STATES OF JERSEY

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ZERO/TEN TAX DESIGN PROPOSALS

Presented to the States on 10th October 2006
by the Minister for Treasury and Resources

STATES GREFFE

REPORT

The Zero/Ten Tax Design Proposals

1. Introduction

1.1 On 7th July 2004 (P.106/2004) the States agreed to move to a new corporate system of taxation, the so called '0/10' system. Since then, substantial and comprehensive research has been undertaken, culminating in the publication of a set of 0/10 tax proposals on 5th May 2006. Following extensive consultation with the business community and stakeholder groups, these proposals have been revised accordingly to take account of, as broadly as possible, the views expressed in the consultation period.[1] The proposals also acknowledge the contributions from the Corporate Affairs Scrutiny Panel contained in their report S.R.4/2006.

1.2 The purpose of this Report is to outline the details of the proposed revised 0/10 tax system, with the necessary legislation being presented to the States shortly, for debate early next year.

2. Background

2.1 The States debated and approved the reform of the Island's tax structure in 2004 (Fiscal Strategy: P.106/2004) and emphatically agreed by 38 votes to 4 to move to a 0/10% tax structure. The Report accompanying that Proposition gave full and detailed information on the importance of the financial services industry, and the necessity of changing the Island's tax system to meet growing international competition and EU rules on harmful tax practices. It is not, therefore, considered necessary to repeat that information in this Report.

2.2 It is extremely important to stress, in meeting the challenges facing us, that business in the Island will not welcome any drawn out period of uncertainty regarding the Island's recognition of these challenges and the willingness to address them without undue delay. Customer business can be lost unless certainty of applicable tax treatment can be provided on any given structure for the whole of its intended lifespan – sometimes up to 20 years. Apart from this, large multi-national financial services providers, who are represented in Jersey and in many of the Island's competitor jurisdictions, have many options for switching business, capital and jobs at a rapid rate away from Jersey to such competitor jurisdictions with relative ease. It should also be borne in mind that once such economic activity is lost by Jersey to competitor jurisdictions then it is unlikely to return in the future without a very compelling reason to do so.

2.3 That is why extensive and detailed consultation has been undertaken with all interested parties and the public for the last few months and why these revised proposals, outlined below, are being brought forward at this time.

3. Revised proposals

3.1 Standard rate of corporate tax of 0%

3.1.1 A standard rate of corporate tax of 0% is being proposed, together with a special rate of corporate tax of 10% for specified financial services companies.

3.1.2 The 0% rate vehicle will ensure that the providers of international financial services have the legal vehicle to deliver the type of financial services their customers require. Such vehicles are commonplace internationally and are currently available in Jersey through the Exempt Company structure.

3.1.3 The 0% rate will be the general and standard rate of tax applied to all companies, whether the company is owned by Jersey residents or by individuals resident abroad. This is to remove the discrimination that currently exists in the tax treatment of resident and non-resident owned (Exempt) companies.

3.1.4 A consequential amendment of introducing a 0% rate of corporate tax is the abolition of the current Article 123A., i.e., the provisions relating to the Exempt Companystructure. However, it is proposed that one particular provision within that Article is retained, that being the definition of an established place of business, renamed as 'permanent establishment', so as to ensure that such a definition remains within the Income Tax Law. The permanent establishment of a non-resident corporate will be charged, as appropriate, at either the standard 0% rate or the 10% rate if that corporate is a specified financial services company.

3.2 Special rate of corporate tax of 10%

3.2.1 A certain and very restricted sector of the Jersey resident corporate sector will be charged at a special corporate tax rate of 10%. They will be specified financial services companies such as banks and trust companies which will be defined as any company licensed, registered or authorised under specified sections of the Financial Services (Jersey) Law 1998, the Collective Investments Fund (Jersey) Law 1988 or the Banking Business (Jersey) Law 1991. The 10% rate will ensure that the financial services industry continues to pay substantial amounts of tax revenues. This is considered acceptable in meeting the criteria of the EU Code of Conduct on Business Taxation, as it is a feature of the way that the EU interprets its approach on harmful tax practices that assessing one – limited – sector at a higher rate of corporate tax (10%) than the general rate (0%) is acceptable.

