').

28.2.3 UUTs can be treated as full look through for their unit holders, known as 'Baker trusts' or as opaque i.e. treated as OEICs.

28.2.4 UUTs and JPUTs apply for concessional exemption from Jersey tax under Concession 2 which is outside the scope of the Code.

28.2.5 **No amendment is proposed in respect of Concession 2.**

29 Trusts: Private trusts and companies

29.1 Use for tax avoidance

29.1.1 Jersey resident trusts in which Jersey residents have no vested or contingent interests are not subject to Jersey income tax by Concession 2. Otherwise Jersey resident trusts are assessed to income tax on their gross income. Jersey resident trusts subject to income tax would be subject to the 100% look through, the three year deemed distribution charge and the deferred distribution charge and their position would be no different to that of individual shareholders.

29.1.2 However, by holding the shares of company resident in the Island through an offshore trust or company a Jersey resident could avoid a charge to income tax on distributions from both specified financial services companies (at an additional 10% rate) and companies taxed at the 0% rate (at the 20% rate) and the 100% look through, the deemed distribution charge and the deferred distribution charge.

29.2 Anti-avoidance responses: restriction of exempt income rules

29.2.1 The United Kingdom limits its exempt income rules where the non-resident is a trust where United Kingdom residents have a vested or contingent interest in the trust. However, to effectively collect the tax requires a withholding regime for distributions by Jersey companies to non-residents which is not envisaged in this Proposal.

29.3 Classification of trusts

29.3.1 Trusts can be classified as (1) those where there is a life interest ('life interest trusts'), (2) those where the settlor retains an interest ('settlor interested trusts') or (3) those where neither (1) nor (2) applies ('complex trusts').

29.3.2 In a life interest trust the income is treated as vesting absolutely in the life tenant and therefore no specific anti-avoidance response is required.

29.4 Anti-avoidance responses: settlor interested trusts

29.4.1 The definition of a settlor interested trust can vary according to the degree of connection of trust beneficiaries to the settlor which may extend to a spouse, children and grandchildren. Parents, grandparents and siblings are rarely included.

29.4.2 The United Kingdom employs automatic look through rules for all settlor interested trusts, both resident and non-resident, (ICTA 1988 Part XV) and look through (ICTA 1988 s.739) subject to a motive defence (ICTA 1988 s.741) for offshore trusts and companies.

29.5 Anti-avoidance responses: beneficiaries

29.5.1 The United Kingdom employs a process whereby 'relevant income' arising in a trust is matched with capital payments made by the trustees (ICTA 1988 s.740) subject to a motive defence (ICTA 1988 s.741). There is no penalty for deferred distributions of income.

29.5.2 The USA employs a 'guilty until proven innocent' approach whereby all benefits are taxed as income and subject to the maximum deferred income charge of 100% of the tax due unless the beneficiary can provide evidence of the year in which the underlying income arose.

29.5.3 **It is proposed that anti-avoidance measures be introduced based on the extended Article 134A (see section 30 below) which will be subject to a separate review independent of this Proposal.**

30 Article 134A

30.1 Basis for tackling tax avoidance

30.1.1 The general anti-avoidance rule found in Article 134A together with the system of pre-transaction rulings by the Comptroller has limited the emergence of large scale tax avoidance by residents of the Island.

30.1.2 It is considered that the rules in this Proposal together with the flexibility provided by Article 134A avoid the necessity for a detailed anti-avoidance code which has proved so unworkable in the United Kingdom, even with the introduction of the Tax Avoidance Schemes (Prescribed Description of Arrangements) Regulations 2004.

30.2 Enhanced disclosure

30.2.1 Assessment under Article 134A has typically been on the basis of voluntary disclosure by the taxpayer and the Jersey individual income tax return only requires that actual income, rather than potential sources of income or rolling up investments, be disclosed.

30.2.2 It is remarkable that whilst companies file income statements and balance sheets individuals only file income statements and their assets remain invisible to the Comptroller unless they become involved with a 'back duty' enquiry. The Comptroller is normally limited to comparing returns year on year to discover any instances of omitted income.

30.2.3 Under the zero/ten system companies assessed at the 0% rate essentially become offshore companies. Under this Proposal various liabilities relating to domestic companies are assessed on the shareholder and therefore the burden of disclosure should naturally fall upon the shareholder.

30.2.4 Disclosure can be limited to a 'tick the box' approach rather than providing a detailed list of investments and interests which however will need to be backed up by statutory powers and a penalty regime in order to be effective.

30.2.5 However, it is proposed that taxpayers provide with their income tax returns a schedule of capital contributions as follows:

Asset class	Domestic	Foreign
Private companies		
Public companies		
Distributing funds		
Capital growth vehicles		
Partnerships		
Private trusts		
Insurance policies		
Property		

30.2.6 Capital contribution would be the total capital i.e. actual cash invested at 31 December each year. If this is too difficult or onerous to calculate the approximate market value can be disclosed.

30.2.7 It is not considered that such disclosure is either onerous or intrusive and would enable the Comptroller to measure the income disclosed on the return against the capital invested by the taxpayer.

30.2.8 **Extension of Article 134A**

30.2.9 Article 134A refers to 'a transaction' and therefore as it stands would not be applicable to settlor interested trusts and/or offshore companies.

30.2.10 **It is therefore proposed that Article 134A be extended to include a 'series of transactions'.**

31 Reporting and compliance

31.1 Company returns

31.1.1 Under the zero/ten system companies subject to the 0% rate do not, prima facie, have any requirement to file accounts and computations with the Comptroller other than when they are in receipt of Schedule A income and profits.

31.1.2 Company accounts and computations will continue to be required for specified financial services companies and, if they have elected to be treated as a group, for the affiliates in the group.