3.2.2 It will also be possible to elect for group relief under new statutory rules, so that any trading loss of a specified financial services company can be offset, with certain restrictions, against the profits of another specified financial services company within the same group.

3.3 Treatment of Utilities

3.3.1 It is proposed that utility companies will continue to be charged at the 20% standard rate of income tax. These companies are excluded from the Code criteria because their activities are non-mobile in nature. Accordingly, they are not within the policy approach of the EU Code Group as to what constitutes 'harmful business tax practices' and are not deemed to be influenced by international competitiveness on tax rates in terms of where they locate themselves. It is thereby considered possible for these companies to be charged at a rate of tax other than the 0% standard rate. They will continue to be charged to income tax at the present standard rate of 20%.

3.4 Schedule A

3.4.1 The position is similar for companies in receipt of income taxed under the provisions of Schedule A (rents, lease premiums and property development profits). This income will continue to be taxed on the companies at the present standard rate of 20%.

3.4.2 Schedule A currently charges all rental income arising from land and property in Jersey. It is proposed that the provisions of that Schedule will be extended to include all property development profits and gains which are currently assessed as trading profits under Schedule D Case 1. This is to ensure that all property development companies making profits and gains out of land and property in the Island continue to pay tax at the 20% standard rate of income tax, rather than being taxed under the general 0% rate of corporate tax. If the Income Tax Law remained unaltered all such profits and gains would escape taxation if the 0% rate corporate is owned by non-residents.

3.4.3 A form of simplified non-resident landlord scheme is being proposed to ensure that non-resident landlords will have a withholding tax of 20% applied to them should they fail to meet their compliance and tax payment obligations. This will ensure that any non-compliant, non-resident landlords will suffer an appropriate tax deduction from their rental income before the rental income is remitted to them by their Jersey letting agent. There will be a *de minimis* level so as to ensure that no undue compliance burden is placed on letting agents or landlords.

3.5 New provisions to change the basis of assessment of profits and gains arising from trades, professions and vocations

3.5.1 Currently an assessment on business profits is based on the accounts ending in the previous year. Thus, if a business prepares accounts to 30th June, the assessment for the Year of Assessment 2006 will be based on the accounts for the year ended 30th June 2005. There are complex special provisions when a business first commences and when it ceases which mean that on commencement some profits are assessed twice, whilst on cessation some profits fall out of charge.

3.5.2 It is proposed that the taxable profits shown in the accounts ending during a year should be used in the tax assessment for the same year. For example, accounts for the year ended 30th June 2009 would form the basis of the assessment for the Year of assessment 2009 (rather than Year of Assessment 2010, as at present). The change in the basis of assessment of business profits will apply to companies, sole traders and partnerships.

3.5.3 There are two key advantages to this proposal –

(a) All profits will be assessed. There will be no double counting on commencement and no profits will fall out of charge on cessation;

(b) The basis of the assessment will be simpler to understand and to explain to taxpayers.

The revenue yield is expected to be similar.

3.6 Actual distribution and deemed distribution for trading companies and 'look-through' provisions for investment companies

3.6.1 An enhanced anti-avoidance, information powers and distribution policy regime is proposed to ensure that the Comptroller has sufficient powers to tackle any potential tax evasion as well as to ensure the maximum level of taxation revenue arising at the shareholder/dividend level.

In terms of distribution policy, it is proposed that Jersey resident shareholders of 0% rate companies have special provisions applied to them to ensure that some of the undistributed profits arising in the trading company which they beneficially own are assessed on them as personal shareholder income in their own personal notice of assessment. Accounts will need to be drawn up under International Financial Reporting Standards or under Generally Accepted Accounting Principles, and the basis of assessment will be as follows –

- In a case of a trading company which distributes at least 60% of its profits in a particular year of assessment, the shareholder or shareholders will be assessed on these actual distributions.

- Where the actual distributions by the corporate are less than 60% of the said profits in a particular year of assessment, then a deemed distribution assessment on the profits arising in the trading company will be raised on the shareholder, or shareholders, in their own name, in proportion to their ownership of the trading company, to bring the total distributions up to 60%. Any shareholder who, in extremis, cannot pay the deemed distribution charge because distributions have not been received from the trading company in which he has a beneficial share, may claim not to be assessed on the deemed distribution, the notice of assessment being raised instead on the trading company itself as agent for that particular individual shareholder.

- Only when a trading company is liquidated, or when the shares are sold, wholly or partly, will the as yet untaxed 40% of the profits generated by the trading company be brought into charge to tax on the individual shareholder(s).

3.6.2 Shareholders could avoid paying personal tax on dividends arising in a 0% rate corporate which they own by simply taking a loan from the company rather than be taxed on a distribution or deemed distribution. To prevent this, it is proposed that all loans from a corporate to a shareholder be treated as a benefit in kind with the full capital value of the loan being assessed on the shareholder in his own personal name at the time the loan is granted. Subsequent repayments of the loan will be credited against the original assessment and the appropriate credit or repayment made.

3.6.3 In the case of an investment holding company, the Jersey resident shareholder(s) will be personally assessed to tax on 100% of the net investment income (after management expenses) which arises in the company under new 'look-through' provisions.

3.7 Anti-avoidance powers

3.7.1 An enhanced anti-avoidance and information powers regime is proposed to ensure that the Comptroller has sufficient powers to tackle any tax evasion and abusive tax avoidance.

3.7.2 Article 134A will be extended to catch a series of transactions, rather than it applying to just one particular transaction as currently, and further work will be undertaken to determine the best way of tackling evasion or abuse by Jersey residents through the use of non-Jersey trusts and corporates. A new 'tick the box' regime is also being considered so that personal taxpayers have to provide, on their personal Income Tax Returns, a degree of disclosure relating to any assets which have passed out of their direct ownership, but this will be kept as simple as possible, and designed not to include minor transfers or gifts.

3.8 Minor proposed provisions

3.8.1 Various minor provisions are also proposed, namely –

- a new category of exempt income for non-residents in relation to bank interest (currently not chargeable on non-residents by concession) and a number of other sources of Jersey income;
- revision to Articles 86 and 87 in respect of abolishing withholding tax on interest;
- revision to Article 88 in respect of dividends paid by companies;
- a new Schedule D Case VIII to incorporate the charge for actual and deemed distributions.

4. Proposals considered but not implemented

4.1 Having listened to the feedback received during the consultation period, it has been decided not to proceed with –

- o the proposals for a Regulation of Undertakings and Development Levy (RUDL);
- o a limited trading partnership vehicle;
- o the full deemed distribution charge provisions;
- o the deferred distribution surcharge; and
- o the withdrawal of Article 115(a) exemption for foreign superannuation funds and charities.

– The RUDL charge has been removed from the proposals given the sustained opposition voiced during the consultation. In summary, this articulated the complexity inherent in the proposed mechanism, the danger that it would distort or deter economic investment in the Island, the vulnerability of low-profit but high-labour component businesses to its introduction, particularly in weak sectors of the economy such as tourism and agriculture, the detrimental cash flow impact it would have on business prior to recovery against personal tax liabilities of shareholders and a number of other perceived drawbacks. When weighed against the relatively modest revenue yield of RUDL in the forecasts of £5-7 million, it has been viewed as sensible to remove RUDL from the present proposition.

However, other mechanisms will continue to be investigated for possible longer term solutions to the underlying problem RUDL was designed to address, viz. an economically acceptable method to raise some revenue contribution from non-finance, non-Jersey owned businesses operating in the Island which under 0/10 would otherwise no longer make any such direct contribution in Jersey.

– The Limited Trading Partnership (LTP) is similarly removed from the current proposals as it was designed to operate in tandem with RUDL as part of the RUDL mechanism and its immediate need for this fiscal purpose is no longer evident. However, the desirability or otherwise of such a vehicle being available in Jersey for a wider range of purposes is still to be considered, as a separate matter, by the Minister for Economic Development.