31.1.3 The Code requires that tax measures are transparent, including where legal provisions are not relaxed at the administrative level in a non-transparent way.

31.1.4 Currently exempt companies do not file accounts or tax computations with the Comptroller and their filing obligations are limited to the annual exempt company application form. In practice the Comptroller's office would be subject to an unacceptable administrative burden if all Jersey incorporated and resident companies were to file accounts.

31.1.5 Companies with Schedule A income will be required to file accounts and Schedule A computations.

31.1.6 **It is therefore proposed that**

- **all Island incorporated and resident companies file a simple return stating (a) whether they are a specified financial services company (or have elected to be within a specified financial services group) and (b), if not, whether they have Island resident shareholders;**
- **if the response for (b) is yes then the company must file its accounts, a trading company confirmation and a dividend profits attribution table.**

31.2 Individual returns: interests in Jersey companies

31.2.1 Individuals resident in the Island with interests in companies resident in the Island are assessed as follows

- 100% look through in the case of investment companies
- benefits provided by trading companies
- deferred distribution charge in respect of distributions by trading companies
- deemed distribution charge in respect of the retained income of trading companies.

31.2.2 In the case of investment companies the company will file accounts as it does currently for the assessment of its income on its shareholder(s). This is analogous to the current filing regime for partnerships.

31.2.3 Shareholder benefits will be returned by trading companies under the existing employee benefits reporting framework.

31.2.4 Distributions by companies should include on the distribution voucher the profits attribution and the analysis between revenue profits and capital profits. Trading companies and their agents would seek agreement of these with the Comptroller prior to their distribution to the company's shareholders (in the same way as net effective rate calculations are currently agreed).

32 Consultation

32.1 Initial consultation period

32.1.1 Initial consultation for the Proposal took place between January and April 2006.

32.2 Persons consulted

32.2.1 The following persons were involved in the initial consultation:

- Terry Le Sueur - Finance Minister, States of Jersey
- Malcolm Campbell - Comptroller of Income Tax
- Clive Tomes - Chairman, JSCCA
- Nigel Woodroffe & Julian Lamb - JFSC
- Brian Coutanche & Gary Conlon - Crown Agents
- Mike King - Department of Economic Development
- Wayne Gallichan - Department of Regulation of Undertakings
- Alex Ohlssen - Cary Olsen
- Wendy Dorman - Deloitte & Co
- Jane Stubbs - PriceWaterhouseCoopers
- John Shenton- Ernst & Young
- John Riva - KPMG
- David Wild - Jersey Finance Limited

Appendix 1

Comparison of the existing system and the 0/10% proposal for the taxation of companies

	Existing system for the taxation of companies			Proposed zero/ten system for the taxation of companies		
Source of income	**Investment company**	**Trading company**	**Exempt company**	**Investment company**	**Specified financial services trading company**	**0% rate trading company**
Jersey source trading income arising to company	N/a	Taxed on company at 20% net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Taxed on company at 20% to the extent carried on through 'an established place of business' in the Island	100% look through to Jersey resident shareholders net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Taxed on company at 10% net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Taxed on company at 0%
Jersey source investment income, excluding bank interest, arising to company	Taxed on company at 20% net of interest and management expenses	Taxed on company at 20% under the 'force of attraction' principle	Taxed on company at 20% net of interest and management expenses	100% look through to Jersey resident shareholders on gross income	Taxed on company at 10% under the 'force of attraction' principle	Taxed on company at 0%
Jersey bank interest arising to company	Taxed on company at 20% net of interest and management expenses	Taxed on company at 20% under the 'force of attraction' principle	Exempt	100% look through to Jersey shareholders	Taxed on company at 10% under the 'force of attraction' principle	Taxed on company at 0%
Foreign source trading income arising to company	N/a	Taxed on company at 20% net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Exempt	100% look through to Jersey resident shareholders net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Taxed on company at 10% net of expenses incurred 'wholly and exclusively' for the purposes of the trade and capital allowances	Taxed on company at 0%
Foreign source investment income arising to company	Taxed on company at 20% net of interest and management expenses	Taxed on company at 20% under the 'force of attraction' principle	Exempt	100% look through to Jersey shareholders	Taxed on company at 10% under the 'force of attraction' principle	Taxed on company at 0%

Appendix 1

Comparison of the existing system and the 0/10% proposal for the taxation of shareholders

Source of income	Existing system for the taxation of shareholders			Proposed zero/ten system for the taxation ofshareholders		
	Investment company	Trading company	Exempt company	Investment company	Specified financial services trading company	0% rate trading company
Dividends from Jersey resident companies arising to Jersey resident shareholders	Franked at 20% for credit or repayment	Franked at 20% for credit or repayment	N/a Tax withheld at 20% in case of CIFs	Tax neutral	Franked at 10% for credit or repayment on extended definition of distribution. Subject to deferred distribution charge and, after three years, deemed distribution charge	Franked at 0% on extended definition of distribution Subject to deferred distribution charge and, after three years, deemed distribution charge
Dividends from Jersey resident companies arising to foreign resident shareholders	Franked at 20% for credit or repayment (represents a final tax for corporate shareholders)	Franked at 20% for credit or repayment (represents a final tax for corporate shareholders)	N/a (but would be franked at 20% in respect of Jersey source income)	Tax neutral	Franked at 10% for credit or repayment (represents a final tax for corporate shareholders)	Tax neutral
Benefits for Jersey resident shareholders provided by Jersey resident companies	N/a	N/a	N/a	N/a	Taxed on shareholders at assessed value	Taxed on shareholders at assessed value
Benefits for foreign resident shareholders provided by Jersey resident companies	N/a	N/a	N/a	N/a	N/a	N/a