– The Deemed Distribution methodology contained in the original Design Proposal has been modified after consultation – which expressed a range of views on its desirability and complexity, mostly adverse. The deemed distribution "in full", i.e. forcing a total distribution of retained profits accruing to Jersey based shareholders after a 3 year deferral and annually thereafter has accordingly been modified to the partial deemed distribution model at 60% of annual qualifying profits. This is considered to meet the various objections to the original proposal whilst simultaneously allowing for internal investment in companies and ensuring a stream of dividend taxation income is still realised by the States commensurate with its spending commitments. It is worth noting that at least one competitor jurisdiction has proposed to go down a similar route.

– The Deferred Distribution Charge has been shelved on the basis of its complexity and other drawbacks outweighing the relatively small revenue yield it would generate.

– The withdrawal of Article 115(a) exemption for foreign superannuation funds and charities is again set in the context of requiring further investigation and quantification with which the States Economic Adviser has been charged. For this reason it has been taken out of the current proposal for subsequent evaluation.

– Management expenses will continue to be allowed under Article 133.

5. Conclusion

5.1 There has been exhaustive and extensive consultation on these 0/10 proposals. Concerns were raised about some of the proposals originally published. The Minister has listened to these concerns and that has been reflected in these revised proposals.

5.2 These revised proposals will now form the basis of the law drafting brief which will result in a draft Law being lodged shortly with a view to a States debate in January 2007.

ANNEX 1

States
of Jersey

JERSEY'S ZERO TEN DESIGN PROPOSALS

A summary of the responses to the public consultation

Introduction

This paper summarises the views expressed in the public consultations held between 5th May and 31st July this year concerning the implementation and operation of Jersey's zero/ten tax system. Since it is intended to provide only an overview of the comments and suggestions that have been made, and for reasons of space, it does not list in detail all of the replies received.

Background

In 2004 the States agreed two major changes to Jersey's tax structure – a reduction in the general rate of tax on corporate profits, from the current 20 per cent to a rate of zero per cent for most companies but with a higher (an yet internationally competitive) rate of ten per cent for financial services providers.

These changes, known as "zero/ten" were considered to be vital to secure a sustainable economic future for Jersey since they would enable European Union demands for non-discriminatory taxes to be met, whilst combating competition from other business centres seeking to attract the highly mobile and economically important financial services industry away from the Island.

Written responses to the consultation were received from individuals, groups, representative bodies and/or companies by the closing date which was extended from the end of June to the end of July 2006.

Among the submissions received, some simply requested information. Others, however, contained very detailed and thoughtful consideration of the zero/ten proposals.

For the sake of simplicity the comments and suggestions received are summarised below.

The Principle of zero/ten

It is important to note that virtually all of the submissions were fundamentally supportive of a zero/ten regime to protect the vital financial services business base so that international products can continue to benefit from a benign tax environment. It was appreciated that adopting the regime will enable the finance sector to maintain its customer base. At the same time Jersey will keep a substantial proportion of its existing taxation from the finance sector. It was generally agreed that the proposed framework is vital to the continuity of Jersey as a successful and vibrant business centre. Where there was concern this was centred on the detail of the proposals outside of the basic corporate tax structure and how the complexity of the proposals may impact on businesses ability to operate efficiently.

Areas of Concern

A number of submissions articulated the complexity inherent in the proposed Regulation of Undertakings and Development Charge (RUDL) mechanism, the danger that it would distort or deter economic investment in the Island, the vulnerability of low-profit but high labour component businesses to its introduction, particularly in weak sectors of the economy such as tourism and agriculture, the detrimental cash flow impact it would have on business prior to recovery against personal tax liabilities of shareholders and a number of other perceived drawbacks**.**

A range of views were expressed on the desirability and complexity of the **Deemed Distribution** methodology, with most being adverse. Many contributors considered these proposals as unwieldly and unduly complex and would add to compliance costs.

Specific Comments

The following specific comments, which have not been attributed to named individuals or organisations, are provided below to reflect the main responses on the many individual and complex features of the proposals:

1. Imposing a £150 charge on foreign incorporated investment companies may be inflationary and may be discriminatory and non-Code compliant

2. Protracted discussions are likely between Comptroller and taxpayers on the split of capital/income on dividend vouchers

3. The proposed tick the box regime leaves the taxpayer with uncertainty and is unsatisfactory/disproportionate to perceived abuse

4. Statutory group relief is welcomed

5. Stock dividends being taxed is fair and reasonable

6. 'Look through' provisions are wanted for trading companies if at all possible/ if trading companies are allowed to retain 33.3% of their trading profits 'look through' could apply to the remainder

7. Companies other than trading companies, i.e., Schedule A and 'other than Schedule D Case 1' companies, should be dealt with as a separate class by giving 'distributor status' to them if non-family companies. Family companies would be like 'close companies' in the U.K. and income would be apportioned pro rata according to family shareholding – that distributed 95% of their income - with the shareholder paying tax on these distributions rather than on 'look through'

8. Unilateral relief should be placed on a statutory basis and not at Comptroller's discretion so as to give Jersey taxpayers relief in respect of all foreign taxes suffered not otherwise covered by existing Double Taxation Arrangement

9. Termination of management expenses is an excessive move and is not welcomed

10. Minority shareholder interest issues were raised, particularly the Human Rights impact

11. Limited trading partnership difficulties were envisaged with switching from corporate form and continuity of contract/majority of taxpayers to rest with entity they currently operate/new type of vehicle which will require detailed legal analysis to ensure it provides same protection to its owners as a company in all jurisdictions in which it operates/but attractive as a means to an end of achieving look through to trading profits/how is FSC registrar to recover from the States the costs involved in conversions

12. RUDL most unwelcome and unsatisfactory/needs to be amended as cash flow disadvantages/£500 per capita charge for seasonal workers would be catastrophic for business/RUDL charge based on licensed headcount will have a most disproportionate effect on those industries least able to afford increased outgoings/penalises labour intensive companies/disincentive to inward investment/also has practical difficulties such as treatment of seasonals/part-time workers/holiday for foreign owned businesses grossly inequitable/places an unfair burden and lacks equity as small shareholders liable on deemed distribution basis will not get credit

13. Current year basis of assessment for trading profits proposals awaited from Comptroller

14. Deemed distribution basis unwieldy and complex and will add to compliance costs/3 year period is arbitrary and will not suit circumstances of businesses in periods of rapid growth/cannot understand the logic of LIFO basis and FIFO basis preferred/shareholders of public companies to be exempted from the deemed/deferred distribution charge, but this overlooks fact that under the Companies Law any company can be a public company where its memorandum of association says that it is a public company/lack of social justice and lack equity particularly in the deferred charge and the deemed distribution charge by penalising small shareholders/most companies retain profits to finance capital expenditure and to finance additional working capital

15. Blanket anti-avoidance legislation in the modern age unsatisfactory so law should set out in detail what can be taxed/unfair for Comptroller to tax a capital gain several years later after investment made/taxpayers will find it intrusive and onerous to detail their capital transactions/any new legislation should not upset the delicate balance that currently prevails/introduce targeted legislation for abuse High value residents 'drive' may be affected by management expenses termination/general anti-avoidance provisions

16. Utility companies/unclear whether to be taxed on ancillary services, e.g., retail/reduce the tax rate on utilities from 20% to 10%

17. Removal of exemption for U.K. superannuation companies and charities will have unintended economic consequences/reduction in capital values/ considerable effect on underlying site/land values/stagnation/seems to fly in the face of everything the States is trying to achieve to promote commercial and business activity. Specified financial services companies – not clear what the position is for general insurance mediation business/bureaux de change/ money transmitters/unclear what the tax status is of shops, medical practices, motor dealers and removal/freight companies who are registered under the Financial Services Law and who conduct general insurance mediation

18. Collective investment funds – the tax position of permit holders under the Collective Investment Funds Law is unclear/uncertainty increased by Commission's proposals for the regulation of fund functionaries to be transferred to the Financial Services (Jersey) Law as per Paper No. 1/2006 issued in February, 2006

19. 10% rate – neither the FSJL or the BBJL were introduced with the intention of deciding the tax treatment of the entity concerned and this will add to complexity when businesses are at the 'edge' of the laws in question

20. The views of the Corporate Affairs Scrutiny Panel and various contributors to that panel, as set out in the Report S.R.4/2006.

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[1] *A summary of responses from the consultation period is included as an Annex to this Report.*